Macron And The EU Financial Transaction Tax

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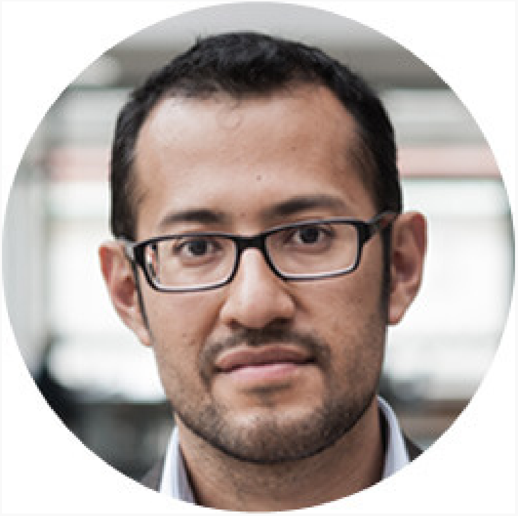

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What do I care about my chitchat of yesterday? The famous statement of German Chancellor Konrad Adenauer could well have been repeated by French President Emanuel Macron with his decision to initiate a postponement in introducing the European Financial Transaction Tax (EFTT). The EFTT should be of major interest for Macron as it is closely linked to one of the central issues in his electoral campaign: bringing in a better-resourced European budget. If an EU finance minister is ever to be installed effectively, s/he will be responsible not only for an anti-cyclical fiscal policy, but also for a minimum harmonization of tax rates in order to avoid tax dumping. Here, the EFTT could serve as a blueprint, although the agreement of last October involved only ten EU member states and usual suspects such as Luxembourg and Ireland did not participate.

Macron's decision against introducing the EFTT was unforeseen by the great majority of political actors not only because it stands in diametric opposition to his campaign promises, but also because it reverses a year-long process, in itself full of pitfalls which, against many odds, ended with the agreement to bring in the EFTT by early 2018. Although it could be argued that the result of those negotiations was not sufficiently far-reaching in terms of setting the compass to limit speculative transactions – for instance because the tax is to be based on the price of options rather than the contract size – the laboriously won compromise demonstrated a European capacity for action.

Why did Macron decide to in effect sabotage this meaningful European initiative? In terms of inherent content, nothing has changed since October 2016. Still, international experts correctly point out the economic rationale behind the EFTT, particularly if the monies generated are reinvested in the education sector. But long-term economic reasons seem to have lost ground relative to short-term strategic ones. Accordingly, the German finance minister says that "quite a bit speaks in favor of the French argument to look first at how the Brexit negotiations are going." (see here).

Many observers argue that Macron's main motive is to make Paris more attractive for financial institutions quitting the City of London if access to European financial markets post-Brexit is shut off. However, this argument is unconvincing for a very simple reason: cancellation of the EFTT affects all major EMU countries (just as its planned introduction would), so by itself it delivers no comparative advantage to Paris (or France) vis-a-vis other European financial centers. Thus, London bankers are no more likely to move to Paris instead of Frankfurt or Milan than before Macron's surprising move. There are also other ways to ensure that countries that do not intend to introduce the EFTT do not benefit disproportionately.

A related explanation put forward is linked to incentives: If continental Europe offered a more benign legal framework to financial institutions, then the incentives for London banks to move their headquarters more swiftly would increase Paris's chances for a short-term stimulus. Eventually, this would even weaken the UK's position in the Brexit negotiations as the resulting structural change for the City of London and the loss of jobs and purchasing power are likely to have widespread macroeconomic implications which would eventually unfold in a full-fledged economic recession. This scenario is not unlikely, as the British economy is still not well diversified. The importance of the financial industry is similar to that of the car industry in Germany. However, this explanation, if correct, is subject to way too many "ifs" for it to actually work. Most financial intermediates will wait for the outcome of the negotiations, before deciding on a costly headquarters move. Others, like Nomura, decided to move independently of the FTT's introduction. And the remainder, who might indeed be influenced by the EFTT decision, represents a type of unsustainable financial market actor. A capable policy maker should therefore ask him/herself whether a short-term gain in jobs and purchasing power in his home region will not be completely worthless through a medium- to long-term increase in financial market risks.

Last, but not least, one may fear political tensions during the Brexit negotiations. From a European perspective, there is no need for such concerns. Most observers have not interpreted the result of the recent UK general election as support for the course of a "hard" Brexit pursued by Prime Minister Theresa May. From a trade-economic perspective, there are certainly good arguments for a "soft" Brexit as preferred by the European Union. If the British negotiating partners do not agree with this at the end of the day, most of the economic projections see the far greater loss of welfare on the part of London. Even a British lawsuit against the EFTT at the European Court of Justice only represents an idle threat, since the exit rules require the process to be completed before judgement takes place (and Britain rejects its jurisdiction in any case). There is no reason to wait for the negotiations, but there are good stability-related reasons for holding on to the existing agreement.

First, the EFTT aims at reducing the share of speculative financial activities by rising costs for all transactions. Although the effectiveness of the EFTT in avoiding asset price bubbles is still disputed in academic circles (see e.g. here and here), the catastrophic consequences of the recent global financial crisis highlighted the necessity to implement new instruments which may reduce the likelihood of a new financial crisis. As a second stability effect, the EFTT represents an instrument for the re-distribution of income. Income inequality has increased in many European countries since the 1990s. One reason is that capital income, which is strongly concentrated at the upper end of the distribution, has gained in importance relative to labor income. The EFTT would lower capital income and could at the same time strengthen the public infrastructure, if revenues are reasonably used for education and healthcare.

Given the push for financial deregulation coming from the Trump administration on the other side of the Atlantic, it can be of historical importance for the EU to decisively position itself as a clear alternative to a deregulated financial capitalism, an alternative where the well-being of its citizens is more important than the short-term speculation profits of financial jongleurs. Let us hope that this insight will also reach Monsieur Macron when the EFTT timetable comes up for settlement at the end of the year.