BBVA Research

Regional Analysis Spain, Banks

More taxes on banks: no free lunch

Expansión (Spain)

Rafael Doménech

8 October 2018

It is always best to be very careful with changes in taxes. Increases can be dangerous if they hamper growth and job creation, just as reductions can be if they affect the sustainability of the welfare state and equity. For this reason it is necessary for changes in taxation to be carefully assessed, to conform to principles of efficiency and to contribute to growth, employment and social welfare and equity. In the case of Spain, the best strategy for boosting public revenue is to increase the tax base by reducing unemployment and temporary employment (which in turn is the best way to reduce inequality) and increasing the rates of employment and productivity.

Regrettably, there is very often a search for short cuts aimed at obtaining small revenue advantages in the short term, without giving due consideration to the negative medium- and long-term effects that may ultimately lead to tax rate increases having counter-productive and undesirable effects. Such is the case of the recent debate in Spain on the additional taxes imposed on banks.

Ever since Arthur Pigou wrote The Economics of Welfare in 1920 we have known that it makes sense to increase taxes differentially on activities that generate negative externalities, which is the justification for environmental taxes for example. The logic is simple: the higher taxation increases the cost of a good or service, discouraging its consumption and producing public revenues that offset the negative effects of the activity concerned. This is evidently not the case of the services provided by banks. Rather the contrary. The sector acts as a conduit for society’s savings and enables households and businesses to finance their consumption and investment decisions, thus contributing to the increase in employment and productivity. Furthermore, their contributions to the Deposit Guarantee Scheme and the Single Resolution Fund contribute towards financial stability in accordance with the regulations already established for this purpose. For all these reasons, the additional taxes on banks, which discriminate against this sector vis-à-vis the rest, will end up harming the interests of society as a whole.

What is the extent of the effects of an additional tax on banks? In a recent study by BBVA Research we assess the negative impact of this tax. We first review in detail the ample empirical evidence available for other countries. In general, the results are fairly conclusive: this kind of tax ends up reducing the volume of credit and leads to higher interest rates.

Secondly, we simulate the effects of these taxes using a model specially designed and estimated to replicate the observed behaviour of the macroeconomic aggregates in Spain, with a dense description of the main sectors (including the banking sector), agents and markets and of the tax structure. The results of these simulations indicate that an increase in taxes on the banking sector aimed ex-ante at increasing public revenues by 0.1% of GDP gives rise in the long term to a decline of 0.09% of GDP, an increase of 10 bps in interest rates on loans and a reduction in the volumes of bank credit, deposits and capital. The explanation for this result is all too clear: the need to maintain profitability following the imposition of taxes on bank capital, in line with the cost of use of capital in the economy as a whole, leads banks in the medium and long term to reduce their size, with lower volumes of capital, lending and deposits, and to increase their interest rates on lending. Therefore the taxes have a negative effect on the real activity of the economy, with a negative elasticity to GDP of close to one. As a consequence of these distorting effects on supply, which are not offset by increased transfers from the public sector to households, tax revenues increase ex-post, but by less than aimed for ex-ante when the taxes are designed. The decline in social wellbeing caused by this measure shows us once again that there is no such thing as a free lunch and no short cuts to a well designed tax structure.

BBVA Research

DISCLAIMER

This document, prepared by the BBVA Research Department, is informative in nature and contains data, opinions or estimates as at the date of its publication. These derive from the department's own research or are based on sources believed to be reliable, and have not been independently verified by BBVA. BBVA therefore makes no guarantee, either express or implied, as to the document's accuracy, completeness or correctness.

Any estimates contained in this document have been made in accordance with generally accepted methods and are to be taken as such, i.e. as forecasts or projections. Historical trends in economic variables (positive or negative) are no guarantee that they will move in the same way in the future.

The contents of this document are subject to change without prior notice, depending on (for example) the economic context or market fluctuations. BBVA does not give any undertaking to update any of the content or communicate such changes.

BBVA assumes no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

Neither this document nor its contents constitute an offer, invitation or solicitation to acquire, disinvest or obtain any interest in assets or financial instruments, nor can they form the basis of any contract, undertaking or decision of any kind.

In particular as regards investment in financial assets that could be related to the economic variables referred to in this document, readers should note that in no case should investment decisions be made based on the contents of this document; and that any persons or entities who may potentially offer them investment products are legally obliged to provide all the information they need to take such decisions.

The contents of this document are protected by intellectual property law. The reproduction, processing, distribution, public dissemination, making available, taking of excerpts, reuse, forwarding or use of the document in any way and by any means or process is expressly prohibited, except where this is legally permitted or expressly authorised by BBVA.

ENQUIRIES TO:
BBVA Research: Calle Azul, 4 Edificio La Vela, Floors 4 & 5 28050 Madrid, Spain. Tel. +34 91 374 60 00 y +34 91 537 70 00 /
Fax (+34) 91 374 25 - bbvaresearch@bbva.com www.bbvaresearch.com