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# The Bernie Sanders Tax Attack on Stock Trades

By Burton G. Malkiel

In the Democrats' presidential debate on Sunday, Bernie Sanders repeated his call for a tax on Wall Street. The levy he has proposed, a 50-cent tax on every $100 of stock trades, "will reduce risky and unproductive high-speed trading and other forms of Wall Street speculation," according to his website, and the "proceeds would be used to provide debt-free public college education."

Taxing stock trades is not a new idea; several such proposals were proposed in Congress after the financial crisis, the first one with the appealing title "Let Wall Street Pay for the Restoration of Main Street Bill." What could be wrong with that?

Plenty. Supporters believe that buy-and-hold individual investors would hardly notice a financial-transactions tax since they trade infrequently—and could even benefit, since trading too much could be hazardous to their wealth. But in reality, all investors would be hurt. It is a very bad idea.

Many developed nations, including the United Kingdom, Germany and Japan have imposed transactions taxes on securities trades, and their experience suggests that the alleged benefits of the tax are likely to be small while the resulting costs and distortions would be large. Enacting such a tax here would fall on small individual investors as well as large ones, and the pre-eminence of the U.S. capital markets would almost certainly be endangered.

How so? As trading becomes more expensive we should expect trading volume to fall. When you tax something, you get less of it. One study by the International Monetary Fund concluded that the volume of trading invariably declined after the imposition of transactions. Another study by John Y. Campbell and Kenneth A. Froot (NBER Working Paper 4587) found that after a tax was imposed on brokerage services in Sweden there were massive declines in the volume of stocks and bonds traded in local markets.

Such taxes tend to raise far less in revenue than expected, based on previous trading volumes. This would be especially true if investors tended to realize fewer taxable capital gains. Moreover, by reducing the volume of trades, such taxes tend to reduce market liquidity and thereby increase bid-asked spreads. When the cost of transacting is thus directly and indirectly increased, larger and more resistant mispricing of securities can be expected.

A review in the Institute for Development Studies found no evidence that a tax on trading will reduce stock-price volatility or the likelihood of bubbles. To be sure, momentum traders who tend to accelerate price changes in bull and bear markets will be discouraged from trading. But so will helpful liquidity providers (aka market makers) who tend to dampen price swings.

## His plan would hurt investors—but, hey, at least it would pay for free college.

Suppose a seller has a block of stock for sale that is far larger than the daily volume of trading. In the absence of a tax, liquidity providers step in to buy shares at a small discount, hold them for a while, and hope to sell them later to buyers at slightly higher prices. But if both sides of the transaction are taxed, liquidity providers will demand extra compensation to cover the extra costs. Hence, share prices could be more volatile rather than less. In any event, the crash of 1987 was as severe in countries with transactions taxes as it was in countries that didn't tax "speculation."

Transactions taxes also are likely to reduce asset values. Stocks that have high trading costs must offer lower prices and higher future returns to attract investors. Hence a tax is likely to increase the cost of capital for business firms. Any resulting decrease in capital investment will reduce levels of real production, economic expansion and ultimately employment.

Individuals who infrequently trade stocks will nevertheless be harmed, along with other investors, by a transactions tax. Mutual funds that cater to individual investors—but which must buy and sell large volumes of equities to invest fund inflows and meet fund withdrawals—would simply pass the tax on to the fund's shareowners. Small individual investors often purchase low-cost, broad-based, indexed exchange-traded funds (ETFs). Such funds tend to sell at the appropriate value of their underlying holdings because high-frequency traders stand ready to arbitrage any differences between the price of the ETF and the net asset value of its holdings. Less-efficient ETF pricing would harm all investors.

The U.S. capital markets are among the world's most liquid and efficient. We should not risk damaging them by encouraging trading to move to other venues where trading taxes may be lower. A tax on securities trades would reduce our comparative advantage in financial services and create large economic and societal distortions.

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