

**Bob Greifeld**  
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### **Don't Tax the Recovery**

It's a new year, a new decade, and I'm very pleased to be here on my first visit to Washington this year. For better or worse, it will be one of many, and I am thankful that Amtrak is basically reliable.

Last January, I came here to discuss the root causes of the global financial meltdown and to suggest steps to improve the quality and transparency of our markets. Twelve months later the financial landscape has improved but it is structurally the same as the days before the crisis. Today, I'd like to talk about where we are in the aftermath of the crisis, and specifically about how financial re-regulation and the urgency to create jobs in this country are fundamentally intertwined.

For the economy as a whole, things are getting better, but most observers agree that we have experienced a fragile, jobless recovery. To encourage recovery and the creation of jobs, my thesis, then, is very simple: good market structure supports increased market liquidity, and this in turn supports the capital formation process – one that allows people with good ideas to raise capital. Good ideas, funded by capital, produce jobs. This is the point of intersection between Main Street and Wall Street. Wall Street's role is to provide the ability to raise capital to grow jobs for Main Street.

The path to building innovative, job-producing companies is filled with many hurdles but access to capital should not be one of them. Take the example of a California-based company founded by two college dropouts. They started building

computer and motherboards in the difficult economic environment of the late 70s. Lacking the funds needed for marketing they sought out and received private and bank funding. When the company went public with 1,000 employees in December 1980, they raised more capital than any IPO since the Ford Motor IPO in 1956. Not so long afterward, in the early 80s the company went through difficult times because of the failure of one of their lead products. However, because of the capital they received in their IPO, they had the funds to hire the necessary engineers who that led to the development of a milestone product in the history of PCs. Today they have over 35,000 employees. The company is Apple. We need to ensure that we provide the environment for the creation of more Apples.

During the last decade NASDAQ-listed companies collectively increased their employment by 70 percent. In 2008, public companies that were once venture backed accounted for 12.1 million U.S. jobs and had revenues equivalent to 21 percent of U.S. GDP. To foster these kinds of companies, you need sound, transparent capital markets.

So my concern as the head of a U.S. market and a global exchange is that we continue to provide the proper market structure and regulatory framework that will foster this formula – connecting good ideas with capital. Last year the collective focus among government, markets, and regulators was financial services reform; I spoke about it here. In the closing days of 2009, the House of Representatives did act on a broad regulatory reform bill patterned on the input from President Obama and his advisors. The resulting bill is not perfect and has attracted criticism over various aspects, but it is a good start. Now, it is the responsibility of the Senate to propose its plan and act quickly to fortify our markets.

So while there are good things happening with regard to fortifying the transparent, smooth functioning of our markets, some proposed initiatives threaten to throw sand directly into the gears of our marketplace. One example is the recent proposal by some in Congress for a securities transaction tax as a way to “punish” Wall Street for the excesses of the past decade. To clarify, I’m not speaking of the “TARP tax” or “financial crisis responsibility fee” which the Administration discussed last week but something very different: a tax on all securities transactions that would cause a long term change to functioning markets. This tax would introduce new and unnecessary friction to our markets, markets that functioned well even during the worst of the financial crisis in the fall of 2008.

While the sentiment of disdain for the architects of the Financial Crisis is understandable, the transaction tax will miss the intended victim and hit the American worker and the American investor, at just the wrong time. We are not speaking of a tax on leverage, or on the balance sheet of a bank; this is nothing other than a tax on market liquidity. Raising trading costs hurts market liquidity, and lowering liquidity hurts job producing capital market activity.

Rather than encouraging capital formation, these proposals would damage our equity and ownership culture.

History shows us that past efforts to tax the functioning of the markets have failed. In 1932 when lawmakers were looking about for ways to raise new revenue in the Depression-spawned deficit, they doubled the transaction tax, as well as sharply increasing income tax rates. Many in the markets saw the move as ruinous, but the

Revenue Act of 1932 under Hoover was enacted nevertheless. And GDP in 1932 fell about 14% from 1931, with another slight decline in 1933. The unemployment rate remained in the 15 percent range for the rest of the decade. Even though it didn't raise a lot of money it remarkably remained on the books for another 34 years, before disappearing in 1966.

