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Transaction tax works against deficits, financial recklessness

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AS PRESIDENT Obama and Congress wrangle over how to close a yawning federal deficit, an obvious place to look is the financial-services industry that precipitated the recent recession. A tax on financial transactions — on the order of a fraction of 1 percent — could cool speculative fevers on Wall Street even as it helps refresh a federal treasury depleted by unemployment benefits and aid to reeling states.

When the commission studying the 2008 financial collapse at last reported back to Congress this week, its six Democratic members placed the blame on excessive borrowing, poor federal regulation, and a "systematic breakdown in accountability and ethics.'' The panel's four Republican members dissented, and most signed onto a separate explanation that noted, among other things, an international credit bubble and flaws in the securitization and credit-rating process. Yet in some ways, both accounts add up to the same thing — regulators aren't omniscient; traders look out for quick profits; a lot of so-called financial innovation makes markets less transparent and more volatile. A trading tax would discourage churn in the markets without having regulators looking over every trader's shoulder.

If, as generally expected, a tax on the buying and selling of stocks, bonds, derivatives, and credit-default swaps were to reduce short-term trading in favor of longer-term investment, the overall effect on the US economy would be beneficial. Such a tax could also raise revenue; low estimates run to about $100 billion a year, but anticipated revenues could run much higher.

A common argument against a financial transaction tax is that it might push financial activity abroad. But Britain has had its own 0.5 percent stamp tax on all trades, and Germany has been pushing for a European Union tax on financial transactions. It should not be too hard to obtain agreement, at least among the major Western financial centers, on comparable rates of taxation. And because all trading activity is already reported to the IRS, there would be little added administrative burden involved in collecting the new tax.

As the financial-crisis study panel notes in its report, the financial sector grew from 10 percent of all US corporate profits in 1980 to 27 percent on the eve of the crisis. Since 2008, most bailed-out financial institutions have returned to profitability, even as businesses in other industries struggle along. As Obama and other policymakers contemplate far-reaching changes to entitlements such as Medicare and Social Security, a financial transaction tax — which would simultaneously raise money and deter another crisis — has to be part of the discussion.