

Chapter 14: The “One-Year” Fallacy

"The more the state plans, the more difficult planning becomes for the individual."

— **F.A. Hayek**, *The Road to Serfdom* (1944)

There is a particular species of modern political argument that begins with a calculator and ends with a hymn. It takes a single-year estimate—usually of some new tax targeted at an enviable minority—multiplies it by a list of cherished programmes, and declares the moral case closed. The people are told that the solution is obvious, the money is sitting there, and only malice or cowardice prevents its retrieval.

This is what might be called the *one-year fallacy*: the treatment of a point-in-time revenue estimate as though it were a stable annuity, repeatable at the same level year after year, immune to behaviour, immune to substitution, immune to exit, immune to political feedback.

It is a fallacy because taxation is not levied on statues. It is levied on agents. Agents respond.

To deny behavioural response is to deny incentives. To deny incentives is to deny economics. To deny economics is to write policy as moral fiction.

Hayek’s warning cuts deeper than the usual caricature. He was not merely complaining about bureaucrats. He was describing the structural consequence of expanding state control: as the state extends its planning and extraction, individuals are compelled to redirect effort toward avoidance, compliance, and defensive strategy. The more the state plans, the more individuals must plan around the state. The result is not a clean transfer from private indulgence to public virtue. It is an arms race of adaptation.

This chapter dismantles the one-year fallacy. It shows why “just one year of a 2% tax” is rarely “just one year,” rarely stable, and never free of second effects. Revenue is not a rock. It is a river, and rivers change course when you build dams.

I. What the one-year estimate actually is

A one-year revenue estimate is not a prediction of a permanent stream. It is, at best, a snapshot under assumptions.

Those assumptions often include:

- a fixed tax base (wealth, income, profits, transactions) that does not shrink;
- no change in reporting or legal structure;
- no relocation of people or capital;
- no change in market prices;
- no change in labour supply or investment;
- no change in enforcement costs or compliance burden;
- no political reaction affecting the tax itself.

These assumptions are not merely optimistic. They are structurally implausible when a tax is large enough to matter.

The more meaningful the tax, the more intense the response. A trivial tax may generate little avoidance because it is not worth the effort. A major tax creates an industry.⁵³

Thus the one-year fallacy is not a minor accounting error. It is the core rhetorical trick by which coercive policies are made to look painless.

II. The behavioural response principle: people do not sit still while being taxed

The basic behavioural response is not ideological. It is universal. If you tax a behaviour, you will see less of it. If you subsidise a behaviour, you will see more of it. If you tax a base, the base will move, shrink, disguise itself, or restructure.⁵⁴

The relevant responses for high-base taxes—especially wealth and capital taxation—are predictable:

- **avoidance:** legal minimisation through structuring;
- **migration:** exit of persons or entities;
- **restructuring:** shifting asset composition toward harder-to-tax forms;

⁵³ **US General Accounting Office (1992).** The 1990 Luxury Tax on yachts projected \$31 million in revenue. It collected \$16.6 million. However, the cost in lost jobs and income tax from the devastated boat-building industry was estimated at >\$20 million, meaning the net revenue was arguably negative. A classic "One-Year Fallacy" failure.

⁵⁴ **Gruber & Saez (2002),** "The Elasticity of Taxable Income," *Journal of Public Economics*. Establishing the ETI (Elasticity of Taxable Income) as a central parameter. They found that high-income earners are highly responsive to tax rates, not by working less, but by shifting income forms, increasing deductions, and engaging in avoidance.

- **leverage:** borrowing to meet obligations or shift tax treatment;
- **valuation games:** contesting, discounting, and obscuring asset values;
- **timing shifts:** accelerating or delaying realisations;
- **compliance substitution:** paying experts instead of investing in production.

None of these require fraud. They require choice. Tax policy changes choice architecture. People respond by choosing differently.

This is why revenue is not a constant. It is an equilibrium outcome.

III. Avoidance: the predictable growth industry

The one-year estimate imagines a tax base that politely submits.

In reality, the base hires counsel.

Avoidance in high-value taxation tends to grow along three channels.

A. Structural engineering

Assets and income streams can be structured to change tax treatment. Ownership can be layered through trusts, holding companies, partnerships, foundations, and vehicles designed to exploit legal distinctions. Jurisdictions differ. Domicile can be shifted. Entities can be relocated. Intellectual property can be housed elsewhere. Funds can be structured for different recognition and reporting.

This is not a moral claim. It is the normal behaviour of people with large exposures. The state makes the rules; the state also creates the incentive to game them.

B. Complexity as camouflage

Complexity has a tax advantage. Simple assets are easy to measure and tax. Complex assets are difficult to value and audit. As tax regimes become aggressive, holding structures often become more complex, not less. Complexity increases administrative cost for the state and increases the value of expert services for the taxpayer.

The society ends up employing more people to shuffle paper and fewer to build things.

C. Administrative arbitrage

Enforcement resources are finite. If a tax system is complex and the base is sophisticated, enforcement becomes selective. Selectivity invites arbitrage: taxpayers learn which areas are lightly enforced and migrate toward them. The law becomes less a rule and more a negotiation.

