Another Look at the Financial Transactions Tax

By Ellen Brown
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The debt ceiling crisis has again brought into focus the perennial gap between what the government spends and what it accumulates in taxes, and the virtual impossibility of closing that gap by increasing taxes or negotiating cuts in the budget.

In a 2023 book titled *A Tale of Two Economies: A New Financial Operating System for the American Economy*, Wall Street veteran Scott Smith shows that we would need to tax everyone at a rate of 40%, without deductions, to balance the budgets of our federal and local governments – an obvious nonstarter. The problem, he argues, is that we are taxing the wrong things – income and physical sales. In fact, we have two economies – the material economy in which goods and services are bought and sold, and the monetary economy involving the trading of financial assets (stocks, bonds, currencies, etc.) – basically "money making money" without producing new goods or services.

Drawing on data from the Bank for International Settlements and the Federal Reserve, Smith shows that the monetary economy is hundreds of times larger than the physical economy. The budget gap could be closed by imposing a tax of a mere 0.1% on financial transactions, while eliminating not just income taxes but every other tax we pay today. For a financial transactions tax (FTT) of 0.25%, we could fund benefits we cannot afford today that would stimulate growth in the real economy, including not just infrastructure and development but free college, a universal basic income, and free healthcare for all. Smith contends we could even pay off the national debt in ten years or less with a 0.25% FTT.

A radical change in the tax structure may seem unlikely any time soon, due to the inertia of Congress and the overweening power of the financial industry. But as economist Michael Hudson and other commentators observe, the U.S. has reached its limits to growth without some sort of debt write down. Federal interest expense as a percent of tax revenues spiked to 32.9% in the first quarter of 2023, and it will spike further as old securities at lower interest rates mature and are replaced with new ones at much higher interest. A financial reset is not only necessary but may be imminent. Promising proposals like Smith's can lead the way to a much-needed shift from serving "capital" to serving productivity and the broader public interest.

A Look at the Numbers

The material economy is roughly measured by the annual Gross Domestic Product (GDP), which for the U.S. had reached $25.6 trillion by the third quarter of 2022. (Michael Hudson observes that even GDP, as currently measured, is largely composed of non-productive financial services.) GDP is defined by spending, which depends on income. Collectively, Americans earned $21 trillion in 2021. The monetary economy is defined as the total amount of money that changes hands each year. Smith draws his figures from data that the Federal Reserve publishes annually in the Bank for International Settlements' Red Book. The Red Book is not all-inclusive; it leaves out such payments as commodity trading, various options, crypto currency trades, and exchange-traded funds. But even its partial accounting shows $*7.6 quadrillion* in payments – more than 350 times our national collective income. Smith includes this chart:

Payments for the Year 2020
(Trillions of Dollars)

Cashless Payments	
Credit transfers	$49
Direct debits	$28
Checks	$25
Cards/e-money	$8
Payment Systems & Service Providers	
Fed check clearing	$8
Private check clearing	$11
CHIPS	$382
EPN	$30
Fed ACH	$32
Fedwire Funds Service	$841
NSS	$24
Counterparties & Clearing Houses	
FICC: GSD	$1,507
FICC: MBSD	$103
NCSS	$430
Central Securities Depositories	
DTC	$130
Fedwire Securities Svc	$362
Stock Exchanges	$142
OTC FX and IR Derivatives	$903
XT Derivatives	$240
XT Futures and Options	$1,890
OTC FX instruments	$480
Grand Total	$7,625

Bank for International Settlements, (Data on cashless payments, payment systems, service providers, counterparties, clearing houses, and central security depositories. Click on the United States, https://www.bis.org/statistics/rpfx22.htm?m=2617 (Data on OTC FX and IR derivative), https://stats.bis.org/statx/srs/table/d1 (Data on XT futures and options), https://stats.bis.org/statx/srs/table/d11.2. (Data on OTC FX Instruments), Federal Reserve Bank of New York, (Data on XT Derivatives), Cboe Global Markets, https://www.cboe.com/us/equities/market_statistics/historical_market_volume/ (Data on stock market volumes). All data is the latest available. Most categories are for 2020, some categories are for

2021 and 2022.

Smith comments:

> Most of these payments have little to do with what we regard as the real economy— the purchase of goods and services and the supply chain. Our GDP represents less than 0.33% of the payments in our economy. Once we see the big picture, the solution is obvious. We should tax payments instead of our income.

