

Discussion of “Can a Financial Transactions Tax
Prevent Stock Price Booms?”
by Adam, Marcet, Merkel and Beutel

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The Paper

- ▶ Can a financial transactions tax prevent stock price booms?
- ▶ Why do we get stock market booms?

Why do we get stock market booms?

- ▶ Adam, Beutel and Marcet (2013) plus belief heterogeneity
- ▶ All agents are trend extrapolators

$$\bar{E}_t \left(\frac{P_{t+1}}{P_t} \right) = \bar{E}_{t-1} \left(\frac{P_t}{P_{t-1}} \right) + g \left(\frac{P_t}{P_{t-1}} - \bar{E}_{t-1} \left(\frac{P_t}{P_{t-1}} \right) \right)$$

Stock market experience (years)	0-5	6-11	12-17	18-23	> 23
Estimated parameter g	0.03161	0.02861	0.02641	0.0230	0.0180

- ▶ Trade is between agents with different experience
- ▶ Good quantitative explanation of boom dynamics

Can a FTT prevent stock price booms?

- ▶ No
- ▶ Volatility of stock prices ↑
- ▶ Likelihood of boom-bust cycle ↑
- ▶ Trading volume ↑
- ▶ Market becomes less liquid so prices more volatile
- ▶ Echoes of Gali (2014)

Is this surprising?

- ▶ I feel sorry for agents in the model
 - ▶ Only smooth consumption by buying and selling stocks
 - ▶ No alternative assets are available, not even money
 - ▶ Never become more experienced, i.e. no OLG structure
 - ▶ Fixed gain g , i.e. never learn about 2nd moments
- ▶ But not very sorry
 - ▶ FTT rebated by type
 - ▶ No transfer of resources between different types
 - ▶ Inexperienced never driven out of market

What is FTT aiming at?



Occupy
WallStreet

Economists supporting the FTT

1. *The introduction of a substantial Government transfer tax on all transactions might prove the most serviceable reform available, with a view to mitigating the predominance of speculation over enterprise in the United States.*
2. *There's considerable evidence suggesting that too much trading is going on. . . it suggests that to the extent that taxing financial transactions reduces the volume of wheeling and dealing, that would be a good thing*
3. *Some form of securities transactions tax would have the desirable economic effects of curbing speculation and of raising a significant amount of revenue*

Economists and the FTT

- ▶ Summers and Summers (1990)
 - ▶ FTT could eliminate “wasteful trading” and “excessive financial engineering”
 - ▶ Benefit of curbing speculation $>$ Cost of reduced liquidity
- ▶ Greenwald and Stiglitz (1986)
 - ▶ FTT could be welfare-improving if markets incomplete or information imperfect
 - ▶ See Kilenthong and Townsend (2014) for a recent challenge
- ▶ Lorenzoni (2008) inefficient credit booms
 - ▶ Pecuniary externalities

What are most important imperfections?

- ▶ Speculators vs value traders
- ▶ Noise vs rational traders
- ▶ Derivatives
- ▶ High frequency trading
- ▶ Automated trading algorithms
- ▶ Pecuniary externalities
- ▶ Inexperienced vs experienced trend extrapolators?

Economists supporting the FTT



mitigating the predominance of speculation over enterprise



reduces the volume of wheeling and dealing



raising a significant amount of revenue