Finacial Transaction Tax—What is it Good For?
Executive Summary

When the U.K. Stamp Act was imposed in 1694, and from time to time since then, there have been sporadic discussions around imposing financial transaction taxes in various markets around the world. Not surprisingly, especially in an election year, the question of enacting a financial transaction tax (FTT) in the United States has again come to the fore.

In a purely theoretical sense, the lure of an FTT seems seductive—by adding a small charge to financial transactions, the government can pay for a bevy of potential programs. Some may point to the costs of healthcare reform, others to the recent massive government stimulus for COVID relief. In the proponents’ view, the FTT should not cause any harm, and the tax revenue could be used to implement a world of good.

However, in reviewing the history, research and the results from our own study of market participants, it is clear that imposing an FTT on the U.S. markets is likely to have far-reaching negative consequences. Moreover, the history of these taxes around the world proves that they do not generate the anticipated windfall—and, in fact, tend to do more harm than good.

METHODOLOGY

In January and February 2020, Greenwich Associates interviewed 58 market professionals regarding their views on the effect of the imposition of a financial transaction tax. The respondents included, among others, retail brokers, wealth managers, institutional asset managers, regulators, banks, hedge funds, institutional broker-dealers, and consultants, primarily from the U.S., but also EMEA and APAC.
With the 2020 U.S. presidential election quickly approaching, the debate about the need for a financial transaction tax has once again come to the forefront. Given the bipartisan nature of such debates in today’s political climate, this research intends to provide an unbiased view of the true impact that the proposed financial transaction tax would have on the market. In addition, Greenwich Associates senior analysts examine the impact similar taxes have had on the market in other parts of the world.

### DEMOGRAPHICS

- **Role**
  - Corporate management/Strategy: 28%
  - Front office: 10%
  - Technology: 10%
  - Research: 10%
  - Business development: 18%
  - Risk management: 4%
  - Other: 20%

- **Region**
  - Americas: 88%
  - Asia Pacific: 10%
  - EMEA: 2%

- **Firm Size**
  - Less than 100: 12%
  - 100-999: 24%
  - 1,000-9,999: 39%
  - More than 10,000: 25%

Note: Based on 58 respondents.
Source: Greenwich Associates 2020 Financial Transaction Tax Study

### Overview of FTT

What is a financial transaction tax? Although there are many possible implementations, the general idea is that a small charge (tax) is added to financial transactions in order to generate revenue. This idea can be traced back to stamp act legislation from over 300 years ago. In those times, stamp duties could be imposed on the transfer of certain documents (such as mortgages), with payment of the stamp duty conferring on them legal effect. From these origins, the modern stamp duties have evolved to include taxes on financial transactions—extending the concept to taxation on securities transactions.¹

### Historical Context—How Did We Get Here?

To be certain, an FTT is not a new idea. Even in the U.S., there have been times when an FTT was imposed. From 1914 to 1966, the U.S. imposed an FTT at various rates before the tax was repealed, with broad bi-partisan support. After elimination of the FTT, trading volume on the New York Stock Exchange increased dramatically. New York State has also imposed a stock transfer tax since 1905, but the full amount of the tax has been rebated upon request since 1981.
Today there is a kind of FTT already imposed on the U.S. market. The Securities and Exchange Commission (SEC) charges a fee to fund its operations (the “Section 31 fee”). For fiscal year 2020, the fee is set at $22.10 per million dollars on sales of securities. These fees are charged to the Self-Regulatory Organizations (SROs, e.g., the exchanges and FINRA), and those entities in turn charge them against their broker-dealer members. These fees are passed along to the final seller in the transaction, often seen on retail and institutional client statements as “regulatory fees” and the like. Thus, even at an effective rate of just .0021%, the industry has developed systems to ensure that the Section 31 fee is passed on to the ultimate seller on the trade.

