

volumes. A speculator may buy 100 contract units of U.S. Treasury bond futures on the CBOT, meaning that the profit realized in one hour of trading (less commissions, etc.) is $\$50 \times 100$, or $\$5,000$.

Second, the actual rate of return placed on a daily or yearly level is huge. For example, were the speculator to continue to realize this 2.47% hourly rate of profit for a week, his rate of return would be above 85%. Who will invest in steel plants, which return about 5% per year, when spectacular rates of return can be made in the derivatives market in a week's worth of trading?

Now, if LaRouche's 0.1% transaction tax is levied to the $\$100,000$ notional principal amount of the U.S. Treasury Bond contract that has been purchased, the tax would yield $\$100$, and could be collected by the exchange. But, in this example, the tax is a necessary, unbridgeable hurdle: The speculator will pay more in tax ($\$100$) than his profit ($\50). The LaRouche tax makes the deal unprofitable. Just to break even to cover the cost of the transaction tax, the speculator would have to make $\$100$ profit, which represents a rate of profit of 5% on this particular transaction. To go over breakeven, the speculator would have to make $\$150$ or so, representing a 7.5% rate of profit on his investment. The chance that a Treasury bond will move up $\$150$ in an hour is slim, although hardly impossible, especially in a manipulated

market. But markets can turn very suddenly, as speculators very well know. In markets, in which the time it takes to transact a trade is measured in fractions of a second, a speculator can be severely burned if he is constrained to wait in the market long enough for it to realize a full 5-7.5% rate of return. If it doesn't in that time frame, the market jolts the other way, he is doomed. The threshold level for real or net profitability, introduced by the 0.1% transaction tax, will, like a surgical tool, slash trading in this market instrument by at least one-fifth to one-quarter of its volume, puncturing this market, and beginning to dry it out: precisely as the tax is intended.

The stock index future

The other example is the Major Market Index (MMI), which is also traded on the Chicago Board of Trade. The MMI is an average of a basket of 20 leading stocks, such as AT&T, Du Pont, or Mobil, and is the favorite of the program traders. By using the MMI in the Chicago futures market, they can send the Dow Jones Industrial Average gyrating up and down. The MMI was one the chief culprits behind the October 1987 stock market crash. The notional principal of the underlying MMI contract is calculated by a formula, which is 500 times the MMI index's closing price. On May 13, the MMI index closed at $\$356.40$, so the notional princi-

The history of the fight against derivatives

The fight to institute Lyndon LaRouche's proposal for a one-tenth of 1% tax on financial derivatives comes after intense warfare over this issue by many nations that were fighting to preserve their national sovereignty. In the United States, trading in options on agricultural commodities had been banned in 1936, and the ban was not officially lifted until 1983.

Farmers had opposed the highly destructive effect of options, one of the earliest forms of the derivative market, starting in the 1920s, long before they became as large as they are today; even then, farmers still exercised significant influence within the United States. In 1933, an attempt was made to manipulate the wheat futures market using options, which resulted in an opportunity for farmers to force the U.S. government to ban trading in these options. There were attempts to re-introduce trading in agricultural options during the 1970s, but the plan met with only limited success.

It was only in January 1983, when President Ronald Reagan signed the 1982 Futures Trading Act, that the ban was officially lifted. This was a major feature in the

disastrous Reagan-era deregulation of the U.S. economy.

Contrary to the "free enterprise" argument that options markets are essential to agriculture, because they make the market more efficient, American agriculture has demonstrated its ability to function and thrive without options trading for the three and a half decades since the ban in 1936 through 1983.

Moreover, America had, for a short time, a small financial transaction tax, and the fight to impose a larger financial transaction tax was very intense in the late 1980s.

Throughout the 1950s and early 1960s, the United States had a low-rate transaction tax—called a stamp tax—on the issuance and transfer of stocks and debt. The tax was repealed in 1965.

Rumblings from Congress

However, in the late 1980s, the fight broke out more intensely for a transaction tax of a greater size. In 1987, Speaker of the House Jim Wright of Texas called for a transaction tax on the financial markets. Wright's proposal called for a 0.5% tax on both the seller and the buyer in the same transaction, thus, effectively, amounting 1%. For six months, there was a heated public debate over Wright's proposal. Wright was soon driven from office in what is generally agreed to be an overblown scandal. The

pal amount of the MMI futures contract was \$178,200. The initial margin requirement that a speculator must commit to buy an MMI futures contract is only \$5,400. The leverage built into this contract is 32 times.

