

## ARTICLES.

### ■ MAIN STREET VS. WALL STREET

# Taxing the Big Casino

DEAN BAKER, ROBERT POLLIN  
AND MARC SCHABERG

**N**ews from the financial markets over the past few weeks makes it abundantly clear that Wall Street is terrified by the prospect of improving economic conditions for the majority of American people. The front page of *The Wall Street Journal* for March 31 conveyed it precisely: on the left side, a headline announcing "Job Market Picks Up"; on the right, more sobering news, "The Bull Stumbles."

Indications that three years of recession and jobless recovery are finally ending sent the stock and bond markets into a frenzy of bearish trading. If job creation is sustained and wages start rising, the reasoning on Wall Street goes, inflation is sure to follow, and with it declining returns on bonds and a likely squeeze on corporate profits. It is much the same reasoning that has prompted Federal Reserve Chairman Alan Greenspan, a product of both Washington and Wall Street, to raise short-term interest rates three times in the past two and a half months. But Greenspan's moves have only intensified the market's anxiety. Now Administration officials seeking to calm the market sound upbeat as they report that wage gains during the recovery have, after all, been minimal.

Despite the market's proclivity for speculative excess and its bias toward wealth-holders over wage earners, enthusiasts of the free-market faith claim that Wall Street makes an essential contribution to economic well-being, moving credit efficiently from savers to investors. The *New York Stock Exchange Fact Book* exults that "by encouraging capital raising among corporations and investment by a broad range of participants, the New York Stock Exchange market helps improve the standard of living in the communities in which we live. And the result is a better quality of life for all of us."

Financial markets do provide an essential service by letting people convert investments easily into money. But this benefit must be weighed against the fact that trading has almost nothing to do with raising funds for investment. Players in the market now trade more than \$100 worth of stocks and bonds for every dollar that nonfinancial corporations raise for new investment in plants and equipment. This ratio is almost four times what it was thirty years ago, and it keeps rising as innovative financiers develop ever more complex "de-

rivative" financial instruments, such as options, futures and currency and equity swaps. Over the last full business cycle (1982-90), not one dollar from Wall Street was needed to finance *any* of the investment in plants and equipment by corporations; the funds the corporations themselves had saved were fully sufficient to finance their investment.

The financial markets are thus little more than well-heeled gambling casinos. Yet neither high rollers in Las Vegas and Atlantic City nor low rollers buying state lottery tickets are serious players in setting the country's economic agenda. Wall Street speculators, by contrast, both distort the investment priorities of corporations and exert near veto power over economic policy via their leverage with both the Treasury Department and the Federal Reserve. This is exactly the situation that moved John Maynard Keynes to write in 1936 that "when the capital development of a country becomes the by-product of the casino, the job is likely to be ill-done."

---

## *A small tax on sellers of stocks and bonds would yield a substantial social benefit.*

---

How can the public exert control over speculative markets? Ultimately, this would require overhauling financial regulation and reordering the Federal Reserve and its priorities toward long-term productive development. But as an important first step, why not treat Wall Street as the casino that it is and place a tax on all financial market trading? At present the revenues from Nevada's casinos are taxed at 6.25 percent and those in New Jersey at 8 percent. The forty states that run lotteries tax their participants an average of 40 percent on each ticket. Given the far larger volume of the financial market casino, a small tax imposed on the seller of every financial instrument would yield a substantial social benefit—either by discouraging speculation or, failing that, by creating a formidable new revenue source, large enough indeed to finance a public investment program of the type Bill Clinton made a cornerstone of his 1992 campaign.

At various points, such a tax or similar measures have been endorsed by former House Speaker Jim Wright, Senate minority leader Bob Dole and even former President Bush. The Clinton Administration's two most distinguished economists, Joseph Stiglitz of the Council of Economic Advisers and Lawrence Summers of the Treasury, have also written persuasively in behalf of such a tax. It's time to give the idea serious attention.

---

*Dean Baker is a macroeconomist at the Economic Policy Institute in Washington. Robert Pollin, co-editor of Transforming the U.S. Financial System (M.E. Sharpe), teaches economics at the University of California, Riverside. Marc Schaberg is a doctoral student in economics at U.C. Riverside.*

**T**he technical features of a trading tax are fairly simple. For stocks, the seller would be charged 0.5 percent of the sale price, which is the amount suggested by Jim Wright when he floated the idea in 1987. In the case of bonds, the tax would be proportional to the bond's duration, at a rate of 0.01 per-

cent per year. Thus, the tax on selling a thirty-year bond would be 0.3 percent, and a tax on a fifty-year bond, 0.5 percent. The tax rate would be adjusted on a comparable basis for derivative financial instruments. Brokers would be responsible for collecting the tax from the sellers at the time of sale. Since there are already reporting requirements with the I.R.S., this would entail very little additional administrative apparatus.

