



Securities Speculation Tax

An Overblown Financial Sector

Today's financial crisis has reminded us that markets are often treated like a casino for excessive risk-taking and speculation. Securities speculation—the purchase and quick sale (days or even hours later) of securities and other financial instruments as a means to profit from rapid price fluctuations—is not new. It has repeatedly led to the creation and later bursting of speculative asset bubbles—the most recent being the housing bubble—which inevitably wreak havoc on the economy, often leaving taxpayers to clean up the mess. This speculation has almost nothing to do with productive investment and has proven to be destabilizing to our financial system and our entire economy. It is time not only to diminish this sort of gambling, but also to bring our bloated financial sector down to a more manageable size.

Today, our economy is overwhelmingly dominated by a type of finance that has less to do with financing corporate production, and more to do with shuffling money around the market to make a profit. George Washington University Professor Lawrence Mitchell said during an interview published by the *Multinational Monitor*, that "Finance and especially hedge funds are becoming completely removed from production and are engaged in this almost circular financial game where they are moving money around from one pocket to the other, but it's got very little to do with increasing or stimulating production in any way, or producing anything meaningful."¹

In fact, economist Robert Pollin recently pointed out in an article published by the *Boston Review*, that as of 2007, "players in the market traded roughly \$300 worth of stocks and bonds for every dollar that nonfinancial corporations raise for new investments in plant and equipment."² This ratio is a threefold increase from what it was during the height of the dot-com bubble only a decade ago.

Moreover, economist Dean Baker showed that in 2004, the financial sector accounted for more than 30 percent of corporate profits; up from the 10 percent it accounted for during our country's most rapid growth period in the 1950s

and 1960s.³ This explosion has also encouraged the proliferation of complex new financial instruments like credit default swaps and collateralized debt obligations that contributed to the current financial crisis. These are sure signs of an overblown financial sector. It is time to stop financial gambling, rein in our financial sector, and return it to its proper role as an intermediary between borrowers and lenders.

A Practical Solution to Gambling in the Financial Sector

Markets serve a very important purpose in raising capital for the investment in and development of productive enterprise. But John Maynard Keynes, in his *General Theory* (1936), says this job will be "ill-done" when "the capital development of a country becomes the by-product of the activities of a casino." He acknowledges the dangerous tendency of markets towards speculation and notes that "casinos should, in the public interest, be inaccessible and expensive. And perhaps the same is true of Stock Exchanges." As a remedy for this tendency of markets towards speculation, Keynes suggests that the "introduction of a substantial Government transfer tax on all transactions might prove the most serviceable reform available, with a view to mitigating the predominance of speculation over enterprise in the United States."⁴

Similarly, Mitchell says the financial sector can be controlled, by changing investors' incentives. One way to do this would be to make speculation unprofitable. We need to redirect resources from risky and purely profit-seeking speculative activities towards productive and socially beneficial investments. Mitchell recommends a tax on stock profits, with a punitive tax on short-term trading, similar to the tax on currency trades proposed by Nobel Prize winning economist James Tobin (The Tobin Tax).⁵

A small Securities Speculation Tax (STT) on all financial-market transactions, while having

¹ Mitchell, Lawrence E. Interview by Multinational Monitor. "Origins of the Speculation Economy." *Multinational Monitor*, May/June 2007, 40.

² Pollin, R., "Tools for a New Economy," *Boston Review*, January/February 2009, [available at <http://bostonreview.net/BR34.1/pollin.php>].

³ Baker, D. "Progressive Conditions for a Bailout." *TPMCafe*, [available at http://tpmcafe.talkingpointsmemo.com/2008/09/20/progressive_conditions_for_a_b/].

⁴ Keynes, J. M., *The General Theory of Employment, Interest and Money*. New Delhi: Atlantic Publishers and Distributors, 2006.

⁵ Mitchell, Lawrence E. Interview by Multinational Monitor. "Origins of the Speculation Economy." *Multinational Monitor*, May/June 2007, 40.

almost no impact on the average investor, would discourage speculation by raising the costs of short-term speculative trading, making such activity less profitable.