Revenue falls. Legitimacy falls faster.

IV. Migration: the understated exit option

The one-year estimate assumes geography does not matter.

But capital and high-skill labour are more mobile than the public likes to admit. Some people can relocate. Some businesses can relocate. Many can shift marginal investment elsewhere even if they do not fully exit.⁵⁵

Migration occurs on several levels:

- personal domicile and tax residence;
- corporate headquarters and incorporation;
- investment allocation and capital deployment;
- intellectual property location;
- timing and realisation of gains;
- choice of jurisdiction for new ventures.

Even when only a small fraction exits, the marginal effects can be large because the tax base is often concentrated. A small number of high-base taxpayers can represent a disproportionate share of potential revenue.⁵⁶

This is why “tax the rich” is not merely moral rhetoric; it is a game of strategic interaction. The taxed party has moves. The state has moves. The one-year estimate pretends the taxed party has no agency.

⁵⁵ **Pichet (2016)**, "The Economic Consequences of the French Wealth Tax." Analyzed the ISF (Impôt de Solidarité sur la Fortune). Found that the tax caused a net outflow of ~€143 billion in capital over 30 years as 42,000 millionaires left the country. The lost revenue from their exit (income tax, VAT) likely exceeded the revenue raised by the wealth tax itself.

⁵⁶ **Young et al. (2016)**, "Millionaire Migration and State Taxation," *American Sociological Review*. While generally skeptical of mass migration, they found a "tipping point." When New Jersey raised its top rate in 2004, it lost \$2.4 billion in adjusted gross income over five years due to the exit of ultra-high earners, destabilizing the state budget.

It is not merely wrong. It is childish.

V. Restructuring: the base becomes something else

Taxing “wealth” encourages wealth to become less legible.

Taxing transactions encourages transactions to become fewer, bundled, offshore, or informal.

Taxing corporate profits encourages profit shifting, changes in financing structure, and changes in investment timing.

Taxing high incomes encourages compensation to shift form: deferred compensation, equity-based compensation, benefits, and structures.

Tax systems do not merely collect revenue. They shape the form of economic life. When a tax is designed around a particular definition, economic activity migrates toward the edges of that definition.

The one-year fallacy assumes the definition is stable and behaviour is inert.

Behaviour is not inert. Definitions are contested.

VI. Leverage: the silent transformation of a tax into fragility

One of the most pernicious adaptations to wealth-based taxation is leverage.

If an asset-holder faces recurring obligations but does not wish to sell, borrowing becomes attractive. Borrowing against assets is common. Yet policy-induced borrowing changes risk profiles. It increases fragility. It can create forced sales in downturns. It can amplify volatility.

A recurring tax can therefore operate as a recurring pressure toward leverage, especially for those whose wealth is illiquid.

This adaptation does not show up in a one-year revenue estimate. It shows up later, in systemic fragility and market stress.

The state collects revenue in the short term, while increasing tail risk in the long term.

The one-year fallacy is thus also a time-horizon fallacy. It values immediate intake over future stability.

VII. Valuation games: when the tax base becomes a legal argument

Chapter 13 described the valuation state. Here the point is narrower: valuation games are not an exception; they are a predictable response to annual wealth assessment.

If assets do not have clear market prices, valuations become contestable. Contestability becomes strategy. Strategy becomes a recurring dispute mechanism. This yields:

- persistent under-valuation incentives;
- aggressive discounting (liquidity discounts, minority discounts, control premiums);
- asset packaging to justify lower valuations;
- litigation and settlement as a normal part of tax life;
- administrative overload.

Revenue falls. Compliance costs rise. Trust decays.

The one-year estimate treats valuation as a solved problem. Real regimes treat valuation as a war.

VIII. The “annuity” illusion: why revenue estimates do not repeat

Why do one-year estimates not repeat? Because the base changes.

In year one, people are caught in the existing structure. They cannot instantly move everything. Some tax is collected. This first-year yield is then used rhetorically as proof of feasibility.

But by year two and three, adaptations accumulate:

- assets are restructured;
- residency changes;
- income streams shift;
- transactions are avoided;
- enforcement resources are strained;
- political exemptions are negotiated;
- industries build avoidance tools.

The tax base shrinks. The effective yield declines. Meanwhile, the administrative apparatus grows because the state attempts to close loopholes, which creates new complexity, which creates new loopholes.

Thus the wealth tax debate often becomes a spiral: shrinking yields lead to higher rates or broader bases, which intensify avoidance, which shrinks yields further, which intensifies enforcement and resentment.

The one-year estimate hides the spiral because it freezes time.

Politics prefers frozen time because time reveals consequences.

IX. The political feedback loop: policy does not remain static

The one-year fallacy also assumes political stability: that the tax will remain unchanged and the economy will remain undisturbed.

In reality, taxes generate political feedback:

- interest groups lobby for exemptions;
- enforcement priorities become politicised;
- public backlash grows if the tax is perceived as arbitrary;
- courts constrain or reshape implementation;
- capital markets respond through valuations and risk premiums;
- business investment adjusts;
- employment and wage growth respond.

