

Chapter 12: The Wealth Tax: The Liquidity Trap

"I contend that for a nation to try to tax itself into prosperity is like a man standing in a bucket and trying to lift himself up by the handle." — **Winston Churchill**, *Speech to the House of Commons* (1903)

The wealth tax arrives in politics wearing the costume of simplicity. Its advocates speak as though the world were a tidy ledger: a number beside a name, a percentage beside a promise. Two per cent, three per cent—small, almost polite. The phrase *just one year* is employed like a sedative. And the public is invited to believe that prosperity is a matter of reaching into the pocket of the very rich and extracting a fraction of the coins that sit there doing nothing.

This is not economics. It is arithmetic theatre.

A wealth tax is not principally a question of compassion or cruelty. It is a question of liquidity, valuation, incentives, and the nature of assets. The central error behind wealth-tax rhetoric is the assumption that “wealth” is cash. It is not. It is a claim on future cash flows, embodied in assets that are often illiquid, often concentrated, and often inseparable from control. The state demands payment in money. The taxpayer holds property. The difference between those two facts is where the entire policy lives—or dies.

If the state imposes an annual tax on asset values, it forces conversion. Conversion is not free. Conversion has prices, spreads, market impact, and legal constraints. Conversion alters ownership. Conversion changes incentives. Conversion, repeated, transforms how capital is held, built, and deployed.

And that, in the end, is why the wealth tax is so rarely the clean instrument it pretends to be. It does not neatly “take from indulgence.” It often takes from investment. It does not neatly punish yachts. It often punishes enterprises. It does not neatly fund the future. It can, if misdesigned or aggressively scaled, consume the seed corn and then marvel that harvests shrink.

Churchill's metaphor remains cruelly apt. A nation cannot tax itself into prosperity any more than a man in a bucket can lift himself by the handle. The effort looks strenuous. The result is still gravity.

This chapter translates the wealth tax into mechanisms—without patronising, and without hiding the inconvenience in jargon. The question is not whether the rich can “afford it.” The question is what it does to the structure of capital, the pricing of assets, the stability of ownership, and the prospects of the people who depend on investment for wages, pensions, and innovation.

I. What “wealth” is: a household analogy that does not insult the reader

Begin with a household, because the household is where intuition lives.

Imagine a family whose “wealth” is mostly its home. The home is valuable on paper. The family is not sitting on a vault of cash equal to the home's value. The home is where they live. It is not a checking account.

Now imagine the government imposes a yearly tax of two per cent on the value of the home, payable in cash. The family's income may cover it. Or it may not. If it does not, they must either borrow against the home or sell part of their assets. But the home is the asset. They cannot sell “two per cent of a kitchen.” They either sell the home, take on debt, or cut consumption elsewhere.

The family is not being taxed on what it *spends*; it is being taxed on what it *owns*. The tax compels liquidity even if the asset is not liquid. That compulsion is the trap.

Now scale this up. Replace the home with a business—a founder's equity stake. Replace the mortgage lender with capital markets. Replace “sell the home” with “sell shares.” Replace “borrow against the home” with “borrow against the stake.” The same mechanism applies, but the consequences are larger and spread outward into the economy.

A wealth tax is a forced-liquidity policy imposed on illiquid wealth.

The rhetoric focuses on lifestyle. The mechanics focus on ownership.

II. The fundamental mismatch: the state wants cash, wealth often is not cash

Wealth, in the modern economy, is often held in forms that are not cash and cannot be turned into cash without cost.

Typical examples include:

- equity in public companies, often concentrated and subject to market impact when sold in size;
- ownership stakes in private companies, which have no daily market and can be difficult to sell at all;
- real estate, which is expensive to transact and often held for long-term yield;
- venture stakes, which may be locked up for years with no secondary market;
- control blocks, whose value is tied not merely to price but to governance and strategic direction;
- intellectual property and business goodwill, whose valuation is complex and contested.

A wealth tax does not ask whether an asset yields income. It taxes the asset's notional value. But the tax must be paid in money. Therefore the taxpayer must find money each year. If they lack sufficient cash flow, they must liquidate or borrow.

This is why the claim "it won't affect how they live" is irrelevant. The question is not whether a billionaire must fly commercial. The question is whether the tax forces asset sales that alter control, depress valuations, reduce investment, or increase leverage.

A wealth tax is not primarily a consumption restraint. It is an ownership intervention.

III. The first mechanism: forced sales and the price-at-the-margin reality

Asset markets clear at the margin. This is a basic but often ignored fact. The price of a stock is not set by the average holder who would never sell. It is set by the next buyer and the next seller. When a policy forces large, recurring sales, it changes marginal conditions.