Benefits of a Securities Speculation Tax

Baker adds that a small SST would be extremely progressive considering the vast majority of trading is done by the wealthiest people. Although middle-class families would see some of this tax, the burden for the typical family saving for retirement or their children's education would be almost unnoticeable.⁶ These investors are not the speculators who buy large amounts of stock at 11:00 A.M. only to sell it at 1:00 P.M. in an effort to make an enormous profit on small differences in price; rather they are investors who buy stock and hold it, expecting its value to increase over time. This type of healthy investment actually stabilizes markets and leads to greater wealth over time.

Furthermore, Baker says that a set of scaled SSTs could reduce not only speculation, but also the volume of trading in financial markets. When financial gamblers find that risky speculation is less profitable, many will refrain from the practice and thereby diminish the volume of trading. This volume will not be missed, because as Baker has pointed out, "much of the economic activity that will be lost has the character of gambling."⁷ It is just this sort of gambling on Wall Street that can lead to the destabilization of financial markets and the greater economy that we are currently experiencing.

Another significant argument for a modest SST is that it could serve as an enormous source of government revenue. Using 2007 figures, economist Robert Pollin estimates that a 0.5 percent tax on stock trades, and a sliding scale for bonds and derivatives, would generate nearly \$175 billion per year even assuming the tax led to a 50 percent decline in trading.⁸

Feasibility of a Securities Speculation Tax

As for effectively implementing a SST, such taxes have proven to be both enforceable and collectible. A much smaller transactions tax is currently employed to pay for the operations of

the Securities and Exchange Commission.⁹ Similarly, the collection of the tax would require minimal government oversight, since the IRS already imposes trade-reporting requirements. Baker points to the stamp tax in the UK to show that a modest financial transactions tax is not at odds with maintaining a vibrant stock exchange. He says that the other benefits of the London exchange, one of the largest stock exchanges in the world, obviously outweigh the burden of the stamp tax employed there. There should be no difference in the United States.¹⁰

Similarly, a 2002 study published by the Political Economy Research Institute at the University of Massachusetts-Amherst, concludes that instituting a financial transactions tax that is larger and broader than what is currently in place to finance SEC operations is both a workable and desirable policy measure in the U.S.¹¹ Given the context of today's financial crisis, this conclusion is even more pertinent.

An Opportunity to Act: H.R. 1068

With Congressman Peter DeFazio's recent introduction of H.R. 1068 "Let Wall Street Pay for Wall Street's Bailout Act of 2009," Congress now has an opportunity to implement a securities speculation tax. This bill proposes a securities transfer tax of up to .25 percent on the purchase and sale of financial instruments such as stock, options, and futures. This tax is estimated to raise \$150 billion in government revenue. This bill is a solution to the exploitation of our financial sector. Congress should pass this legislation to put an end to excessive and unproductive speculation.

Instead of forcing American taxpayers to clean up after Wall Street's speculative excess, it is appropriate and necessary to require Wall Street to pay for the bailouts. The employment of a small SST is one measure that will do just that. Congress should listen to Main Street's demands for reform and implement a securities speculation tax.

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⁶ Baker, Dean. 2008. "Let's Get Down to a Gas Tax." *guardian.co.uk*, August 11, 2008, [available at <http://www.guardian.co.uk/commentisfree/2008/aug/11/oil.commodities?gusrc=rss&feed=global>].

⁷ 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>].

⁸ Pollin, R. "Tools for a New Economy," *Boston Review*, January/February 2009, [available at <http://bostonreview.net/BR34.1/pollin.php>].

⁹ "Fee Rate Advisory #3 for Fiscal Year 2009: Press Release 2009-41." SEC Official Website. 2009. Securities and Exchange Commission. Web. 4 Mar. 2009. [available at <http://www.sec.gov/news/press/2009/2009-41.htm>].

¹⁰ 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>].

¹¹ Pollin, R., D. Baker, and M. Schaberg, 2002. "Financial Transactions Taxes for the U.S. Economy," Amherst: MA: Political Economy Research Institute, [available at <http://www.peri.umass.edu/236/hash/aef97d8d65/publication/172/>].