Assume that the MMI index trades upward for the day by 25¢, which, multiplied by 500, per the formula, makes a profit on the contract of \$125. However, the 0.1% transactions tax for the single trade in the Major Market Index will yield \$172. Thus, once again, the tax level is higher than the anticipated profit. A trader in the MMI contract would have to make more than 3.2% on his margin investment to go over breakeven. Again, the trading volume of the market in this destructive contract will shrink.

A sizeable revenue

This is how the tax acts to exert reverse leverage. The higher the leverage of the transaction, as in the case of the U.S. Treasury Bond futures contract, the more bite the derivative tax takes, thereby shrinking the markets. In the case of stocks traded on the New York Stock Exchange, the effect is important, but less remarkable. The tax is applied in similar fashion to every section of financial derivatives markets, such as currency and interest-rate swaps held by the banks in the United States.

If one adds up the value of the annual transactions in all

the diverse segments of the financial derivatives market—the many and varied derivatives in currencies, stocks, bonds, interest-rate futures, commodities, etc.—the sum of the notional principal value traded is between \$80 and \$100 trillion. A precise figure does not exist, in part because the different trading exchange and government regulatory bodies have not compiled figures for the different segments of the market—and do not want to—because it would expose how large the markets have become. It can be assumed that the tax will reduce trading volume and, in parallel, a roughly corresponding dollar volume, in all the financial and financial derivative markets by at least one-fifth to one-quarter. This reduction will occur within a matter of weeks of the application of the tax, so that the derivatives market against which the LaRouche tax can be applied will be reduced to a low of \$60 trillion or a high of \$80 trillion. A tax on this range of 0.1% range will yield \$60-\$80 billion in annual revenue. After the first year, because the tax is, in part, a “sin” tax, the tax revenue will be smaller. However, as every congressman and senator caught in the budget debate will admit, such a tax produces a very, very large revenue figure.

Most importantly, the tax harms nothing essential in the physical economy, while lancing a growing malignancy. It constitutes a crucial step toward restoring America’s sovereignty.

Oct. 16-19, 1987 stock market crash confirmed Wright’s warnings of the instability of the financial markets.

Also in the 1989-90 period, during discussion of the 1990 Budget Reconciliation Act, Sen. Lloyd Bentsen, then chairman of the Senate Finance Committee and now secretary of the treasury, raised a proposal for a transaction tax on selected financial instruments on the floor of the Senate.

In February 1990, partly in response to the furor over this issue, the Congressional Budget Office, in its report “Reducing the Deficit: Spending and Revenue Options,” had a section on pages 388-89, entitled “Impose a 0.5% Tax on the Transfer of Securities.” Its analysis of the tax reported that “the tax would have to be broad-based, applying to stocks, debt, options and trades by Americans on foreign exchanges.”

What other nations have done

Various nations have taken action to tax and/or ban some of the instruments traded in the financial derivatives market, in an attempt to assert sovereign control over their national credit and finances.

- In 1986, the government of Sweden doubled its equity transaction tax, which is the tax on trade of stocks on the Swedish stock market. In 1989, Sweden extended

the tax to futures and options trades. The effect of this new tax was to substantially reduce the trading of futures on Sweden’s Stockholm market. Furthermore, the tax closed the Swedish Option and Future Exchange (SOFE) for two years. But in 1990, apparently under pressure from financiers, Sweden abolished the derivative tax, and trading in the derivatives market exploded, helping to deepen Sweden’s financial problems.

- Until as late as 1989, the German government held firm and refused to legalize the trading of some financial derivatives within the country. As a result of pressure from the trading of German government bond futures in the London markets, amendments to Germany’s gambling law in 1989 made changes and permitted retail participation in derivative markets, followed by the opening of Germany’s first financial exchange, Deutsche Terminbörse in 1990.

- At present, derivative taxes are assessed in Finland, France, Hong Kong, and Japan. These countries assess a transaction tax on various securities at rates 3-6 times larger than the LaRouche-proposed tax. In France, the fee is only used to finance the annual budget for CMT, the French regulatory body for the futures and options markets. Once the CMT’s budget requirement is met, the fee is no longer levied.—*Richard Freeman*