A. The "paper wealth" illusion

Political rhetoric treats stock wealth as "paper" in a comforting way: it exists only as a number; therefore, taking a percentage of it is painless. But the number is a market price, and market prices respond to flows.

If a large cohort of high-wealth individuals must sell each year to pay wealth taxes—especially those with concentrated equity positions—selling pressure becomes persistent. Persistent selling pressure can depress prices, widen spreads, and increase volatility.

The effect is not always dramatic in a single year. But wealth taxes, by design, are recurring. The mechanism compounds. It does not need a crash to do damage. It needs only a systematic bias toward net selling.

B. The spillover to ordinary savers

The fantasy is that forced selling harms only the wealthy. The reality is that public equities are widely held indirectly through pension funds, index funds, retirement accounts, insurance pools, and endowments.⁴⁸

A policy that depresses valuations does not merely “take from billionaires.” It also reduces the asset base that underwrites pensions and institutional stability. It shrinks returns. It changes the expected future incomes of millions whose wealth is not theatrical but necessary.

The wealth tax thus risks becoming an involuntary tax on retirement returns.

C. The “liquidate the founder” problem

Many fortunes are concentrated in founder stakes. These stakes are often tied to company identity and long-term strategy. Forced sales dilute founder control. Dilution can change governance outcomes and strategic direction, potentially reducing long-term value.⁴⁹

The irony is that founders often create wealth precisely by holding long-term, resisting short-term market pressures, and investing in growth. A policy that forces annual liquidation pushes behaviour toward short-termism and diversification away from productive concentration.

It taxes patience.⁵⁰

IV. The second mechanism: borrowing to pay the tax — a permanent leverage ratchet

⁴⁸ **OECD (2021)**, *Pension Markets in Focus*. Reports that in major economies (US, UK, Canada, Netherlands), pension funds allocate between 40% and 60% of their assets to equities (public and private). In the US alone, pension funds hold over \$10 trillion in assets, meaning the “middle class” is heavily exposed to asset repricing.

⁴⁹ **Saez & Zucman (2019)** vs. **Summers (2019)**. While Saez/Zucman advocate for the tax, Larry Summers (former Treasury Secretary) argued that because so much wealth is illiquid (private business), a wealth tax would require massive, distortive liquidation or government valuation regimes that are administratively impossible. The debate highlights the liquidity trap as the central operational flaw.

⁵⁰ **Jakobsen et al. (2020)**, “Wealth Taxation and Wealth Accumulation: Theory and Evidence from Denmark,” *Quarterly Journal of Economics*. Used administrative data from Denmark’s wealth tax (abolished in 1997). Found that the tax significantly reduced wealth accumulation by reducing savings and investment incentives, particularly among the “productive” wealthy (entrepreneurs), leading to a smaller capital stock over time.

If selling assets is costly or undesirable, the taxpayer may borrow against assets to pay the tax.

This produces a second mechanism of harm.

Borrowing has interest costs. Those costs turn the wealth tax into a recurring carrying burden. If the tax is two per cent and borrowing costs are five per cent, the effective drag is not two per cent; it is the tax plus the financing cost.

Borrowing also increases leverage. Increased leverage increases fragility. Fragility matters not because one sympathises with the wealthy but because leverage transmits risk through financial systems. Leverage creates forced selling in downturns. Forced selling amplifies volatility. Volatility raises risk premiums. Risk premiums lower valuations. Again, the burden spreads.

Borrowing to pay wealth taxes can therefore function as a systemic risk generator, not merely a revenue tool.

The policy creates a ratchet: each year, more borrowing or more selling is required.

V. The third mechanism: control dilution and the end of concentrated stewardship

A wealth tax does not merely transfer money to the state. It can transfer control away from founders and long-term owners toward dispersed holdings and institutional managers.

This has implications.

Concentrated ownership can align governance with long-term strategy. Dispersed ownership often increases reliance on managerial incentives, short-term performance metrics, and institutional investor pressures. A wealth tax that forces the gradual unwinding of control blocks can therefore change the character of corporate governance.

This is not a defence of every billionaire's stewardship. Some are poor stewards. Some are excellent. The point is that the wealth tax makes concentrated stewardship structurally harder. It creates a bias toward financialisation: the owner becomes a portfolio manager rather than a builder.

In an economy that already suffers from short-termism, this is not a neutral change.

VI. Administration: valuation is not a footnote, it is the engine room

A wealth tax requires valuation. Valuation is straightforward only for liquid public assets. For private assets, it is a battlefield.⁵¹

A. Private business valuation

Private businesses do not have daily market prices. Their value is estimated based on models: discounted cash flows, comparable transactions, revenue multiples, and assumptions. These assumptions can be contested. Honest experts disagree. Small changes in discount rates produce large changes in valuations.

