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 \uparrow
- Likelihood of boom-bust cycle \uparrow
- ► 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?



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