

Economists must liberate their thinking in response to ...

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Giles Wilkes writes the [Freethinking Economist blog](#) and like others he has so far found little way to really land a blow on the report entitled [Taxing Banks](#) published yesterday. He has he admitted, written a long response though without reading it all. In response I wrote, in a personal capacity:

There are so many issues raised here it is hard to know where to start.

First, and most importantly though is that whilst financial transaction taxes are the issue of the moment they need not be the place to start when taxing banks. This report makes that very clear. This report also suggests:

1. An accounting standard to require banks to report their profits and losses, tax paid and limited balance sheet information for each jurisdictions where they operate
2. Global adoption of a General Anti-Avoidance Principle to strengthen the position of tax authorities wanting to challenge sophisticated tax avoidance structures used by banks to shift profits to low or zero tax jurisdictions
3. Binding Codes of Conduct for banks requiring them to adopt tax compliant policies.
4. Limitations on the time period that banks can carry forward their losses incurred during financial crises for offset against future profits
5. Limitation on the amount of bonus distribution that can be offset against profits for the purposes of reducing the bank's tax liability.

In other words, financial transaction taxes are an option and there are ample more available for those who think them inappropriate. Those submitting the report deliberately present options: it is equally clear that not all could be done — the capacity to impose them all does not exist. We know that. I recommend reading of the whole report.

Turning to financial transaction taxes, as Giles Wilkes does, I think he has missed the point of the report, which is very different from the standard NGO approach to this issue. First, it does not claim that all FTT revenue will be paid by banks. It sets clear limits on their capacity to do so. Second, in the case of stamp duties it recognises the incidence issue is unclear at present and suggests more research is needed (although I would argue, and do below, that the issues involved are not those that standard

analysis suggests to be the problem). Third, it clearly recognises that an FTT will reduce other tax yields: gross revenues for this tax are not the same as net revenues to any exchequer in this case and the report is honest about this fact. In other words, all the issues raised have, I hope been considered.

We've even considered that rather odd ratio (I admit) of UK stamp duty take to total predicted revenues around the world from such a charge. The explanation is the USA: Dean Baker et al suggest that stamp duty take there will be \$165 billion of the \$225 billion referred to in the report. That makes the UK ratio seem entirely plausible when the tax base is extended, as the FTT we suggest would do. The numerical oddity of this is acknowledged: I took comfort in publishing the data that someone like Dean Baker had concluded as he did using similar assumptions and probably similar data to that I used. My suggestion is therefore, be careful before you extrapolate.

But I'd also suggest much more care needs to be taken on the issue of what is profit and how incidence falls. I considered these issues in depth when writing — which is one reason why the report is long. First — profit is a residual after costs. But when those costs clearly include rents purloined by bankers then that residential should be treated with care is my suggestion — this is a dynamic situation after all, not a static one. I suggest in the report that a significant part of the incidence of a currency transaction tax on foreign exchange, and probably one on derivatives etc as well, will fall on bankers and not just banks. It would be quite dishonest to assume that there would be a 25% fall in volume of transactions and no staff implications and that a fall in demand for those doing these deals would not have considerable impact on their pay rate, which may fall dramatically. The consequence is, I argue, that third parties trading with banks will see reductions in volume costs to offset their tax incidence and banks will likewise save significant cost to offset tax paid — but will also, I admit, probably suffer profit falls too. I cannot be sure that will happen outside that sector — and see no reason why it should. I happen to think the perverse paradox of this tax is that it will be the ultimate tax on bankers' bonuses and that the charge will rebound into banks and on bankers. It's not a simple argument, but let's not pretend this is a simple issue. Please read the logic in the report.

Next let's also be clear: incidence is not an issue for taxes alone. If the incidence of stamp duties falls on pensioners (and that's odd as they are only a part of the stock market — and not the largest part either) let's also be clear that the incidence of the charges for churning their investments made by the finance sector of which stamp duties are a part, but not by a long way the biggest part, also falls on pensioners. You really can't have the argument both ways. In other words — bankers' (and similar persons') pay comes out of pensions right now — and in that case there is a massive potential social yield by cutting deal volumes — especially given the appalling overall rates of return after charges on equities over the last decade.

This issue of the tax cannot be picked in isolation — the broader issue has to be addressed as well. But this, I think, may have broader employment and pension related

consequences which I honestly admitted needed more research in the report — work I'd like to do as the capture of pension funds for the current benefit of the financial elite seems to me to be a matter of enormous significance which this analysis of incidence — when done properly, as I think I am trying to do — suggest needs much more work if we are to right the wrongs going on.

Finally — a small point on liquidity. The UK stock market saw trading volume by value fall by 50% in 2009 and the world did not fall apart as a result: there is no need for volume to create liquidity, at least in the scale seen to date.

None of this though says that these issues tackled all the problems in banking: the corporation tax issues may well do so more than the FTT ones in any case. But they do indicate ways to raise revenue — and that is what the IMF is looking at and that is why the report was written. In the process of doing so serious issues that will I hope allow the tax incidence of FTTs to be reappraised, the impact of the finance sector on pension yields to be highlighted, the issue of international tax avoidance to be noted once again and practical measures (such as those advanced on the treatment of bankers' pay for corporation tax purposes) to be promoted, all arose. That is what the report tried to do in a dynamic and honest way.

When analysing it please read it in that light. Please don't read profit as a given. Please note tax follows the money and incidence is not unrelated to charge. Please do consider the issue of rents. And please consider the whole smorgasbord of recommendations: the report would remain relevant without any mention of FTTs. But to offer analysis now without considering them would have been wrong. That said, if revenue is to be raised then the report offers easier ways of doing it — and that is not by way of a levy either.