A wealth tax regime must either:

- impose strict valuation methods, creating constant disputes and litigation; or
- allow flexibility, creating porousness, unfairness, and avoidance; or
- outsource valuation to authorities, creating discretionary power and corruption risk.

There is no magical fourth option where valuation is accurate, cheap, non-intrusive, and ungameable.

B. Real estate and complex assets

Real estate valuations fluctuate, and appraisals are not precise instruments. Intellectual property is even worse. Art, collectibles, and complex partnership interests are worse still.

A wealth tax that is “small” in percentage can still produce enormous administrative machinery because the difficulty is not the rate but the base.

And administration is not neutral. It consumes resources. It creates incentives for avoidance industries. It rewards those who can afford expert planning. It punishes those who cannot. It expands state discretion over private holdings.

Wealth taxes therefore tend to generate a political economy of valuation games.

The taxpayer pays not only the tax but the compliance.

VII. Behavioural response: the “annuity” illusion and the reality of avoidance

⁵¹ **Duff (2019)**, "The Wealth Tax: Efficiency, Equity, and Administration". Detailed the administrative nightmare of valuing private assets annually. Noted that in countries with wealth taxes, valuation disputes consumed disproportionate legal resources and often led to "formulaic" valuations that bore little resemblance to market reality, creating new inequities.

Wealth tax advocates often cite a one-year revenue estimate and treat it as a stable annuity. This assumes that behaviour does not change.

But behaviour changes.

High-net-worth individuals restructure holdings, shift residence, diversify into harder-to-tax assets, use trusts and vehicles, litigate valuations, and alter investment strategy. The more aggressive the regime, the more energy is directed toward avoiding it. The society shifts talent from production to planning.

This is not a moral condemnation. It is predictable behaviour under incentives.

The result is that a wealth tax can produce declining yield over time, increasing complexity, and increasing distortions, while failing to achieve the rhetorical promise of effortless funding.

The policy becomes a machine that produces paperwork and resentment, not stable revenue.⁵²

VIII. The incidence question: who really bears the wealth tax?

The wealth tax is proposed as a tax on the ultra-wealthy. The incidence can spread more broadly.

A. Through asset repricing

If valuations fall due to persistent forced sales, the burden hits pension funds and savers.

B. Through reduced investment

If entrepreneurs and investors shift away from long-term illiquid investment—because holding such assets becomes fiscally punitive—the society receives less innovation, less business formation, and less capital deepening. Wages grow more slowly. Employment opportunities weaken. The burden hits workers.

C. Through increased short-termism

If ownership shifts from founders to institutions, governance may become more short-term. That can reduce long-term productive capacity. Again, the burden spreads.

The rich may pay the cheque. The society may pay the growth.

⁵² **OECD (2018)**, "The Role and Design of Net Wealth Taxes". Reported that in 1990, twelve OECD countries had wealth taxes; by 2017, only four remained. The primary reasons for repeal were high administrative costs, capital flight, and failure to raise significant revenue (often <1% of GDP).

IX. The emotional argument and the mechanical rebuttal

Wealth tax proposals often rest on a moral intuition: that concentrated wealth is offensive, and that taking a portion is justice.

Even if one accepts the intuition, the mechanism matters.

One can desire redistribution and still reject mechanisms that destroy the capital base. One can desire fairness and still care about how fairness is funded. One can be morally serious and still refuse policies that collapse into administration and coercion.

This is why Churchill's metaphor endures. A wealth tax can be rhetorically satisfying and mechanically self-defeating. It can feel like lifting oneself while producing only strain.

The moral impulse does not exempt the policy from constraint.

X. A clearer way to think: tax flows, not stocks

One recurring critique of wealth taxes is that they tax stocks rather than flows.

Stocks are accumulated claims. Flows are incomes, dividends, realised gains, consumption. Taxing flows aligns taxation with liquidity. Taxing stocks does not.

This does not mean all stock-based taxation is impossible. It means it is distortionary and requires coercive mechanisms to enforce because it compels liquidation. A system that taxes flows can still be progressive without forcing annual sales of illiquid assets.

The debate is often framed as “do you want to tax the rich?” The more serious question is: “do you want to force liquidation of productive capital?”

Those are not identical questions. They are frequently treated as though they were, because the rhetoric prefers moral clarity over mechanical clarity.

XI. What a wealth tax tends to become: coercion disguised as arithmetic

A wealth tax begins as a percentage. It ends as a set of compulsion tools.

