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Leading Democratic candidates want to tax Wall Street

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If the Democratic presidential candidates gathered in Las Vegas for the party's first debate trade punches on issues like immigration and foreign policy, one area where they're likely to agree is that Wall Street continues to pose a clear and present danger to the U.S. economy.

Three of the five who'll be on stage Tuesday night -- Hillary Clinton, the front-runner for the nomination; Bernie Sanders, No. 2 in the polls; and Martin O'Malley -- have proposed some kind of tax on securities trades as part of their platforms to rein in speculation, safeguard the financial system and prevent the kind of financial crisis that leveled the economy in 2008.

Backers of a so-called financial transactions tax say it's an effective way to deter excessive risk-taking by investors, while also raising substantial amounts of government revenue. The Tax Policy Center, a joint venture of centrist think tanks The Urban Institute and Brookings Institution, estimates that such a tax would raise as much as $50 billion annually.

As campaign season heats up, the tax proposals are one way the Democrats in the race can underline their willingness to get tough with Wall Street, which remains deeply unpopular as the economy continues to recover from the housing crash.

To that end, Clinton also wants to charge the country's biggest financial institutions a "risk fee" to help offset their potential to contribute to another financial crisis. Sanders and O'Malley would reinstate Glass-Steagall, a New Deal-era law partially repealed in 1999 that separated commercial and investment banking.

A financial transaction tax, anathema to most Republican lawmakers, has in recent years also proved unpopular among leading Democrats. The Obama administration, led by former U.S. Treasury Secretary Tim Geithner, opposed imposing a small tax on buying and selling equities, derivatives and other financial assets, arguing that it was a poor way of tamping down risk.

Clinton and O'Malley stop short of the broad levy on securities trading backed by Sanders. Instead, Clinton favors a narrower tax on high-frequency trading firms, whose souped-up, computerized trading critics have linked to increased market volatility in recent years. Similarly, O'Malley's plan calls for applying a "small" tax on high-speed traders, "not to soak financial traders, but to fix bad incentives for speculation that comes at the cost of real job-creating investment."

The other two Democrats taking part in tonight's debate, Jim Webb and Lincoln Chafee, have not outlined a position on a tax aimed at Wall Street.

Although Clinton hasn't specified how large a tax she would put on such firms, her plan would target high-frequency traders that show an excessive level of canceled orders. Clinton says in her campaign literature that such trading makes financial markets "less stable and less fair."

Mike Konczal, a fellow at The Roosevelt Institute, a liberal-leaning think tank, said a tax on high-frequency trading must be part of a more comprehensive plan to shore up the financial system, including raising capital requirements for Wall Street banks and reducing their reliance on using borrowed money to magnify investment returns. But he praised Clinton's proposal as a "useful idea," saying raising the costs of trading could deter some of the rapid-fire transactions, executed in milliseconds, that experts link to wild swings in stock prices.

"I like the fact that it will fall on the financial sector," Konczal said. "To the extent it might reduce churn, it seems like a good thing because overactive investors tend to lose a lot of money, and longer-term [investment] strategies are generally good."

Sanders would go further than Clinton and O'Malley. The Vermont senator supports a tax on all securities trades as a way to curb Wall Street speculation and to raise revenue, which he would use to help students pay for the cost of attending a public college or university.

In policy circles, a transactions tax attracted renewed interest following the financial crisis and after the 2010 "Flash Crash," in which the Dow Jones industrials fell roughly 1,000 points in a matter of minutes. But the idea has been around in one guise or another for centuries.

The U.K. has long charged a "stamp duty" for buying and selling stock. Economist John Maynard Keynes backed the idea of a tax on trading stock in his seminal book, "The General Theory of Employment, Interest and Money," arguing that it could reduce dangerous speculation in equities.

Between 1914 and 1966, the U.S. imposed a "transfer" tax for issuing and trading both equities and debt. In the 1970s, the late Nobel Laureate economist James Tobin suggested levying a tax on currency trading as a way to stabilize exchange rates and reduce volatility in that market. Other illustrious proponents of a transaction tax include Warren Buffet, Bill Gates and former Federal Reserve Chairman Paul Volcker.

Now, as then, the debate over such taxes centers on an inherent tension in modern financial systems: how to strike a balance between helping businesses and individuals raise capital, which a national economy needs to grow, and the need to curb the kind of destructive speculation that was a hallmark of the financial crisis and previous bubbles.

Mark Calabria, an economist with libertarian think tank the Cato Institute, doesn't think raising costs on computerized trading is a good way to deter financial bubbles or make the financial system more stable. "There's not much evidence that large taxes on transactions will throw enough sand in the gears to slow bubbles from forming."

He also cites many of the usual criticisms aimed at a transactions tax, saying it reduces the value of financial assets, boosts the cost of capital for businesses, and makes it harder for investors to buy and sell securities. Other detractors also say the approach would hurt small investors and discourage companies from listing on U.S. exchanges.

Yet while he opposes a transactions tax, Calabria agrees that the financial system remains risky. "Our financial system is dangerously flawed, and there's reason to think we'll have another crisis within the next decade. We need deep structural change in our financial system," he said.

Noting that the European Union is considering adopting a trading tax, Konczal said companies would be unlikely to abandon the U.S. in favor of listing overseas if the tax were implemented internationally. Commenting on Clinton's plan, he also dismissed concerns that a tax on high-speed trading firms would harm smaller companies.

Of course, even if a Democrat takes the White House next year, the odds of a trading tax successfully running the gantlet in Congress are low, and the opposition any such proposal would face from large financial firms would be fierce. But Konczal said it's a conversation worth having.

"It's only one piece of the puzzle, but an important piece," he said. "And done in the right way, with international coordination, it could make a difference."