These feedbacks alter the economy that generates the revenue.

A tax is not just a rule. It is a shock to a system.

Systems adapt.

X. The moral temptation: one-year estimates as permission to stop thinking

The one-year fallacy is seductive because it allows moral certainty without technical humility. It allows the advocate to say: “We can fund everything; we simply refuse.” It turns politics into a morality play with villains and easy numbers.

But economics is not impressed by virtue-signalling arithmetic.

If you want to take money from a group, you must explain how you will keep the base from moving, shrinking, or disguising itself. If you cannot explain this, you are not proposing a policy. You are proposing a wish.

Hayek's line is relevant here because it captures the deeper consequence: as the state expands planning and extraction, individuals must plan defensively. The society becomes less productive because mental energy is redirected from creation to survival in the administrative jungle.

You can call this "closing loopholes." The economy experiences it as a tax on initiative.

XI. A plain-language summary: why "just one year" is never "just one year"

If a politician says, "Just one year of a small tax," translate it into reality:

- "Just one year" means "we are using the first-year snapshot before people adapt."
- "Small" means "we are ignoring the difficulty of liquidating illiquid assets."
- "Won't change behaviour" means "we are assuming away incentives."
- "Won't hurt growth" means "we are ignoring investment response."
- "Won't hurt the poor" means "we are ignoring incidence and market repricing."
- "Won't be complex" means "we are ignoring valuation and compliance."

The one-year estimate is not proof. It is an advertisement.

The Lesson Line

A one-year estimate is not a revenue stream; it is a frozen snapshot taken before avoidance, exit, and valuation games begin.

Chapter 14 Notes:

[1] The French Exodus Pichet, "The Economic Consequences of the French Wealth Tax" (2016). Analyzed the long-term impact of the ISF. Estimated a net capital outflow of ~€143 billion over 30 years as 42,000 millionaires emigrated. Concluded that the fiscal cost of their departure (lost income tax, VAT, etc.) was likely twice the revenue the wealth tax generated.

[2] Behavioral Elasticity Gruber & Saez, "The Elasticity of Taxable Income," *Journal of Public Economics* (2002). Established the "Elasticity of Taxable Income" (ETI) as a key metric. Found that high-income earners are highly sensitive to marginal tax rates—not necessarily by working less, but by shifting income forms, increasing deductions, and engaging in structural avoidance.

[3] Domestic Migration (The Tipping Point) Young et al., "Millionaire Migration and State Taxation," *American Sociological Review* (2016). While generally skeptical of mass migration, the study found a "tipping point" effect. When New Jersey raised its top rate in 2004, the state lost \$2.4 billion in adjusted gross income over five years due to the exit of ultra-high earners, destabilizing the budget.

[4] The Luxury Tax Failure US General Accounting Office (1992). The 1990 Luxury Tax on yachts projected \$31 million in revenue but collected only \$16.6 million. The devastation of the domestic boat-building industry cost the government >\$20 million in unemployment benefits and lost income tax, resulting in a likely net fiscal loss.

Governing Claim A one-year revenue estimate is not a prediction of a stable future stream; it is a "frozen snapshot" that ignores behavioural responses. Because taxes change incentives, agents respond by avoiding, migrating, restructuring, or leveraging assets—meaning the tax base shrinks or moves, often turning a projected windfall into a fiscal disappointment.

The "Hazlitt" Examples (Primary)

1. The French Exodus (Migration):

- o *Claim:* A wealth tax will raise revenue from the rich without broader economic damage.
- o *Hidden Assumption:* Capital and high-net-worth individuals are immobile fixtures.
- o *Mechanism:* The *Impôt de Solidarité sur la Fortune* (ISF) caused 42,000 millionaires to leave France. The loss of their income tax, VAT, and investment activity likely exceeded the revenue raised by the wealth tax itself.
- o *Lesson:* When you target a mobile base, the exit door is the ultimate check on extraction.

2. The Luxury Tax (Substitution):

- o *Claim:* Taxing yachts and private planes targets only the indulgences of the wealthy.
- o *Hidden Assumption:* Demand for luxury goods is inelastic and production creates no jobs.
- o *Mechanism:* The rich stopped buying yachts in the US (buying elsewhere or not at all). The tax raised little revenue, but the boat-building industry collapsed, destroying blue-collar jobs and reducing aggregate tax revenue.
- o *Lesson:* A tax on a "rich person's toy" is often a tax on a "poor person's job."

3. Static Scoring (The Calculator Illusion):

- o *Claim:* "We can fund this programme with a 2% tax on X."
- o *Hidden Assumption:* The tax base (X) will remain the same size after the tax is imposed.

- o *Mechanism:* High-value taxation creates an "avoidance industry." Taxpayers restructure assets, increase leverage, or shift timing. The base shrinks or becomes less legible, causing revenue to fall short of the "calculator" estimate.
- o *Lesson:* Revenue is not a rock; it is a river that changes course when you build a dam.