Current U.S. FTT Proposals

Although the prospect of an FTT for the U.S. has been proposed multiple times since the 60s, it has never gained significant traction. The idea is often raised in the context of how to pay for other programs. In the current election cycle in particular, it is not surprising to see several different versions of the FTT bandied about. For example:

- **Inclusive Prosperity Act** – Introduced during Bernie Sanders’ presidential campaign, this proposal seeks to impose a tax of 0.5% on stocks, 0.1% on bonds and 0.05% on derivatives.
- **Wall Street Tax Act of 2019** – Proposed in March of 2019, this act sought a tax of 0.1% on the fair market price of stocks and bonds transactions, and on the transaction amount of a derivative transaction.

Moreover, several of the original Democratic candidates also proposed financial transaction tax regimes that differed in their specifics but generally sought to institute a tax somewhere between 0.1% and 0.2% on all stock, bond and derivative trades. Presumptive Democratic presidential nominee Joe Biden originally weighed in against the financial transaction tax. However, at the end of 2019, he appeared to shift toward supporting one, although noting it would not raise the kind of money that his opponents seemed to believe.

To put these proposals into perspective, it is instructive to compare them to the current SEC Section 31 fee. These proposed taxes would be in excess of anywhere from 47 to 238 times the 2020 Section 31 fee. Such a dramatic change to the trading landscape would have a real and immediate effect. Simply put, spreads would widen, liquidity would decrease, stock prices would fall, and both the explicit and implicit costs to trade would rise.

For many firms, in particular market-making firms, which already operate on razor-thin margins, the only response would be to quote at wider increments with less volume. FTT proponents often argue
that the friction of the tax would reduce high-frequency trading (HFT), suggesting that this would be good for the market overall. However, this overlooks the fact that this tax would affect all electronic trading, which constitutes the vast majority of equity trading today. While some consider a reduction in HFT a feature of an FTT, the real-world result would be a reduction in the quality of the U.S. markets.

Another rationale for implementing an FTT is that the tax would result in lower volatility. However, the studies on this have been inconclusive at best, and there is the strong probability that an FTT would actually increase volatility—not just as measured in the market but more broadly. For example, by decreasing liquidity provision, an FTT would tend to increase gyrations in the market, particularly in times of stress. In addition, due to a reduction in portfolio value over time as a result from an FTT, investors may look for higher returns in riskier endeavors. Similarly, an increase in hedging costs may actually expose the market to wilder swings when under stress.

Fortunately, we do not simply have to speculate about these types of impacts—there are plenty of real-world examples which help clarify the analysis.

International FTT

FTTs have been imposed or debated in multiple jurisdictions around the world with some frequency. A small sampling of the historical trials and current proposals is instructive.

Sweden – In 1984, Sweden instituted an FTT of 1% on equity round trips. This tax was then doubled in 1986. At both the institution of the tax and its increase, prices on Swedish stocks dropped appreciably. Moreover, volumes fled the country, with more than half of all stock trading occurring in London before the tax was abolished in 1991. The revenue received from the tax was significantly less than predicted.

France – In 2012, France imposed an FTT of 0.2% on stock purchases of certain French companies and added an additional tax for HFT (with an exemption for market makers). Various studies found that as a result, market volumes declined and bid-ask spread increased. The revenues from the French FTT have fallen far short of the projections—by as much as 50%.
Italy – In 2013, Italy imposed an FTT of 0.1% for on-exchange and 0.2% for off-exchange trades in certain securities, plus a charge for HFT (with an exemption for market makers). Various studies have found that the actual revenue received was much lower than anticipated (around 20%), that trading volumes have fallen (or strategies have changed to avoid the tax), bid-ask spreads have increased, and volatility has risen since implementation.

European Union – The EU has been debating the possibility of imposition of an FTT across at least some of its members for a number of years. In its original form, the plan called for a 0.1% tax on securities and bonds and 0.02% tax on derivatives. This 2011 proposal failed to move forward. Today, out of the 27 EU member states, 17 have not signed onto the proposal, leaving it on life support since 2013 through a rarely used “enhanced cooperation” procedure. Nevertheless, in 2019, Germany and France presented a joint position paper that the EU FTT could be based on the French FTT model (noting that IPOs and market making should be exempt).

