The Financial Transactions Tax

The Problem

In the mindless pursuit of illusory "market efficiency", short-term speculation has displaced productive investment, destabilized markets, and harmed trust. High frequency trading is only the most extreme example of our hyper-speed, dis-functional secondary markets. John Maynard Keynes' famous warning in *The General Theory* against secondary markets becoming "too efficient" with rampant speculation is prescient:

Speculators may do no harm as bubbles on a steady stream of enterprise. But the situation is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes the by-product of the activities of a casino, the job is likely to be ill-done.

Short-termism is perhaps the leading criticism of modern corporate behavior. In September 2009, the Aspen Institute gathered a group of prominent businesspeople (including Warren Buffett, Founder of The Vanguard Group John Bogle, and Former Chairman of Goldman Sachs John Whitehead) who signed on to a document saying, "High rates of portfolio turnover harm ultimate investors' returns." They continued to argue that this exacerbates the problem of fund managers seeking short-term trading gains with little concern for long-term corporate performance or externalities, emphasizing that this all puts corporations and the interests of shareholders seeking long-term growth at risk.[1]

The Proposal: A Uniform FTT Applied Evenly across all Secondary Trading Activity

The Capital Institute believes that a Financial Transactions Tax (FTT) will improve market resiliency at the expense of counterproductive "market efficiency", discourage excessive short-term speculation in favor of longer-term investment, and raise substantial revenues. Current experience in the United Kingdom, Switzerland, Singapore and Hong Kong prove the mechanics are workable, despite concern expressed by certain academics. Though many have proposed an FTT as punitive tax against the Wall Street following the 2008 financial crisis, the Capital Institute supports the FTT primarily as a resiliency enhancing and volatility dampening regulatory tool, ideally adjusted dynamically in times of heightened volatility.

Those who argue that an FTT will harm liquidity fail to understand the imperative for well functioning systems to balance efficiency with resiliency. Suggestions that an FTT will harm growth are wrong, blindly confusing the efficiency of secondary market trading with the cost of real investment capital on the efficiency of economic growth. An FTT will not impact the cost of capital to any perceptible extent, while enhancing financial system resiliency will have demonstrable positive affects, as we should now understand.

For more on the Financial Transactions Tax, visit CapitalInstitute.org/blog and look for John Fullerton's blogs entitled "Why We Need a Financial Transactions Tax" and "Taming the Casino." Also see John Fullerton's April 2010 Press Briefing at http://capitalinstitute.org/resources/statement-financial-transactions-tax-dc-press-club-04-15-2010

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[1] "Overcoming Short-Termism: A Call for a More Responsible Approach to Investment and Business Management" Aspen Institute, September 9, 2009