I have talked about market structure that will aid economic growth. When we speak about the transaction tax, lawmakers are wielding a tool that will slow economic progress. In some cases, such as when the Fed raises interest rates, we are purposefully implementing policy to cool growth and tamp down asset bubbles. I don't think anyone in Washington is seeking to cool off our economic growth. We look forward to the day when we have the happy problem of choosing which policy levers will slow down economic growth.

The international examples where this tax has been tried and failed also offer a strong warning. Consider Sweden, a country NASDAQ knows well since our merger with OMX. In 1984, Sweden introduced a 1 percent transaction tax and then doubled it. By 1990, over 50 percent of the volume of Swedish shares traded in London. The day the tax was announced, the Swedish market fell by 2.2 percent.

Revenues were sharply lower than expected – only about 5 percent of the expected total was derived from the tax on fixed-income securities, for instance. And that tax was only *two-thousandths* of a percent. Even with such a low level of taxation, bond trading fell 85 percent in the first week – a sign of the lengths to which parties will go to avoid a tax. Futures trading fell by 98 percent.

Fortunately for Sweden, the taxes were abolished in 1991. Now, the Swedish markets are dynamic, innovative, and growing.

To get a further sense of what a transaction tax would do to the markets, look also at China. In 2007, concerned that its markets were overheating, China tripled its 0.1% transaction tax – and the markets fell by 6.9% in only a few hours. Trading *stopped* for 50 of the CSI 300 benchmark members that hit the limit of a 10% decline. All this shows the lengths to which people will go to avoid a tax -- and the predictable effect a tax would have on trading levels and stock valuations.

Well functioning markets are fundamental to capital raising. A debated topic in 2009 was the role of “darkness” in the markets, trading that is not subject to the normal, open pricing on a public market. Most commentators from outside the industry reflexively decided that dark markets were bad. But, the answer is more nuanced. It is true that darkness sometimes reflects legitimate trading interests. The innovation, commitment of capital, and participation in the “dark” markets brings value, especially for large institutional orders and for low-volume equities that may have great ideas but little public following. In fact, dark liquidity from dealers improves trading in low-volume stocks by 25 percent.

There is a tipping point beyond where darkness which does not contribute to price discovery can harm the markets, reduce liquidity, and distort the pricing process that should instead offer fair and equal access to all market participants. The SEC recently published a concept release on market structure, a good thing given it has been a decade since we have visited fundamental market structure issues. We look forward to an open,

healthy discussion on these topics. While our markets remain the envy of the world, they are not perfect and we take pride in our ability to continually improve.

There was a great deal of discussion in 2009 around dark pools, but, to borrow a phrase from Chairman Gensler of the CFTC, there is a ‘dark ocean’ out there – the OTC derivatives market.

We also need comprehensive reform in this market, the notional value of which now amounts to \$300 *trillion*, or more than 20 times the size of the American economy.

Given that derivatives contracts have become more standardized since they were introduced a few decades ago, sensible regulation becomes easier. I call on the Congress and Administration to take action on the regulation of OTC derivatives this year.

Each of the issues I have discussed – dark pools, regulation of OTC derivatives, and the transaction tax – share a common theme. How (and whether) we address them will significantly affect the course of the markets.

More broadly, we can say with confidence that the kinds of companies that list on NASDAQ are those now driving innovation and driving economic recovery. Since 2005, NASDAQ-listed companies have added over 1,000,000 jobs to the US economy, and these companies have increased their workforces by over 20 percent. That’s an impressive figure at any time, but still more in the aftermath of a deep and prolonged recession.

We’re now in the second decade of this century. The teen years of the 20<sup>th</sup> century were marked by an intense interest in economic regulation after the trust-busting of Theodore Roosevelt and William Howard Taft – an earlier decade’s approach to handling companies that were “too big.” From this debate came the Federal Reserve, the

Clayton Antitrust Act, and the FTC. I don't know whether the reforms that Congress and the Administration will be as far-reaching – or as enduring – as those of a century ago. I do know that sound regulation, including market transparency and OTC derivatives reform within a strong financial services reform bill, is a far better approach to avoiding another financial crisis than taxation.

We need an enlightened regulatory effort that will encourage capital formation and growth. And sustained economic progress will be the best way to ensure the health of the markets.

Thank you for your time today and I'd be happy to take your questions.