Over the years, there has been an interesting pattern. Many countries have imposed FTTs, adjusted the rates over several years and then finally repealed them when the impacts became clear—whether due to failure to achieve anticipated revenue, loss of volume to other markets or trading methods, or some combination thereof.

Assessment of Impact of FTT on U.S. Markets

In January and February 2020, Greenwich Associates interviewed 58 market professionals regarding their views on the imposition of a financial transaction tax. The respondents included, among others, retail brokers, wealth managers, institutional asset managers, regulators, banks, hedge funds, institutional broker dealers, and consultants, primarily from the U.S., but also EMEA and APAC.

Nearly 70% of respondents anticipate a reduction in their firm’s trading, with only a quarter seeing no impact (and zero firms anticipating an increase). This is not surprising in that any of the proposed FTT regimes will significantly increase costs of trading. The rational economic response to the increase in costs will be a reduction in the amount of trading.

Many countries have imposed FTTs, adjusted the rates over several years and then finally repealed them when the impacts became clear.
Although some argue that the reduction in the amount of trading is a feature of the FTT, our respondents overwhelmingly believe that there will be negative impacts from an FTT. For example, more than 70% believe that the amount of overall available liquidity in the market will drop. Similarly, 66% think that there will be less liquidity available at the best bid and offer, and 64% expect that the spreads will widen as a result of decreased liquidity. Moreover, 64% believe that costs of capital will go up for issuers, and 57% believe that borrowing costs will go up for both the public and private sector. While 10% think that an FTT would not have a significant impact on the market, all firms believed there would be some impact.5

[Impact of FTT would include] reduced trading and liquidity, particularly for mid and small caps.

Note: Based on 58 total respondents.
Source: Greenwich Associates 2020 Financial Transaction Tax Study

PERCEIVED IMPACT OF FTT ON AMOUNT OF TRADING BY FIRMS

Note: Based on 58 total respondents.
Source: Greenwich Associates 2020 Financial Transaction Tax Study

ADDITIONAL IMPACTS OF FTT

Note: Based on 37 total respondents.
Source: Greenwich Associates 2020 Financial Transaction Tax Study

Lessen available market liquidity, both display market and upstairs

Cause electronic market providers to quote less often, providing less enhanced liquidity over size available at the quote

Likely to widen spreads

Increase costs of capital for issuers

Increase costs of borrowing, impacting both the public and private sector

Will not have a significant impact

Will not have an impact

Other
These responses again show the interconnected nature of the financial marketplace. By turning the dial up on costs, the impacts are felt across the entire ecosystem.

Much less trading, less order flow... probably wider spreads, and less liquidity.

Another important consideration is how these changes will impact retail traders. Although the issues described above may seem somewhat removed from the average retail trader, the truth is quite different.

Retail traders have never had it better. They have access to tremendously sophisticated trading tools. The execution quality they receive has been on a decades-long improvement streak. As of late 2019, they largely pay zero commission to get their trades executed. In this environment, what would be the result of instituting an FTT?

**FTT’s Effect on Benefits of Drop in Retail Commissions**

![Chart showing the percentage of respondents' views on FTT's impact on retail commissions]

- 49% will cause commissions to increase, functionally ending zero commissions
- 23% will cause spread widening, negatively impacting trade execution
- 14% will not cause commissions to increase
- 10% will have no effect or impact on retail trading
- 4% other

Note: Based on 51 total respondents
Source: Greenwich Associates 2020 Financial Transaction Tax Study

