A Proposal to Tax Financial Transactions

In a new book titled *Tackling the Tax Code: Efficient and Equitable Ways to Raise Revenue*, The Hamilton Project offers a range of detailed proposals by leading economists and other experts for better tax policies that can raise revenue in a progressive and growth-friendly manner. In one chapter, Antonio Weiss of the Harvard Kennedy School and Laura Kawano of the University of Michigan propose to raise revenue through a financial transaction tax (FTT).

Weiss and Kawano's proposal includes the following core elements:

- **An FTT of 10 basis points,** applied to most trading in stocks, bonds (excepting U.S. Treasury securities), and derivatives.
- **A phase-in over four years,** where the tax will increase by 2 basis points each year until it reaches the 10-basis points level.
- **An annual review** in which the U.S. Department of the Treasury will submit a report to Congress prior to each adjustment during the phase-in period, allowing for further calibration of the FTT.

Issue Overview

- **Some existing tax instruments—like payroll taxes—put excessive burdens on low earners.** Other taxes can be inefficient or have limited revenue potential.
- **A tax on financial transactions can raise substantial revenues** without large efficiency costs or burdens on low earners. By taxing financial activity, the federal government will be able to raise an estimated $508 billion over the next decade, with nearly 70 percent of the tax burden falling on those in the top income quintile.
- **An FTT at the proposed level would not hinder market functioning or impede price discovery**, and in fact in many markets would be less than declines in transaction costs that have occurred over the past decade. Some of the financial activity it would discourage, including some high-frequency trading and algorithmic trading, may not significantly add to the allocative efficiency of financial markets and broader economic growth.

The Challenge

Addressing the current gap between government revenues and outlays needed for vital programs will likely require a number of incremental tax measures. No single tax instrument, by itself, can efficiently and fairly raise the funds needed to provide public services at different points throughout the business cycle. Our tax system reflects this reality, relying on a mixture of taxes that have different behavioral impacts, economic incidences, and covariances with economic output.

One way to raise revenue to help address the current gap is through a tax instrument that is not currently used to any significant degree by the United States: an FTT. If carefully designed and implemented, an FTT would raise substantial revenue, largely from high earners, while not hindering market functioning.

The Path Forward

To raise significant revenue in a progressive manner, Weiss and Kawano propose an FTT.

- **The FTT would apply to transactions in a broad range of assets, including stocks, bonds, and derivatives.** Applying the FTT to different types of financial transactions will provide a broad tax base, that will help to limit the scope for tax avoidance. The proposal makes allowances where appropriate, such as an exemption for U.S. government securities and money market instruments.

- **The tax would start at 2 basis points and be raised by 2 basis points each year until it reaches 10 basis points.** Because the United States does not have recent experience with a nontrivial FTT, some aspects of its effects remain uncertain. The authors suggest phasing the rate in to allow time for policymakers to monitor market functioning, address avoidance techniques that will arise, and, if necessary, more carefully calibrate the level of the tax. Prior to each annual adjustment, the U.S. Department of the Treasury would submit a report to Congress assessing the effects of the FTT.

- **Administration of the FTT would be relatively straightforward in most instances.** The significant infrastructure that is already in place to facilitate and report financial market transactions can be used to collect the FTT and decrease compliance costs, as is done with the small fee the Securities Exchange Commission already collects on equities transactions.

- **Given current and historical transaction costs, the proposed 10 basis point FTT appears unlikely to increase costs beyond manageable levels.** In many markets, the proposed FTT would be less than the decline in transaction costs that has occurred in recent years.

- **Ideally, an FTT would be implemented in coordination with other countries.** In the absence of global coordination, the United States could take several steps to minimize offshore shifting and any negative effects on the competitiveness of U.S. capital markets.

- **The proposal would raise approximately $60 billion in annual revenue once it is fully phased in.** The tax would also be highly progressive, with nearly 70 percent of the tax burden falling on those in the top income quintile.

Weiss and Kawano argue that the FTT can raise revenue in a progressive and administrable manner without significantly disrupting financial markets. They conclude that as part of a broad portfolio of progressive tax reforms, a moderate, well-designed FTT can help pay for existing public obligations and public investments that underlie future economic growth.

About the Authors

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