A trading tax of this size would have virtually no impact on anyone who bought an asset and did not promptly resell it for a quick profit. If someone bought shares of stock at \$50 and sold them ten years later at \$100, the trading tax would be 50 cents per share. But even this small burden diminishes in historical perspective, since the costs of carrying out trades on the stock market have fallen tremendously in recent years. Including commissions to brokers and related expenses, overall trading costs on the stock exchanges in 1980 averaged 1.4 percent of the value of trades. By 1990 (the last year for which we have full data), these costs amounted to 0.6 percent of trades. Assuming trading costs are now roughly at their 1990 level, the imposition of a 0.5 percent tax would still mean that people would pay less now (1.1 percent) than in 1980 (1.4 percent) in carrying out their trades.

On the other hand, a 0.5 percent tax would seriously reduce the profit prospects for short-term speculators. It is not uncommon for speculators to buy a stock or other financial asset, hold it for a day or even hours, then resell it for a small gain. If someone bought a share for \$99 yesterday, then sold it for \$100 today, the transaction would net a \$1 profit, a good return on a one-day investment. But the tax in this case would again be 50 cents (0.5 percent of \$100), wiping out half the profit from the trade.

The potential benefits of a securities trading tax can be appreciated only in terms of the magnitude of the financial markets. The table on page 624 provides some perspective, comparing the total trading volume of existing stocks and bonds with the value of new stocks and bonds issued. The comparison is important: The trading of existing securities serves only to transfer ownership claims; no new funds are raised for any purpose. The only way for businesses or the government to raise funds from the market is through issuing new stocks and bonds. (What is then done with the new funds—investing in the environment, education, corporate takeovers or the military—is a separate question.)

Trading volume of existing securities is enormous: in 1992, \$3.1 trillion in the stock market; \$8.2 trillion in the corporate bond market; \$44.4 trillion in the government securities market. By comparison, the U.S. economy's total output of goods and services (G.D.P.) in 1992 was \$6 trillion. In other words, trading on all three markets—a total of \$55.7 trillion—was nearly ten times greater than the economy's output that year.

More to the point, new issues were minuscule relative to trading volume. Considering just the stock market, the ratio of trading volume to new funds raised—113.8 on the table—means that \$113.80 in stock trades took place for every dollar raised to finance new corporate investments. In 1961, by comparison, there were approximately \$30 in trades for every dollar raised. The ratios are even higher for the corporate bond and government securities markets, indicating even

more speculation for every dollar of funds raised on these markets. But even these figures offer only a partial picture. The annual volume of trading in the derivative markets now exceeds \$100 trillion by some measures.

Such vast trading creates serious distortions on the productive side of the economy. For one, corporate managers are forced to hew to the performance standards as defined by the financial markets or else place their careers in jeopardy. This means showing positive numbers to the fund managers at least every quarter; by contrast, developing a company's productive capacity is a long-term process in which gains generally emerge only over a period of years. Indeed, a recent survey of C.E.O.s of the largest 1,000 U.S. corporations reported that the average C.E.O. holds 1.4 meetings per week with money managers and stock market analysts, and that the firms' chief financial officers average 3.2 weekly meetings with these groups. From this we can surmise that chief financial officers devote roughly 20 percent of their work time to creating favorable impressions on Wall Street.

The economic distortions created by Wall Street are also reflected in its approach to "human resources." The lavishly remunerated forecasters and deal-makers operate as little more than a herd, and the stars of the industry are merely those able to lead the herd wherever it may go. Accurate "Fed watching" is another richly compensated skill. The success stories in this field include recently retired Federal Reserve governor Wayne Angell, who, until his appointment in mid-April as chief economist at Bear Stearns, had parlayed his insider knowledge of the Fed's operations into a \$100 *per minute* consulting service to fund managers.

The cozy relationship between the Federal Reserve and Wall Street is longstanding, the Angell case being only one example of the bounteous opportunities available to this exclusive



club. But the priorities of the financial markets—against low unemployment, wage gains and inflation—are reflected far more broadly among policy-makers. Laura D'Andrea Tyson, chairwoman of the Council of Economic Advisers and a liberal within the Administration, obviously felt it necessary to ease Wall Street's obsession with inflation in a recent *New York Times* Op-Ed piece, though she has not felt similarly compelled to address working people's concerns about the lack of wage gains in the current recovery.

