

Studies Highlighting the Damaging Impacts of a Financial Transaction Tax

Multiple studies have concluded that transaction taxes are economically damaging to the jurisdictions that have imposed them, causing declines in trading volume and liquidity, increased costs, and market shifts to other jurisdictions with no transaction tax. This paper highlights the conclusions of various studies across the globe.

[The Tax Policy Center, Urban Institute, and Brookings Institution, "Financial Transaction Taxes in Theory and Practice" \(July 2015\)](#)

- "Empirical evidence strong confirms that higher transaction costs in general, and a higher FTT in particular, reduce trading volume."
- "Higher tax rates caused by the New York State FTT reduced trading volume on the New York Stock Exchange and induced shifts of trading to other exchanges."
- "Suppose an investor purchases an asset for \$10,000 that produces a 5 percent annual rate of return. If the asset is held for a year and sold, the pretax return is \$500 (see table 3). If a 0.1 percent FTT is assessed upon sale, the tax bill is \$10.50 (0.1 percent of \$10,500). The 0.1 percent FTT actually represents more than 2 percent of the income generated. The effective tax rate on transactions falls with the holding period."
- "An FTT would drive a wedge between bids and asks, because tax would have to be paid on the asset sale, and hence it would raise bid-ask spreads. An FTT also may increase the bid-ask spread if it substantially cuts market volume. Empirical evidence generally supports this notion."
- "FTTs have the potential to slow price discovery in financial markets, primarily by reducing liquidity...Assets are priced on old our outdated information because the transaction costs imposed by the FTT make it unprofitable for market participants to act on small price disequilibria. The presence of even very small transaction costs makes continuous rebalancing infinitely expensive."
- "Taxes are ultimately borne by people, not by corporations or other businesses. Thus, the notion that the FTT would hit "banks" or "investment houses" is misguided."

[CFTC, "U.S. Experience with Futures Transactions Taxes: Effects in a Highly Intermediated Market" \(January 2016\)](#)

- A futures transaction tax was originally put in place to raise revenue for the Spanish American War (1898-1901), revived to raise revenue for the First World War (1916-1918), and then put in place for general revenue purposes from 1919 to 1938.
- The tax applied to sales for future delivery, but not to transactions in the cash markets, varied from one basis point of the notional value of the transaction to five basis points, applied to all commodities at the same rate, and there were no exemptions for market making.
- "Trading volume declined nearly 15% when the tax was set at one basis point and declined more at higher levels of the tax."

- “In 1933 exchange members voted to increase the minimum tick size...all end users now faced this increased tick size that effectively raised the price of a contract by \$3.125 in order to offset a \$2.50 tax.”
- “The commodity futures regulator weighed in on the tax, telling Congress that the tax placed a particularly heavy burden on market makers. The Chief of the regulator testified that elimination of the tax would increase the ‘stability and flexibility’ of the market. Congress eliminated the tax in 1938, but the tick size increase remained in place.”

[Congressional Research Service, “Financial Transaction Taxes: In Brief” \(October 2015\)](#)

- “If the counterparty is considered a speculator subject to an FTT, they may respond by raising their price in the market, and, in turn, increasing the cost to hedge.”
- “Short-term traders are an important supplier of liquidity to the market, which, at certain times, performs a stabilizing role. While several countries provide an exemption for market makers, most of the proposals in the U.S. do not. Subjecting market-makers to an FTT may infringe upon their ability to carry out their role.”
- An FTT would not have helped prevent the financial crisis. “It appears that an FTT would have done little to address excessive leverage, deteriorating lending standards, and direct over-investment in residential housing, all of which are widely thought to have contributed to the financial crisis. Additionally, it is possible that the presence of an FTT would have worsened the already dampened interest in buying stocks, which would have impeded the stock market recovery.”

