A Brief Review of the Financial Transactions Tax

Proponents of the Financial Transactions Tax (FTT) argue that the average investor in individual stocks will not feel the impact of this kind of tax because such a small tax on a securities transaction is almost nothing for an individual investor. Proponents also argue that an FTT tax has the potential to raise billions in revenue, which they say could decrease market volatility by stabilizing market prices and eliminating the adverse effects felt by the market due to high frequency trading. Lastly, proponents argue that the most direct and immediate consequences of this tax would be felt by top income earners, thus increasing the progressivity of the tax system.[1]

On the other hand, critics of this tax point out that high-frequency trading, which is responsible for an estimated 50% of the volume on U.S. exchanges, would essentially end under any FTT because of the small margins on each trade.[2] They argue specifically that mutual funds and exchange traded funds would become almost impossible to trade and would likely disappear from the financial market which could actually increase the volatility of the market by increasing the transaction cost and reducing the profitability of some trades.[3] They say that because HFTs would leave the market, liquidity would dry up, which will cause the bid-ask spread to increase and could lead to higher volatility and lower security prices. Lastly, critics argue that if the United States implements an FTT, unless it is applied globally, the tax will only result in a flow of investment away from the country.

Empirical evidence collected on the impact of FTTs on trading volume and market liquidity suggests that a narrowly based transaction tax would provide a strong incentive for traders to migrate to foreign markets and furthermore, a reduction in trading volume would widen the bid-ask spread while decreasing market liquidity.[4] There were two studies done in 1976 that found that transaction costs and trading volume have a negative relationship and that the FTT has a negative effect on local trading.[5]

In 1984, Sweden introduced an FTT of 0.5% on the sale or purchase of an equity security traded with a local brokerage service. The 0.5% was later doubled to 1.0%, and a 0.002% tax on fixed-income securities was introduced, as well as a 0.003% tax on bonds with 5 year maturities. The day these taxes were announced, share prices fell by 2.2% and declined again when the tax was increased. During the first week of the tax, the volume of bond trading fell by 85%, and the volume of futures trading fell by 98%, while the options market completely dried up. As a result of the vast decline in trading of all securities, the amount of revenue raised by the tax was far lower than Sweden anticipated. In 1993 a study showed that 30% of the total trading volume in Sweden shifted to the London stock exchange when the Swedish transaction tax on equity increased from 1 to 2%.[6]

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[1] A Securities Transactions Tax: Brief Analytic Overview with Revenue Estimates, Keightley, Mark P., Congressional Research Service, Nov. 9, 2011.

[2] Financial Transactions Taxes In the United States, Scott, Jeremy, Tax Notes, May, 2012.

[3] New Dem Tax for Speculators Will Hurt Individual Investors**,** Lehrer, Eli, Sept. 4, 2009.

[4] Would a Financial Transaction Tax Affect Financial Market Activity? Insights from Futures Markets, Wang, George and Yau, Jot, Policy Analysis, July 2012.

[5] Id. at 9-10.

[6] Id. at 10.

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Does the U.S. Already Have a Financial Transactions Tax?

The Fee Relief Act (P.L. 107-123) enacted in 2002, established a target amount of funding to be collected from Section 31 transaction fees. The Act requires the SEC to adjust such rate changes for the beginning of each fiscal year (announced in late April and implemented on October 1, or thirty days after the enactment of that year's SEC appropriations bill) with semi-annual adjustments, if necessary (announced on March 1, and implemented on April 1, of each year). The adjustments are made using a historical rolling average of market data.

In 2010, President Obama signed H.R. 4173, the "Dodd-Frank Wall Street Reform and Consumer Protection Act." Section 991 of the Dodd-Frank Act included amendments to the Securities Exchange Act of 1934 that would change the funding mechanisms for the SEC. The SEC is now entirely funded by Section 31 transaction fees. The Dodd-Frank Act also created an SEC Reserve Fund which is available for use by the SEC and funded by section 6(b) and 24(f) registration fees. The Act also modified fees pursuant to Sections 13(e) and 14(g) of the Securities Exchange Act of 1934, which are deposited and credited as general revenue for the Treasury.

Ultimately, financial transactions are already charged fees by the SEC and certain fees are reserved for the Treasury. If an FTT were implemented in the United States, it would impose a tax on these same transactions. In addition to the potential negative and volatile effects an FTT could have in the United States, it could also place a disproportionate burden on the financial sector, by levying a tax on transactions that have already paid a fee.

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