In our study, 72% of respondents believe that the introduction of an FTT would either end zero commissions or negatively impact execution quality because of widening spreads. The plain fact is that one way or another, these fees will be passed along to the trading public. This can happen directly in the form of a “regulatory fee” on a client’s account statement (which is how SEC Section 31 fees are generally handled). It can also happen indirectly, such as where a mutual fund does not return as much as anticipated over the course of an investment due to the FTT. In both cases, the FTT poses real harm to the retail investor.
Higher Costs for the Retail Investor

So, who pays for the FTT in the end? According to our study, the “waterfall” of the results is rather clear-cut:

**WHO PAYS FTT COSTS?**

<table>
<thead>
<tr>
<th>Least Likely</th>
<th>Most Likely</th>
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<tbody>
<tr>
<td>Firm engaged in trading</td>
<td>Investing public overall</td>
</tr>
<tr>
<td>27%</td>
<td>73%</td>
</tr>
</tbody>
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**Note:** Based on 21 total respondents.
Source: Greenwich Associates 2020 Financial Transaction Tax Study
In the middle of the waterfall, respondents noted that there would be impacts felt beyond the financial markets. What kind of impacts could those be?

### FTT Impact Beyond Financial Markets

<table>
<thead>
<tr>
<th>Impact</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Increasing the costs of hedging for producers which will be passed along to consumers</td>
<td>86%</td>
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<tr>
<td>Increasing the cost of interest rate trading in turn increasing the cost of home mortgages</td>
<td>77%</td>
</tr>
<tr>
<td>Increasing the cost of capital for public projects such as infrastructure projects</td>
<td>73%</td>
</tr>
<tr>
<td>Increasing the cost of corporate financing</td>
<td>73%</td>
</tr>
<tr>
<td>Increasing the cost of government financing</td>
<td>68%</td>
</tr>
<tr>
<td>Other</td>
<td>14%</td>
</tr>
</tbody>
</table>

Note: Based on 21 total respondents.
Source: Greenwich Associates 2020 Financial Transaction Tax Study

Each of these areas is worthy of discussion.

**Hedging:** Providers of goods and services use hedges to protect themselves from cost shifts embedded in their business cycles (e.g., airlines hedging against fuel price increases). When hedging becomes more expensive, those costs are passed along to the end user—be it through airline tickets or groceries.

**Mortgages:** In simple terms, interest-rate trading helps set the mortgage rates for homebuyers. If the costs of trading increase, the cost of mortgages will go up. Even a small change in an interest rate can have a significant impact on the ability to obtain a mortgage and how much is paid back over its lifespan.

**Public project cost:** Much like private investors, the cost of capital to build public works will also increase. Roads, bridges and the like will all become that much more expensive to build, and that cost will be borne by the public.

**Corporate Financing:** The FTT will decrease bond liquidity and result in investors demanding higher interest rates to compensate. As interest rates increase, the cost of corporate financing will also rise. Moreover, evidence shows that an FTT will cause stock prices to drop, further inhibiting the ability of businesses to grow.
Another area to consider when reviewing the possible imposition of an FTT on the U.S. markets is the differential impact to active trading versus passive trading. Our data shows that the overwhelming number of respondents (84%) believe an FTT would have a negative impact on active managers, and a strong majority (68%) think an FTT would harm passive managers as well.

**REASONS FTT WILL NEGATIVELY IMPACT ACTIVE MANAGERS**

- Active managers tend to trade more frequently than passive managers and will therefore incur an outsized proportion of the FTT impact versus their passive counterparts.
- FTT will further accelerate the movement to passive investing.
- Active managers already have additional costs in research and portfolio management, and FTT will add negatively to this dynamic.
- By shouldering a larger portion of the FTT impact, active investors will be required to seek out higher volatility trades in order to attempt to recoup the difference.

Note: 1 Based on 57 total respondents. 2 Based on 9 total respondents.
Source: Greenwich Associates 2020 Financial Transaction Tax Study

While the FTT would impact both active and passive funds, active funds trade more frequently than passive funds by intent and design. With an FTT in play, the shift from active to passive investment would accelerate. Another concern is that active managers would be required to seek out riskier trades in order to offset the heightened burden they carry from an FTT.
Increased transaction costs will reduce returns for end investors further, in an already low-yield environment. The unintended consequence will be for investors to reach for yield, focusing on riskier assets. That will have a destabilizing effect, not just on the markets, but the broader economy—particularly in times of stress.

Beyond these anticipated impacts to the markets and the economy, market participants in the study are not just dispassionate observers of the likely outcomes. Rather, they consider an FTT to be potentially harmful to their individual outlooks as well.

### FTT Impact on a Personal Level

- **I believe that the FTT will negatively impact my 401(k) or other retirement portfolio options**: 65%
- **I believe that the FTT will adversely impact my current trading strategies**: 46%
- **I believe that the FTT will increase cost for me to obtain home loans and/or other loans for other purposes**: 44%
- **I do not believe that the FTT will have an impact on me personally**: 15%

Note: Based on 45 total respondents.
Source: Greenwich Associates 2020 Financial Transaction Tax Study

In fact, they believe that an FTT will negatively impact their retirement savings (65%), their ability to obtain a mortgage or other loan (44%), or their personal trading strategies (46%). Although a small number (15%) did not expect a personal impact, these were also the respondents who were more favorably disposed toward an FTT overall.

[An FTT] will harm investors in the U.S., reducing their ability to retire in the manner that they would like.
Conclusion

A financial transaction tax may seem alluring to those who lack a deep understanding of our financial markets or who have little experience with the history of such taxes. As has been said many times before, the machinery of the U.S. markets underlies the most liquid, best-functioning and well-regulated markets in the world. Even through times of stress, such as the COVID crisis, U.S. markets remain the envy of the world. The imposition of an FTT would damage that machinery, resulting in widening spreads, diminishing liquidity and falling stock prices. Rather than being dampened, volatility could well rise.

So why do FTTs keep getting proposed? If the results are so obvious, how could an FTT ever gain traction? These are key and critical questions.

One reason FTTs retain some popularity is that they seem to be a de minimis thing. A small friction inserted into every transaction is not obviously seen as having wide-ranging and damaging effects.

Moreover, there has been a concerted effort to cast HFT in a negative light. Although portrayed by some as the boogeyman of the markets, electronic trading firms are the main source of liquidity in today’s markets—whether functioning as registered market makers (or designated market makers) or as providers of limit order liquidity. Banks and brokers, sell-side firms and buy-side institutions, direct trading firms, and algo providers all contribute to the electronic trading that makes up the majority of the trading in the U.S. markets.

Finally, the interconnected nature of the markets and the overall economy is not always well understood. When you consider imposing a tax on the financial markets, it is not always immediately apparent what the downstream results could be, such as increased costs for mortgages, consumer goods, public works, or corporate financing.

Taken together, the weight of the evidence, the experience of history and our own market experts show that instituting an FTT in the U.S. would result in far more harm than good. This conclusion may best be summed up by one market participant in our study:

Financial transaction taxes have been tried many times in a number of different jurisdictions. Time and time again, we have seen that these taxes drive volume to other countries, reduce liquidity and widen bid-ask spreads, resulting in firms trading other products to avoid the tax that ends up being borne by the very people it is purported to help. I find it astounding that policy makers have not learned from all the failures of the past.
1And, of course, the United Kingdom’s Stamp Duty Reserve Tax still imposes a transaction tax on the transfer of shares, albeit with significant exemptions, such as for market makers, making about 70% of the trading volume in the U.K. exempt from the tax.

2Under Section 31(j)(2) of the Securities and Exchange Act of 1934.

3Securities futures transactions are charged $.0042 for each round turn transaction.

4Forthcoming research from Greenwich Associates shows that most market participants believe that regulations imposed during the last credit crisis actually impeded the ability of banks to make markets and therefore hurt liquidity in credit.

5Although, to be clear, the minority view was that the overall impact would be beneficial.
