

MACROECONOMIC IMPLICATIONS OF A TAX ON BANKS' PROFITS

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ABSTRACT

This paper investigates the potential macroeconomic effects of a tax on banks' profits for the Greek economy. To this end, a Dynamic Stochastic General Equilibrium (DSGE) model is employed, which allows the identification of the main transmission channels through which a tax on bank profits may affect the real economy and the financial sector. We find that such a tax affects the economy primarily via the banking capital channel and the bank funding channel, constraining the supply of credit, reducing the value of banking collateral and potentially leading to a contraction in economic activity. Overall, the findings highlight that a tax on bank profits may generate adverse effects on both the financial sector and the real economy, underscoring the need for careful policy design and evaluation of such a policy measure.

Keywords: bank profit taxation; banking capital; bank funding cost; Greece; dynamic stochastic general equilibrium model

JEL classification: E44; E62; G21; O52

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ΜΑΚΡΟΟΙΚΟΝΟΜΙΚΕΣ ΕΠΙΔΡΑΣΕΙΣ ΤΗΣ ΕΠΙΒΟΛΗΣ ΦΟΡΟΥ ΣΤΑ ΚΕΡΔΗ ΤΩΝ ΤΡΑΠΕΖΩΝ

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ΠΕΡΙΛΗΨΗ

Η παρούσα μελέτη διερευνά τις δυνητικές μακροοικονομικές επιδράσεις στην ελληνική οικονομία από την επιβολή φόρου στα κέρδη των τραπεζών. Για το σκοπό αυτό, χρησιμοποιείται ένα δυναμικό στοχαστικό υπόδειγμα γενικής ισορροπίας (Dynamic Stochastic General Equilibrium model), το οποίο επιτρέπει την ανίχνευση και την κατανόηση των διαύλων μετάδοσης μέσω των οποίων ένας φόρος στα τραπεζικά κέρδη ενδέχεται να επηρεάσει την πραγματική οικονομία και το χρηματοπιστωτικό τομέα. Τα αποτελέσματα δείχνουν ότι ένας τέτοιος φόρος επηρεάζει την οικονομία μέσω δύο κύριων διαύλων, του τραπεζικού κεφαλαίου και της τραπεζικής χρηματοδότησης, περιορίζοντας την προσφορά πιστώσεων, μειώνοντας την αξία των τραπεζικών εξασφαλίσεων και οδηγώντας δυνητικά σε συρρίκνωση της οικονομικής δραστηριότητας. Επομένως, η επιβολή φόρου στα τραπεζικά κέρδη ενδέχεται να έχει αρνητικές επιδράσεις τόσο στο χρηματοπιστωτικό τομέα όσο και στην πραγματική οικονομία. Οι θεωρητικοί δίαυλοι μετάδοσης που αναδεικνύονται στο υπόδειγμα υπογραμμίζουν την ανάγκη συνεκτίμησης μιας σειράς παραγόντων για την αξιολόγηση ενός τέτοιου μέτρου πολιτικής.

ΜΗ ΤΕΧΝΙΚΗ ΣΥΝΟΨΗ

Η μελέτη διερευνά τις πιθανές μακροοικονομικές επιδράσεις της επιβολής φόρου στα κέρδη των τραπεζών για την ελληνική οικονομία. Για το σκοπό αυτό, χρησιμοποιείται ένα δυναμικό στοχαστικό υπόδειγμα γενικής ισορροπίας (Dynamic Stochastic General Equilibrium model), το οποίο επιτρέπει να ανιχνευθεί και να γίνει κατανοητό μέσω ποιων διαύλων η επιβολή ενός προσωρινού φόρου στα τραπεζικά κέρδη μπορεί να μεταδοθεί στην πραγματική οικονομία και στο χρηματοπιστωτικό τομέα.

Διαπιστώνεται ότι η επιβολή ενός τέτοιου φόρου επιδρά στην οικονομία μέσω δύο κύριων διαύλων, του τραπεζικού κεφαλαίου και της τραπεζικής χρηματοδότησης, περιορίζοντας την προσφορά πιστώσεων, μειώνοντας την αξία των τραπεζικών εξασφαλίσεων και οδηγώντας δυνητικά σε συρρίκνωση της οικονομικής δραστηριότητας. Η αναδιανομή των εσόδων από το φόρο προς τα νοικοκυριά λειτουργεί ως αντισταθμιστικός μηχανισμός, περιορίζοντας εν μέρει τις αρνητικές επιδράσεις στο εισόδημά τους και στη συνολική ζήτηση. Ωστόσο, δεν επαρκεί για να αντισταθμίσει πλήρως τις αρνητικές επιδράσεις του φόρου και, ως εκ τούτου, το καθαρό αποτέλεσμα στη συνολική ζήτηση και το ΑΕΠ είναι αρνητικό.

Επισημαίνεται ότι οι δίαυλοι που ανιχνεύονται στην παρούσα μελέτη προκύπτουν στο πλαίσιο ενός θεωρητικού υποδείγματος της οικονομίας. Στην πράξη, στην περίπτωση του ελληνικού τραπεζικού συστήματος, ο άμεσος αντίκτυπος των ως άνω διαύλων αναμένεται ότι θα ήταν περιορισμένος, δεδομένου ότι τα ελληνικά πιστωτικά ιδρύματα διαθέτουν υψηλά επίπεδα κεφαλαιακής επάρκειας και ρευστότητας, αρκετά άνω των ελάχιστων απαιτούμενων εποπτικών ορίων. Συνεπώς, έχουν σημαντικό βαθμό ευελιξίας και η όποια μείωση της κερδοφορίας τους πιθανόν να μην επηρεάσει άμεσα τη δυνατότητά τους να αντλούν κεφάλαια από τις αγορές. Μολαταύτα, το υπόδειγμα αναδεικνύει τις δυνητικές επιπτώσεις της επιβολής ενός φόρου στα κέρδη των τραπεζών και τους διαύλους μέσω των οποίων θα μπορούσε αυτή να επιδράσει στα πραγματικά μεγέθη της ελληνικής οικονομίας, υπογραμμίζοντας έτσι την ανάγκη να λαμβάνεται υπόψη μια σειρά παραμέτρων για την αξιολόγηση ενός τέτοιου μέτρου πολιτικής.

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I INTRODUCTION

Over the past few years, European banks have been reporting increased profitability, fuelled by the post-pandemic economic recovery and the rise in inflation. At the same time, the tightening of monetary policy, together with the slow pass-through of policy rate increases to deposit rates, widened the interest rate spread between loans and deposits, further boosting bank profits.

Greek banks are no exception, having markedly improved their fundamentals in recent years. They have recorded persistently strong profitability, underpinned by an increase in net interest income and a decline in loan-loss provisions, coupled with strong credit expansion. These improvements have also been reflected in a series of upgrades of their credit ratings by international rating agencies (see Bank of Greece 2025).

On the fiscal front, faced with rising budget deficits, many European countries have already imposed or are considering imposing additional, permanent or temporary, taxes on banks. This development has triggered discussions in both academia and international institutions about the potential effects of such a policy on the financial sector and the real economy (see, *inter alia*, Maneely and Ratnovski 2024 as well as Chen et al. 2024).

Against this backdrop, this paper explores the potential macroeconomic effects of a tax on banks' profits for the Greek economy. To this end, a Dynamic Stochastic General Equilibrium (DSGE) model is employed, which allows the identification and understanding of the propagation channels through which a tax on bank profits may affect the real economy and

the financial sector. The results indicate that the imposition of such a tax affects the economy via two primary channels. First, through the banking capital channel, the tax reduces banks' internal net worth, weakening their balance sheets and limiting their capacity to extend credit. Second, via the bank funding channel, lower bank profitability and equity returns increase the cost of external finance and further tighten credit conditions. Together, these channels constrain the supply of credit and reduce the value of banking collateral, leading to a contraction in economic activity. Thus, a tax on bank profits could potentially have negative effects on both the financial sector and the real economy.

The paper relates and contributes to the literature on bank taxation in several important ways. First, it provides an analysis of bank profit taxation within a structural general equilibrium framework, allowing us to examine how such a tax affects both the financial sector and real economic activity in general equilibrium. While much of the existing literature relies on reduced-form empirical approaches or focuses on balance-sheet-based bank levies (see Section 2), the analysis of bank taxation within DSGE models remains relatively limited.¹ Our framework jointly captures the main transmission mechanisms through which bank profit taxation operates, allowing them to interact endogenously in general equilibrium. Second, within this unified framework, we

* The views expressed in this article are of the authors and do not necessarily reflect those of the Bank of Greece. The authors are responsible for any errors or omissions.

1 Boscá et al. (2019) develop a DSGE model with a banking sector to study the macroeconomic effects of different banking taxes, including a tax on bank profits. Our analysis extends this line of research by incorporating endogenous default risk at the level of households, firms and banks, allowing the tax to also impact the systemic resilience of the economy. Balfoussia et al. (2017) use a set-up closely related to ours to examine the effects of bank transaction taxes.

identify and assess the relative importance of two core transmission mechanisms, namely the bank capital channel and the bank funding channel. We demonstrate how the taxation of bank profits tightens lending conditions, reduces collateral values and dampens economic activity.

The remainder of this paper is structured as follows: Section 2 offers a literature review; Section 3 briefly describes the model and methodology employed; Section 4 presents the findings and discusses their policy implications and Section 5 concludes.

2 LITERATURE REVIEW

Recent instances of bank profit taxes

The taxation of banks, and in particular of bank profits, entered the academic and policy discussion in the aftermath of the global financial crisis. The crisis exposed the systemic risks posed by large and interconnected financial institutions and highlighted the substantial fiscal costs of bank bailouts. In response, policymakers sought instruments that could internalise the social costs of bank risk-taking and moral hazard as well as recoup public funds. In this spirit, the IMF (2010) proposed several instruments, including bank levies and financial activities taxes, aimed precisely at internalising systemic externalities while raising public revenue. The European Commission (2010) also explored bank taxes as tools to reduce excessive risk-taking, as did several national authorities. In parallel, academic research at the time suggested that bank taxation could, in theory, correct distortions arising from implicit government guarantees and moral hazard (Acharya et al. 2010). Other studies cautioned that bank taxes could influence a number of variables, including leverage, risk and credit supply, thus potentially generating broader macroeconomic effects (Keen 2011; Devereux et al. 2019). In sum, while post-crisis taxes were in practice largely focused on balance-sheet size or liabilities, rather than profits per se,² their conceptual

foundation was based on the notion of taxing excessive bank profits and excess revenue.

In recent years, following a prolonged period of low interest rates and subdued earnings, European banks have been experiencing a sharp recovery in profits, largely driven by the post-pandemic economic recovery, rising policy rates and widening net interest margins. This trend renewed interest in bank taxation and prompted several countries to introduce temporary “windfall” taxes on bank profits or net interest income, motivated by the need to boost fiscal revenue and respond to political economy considerations (Maneely and Ratnovski 2024).³ The design of these taxes varies, from narrow tax bases targeting excess profits relative to historical averages (e.g. in the Czech Republic, Lithuania and Italy) to broader turnover-based instruments (e.g. in Romania and Hungary). Some measures were explicitly temporary, while others have evolved into more permanent instruments. This notable cross-country heterogeneity points to the need to factor in both financial conditions and the institutional context in designing bank profit taxation.

Possible transmission channels

Turning to the theoretical underpinnings of bank taxation, in a benchmark setting where profits reflect pure economic rents, taxation may be largely non-distortionary and welfare-enhancing. Applying this principle to banking, if high profits reflect rents from implicit safety nets or concentrated market power, taxing these rents could in theory enhance allocative efficiency, without adversely affecting credit supply. However, in more realistic models of

² Devereux et al. (2019) details 14 such instances of bank levies imposed following the global financial crisis across Europe.

³ Maneely and Ratnovski (2024) document multiple such measures imposed recently across Europe. For example, Lithuania has applied a 60% tax on excess net interest income for 2023-24; the Czech Republic has imposed a 60% tax on excess profits through to 2025; Hungary has progressively taxed net revenue culminating in a 30% rate; and Romania has introduced a new turnover-based bank tax for 2024-26. In addition, Slovakia has adopted a bank corporate income tax surcharge, while Spain has levied a 4.8% surtax on banks' net revenue and Italy instituted a one-off 40% windfall tax on excess net interest income in 2023, alongside a higher statutory corporate rate for banks compared to other sectors.

financial intermediation, bank profits are closely linked to lending, risk-taking and capital accumulation decisions, giving rise to potentially significant macroeconomic effects (Devereux et al. 2019).

Indeed, standard intermediation models suggest a number of transmission channels through which taxes on bank profits can affect macroeconomic outcomes. First, profit taxation reduces net returns to equity and retained earnings, potentially increasing the cost of capital for banks (Bini Smaghi 2025). This can curtail lending or increase lending rates, thereby dampening investment, consumption and output (Freixas and Rochet 2008).

Second, banks facing higher tax burdens may partially pass costs on to borrowers, as aforementioned, through higher lending rates or to depositors through lower interest rates on savings. This pass-through can weaken monetary policy transmission, potentially hampering central bank efforts to stimulate or cool economic activity. For example, an increase in banks' tax burden coupled with monetary policy tightening could exacerbate credit tightening. The extent of the pass-through depends on market structure and the interest-rate elasticity of deposit and loan demand.

Finally, taxation, depending on its design, can affect capital accumulation and risk-taking incentives. By reducing retained earnings, profit taxes may constrain capital buffers, dampening the sector's resilience to shocks (Berger et al. 2025). Conversely, if tax liabilities are tied to a measure of excess profits, banks may be discouraged from excessive risk-taking, thus enhancing financial stability.

Empirical evidence

Empirical research on the macroeconomic implications of bank profit taxation remains relatively limited. Studies examining bank taxes in Europe, in the aftermath of the global financial crisis, find that these taxes reduced leverage and altered balance-sheet composition, though the effects on credit growth were

modest and heterogeneous across countries (Devereux et al. 2019; Buch et al. 2016). Others find that banks shifted the tax burden to customers with low credit demand elasticity, such as households, i.e. they increased intermediation costs (Capelle-Blancard and Havrylchyk 2017).

More recent evidence, focusing specifically on profit-based or windfall taxes, suggests a partial pass-through to lending rates and potential reductions in credit supply, particularly in less competitive banking systems, with potential macroeconomic implications. For example, Sobiech et al. (2021) use exogenous variation in bank taxation to show that bank profit taxation can increase bank leverage, lower bank credit to firms and dampen corporate investment. Additionally, Valentinaite et al. (2025) show that the short-run macroeconomic effects of windfall taxes have been limited in countries with strong bank capital positions, but announcement effects and uncertainty about tax permanence can affect market valuations and funding costs. Martins (2025) finds that the announcements of a windfall tax on bank profits in Spain and Italy generated market volatility, precipitating sharp declines in bank equity prices, potentially signalling market concerns about profit prospects and credit contraction, while small and profitable banks were the ones most affected. All in all, evidence on the recent windfall taxes indicates that, where applied, banks continued to lend, underpinned by their strong profitability and substantial capital buffers, but uncertainty about the permanence of taxes and their design may have heightened risk premia and impaired investment decisions in sectors reliant on bank credit.

In sum, the literature suggests that bank profit taxation is likely to affect the macro economy, but its impact may vary across countries and over time, depending on the state of the business and financial cycle, regulatory constraints and market structure. Furthermore, the absence of bank profit taxes in many countries, including Greece, indicates that policymakers

may be carefully weighing potential credit and stability costs, especially if banks are still rebuilding their balance sheets.

3 MODEL AND METHODOLOGY

To study the transmission mechanisms of a tax on banks' profits, we build on the theoretical framework of Clerc et al. (2015), as implemented in Balfoussia et al. (2025), and augment it to include a tax on bank profits. This is a DSGE model, suitable for studying the interactions between the real economy and the financial sector in the presence of financial frictions and endogenous default risk.

The economy consists of households, entrepreneurs, bankers and firms. Households are infinitely lived and derive utility from consumption and housing services, while supplying labour in a competitive labour market. The model features two types of households, namely patient and impatient, which differ in their subjective discount factors. In equilibrium, patient households act as savers (depositors), whereas impatient households are borrowers who obtain mortgage loans from banks under limited liability and non-recourse conditions, using housing as collateral. They may optimally choose to default on their mortgage obligations, in which case they lose the housing units against which the mortgage is secured.

Entrepreneurs own the physical capital stock and finance their purchases of capital using a combination of internal net worth and external corporate loans. Similar to households, entrepreneurs face limited liability and may default on their debt obligations when adverse shocks reduce the value of their assets below outstanding liabilities.

Bankers are the providers of inside equity to perfectly competitive financial intermediaries, referred to as banks. Banks provide mortgage loans to households and corporate loans to entrepreneurs, which are financed through

household deposits and equity funding supplied by bankers. They operate under limited liability and are subject to regulatory capital constraints that require a fraction of their lending to be backed by equity. Bank balance sheets are exposed to default risk arising from both idiosyncratic and aggregate shocks affecting the performance of the loan portfolios.

Finally, the final consumption good as well as new units of physical capital and housing are produced by perfectly competitive firms using standard constant-returns-to-scale technologies.

A central novelty of the model is the incorporation of three “layers of default”, at the level of households, firms and banks, capturing the conditions under which default on outstanding loan obligations becomes an optimal “strategic” choice, with knock-on effects on the financial system and the real economy.

3.1 TAXATION OF BANK PROFITS

Within this framework, we introduce a tax on bank profits to examine how it interacts with the existing financial frictions and affects the financial sectors and the real economy. To maintain analytical tractability, while preserving the key propagation mechanisms, we model the tax on bank profits, τ_t^π , as a levy on the equity payoff of the banking sector, specifically the net worth of bankers prior to the distribution of dividends.⁴

Formally, the post-tax net worth of bankers evolves according to:

$$W_{t+1}^b = (1 - \tau_t^\pi)[\tilde{\rho}_{t+1}^F e_t^F + \tilde{\rho}_{t+1}^H (n_t^b - e_t^F)] \quad (1)$$

where $\tilde{\rho}_{t+1}^F, \tilde{\rho}_{t+1}^H$ are the ex-post gross returns on the inside equity invested in banks that specialise in entrepreneurial loans (F banks) and mortgage loans (H banks), respectively. The variable e_t^F represents the amount of the ini-

⁴ In the model, the equity payoff of banks is equal to the difference between the returns on loans granted and the repayment obligations on deposits.

tial wealth of bankers, n_t^b , invested as inside equity in F banks and the remaining, $n_t^b - e_t^F$, in H banks.

The tax rate follows an $AR(1)$ stochastic process:

$$\tau_t^\pi = \rho_\pi \tau_{t-1}^\pi + \varepsilon_{\pi,t} \quad (2)$$

where $\rho_\pi \in [0,1)$ is the persistence parameter and $\varepsilon_{\pi,t} \sim N(0, \sigma_\pi^2)$ is an *i.i.d.* innovation. We assume that the resulting tax revenues are distributed back to the saving households in a lump-sum fashion. The remaining structural equations of the model are identical to those presented in the Appendix in Balfoussia et al. (2025).

3.2 CALIBRATION AND POLICY EXPERIMENTS

The model is calibrated for the Greek economy on a quarterly basis, using the parameter values from Balfoussia et al. (2025).⁵ For the purposes of our policy experiment, it is assumed that a temporary tax of 1% is imposed on bank profits, with a persistent parameter of $\rho_\pi = 0.6$. The calibration of the size and duration of the tax is illustrative and aims to investigate the sensitivity of macroeconomic variables to the imposition of the tax. Given that the shock is temporary, all macroeconomic variables will gradually converge back to their initial levels.

4 DYNAMIC EFFECTS OF A TAX ON BANKS' PROFITS

The chart shows the dynamic effects of introducing a tax on banks' profits. According to the model's results, the tax affects the economy through two main channels.

The first channel operates through banking capital. The tax reduces banks' profits, negatively affecting the return on equity and, thus, the ability of banks to raise new equity. This limits the supply of loans in the model, exerting a negative impact on investment expenditure and, consequently, on the output of the real economy. At the same time, the tax creates

an incentive for banks to increase lending rates on business and mortgage loans, in an effort to offset the decline in profits caused by the tax burden and to attract new equity funding. However, higher lending rates dampen demand for business and residential investment, leading to a further decline in output and a further widening of the interest rate spread between loans and deposits.

Additionally, the decline in output negatively affects the prices of physical and residential capital. Given that, in the model, these assets are used as collateral to provide business and mortgage loans respectively, the fall in their value leads to an increase in the default rates of households and entrepreneurs, as it is now more advantageous for borrowers to grant the mortgaged asset to the bank rather than repay the loan. This development prompts a deterioration in the quality of banks' loan portfolios and a weakening of banks' balance sheets and leads to a further decline in banking capital. As a result, the adverse effects of the policy measure under consideration on the financial sector, as well as on the real economy and household incomes, are amplified.

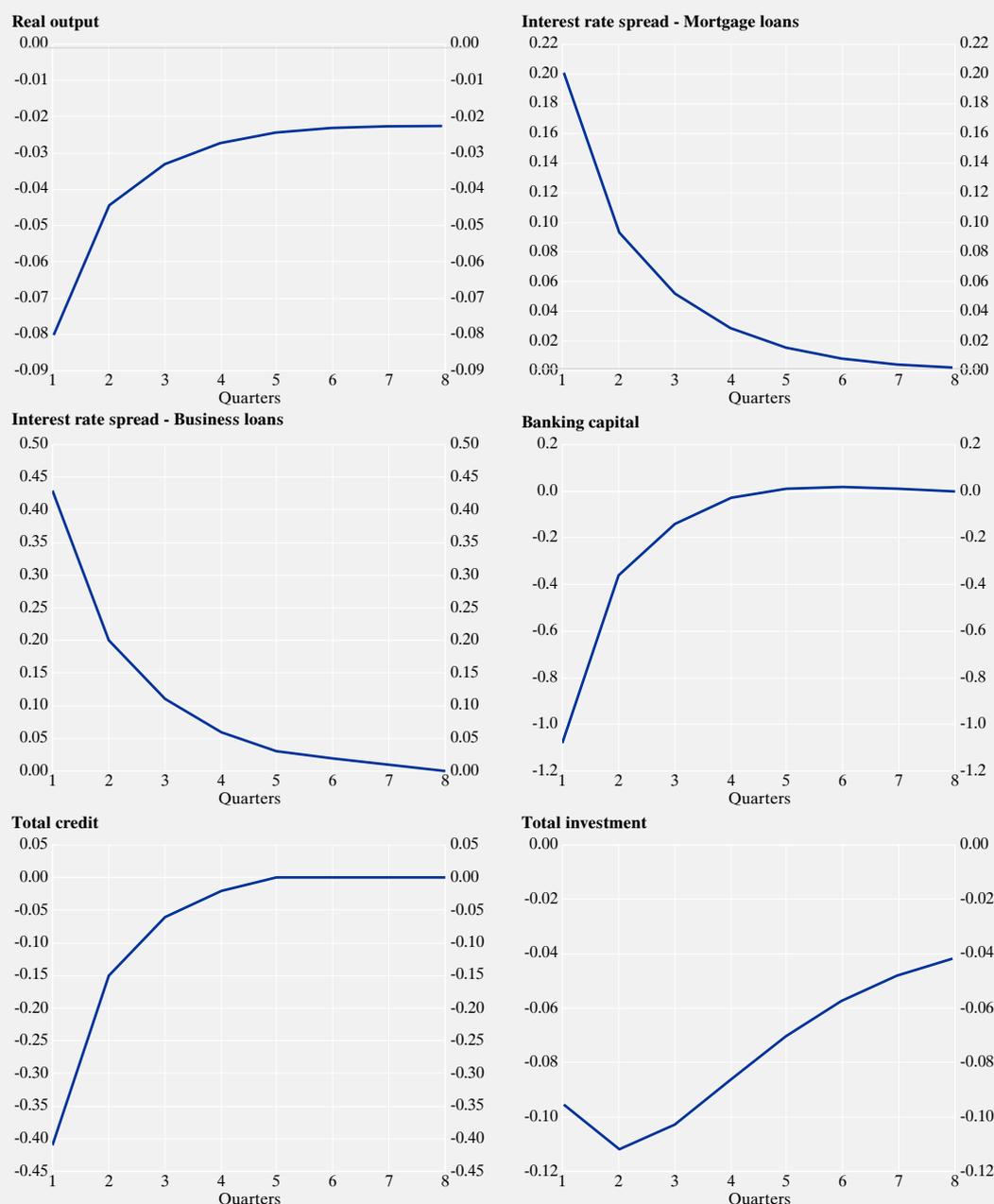
The second channel through which the tax affects the economy relates to the cost of bank funding through deposits. Higher default rates by households and firms negatively affect the creditworthiness of banks in the context of the model, leading to an increase in the interest rate demanded by depositors. As a result, the cost of funding through new deposits increases, leading to a further decline in banking capital and total credit. The increase in the deposit rate is in turn passed on to lending rates, further reducing credit demand and exacerbating the contraction of economic activity.