He calculates that U.S. spending by federal, state and local governments will total around $8.5 trillion in 2023. Dividing $7,625 trillion in payments by $8.5 trillion in government spending comes to a little more than 0.001, or a tenth of a percent (0.1%). Taxing payments at 0.1% could thus eliminate every tax we pay today, including social security (FICA) taxes, sales taxes, property taxes, capital gains taxes, estate taxes, gift taxes, excise taxes and customs taxes. With a 0.25% FTT, "If you have a net worth of $20 million or less, you would come out ahead. And if you make $500 million per year, you will finally be paying your fair share of taxes – $1.25 million!"

Bridging the Wealth Gap

The financial transaction tax is not a new concept. The oldest tax still in existence was a stamp duty at the London Stock Exchange initiated in 1694. The tax was payable by the buyer of shares for the official stamp on the legal document needed to formalize the purchase. Many other countries have imposed FTTs, including the U.S. — some successfully and some not. In January 2021, U.S. Rep. Peter DeFazio reintroduced The Wall Street Tax Act, which was accompanied in March 2021 by a Senate bill introduced by Sen. Brian Schatz. According to a press release on the Schatz bill, the tax "would create a 0.1% tax on each sale of stocks, bonds, and derivatives, which will discourage unproductive trading and redirect investment toward more productive areas of the economy. The new tax would apply to the fair market value of equities and bonds, and the payment flows under derivatives contracts. Initial public offerings and short-term debt would be exempted." Schatz stated:

> During the pandemic, Wall Street has cashed in on high-risk trades that add no real value to our economy and leave working families behind. We need to curb this dangerous trading to reduce volatility in the markets and encourage investment that can actually help our economy grow. By raising the price of financial transactions, we can make our financial system work better while bringing in billions in new revenue that we can reinvest in our workers and our communities.

Scott Smith concurs, noting that millions of people were forced into poverty during the first two years of the pandemic. In the same two years, the 10 richest men in the world doubled their fortunes and a new billionaire was minted every 26 hours. Much of this disparity was fueled by fiscal and monetary policy aimed at relieving the effects of the pandemic and of the 2008-09 banking crisis. Smith writes:

> Our burgeoning monetary economy has fueled the rise of securitization, private equity, hedge funds, the foreign exchange market, commodity trading, cryptocurrency, digital assets, and investments in China. Quantitative easing further fanned these flames, driving up the price of financial assets. All such assets are monetary equivalents, and,

> thus, inflating the price of such assets balloons the money supply.
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> What many lauded as a robust economy was really monetary inflation. This makes it more difficult for the next generation to start life. Monetary inflation moves a select few out of the middle class, making them newly rich, while relegating many more to being poorer.
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> … The trading of financial assets in the monetary economy represents the majority of the payments in the economy, eclipsing payments related to wages or the purchase of goods or services. Thus, it would be wealthy individuals and institutions, such as hedge funds, that would shoulder most of the burden of a payment tax.

Predictably, the Wall Street Tax Act has gotten pushback and has not gotten far. But Smith says his proposal is different. It is *not adding a tax but is replacing existing taxes* – with something that is actually better for most taxpayers. He has asked a number of hedge fund managers, day traders, private equity fund managers, and venture capital managers if a quarter-point tax would impact their businesses. They have shrugged it off as not significant, and have said that *they would certainly prefer a payments tax to income taxes*.

Responding to the Critics: The Sweden Debacle Among failed FTT attempts, one often cited by critics was undertaken in Sweden in the 1980s. As reported by the Securities Industry and Financial Markets Association (SIFMA):

> There were negative capital markets impacts seen in the great migration of trading volumes across multiple products to London, equity index returns fell, volatility increased and the interest rate options markets essentially disappeared.

But as argued by James Li in a podcast titled "The Truth About a Financial Transaction Tax":

> Sweden's tax policy … had an obvious, massive loophole, which is that Swedish traders could migrate to the London Stock Exchange to avoid the tax — which they did, until it was eventually abolished. On the other hand, the UK's financial transaction tax has been much more successful. In 1694, King William III levied a stamp duty on all paper transactions, and a version of that levy still exists today, taxing many stock trades at 0.5 percent. Unlike the defunct Swedish tax, it applies to trades of shares of any UK company, regardless of where traders are based.

