Securities Transaction Taxes

What’s a securities transaction tax and why might it be a good idea? A securities transaction tax is a small tax that is paid whenever securities (such as stocks, bonds, options, or futures) change hands. The size of the tax would be quite modest – for example, 0.5 percent of the sales value of the security. The tax would be imposed on each trade. Therefore, investors who buy and sell securities rapidly in order to grab short-term, speculative gains would end up paying a significant amount in taxes. However, for people who treat securities as medium- to long-term investments, the amount of the tax would be negligible.

Why might a securities transaction tax be a good policy intervention? The past few decades have witnessed a significant increase in the volatility of world financial markets and financial crisis have become much more common in recent years. Speculative investment activities, in which investors move money rapidly from one place to another in order to profit from small changes in securities prices, contributes to this turbulence. A securities transaction tax would discourage such speculative investments without imposing a large penalty on more productive medium- to long-term investments.

There are a number of reasons why speculative investment can be bad for an economy. A financial crisis can trigger a number of economic problems – from rising unemployment to declining net worth – that affect people not directly involved in financial markets. Uncertainty about the future makes economic decisions more difficult and costly. Therefore, in an uncertain environment, many beneficial investments simply might not happen. In addition, economic policy is more difficult to formulate and implement in highly uncertain conditions. Finally, an emphasis on short-term gains often means that real resources are used to “outguess” the market, instead of gathering information on more productive investments.

A securities transaction tax, therefore, could reduce some of these harmful outcomes associated with speculative investment activity. Since the rapid movement of finance often allows investors to undermine government policies, such a tax could also improve the effectiveness of economic policies in achieving desirable social outcomes.

The securities transactions tax has another benefit – it can generate substantial revenues that can be used to finance programs that improve eco-
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Economic stability or public well-being. Since many people other than large speculative investors pay the costs of a financial crisis, a securities transaction tax is a means of forcing speculators to pay for some of the social costs of their activities.

A securities transaction tax doesn’t have to be limited to domestic financial markets. An early version of the transaction tax – called a Tobin tax – was proposed by economist James Tobin for foreign exchange markets. Theoretically, the Tobin Tax could limit volatility in international markets the same way a securities transaction tax would reduce uncertainty in domestic markets.

Source: