

## “Tax the Rich”: An Exercise in Unintended Consequences

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One of the many American political slogans that seems to elude the obsolescence wrought by changing times and conditions is the familiar trope: “tax the rich.” The underlying logic that justifies the advocacy for policies that beget ever increasing tax burdens on “the rich” for the purposes of redistribution has been dealt with and answered in myriad ways by legions of brilliant minds who have seen through this particular form of political agitation. However, I think it is worth repeating a few of these remarks every now and again in order to remind people how, if pursued in the manner intended by those who zealously pursue this phony panacea, “taxing the rich” yields results that have quite the opposite effect of what is actually intended. Before doing that, however, it is worthwhile to address some points of confusion that tax-the-rich advocates betray in their rhetoric.

### Who and what are “the Rich”?

For the purpose of clarity and to strengthen the tax-the-rich narrative, what I refer to as “the rich” will be those who are near the top tenth of the top one percent of income earners, which, as of 2023, was in the vicinity of \$2.8 million a year.<sup>1</sup>

In the first place, the rhetorical device “the rich” implicitly conveys the notion that, in the United States, there is a permanent and largely immutable class of exceedingly wealthy individuals. The portrait that those who employ this rhetoric are trying to paint is one that, intentionally, conjures up images of the European aristocracy in pre-revolutionary eras. However, there is obviously no analogy between the rich in the United States and the rich in, say, 15th century England or France where primogeniture and entail consolidated land wealth into the hands of individual heirs, who used this property to extract legally enforced rents and obligations imposed on the peasants who worked it.

One of the first undertakings pursued by Thomas Jefferson in helping craft the Virginia constitution in 1776 was to eliminate this archaic practice for the purpose of “annulling this privilege and instead of an aristocracy of wealth ... to make an aristocracy of virtue and talent.”<sup>2</sup> The legal system of the union ultimately followed suit. Estate laws in the United States tend to give rise to the fragmentation of property (including land), which begets itself each successive generation until it is finally diluted to a fraction of its original whole. In the early 19th century, the Frenchman Alexis de Tocqueville, upon traveling the U.S. and studying its customs

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<sup>1</sup> The custom of identifying the rich with the top one percent, although widely practiced, is a weaker form of the “tax the rich” agenda. The reason for this is that *households* earning over \$660,000 per year put them at the top one percent. If composed of two income earners, this is \$330,000 a year per person. These are very handsome incomes, but hardly what anyone imagines by “the rich.”

<sup>2</sup> Dumas Malone, *Jefferson and His Time*, vol. 1, *Jefferson the Virginian* (Boston: Little, Brown and Company, 1948), 247–60.

remarked, “fortune turns there with incredible rapidity and experience teaches that it is rare to see two generations collect its favors.”<sup>3</sup>

In the United States, there is high turnover in those who constitute the rich. The reason for this is simply owing to the fact that we are a highly industrialized society. The Austrian economist Ludwig von Mises expounded upon this point: “seldom does mercantile and industrial wealth maintain itself in one family for more than two or three generations.”<sup>4</sup> The reason for this is that “production must continually replenish capital . . . to own capital one must earn it afresh day by day. In the long run a capital fortune is not a source of income which can be enjoyed in idleness.”<sup>5</sup> The genius required to continually keep up with and satisfy rapidly changing tastes and preferences among the people is not something that can automatically be bequeathed to the next generation. The talent and foresight in those who find a way to effectively meet the demands of enough consumers so as to amass a fortune for oneself are exceptional. When the heirs of these fortunes are unable to replicate the genius of their fathers in industrial work, the revenues fall, the capital depreciates without replacement, and the fortune quickly founders.

To buttress their arguments in favor of raising the tax burdens on the rich, you commonly hear another catchphrase that is as old as it is hackneyed: “the rich get richer, while the poor get poorer.” However, as was explained, there is rapid turnover in wealth in industrial societies like the United States. Therefore, the individual persons who comprise the station of “the rich” are not necessarily the same individuals from one generation to another.

Even within any given year there is tremendous turnover in the ranks of “the rich.” The tax-the-rich lobby routinely fails to distinguish between wealth and income. Taxing incomes is the easiest, and most common, way to extract money from the so-called “rich.” However, those at the top one percent of incomes experience even greater turnover than those with lavish wealth. The top one percent of incomes is reached by 11 percent of Americans at some point in their lives.<sup>6</sup> Moreover, the U.S. Treasury Department released a famous study almost two decades ago that found that only one-quarter of the individuals at the top one-hundredth of the top one percent of income earners in 1996 were still there in 2005.<sup>7</sup> The reason for this is also simple: people have large spikes in their incomes from the occasional property sale or capital gains, for instance.

Besides the issue of wealth turnover and the income-wealth distinction, a more important flaw in this rhetoric is the fallacy which pretends that the amount of wealth in a given society remains static at all times, so that when one individual acquires more wealth, another holds less. A prime example of how this misunderstanding manifests itself is an excerpt from the Washington State Budget and Policy Center’s FAQ pamphlet for the new Millionaires Tax: “The ultra-wealthy keep hoarding wealth and getting a special deal in the tax code at the expense of

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<sup>3</sup> Alexis de Tocqueville, *Democracy in America*, trans. and ed. Harvey C. Mansfield and Delba Winthrop (Chicago: University of Chicago Press, 2000), 50.

<sup>4</sup> Ludwig von Mises, *Socialism: An Economic and Sociological Analysis* (Martino Publishing, 1951), p. 378.

<sup>5</sup> *Ibid.*, p. 379.

<sup>6</sup> Thomas A. Hirschl and Mark R. Rank, “The Life Course Dynamics of Affluence,” *PLoS ONE* 10, no. 1 (2015): 5.

<sup>7</sup> United States Department of the Treasury, *Income Mobility in the U.S. from 1996 to 2005* (Washington, DC, 2007), 2, 4.

the rest of us.”<sup>8</sup> Remarks like this ignore two facts: one, a growing economy creates more wealth — wealth in a society isn’t static — and two, the top earners can earn a larger share of total income while those at the bottom earn more income in real terms. It seems that those who employ the “rich-get-richer” rhetoric are completely unaware of both of these points.

There is much more to be said about the confusion behind the tax-the-rich impetus, but this sample of issues should suffice to show that the portrait of an America containing a perpetual class that is “the rich” has no relationship to reality. At this point I turn to the ways in which taxing the rich in excess creates unintended blowback for precisely the individuals these taxes are intended to benefit.

## **Economic Consequences**

A recent example of a tax that will end up producing blowback is the Washington state “Millionaires Tax.” On March 30th of this year, Governor Bob Ferguson signed the Millionaires Tax into law. This is an additional 9.9% tax on all household earnings above \$1 million per year for those living or working in Washington state. This includes all realized income.

According to 2023 IRS data, those at the top 0.001% of income earners receive only 7% of their income, on average, from wages/salaries. Nearly 88% of their incomes are made up of investment and business income (interest, dividends, capital gains),<sup>9</sup> which means that the proposed tax will fall disproportionately on this kind of income. Why is this a problem? Because “various types of [economic] models and approaches” predict that “in a steady state, the optimal capital income tax rate is zero.”<sup>10</sup>

The reason is simple, taxes on capital income are essentially a compounding tax on consumption. This can be easily seen if we use a simple example. Imagine you invest \$1 today that earns 100% returns each year. Say the tax rate is 50% per year. Without the tax, you double your investment every year so that in year one you earn \$2, in year two \$4, in year three \$8. With the tax, however, you earn \$1.50 in year one, then \$2.25 in year two, then \$3.38 in year three. The total amount of income lost due to the tax is \$4.62. This gap grows over time, meaning, as you delay consumption via investment, you effectively incur an ever larger (implicit) tax.

The consequences are, in plain English, that these kinds of taxes incentivize individuals to spend their earnings sooner and to reduce investment at both intensive and extensive margins (meaning they reduce the amount of investment and the frequency with which they do invest). As a result, when taxes on capital go up, investors require higher returns on any investment to offset the cost of the tax. Consequently, this contraction in investment slows down capital accumulation; capital being what ordinary workers use to produce goods and services. With less

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<sup>8</sup> <https://budgetandpolicy.org/resources-tools/2026/03/Updated-3-3-BPC-Millionaires-Tax-FAQ.pdf>

<sup>9</sup> William G. Gale and Semra Vignaux, “The Difference in How the Wealthy Make Money—and Pay Taxes,” Brookings Institution, September 7, 2023, <https://www.brookings.edu/articles/the-difference-in-how-the-wealthy-make-money-and-pay-taxes/>.

<sup>10</sup> Atkeson, Andrew, V. V. Chari, and Patrick J. Kehoe, “Taxing Capital Income: A Bad Idea,” *Federal Reserve Bank of Minneapolis Quarterly Review* 23, no. 3 (1999): 3--17.

capital, all else equal, an economy produces fewer goods and services, rendering it less productive, and pushing down incomes.

Additionally, in this example, only \$2.37 gets collected in tax revenue by the government, for a total value of  $\$3.38 + \$2.37 = \$5.75$ . The value destroyed is  $\$8 - \$5.75 = \$2.25$  is what economists call deadweight loss; it goes to no one. As a result of the tax, the returns on the investment not only compound by less, the amount of resources available to tax shrinks. These consequences also hold in the case of a tax on realized capital gains, though the deadweight loss is less in that case.

What's more, the majority of the tax revenue that the government *does* receive is dissipated in the form of transfers. Since 2023, government transfers, as a percent of non-interest spending, have exceeded 75%.<sup>11</sup> The bulk of these transfers are redistribution (social security, medicare/medicaid), meaning that this spending doesn't produce more factories or machines that, in turn, produce more goods and services — it's consumed. Therefore, as it already stands, the government destroys enormous amounts of value that would have been invested in our economy, creating jobs and raising standards of living.

The great irony is that, if we continue down this path and heed the prescriptions of socialist politicians, we will not only reach a point where we generate less tax revenue in the wake of a shrinking tax base, but our economy will stagnate and, eventually, begin to shrink. The reason follows straightforwardly from what was laid out above and is best captured by John F. Kennedy's remarks in 1962, pointing to investors' "efforts to avoid tax liabilities [and making] certain types of less productive activity more profitable than other more valuable undertakings ... inhibit[ing] our growth and efficiency."<sup>12</sup>

The rich don't stand around and wait to be fleeced — they respond by spending inordinate amount of time and resources exploiting loopholes and putting their funds to work in less productive vehicles like tax-exempt securities.

## **Brief Concluding Remarks**

Besides the economic consequences of the "tax the rich" movement, which are manifold in its current popular form, the spirit behind it is immoral.<sup>13</sup> It's amazing how consistently it is the case that if we simply do the right thing in all circumstances, it redounds to our benefit. Michel de Montaigne once famously said: "When I do not follow the right path for the sake of righteousness, I follow it for having found by experience that all things considered, it is commonly the happiest and most useful."<sup>14</sup>

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<sup>11</sup>Chris Edwards, "How the Federal Government Spends \$6.7 Trillion," *Cato Institute*, Briefing Paper no. 174, March 12, 2024, <https://www.cato.org/briefing-paper/how-federal-government-spends-67-trillion>.

<sup>12</sup> Public Papers of the Presidents of the United States: John F. Kennedy, 1962, 878–880.

<sup>13</sup> This is not an evaluation of capital income taxes or even progressive income tax schemes, it is an evaluation of the ideas and attitudes galvanizing the *movement* that marches under the banner of "tax the rich."

<sup>14</sup> Montaigne, "Of Glory," *Essays*, II 16.

By plundering the resources of those who produce for the purposes of redistribution, we artificially obstruct the progress of our economy by slashing at investment. On the other hand, by respecting property rights and the accumulation of legitimate wealth, we offer enterprising individuals the capacity to pursue their self-interest, which, ironically, leads to productive uses of their resources to that generate more jobs, products, services, and higher living standards for everyone.