Again, Smith argues that the challenges met by other transaction tax proposals have arisen because they were being proposed as an *additional* tax. A payment tax *in lieu of* personal and corporate income taxes takes on a whole different character. He argues that big firms, rather than moving offshore to avoid a payments tax, would move to the U.S., since the tax rate in other nations would be much higher. Without a corporate or income tax, the U.S. would be the most favored tax haven in the world.

He adds that an exit tax could be a good idea: any money leaving the U.S. could be taxed at a 5% rate. That would discourage people from wiring money to an offshore exchange. But incoming money would not be taxed, encouraging foreign money to come to the U.S. to stay long-term, where it would be taxed less than elsewhere.

The Alleged Threat to Retirees

James Li's favorite myth about a financial transactions tax is that it would be devastating for

Main Street investors. He cites a report from the Modern Markets Initiative on the effects of the tax on savings and retirement security. A Business Wire headline on the report warns, "Latest Data from Modern Markets Initiative Shows the Financial Transaction Tax Would Threaten the Retirement Savings of Millions of Americans." Among other claims is that a financial transactions tax would cost "$45,000 to $65,000 in FTT over the lifetime of a 401(k) account, or the equivalent of delaying the average individual's retirement by approximately two years." How that calculation was made is not included in the article, which refers the reader to the report. Li looked it up, and says on his podcast that it was highly misleading:

> [T]he study stated that under this type of tax, for every $100,000 of assets in a 401(k) plan, the saver would owe $281 dollars in FTT taxes in a given year; and then over a 40-year time horizon paying in at $281 a year at 7% annual growth – the average for pension funds – that this would yield a total value of $64,232 after 40 years.
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> … [What they were] actually saying is, "If you put $100,000 a year into your 401(k), you would be paying approximately $281 in taxes for that $100,000; and if you had instead invested that money every year in a fund with 7% interest, that amount would add up to about $64,000 after 40 years."
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> … I don't know about you, but I can't put $100,000 in my 401(k) plan every year. Very few people can. A more accurate estimate on how this would actually impact the average retirement savings is to look at the median income, which is around $52,000 a year, with an estimated $5,000 contribution into a 401(k) annually, which is around 10% of your gross pay based on commonly accepted financial planning advice. So the average person would only pay about $13 in FTT taxes in a given year.
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> These people are extremely tricky and their logic is also extremely flawed, because we pay taxes all the time. It's like saying, "Oh, if I didn't have to pay an income tax, I would be able to put all that money away and be up like a million bucks when I retire."

Similar arguments are made concerning potential losses from FTTs to pension funds and the stock market. SIFMA contends, "What's bad for the capital markets is bad for the economy," stating "The capital markets fund 65% of economic activity in the U.S." Perhaps, but the money paid for shares of stock traded in the stock market does not go to the corporations issuing the stock. It goes to the previous shareholders. Only the sale of IPOs – initial public offerings – generates money for the corporation, and this money is typically exempted from FTTs. Trades after that are simply gambling, hoping to sell at a higher price to the "greater fool."

Killing the Parasite That Is Killing the Host

In the 2015 book Killing the Host – How Financial Parasites and Debt Destroy the Global Economy, Michael Hudson calls "finance capitalism" a parasite that is consuming the fruits of "industrial capitalism" – the goods and services traded in what Smith calls the material economy. Pam Martens writes in a review of Hudson's book that this "blood-sucking financial leech [is] affixed to your body, your retirement plan, and your economic future."

But it is not actually the pension funds that are doing most of the financialized trades or that would get taxed on those trades. It is their asset managers – including BlackRock and Vanguard, both of which lost money overall in 2022. If the asset managers can't make money in the financialized economy, perhaps it would be better for the pension funds to move to more productive investments – from "finance capitalism" to "industrial capitalism."

Publicly-owned banks mandated to serve the public interest would be good options if we had them. As the economy falters, the public banking movement is picking up steam, part of a much-needed shift towards an economy that puts the public interest above private profits.

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Ellen Brown *is an attorney, chair of the Public Banking Institute, and author of thirteen books including Web of Debt, The Public Bank Solution, and Banking on the People: Democratizing Money in the Digital Age. She also co-hosts a radio program on PRN.FM called "It's Our Money." Her 400+ blog articles are posted at EllenBrown.com. She is a regular contributor to Global Research.*

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