To collect it, the state must:

- value assets annually, including private holdings;
- compel disclosure of complex ownership structures;
- enforce payment through penalties, liens, forced sale powers, or legal coercion;

- police avoidance through expanding rules;
- litigate valuation disputes.

This is not an argument that the state should never compel anything. It is an argument that a wealth tax has a built-in tendency toward intrusive control because its tax base is hard to measure and harder to liquidate.

The rhetoric says “small.” The machinery says “large.”

XII. The core lesson: prosperity is built, not seized

The wealth tax is often marketed as a painless seizure: take a fraction of a dormant pile and fund the future. But wealth, in most cases, is not dormant. It is invested. It is embodied in businesses, projects, and long-term plans. A policy that treats it as inert cash misunderstands its function.

Prosperity is not a hoard. It is a productive system.

If a society wants more prosperity, it must protect the incentives and structures that produce it: investment, entrepreneurship, capital formation, stable rules, and credible institutions. It can still tax. It can still fund obligations. But it should not pretend that taxing stocks of illiquid wealth is an act without consequence.

The consequences exist. They are merely easier to hide than the bill.

The Lesson Line

When you tax what cannot easily be sold, you force selling—and the policy stops targeting indulgence and starts dismantling the capital that pays everyone’s future.

Chapter 12 Notes:

[1] The Liquidity & Liquidation Problem Saez & Zucman vs. Summers (2019). While advocates argue for the tax's fairness, critics like Larry Summers (former US Treasury Secretary) highlight the "liquidity trap": because most wealth is illiquid (private business), a wealth tax compels massive, distortive liquidation or impossible government valuation regimes.

[2] The Failure of Implementation OECD, "The Role and Design of Net Wealth Taxes" (2018). Reported that in 1990, twelve OECD countries had wealth taxes; by 2017, only four remained. The primary reasons for repeal were high administrative costs, capital flight, and failure to raise significant revenue (often <1% of GDP).

[3] Valuation as Administrative Nightmare Duff, "The Wealth Tax: Efficiency, Equity, and Administration" (2019). Detailed the administrative impossibility of valuing private assets annually. Noted that in countries with wealth taxes, valuation disputes consumed disproportionate legal resources and often led to "formulaic" valuations that created new inequities between asset classes.

[4] Impact on Capital Accumulation Jakobsen et al., "Wealth Taxation and Wealth Accumulation: Theory and Evidence from Denmark," *Quarterly Journal of Economics* (2020). Using administrative data from Denmark's wealth tax (abolished in 1997), this study found that the tax significantly reduced wealth accumulation by reducing savings and investment incentives, particularly among "productive" entrepreneurs, leading to a smaller national capital stock over time.

Governing Claim A wealth tax is not merely a tax on the rich; it is a forced-liquidity policy imposed on illiquid assets. Because "wealth" is often control over productive capital (factories, shares, IP) rather than cash, taxing it annually compels forced selling, borrowing, and the dilution of stewardship—transforming a tax on indulgence into a tax on the capital base itself.

The "Hazlitt" Examples (Primary)

1. Forced Liquidation (The Price-at-the-Margin Problem):

- o *Claim:* "It's only 2%; they can afford it."
- o *Hidden Assumption:* Wealth is a pile of cash, or assets can be sold in slices without affecting their price or control.
- o *Mechanism:* Paying cash taxes on illiquid assets forces annual sales. Persistent selling pressure depresses asset prices. Since markets clear at the margin, this reprices the entire asset class, hurting pension funds and ordinary savers who hold similar assets.
- o *Lesson:* You cannot liquidate the rich without repricing everyone else's savings.

2. Valuation Bureaucracy (The Engine Room):

- o *Claim:* "We can tax net worth easily."
- o *Hidden Assumption:* All assets have a clear daily market price like Apple stock.
- o *Mechanism:* Most wealth is private business, real estate, or complex partnerships. Valuing these annually creates a massive administrative apparatus of disputes, litigation, and "formulaic" errors. The tax becomes a subsidy for lawyers and appraisers.
- o *Lesson:* The rhetoric says "simple fairness"; the reality delivers "complex bureaucracy."

3. Capital Flight (The Shrinking Base):

- o *Claim:* "They won't leave; they live here."

- o *Hidden Assumption:* Capital is physically anchored and cannot be restructured or moved.
- o *Mechanism:* Wealthy individuals restructure holdings, borrow against assets (increasing systemic leverage), or physically relocate. The tax base shrinks, and the revenue often falls far short of projections (the "annuity illusion").
- o *Lesson:* A tax designed to fund the state often ends up shrinking the economy it feeds upon.