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The case for a windfall tax on banks

November 2022

Background

- Banks are set to receive tens of billions of pounds of public money over the coming years due to the manner in which the Bank of England remunerates central bank reserves at its base rate, which is currently rising.
    - Former Bank of England deputy governor Sir Paul Tucker estimated in October that **banks are due to receive £42bn and £33bn in each of the next two financial years** from interest paid on reserves.
    - The OBR's latest forecasts suggest that **around £150bn of interest on reserves will be paid to banks from 2022 to 2028** (an average of around £25bn a year).
- The Bank of England started paying interest on all reserves held by banks in 2009 following the introduction of quantitative easing (QE). Ordinarily the interest on reserves are covered by the income the Bank of England receives on the bonds it has purchased via QE, but with interest on reserves rising higher than that paid by those bonds, the Treasury, which indemnifies the scheme, is forced to cover the losses.
    - Parliament has already voted to transfer more than £11bn of public money to cover QE losses.
- The scale of this transfer from the public to banks is especially difficult to justify at a time when workers are set to pay significantly more tax, and public services are facing even more cuts. The Chancellor instead opted to cut the surcharge banks pay by 60% (from 8% to 3%) in the Autumn Statement.
- The government was due to have published its next review of the monetary policy framework by the end of 2019, but in the Autumn Statement the Chancellor appeared to rule out any such review of the Bank of England's remit. In the absence of any change in the monetary policy framework, the government should use fiscal policy to minimise net transfers to the banking sector resulting from reserve remuneration.

Recommendation: Introduce a windfall tax on banks

- **The government should introduce a windfall tax to recapture excess profits banks derive from reserve remuneration.**
- The windfall banks are set to receive arises simply from their exclusive ability to hold central bank reserves. Banks are paid interest on the risk-free reserves they hold as a means of implementing monetary policy, rather than as compensation for any risk taken or goods and services rendered, making it a form of unearned rent.[1]

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[1] Issues with this method of implementing monetary policy have been discussed in more detail by former BoE deputy governor Sir Paul Tucker for the IFS, as well as the New Economics Foundation. Changes to this policy have also been proposed by a range of figures, including former BoE deputy governor Sir Charlie Bean, former Financial Services Authority chairman Adair Turner, former MPC member Charles Goodhart, Gerard Lyons, and Richard Murphy.

- The windfall from reserve remuneration comes in addition to the gains banks are set to receive from higher interest rates more generally, which boosts banks' profitability.
    - In 1981 the government introduced a 2.5% windfall tax for banks who saw profits surge after interest rates were increased.
- The Spanish government is currently planning to implement a 4.8% levy on banks' net income from interest and commissions.
- Former Bank of England deputy governor Sir Charlie Bean recently proposed taxing windfalls banks receive from reserve remuneration, suggesting that it could raise tens of billions of pounds.
- In line with the government's approach towards taxing oil and gas companies a 35% Energy Profits Levy for windfall profits arising from the energy crisis, it would also be appropriate to tax banks on the windfalls received simply for holding reserves.
- **Increasing the bank surcharge from 3% to 35% would raise around £67bn between 2022-3 and 2027-8** (over £11bn a year on average), based off OBR forecasts.
- Another option to reverse the transfers to banks could be an unreserved deposit tax. For instance, a 2% tax on deposits not backed by reserves would raise more than £25bn a year.

Suggested questions for policymakers

➔ Why is the Chancellor cutting the bank surcharge?
➔ Why is the Chancellor raising taxes on working people and cutting public services at the same time the government is set to pay out tens of billions to banks?
➔ If banks profits increase as a result of receiving public money via higher interest on reserves, will the Chancellor consider introducing windfall tax on excess profits, in a similar manner to the Energy Profits Levy?

For further reading, see 'Why are we paying tens of billions to banks during a cost of living crisis?'

Positive Money is a not-for-profit research and campaigning organisation, working towards reform of the money and banking system to support a fair, democratic and sustainable economy. We are funded by trusts, foundations and small donations.

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