Jahrbücher f. Nationalökonomie u. Statistik (Lucius & Lucius, Stuttgart 2008) Bd. (Vol.) 228/2+3

Who Does a Currency Transaction Tax Harm More: Short-Term Speculators or Long-Term Investors?

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JEL C15, F31, F32, G15, G18

Currency transaction taxes, financial market volatility, foreign exchange markets, heterogeneous interacting agents.

Summary

We propose a novel heterogeneous interacting agents model in which traders are allowed to select endogenously between two different forecasting models and are moreover allowed to be short-term speculators or long-term investors. Within this model framework we study the effects of currency transaction taxes on exchange rate volatility and traders' behavior measured by their population fractions. The numerical analysis yields the result that these taxes reduce the variance of exchange rate returns, but increase that kurtosis. Moreover it does not lead to a reduction in the misalignment. The second result is, the tax harms short-term speculation in favor of long-term investments, while it also harms trading rules based on economic fundamentals in favor to trend-extrapolating trading rules. But these results are only valid if agents trade very aggressively. Otherwise taxation is not necessary.