It should be noted that the redistribution of tax revenue to households acts as a compensating mechanism, partially offsetting the negative effects on their income and on aggregate demand. However, it is not sufficient to fully

⁵ For details on the calibration of the model for the Greek economy, see also Balfoussia and Papageorgiou (2016).

Dynamic effects of a tax on banks' profits

(percentage %)



Source: Bank of Greece estimates.

Note: All variables are expressed as percentage deviations from the steady state, except for the interest rate spreads that are expressed as percentage point changes (annualised). Interest rate spreads are calculated as the difference between lending and deposit rates.

offset the negative impact of the tax and, thus, the net effect on aggregate demand and output is negative.⁶

⁶ The decline in household income also leads to a reduction in household consumption expenditure, further dampening aggregate demand and, thus, real output.

These results are consistent with recent findings in the relevant literature. For instance, as confirmed by empirical studies for European countries, the imposition of a tax on banks leads to an increase in lending rates and a decline in bank credit. Reduced lending, in turn, causes a drop in business investment.⁷ Nevertheless, it should be noted that the channels identified in this study operate in the context of a theoretical model of the economy. In practice, in the case of the Greek banking system, the direct impact of these channels may be limited, given that Greek credit institutions have high levels of capital adequacy and liquidity, well above the regulatory minimum required. Therefore, they have a considerable degree of flexibility and any decline in their profitability may not directly affect their capacity to raise funds from the financial markets. Nonetheless, the model highlights the potential implications of a tax on banks' profits as well as the channels through which such a policy could affect Greece's real economic aggregates, thus underlining the importance of including a range of factors in the assessment of such a policy measure.

5 CONCLUSIONS

This paper examines the potential macroeconomic effects of a tax on banks' profits, using a Dynamic Stochastic General Equilibrium (DSGE) model calibrated to the Greek economy. It is found that the imposition of such a tax affects the economy primarily through the banking capital channel and the bank funding channel, constraining credit supply and reducing the value of banking collateral, thereby leading to a contraction in economic activity. At the current juncture, Greek banks have high levels of capital adequacy and liquidity, therefore any decrease in their profitability is not likely to directly affect their ability to raise new capital. Nevertheless, the theoretical transmission channels identified in the model highlight the need to take into account a number of factors when evaluating the merits of a tax on banks' profits.

⁷ See, among others, Borsuk et al. (2024) and Buch et al. (2016).

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