A tax on trading would certainly not solve all these problems. However, if it succeeded in reducing speculation significantly, it would clearly promote financial stability and productive investment. And even if it failed to dampen speculation, revenues generated from the tax would be equally beneficial. We estimate that a 0.5 percent tax on stock trades and the sliding scale described above for bonds and derivative instruments would raise about \$60 billion annually if trading did not decline after the tax was imposed. By this estimate, even if trading declined by 50 percent as a result of the tax, the government would still raise \$30 billion.

This \$30 billion could then be channeled, for example, toward education, military conversion and environmental technologies, which, as Candidate Clinton maintained repeatedly in 1992, would also increase opportunities for high-wage jobs. Alternatively, some of the funds could be used to avoid the types of austerity measures that, in the name of deficit reduction, President Clinton has proposed in his 1995 budget—such as cuts in the home heating subsidies that keep old people and the poor from freezing in winter.

Technical challenges will emerge in properly implementing the tax, but such problems are not insurmountable. For instance, to discourage funds from leaving the U.S. market in favor of tax havens like the Cayman Islands, the tax should be levied on all trades made by U.S. taxpayers, regardless of the country in which the trade occurred. Experiences with similar taxes in many other countries, including France, Germany, the Netherlands and Japan, provide useful guidelines toward the most effective strategy for implementation.

The major obstacle to the passage of a securities trading tax is not technical but political. Wall Street will be vehemently opposed, as will its champions in the Clinton Administration. These include National Economic Council chairman Robert Rubin, formerly head of the powerful investment banking firm Goldman Sachs, and Treasury Deputy Secretary Roger Altman, formerly of the Blackstone Group, another

major Wall Street firm. Yet the case for the tax is compelling, as the Administration's own best economists have shown.

The broader logic is also clear: Government is perfectly willing to tax Las Vegas, Atlantic City and the lotteries, where working people place their bets with virtually no consequence to the country's economic future. Why then should it not also tax the preferred gambling venue of the wealthy, especially given the serious costs their activities impose on the economic prospects of the majority? □

## ■ RACE AGAINST HOPE

# Fear Campaign in South Africa

MARK GEVISSER

A few days before the Inkatha Freedom Party decided to contest the elections, I asked Ma Thuli, an elderly Soweto resident and an African National Congress supporter, whether she would vote. "You know, young man, I'm an older lady and I'm not in the best health. I will not be alive for the next election. This is my one and only time in my life to vote. But I will not do it—it just seems too dangerous. To die in my land without voting! Now is that not a tragedy?"

On Tuesday April 19, following Mangosuthu Buthelezi's eleventh-hour volte-face, thousands of I.F.P. supporters spontaneously streamed into Durban in a wild, cheering mass—evidence that even among his own supporters, his election boycott call had been unpopular. And in Natal, A.N.C. supporters too were jubilant: With the I.F.P. in the running they were no longer assured of a landslide, but at least they felt free to vote.

Back in relatively peaceful Soweto I managed to contact Ma Thuli. Would she still stay at home? She sighed. "I will have to see. It all depends on what happens on the day. Just because Buthelezi is in, it doesn't mean there won't be violence. Look at Thokoza."

Indeed, on the very "miracle day" of the I.F.P.'s announcement, fierce gunfighting continued between Inkatha-supporting hostel dwellers and A.N.C.-supporting self-defense units in the township of Thokoza, outside Johannesburg. Five more people were killed, bringing to twenty the number of deaths in the township since the previous weekend.

Even after the momentous "peace" of April 19, it seems likely that political violence and concomitant fears of intimidation will keep at least some voters away from the polling booth. Ma Thuli is right: It would be a tragedy if many South Africans stay home in an election that empowers them, for the very first time, to participate fully in their country's political life. The battle of this election, ultimately, is not between different political parties for the allegiance of South Africans. It is a battle between hope and fear. That battle is

*Mark Gevisser is The Nation's Southern Africa correspondent.*

### SPECULATIVE TRADING VERSUS PRODUCTIVE FINANCING (figures are for 1992)

	Existing Stocks & Bonds Traded	New Stocks & Bonds Issued	Ratio of Trading to New Issues
Stock Market	\$3.1 trillion	\$26.8 billion	113.8
Corporate Bond Market	\$8.2 trillion	\$67.3 billion	122.1
U.S. Government Securities Market	\$44.4 trillion	\$272.2 billion	160.3

Copyright of Nation is the property of Nation Company, Inc.. The copyright in an individual article may be maintained by the author in certain cases. Content may not be copied or emailed to multiple sites or posted to a listserv without the copyright holder's express written permission. However, users may print, download, or email articles for individual use.