



Securities Speculation Tax

FAQs

What is a securities speculation tax?

It is a small tax on financial transactions such as the purchase and sale of financial instruments like stock, options, and futures. Intended as a deterrent against short-term speculative trading, it would help raise revenues to repay taxpayers for the money used to bail out Wall Street banks.

Why do we need a securities speculation tax?

One of the main arguments for the tax is its ability to dampen rampant speculation in the financial markets. Speculation—the purchase and quick sale (days or hours later) of securities and other financial products as a means to profit from rapid price fluctuations—by those on Wall Street who contributed to the current crisis without providing any tangible benefit to the broader economy. A tax that raises the transaction cost of speculation would make this speculation less profitable and thereby lessen the incentive to speculate.

Another argument for the tax is its revenue-generating capabilities. It has been estimated that a tax of .25 percent could raise \$150 billion per year in government revenue. Speculators make a profit by shuffling money without making any actual investment in goods and services. The revenues raised by the tax would be removed from the Wall Street merry go round and used to reimburse taxpayers, help fund government agencies responsible for regulating the market, and help pay for stimulus programs and other productive investments.

Aren't there better ways to generate revenue like closing tax loopholes or getting rid of offshore tax havens?

There are other important ways to raise government revenue and they should be pursued, however a financial transactions tax is both easy to implement quickly and has the added benefit of helping to prevent future abuse of our financial markets by greedy speculators.

Who supports the tax?

John Maynard Keynes, in his *General Theory* said that such a tax would have the positive effect of mitigating speculation over enterprise in the United States. In the 1970s, Nobel Prize winning economist James Tobin argued for a levy on speculative currency trading, which became known as the Tobin tax (explained below). In 1987, Lawrence Summers, who later became President Clinton's Treasury Secretary, supported such a tax in his paper "When Financial Markets Work Too Well: a Cautious Case for a Securities Transactions Tax." Joseph Stiglitz, another Nobel Prize winning economist supported a financial transaction tax in 1989, saying that it would increase the efficiency of the stock market and reduce price volatility. More recently, economists Robert Pollin and Dean Baker have made arguments for such a tax.

Wouldn't this tax affect everyone? Why punish middle-class investors who never engaged in risky speculation?

The tax would fall on those whose behaviors create stress on the financial system—day traders and the speculators who trade huge amounts of stocks. The tax would have virtually no impact on Americans who invest to save for retirement or other long-term purposes. Just as a gas tax makes those who drive more pay more at the pump for highway repairs, a financial transactions tax would make those who trade more pay more for the stress they cause to the financial system.

Isn't a securities transaction tax is too difficult to implement?

H.R. 1068 – Let Wall Street Pay for Wall Street’s Bailout Act of 2009

Not at all. The United States currently employs a small financial transactions tax to pay for the Securities and Exchange Commission. The US also levied a 0.2% tax on all sales or transfers on stock from 1914 to 1966. In 1932, Congress more than doubled this tax to help raise revenue during the Great Depression. Today, the United Kingdom effectively employs a modest financial transaction tax as well.

Won’t it stifle innovation and efficiency in the financial sector?

This “innovation” and “efficiency” is what led to Wall Street’s creation of complex new financial products that have turned out to be more damaging to our financial system than good. It appears that the inventors of these products didn’t fully understand the risks associated with them. Just as we encourage innovation in the medical field, but restrict experimentation of complex new medical and drug products on patients, we should limit what types of financial innovations can be used in capital markets.

Won’t it create distortions in global capital markets?

The benefits of trading in the United States vastly outweigh the negative effects of a securities speculation tax and it is therefore unlikely that traders will flee US capital markets. More importantly, the US has significant influence in international negotiations and could work with other powers to create uniform taxes intended to prevent distortion. The likelihood of this collaboration is greatly enhanced today as nations across the globe look to strengthen regulation to prevent future financial crises.

Wouldn’t such a tax reduce liquidity?

The tax will reduce trading volume and therefore also liquidity, however, economist Dean Baker says it is “not clear that the impact will have much consequence. For example, if trading in liquid assets, like government bonds, were cut by 50 percent, or even 75 percent, these assets would still have enormous markets.” The volume of trading may reduce to levels of 20-25 years ago, but Baker says that, in the 1980s, these markets were already highly liquid.¹

What is the Tobin tax mentioned above?

Proposed in the 1970s by Nobel Prize winning economist James Tobin, the Tobin tax is a small (less than half of one percent) worldwide tax on foreign exchange transactions intended to lessen speculative currency trading.

In the foreign exchange market, speculators seek to profit from minute-to-minute, hourly, or even daily, fluctuations in prices. When a tax is imposed on these currency transactions, in order for this speculation to be profitable, the value of the currency being traded must be greater than the proposed tax. Because speculative currency trades occur on small margins, any tax on such trades will reduce and even eliminate profits. This would greatly lessen the incentive to speculate.

Additionally, the Tobin tax would benefit people by helping to avoid the social devastation caused by financial crises. It would do this by reducing speculation, which causes the instability of financial markets that leads to financial crises. Furthermore, the revenue generated by the tax could also be used to benefit the public good.

There has been long-standing support for the Tobin tax since James Tobin introduced it in the 1970s.

¹ Baker, D, 2008. “The Benefits of a Financial Transactions Tax,”. Washington: DC: Center for Economic and Policy Research, [available at <http://www.cepr.net/documents/publications/financial-transactions-tax-2008-12.pdf>].