[Dr. Christopher L. Culp, Research Fellow, Johns Hopkins University-Institute for Applied Economics, Global Health, and Study of Business Enterprise and Adjunct Professor, Swiss Finance Institute, “Financial Transaction Taxes: Benefits and Cost” \(March 2010\)](#)

- “The research indicates that FTTs are unlikely to generate significant revenue and are likely to interfere with the performance of U.S. financial markets.”
- “In addition to increasing the direct fee-based costs of engaging in a financial transaction, FTTs will also increase the cost of liquidity provision by market makers and other suppliers of liquidity in a marketplace. That cost will be passed on to customers in part (or in whole) through bid-ask spreads.”
- “The recent experience of Brazil provides further evidence that FTTs result in trade migration to low-tax jurisdictions. Brazil imposed a FTT of 2.0% on all foreign portfolio investments in the country in October 2009 and, as a result, foreign investors responded by buying Brazilian ADRs in New York and converting them into locally-issued shares, thereby avoiding the tax.”
- Although most studies suggest that a FTT would not decrease price variability, the imposition of a FTT might nevertheless reduce the velocity at which prices adjust to new information. Ironically, a FTT that decreases market efficiency may benefit speculators by increasing opportunities to trade at less-informative prices.”
- “Economic literature suggests that the average investor and pension funds will face significant costs as a result of FTTs. (p. 36) For example, even though investors will not be taxed directly when they buy or sell mutual fund shares, the mutual funds that invest customer funds will still

themselves have to pay the FTT. And their own costs will almost certainly be passed along to investors.”

- “Liquidity is also important from a risk management perspective. Without adequate liquidity, market participants find it more difficult to hedge or liquidate losing positions, especially during periods of market volatility and stress (as the last half of 2007 and 2009 painfully reminded us.”

The Institute of Economic Affairs (UK), “The Case Against a Financial Transactions Tax”

- “No net revenue will be raised by the specific proposals that have been put forward...While there will indeed be revenue from the tax itself, there will also be falls in revenue from other taxes. The net effect of this is that there will be less revenue in total as a result of an FTT.”
- “The economic burden of the FTT will be upon workers in the form of lower wages, upon consumers of financial products in higher prices and that the incidence, the loss of income resulting from the tax, will be over 100%. The loss will be greater than the revenues raised.”
- “A transaction tax would increase, not decrease volatility. Since an FTT would decrease the size of the financial markets, prices would jump around rather more than they do at present - completely the opposite of what certain supporters of the FTT conclude in their theoretical musings.”

European Commission, “Commission Staff Working Paper: Impact Assessment Accompanying the document ‘Proposal for a Council Directive on a Common System of Financial Transaction Tax and Amending Directive 2008/7/EC’ (September 2011)

- “With a tax rate of 0.1% the model shows drops in GDP (-1.76%) in the long-run. It should be noted that these strong results are related to the fact that the tax is cumulative and cascading which leads to rather strong economic reactions in the model.”
- “[A] stylised transaction tax on securities (STT), where it is assumed that all investment in the economy are financed with the help of securities (shares and bonds) at 0.1% is simulated to cause output losses (i.e. deviation of GDP from its longrun baseline level) of up to 1.76% in the long run, while yielding annual revenues of less than 0.1% of GDP.”

PwC, “Financial Transaction Tax: The Impacts and Arguments: A Literature Review” (November 2013)

- The EC’s impact assessment of the FTT estimated that the tax would have a significant effect on the derivatives market, reducing trading volume by between 70% and 90% (EC,2013b).”
- “Sweden’s introduction of a FTT led to a 98% reduction in the trading of interest rate futures (Campbell and Froot, 1993).”
- “Oliver Wyman (2012) reports that the increase in direct costs on derivatives transactions as a result of the FTT (and depending on the type of product) could be a magnitude of 18 times the bid/offer spread in normal market conditions.”
- “The EU FTT is likely to predominantly hit the real economy (pension funds, asset managers, insurance companies and corporates) as both direct and indirect costs will largely be passed on to the end users; these end users will be the least able to move transactions to jurisdictions not subject to the tax. (Wyman, 2012).”

[The Political Economy Research Institute at the University of Massachusetts Amherst, “The Revenue Potential of a Financial Transaction Tax for U.S. Financial Markets” \(March 2016\)](#)

- A combination of trading volume decline and tax avoidance would generate a 50 percent fall in trading revenue.