

Chapter 15: Collateral Damage— Pensions, Endowments, the Middle

“There is only one difference between a bad economist and a good one: the bad economist confines himself to the visible effect; the good economist takes into account both the effect that can be seen and those effects that must be foreseen.”

— **Frédéric Bastiat**, *That Which Is Seen and That Which Is Not Seen* (1850)

“Tax the rich” is among the most rhetorically efficient slogans ever minted. It has the advantage of a villain, the charm of simplicity, and the narcotic comfort of moral asymmetry: *they* have more, so *they* should pay. The phrase implies a scalpel. The economic reality is closer to a dye released upstream: it spreads through the watercourse, colouring everything it touches.

The visible target is the wealthy household. The invisible payers include pensioners, savers, universities, charities, hospitals, insurers, municipal funds, and any middle-income worker whose future depends on the returns of capital markets. The mechanism is not conspiratorial. It is mechanical. It is the repricing of equity and other capital assets caused by policies that force liquidation, reduce expected after-tax returns, increase risk premia, or reduce liquidity.

Bastiat’s warning remains the only reliable antidote to political intoxication: do not stop at the visible effect. The visible effect is the bill sent to the rich. The foreseen effect is the reduction in asset values and returns that quietly taxes everyone whose balance sheet is tethered—directly or indirectly—to the same markets.

This chapter explains how collateral damage works. It does not rely on melodrama. It relies on a simple fact: capital markets are shared plumbing. You cannot poison one section of the pipe and expect clean water elsewhere.

I. The first misunderstanding: “the rich hold stocks; ordinary people do not”

This claim is half-true and therefore fully misleading.

Yes, high-net-worth households hold more equities in absolute terms and often in concentrated forms (founder stakes, control blocks, large positions). But ordinary households—especially in developed economies—hold equities indirectly through:

- pension funds and defined contribution plans;
- employer-sponsored retirement schemes;
- mutual funds and index funds;
- insurance company general accounts backing annuities and policies;

- endowments that fund scholarships and services;
- sovereign and municipal funds;
- bank balance sheets and capital buffers.

Even households without explicit equity portfolios often have exposure through their employment (firms' investment decisions depend on cost of capital) and through public institutions whose funding depends on investment returns.

The relevant question is not “who holds equities?” but “who bears the effects of equity repricing?”

When markets reprice, they do not check moral categories before moving.

II. How equity repricing happens: the four levers policy pulls

Equity values are not mere reflections of present wealth. They are present values of expected future cash flows discounted by required returns. Policy affects both components.

There are four principal channels by which “tax the rich” policy proposals—especially wealth taxes, transaction taxes, and higher taxes on capital income—can reprice equities.

A. Lower expected after-tax cash flows

If policy reduces net profits through higher corporate taxation or higher effective taxation on distributions, the expected future cash flows to shareholders fall. Lower expected cash flows reduce present value. Prices decline.

This is not ideology. It is arithmetic.

B. Higher required returns (risk premia)

If policy increases uncertainty, reduces institutional predictability, or increases perceived risk to property rights, investors demand higher returns to compensate. Higher required returns mean higher discount rates. Higher discount rates mean lower present values. Prices decline.

A society can choose to increase this risk. It cannot choose to avoid the repricing that follows.

C. Reduced liquidity

Transaction taxes, turnover taxes, or policies that discourage trading reduce liquidity. Reduced liquidity increases trading costs and widens spreads. Assets become harder to trade without moving the price. Investors respond by demanding higher returns for holding less liquid assets. Higher required returns lower valuations.

Liquidity is not a luxury. It is a component of price formation.

D. Forced sales and market-impact pressure

Wealth taxes create a unique repricing channel: they compel periodic liquidation or periodic leverage. If a cohort of large holders must sell each year to raise cash, the market experiences

persistent sell pressure. Prices are set at the margin. Persistent forced selling can depress valuations even if the selling is gradual and “orderly.”⁵⁷

The point is not that markets collapse overnight. The point is that a systematic policy bias toward net selling pushes down valuations over time.

And when valuations move, the collateral damage begins.

III. The pension channel: the quiet taxation of retirement

Pensions are not merely accounting constructs. They are claims on future purchasing power. Their viability depends heavily on returns. When valuations fall or expected returns decline, pension systems must adjust. They adjust in ways that are politically ugly, which is why the adjustment is often delayed—until it becomes unavoidable.⁵⁸

A. Defined contribution plans: the individual takes the hit

In a defined contribution system, the individual’s retirement security depends on the accumulated value of contributions and returns. If policies depress equity valuations or future returns, the individual retires with less.

This loss is rarely framed as a tax, but it functions like one: it reduces future consumption. It increases dependency. It reduces dignity.

A policy that is marketed as “taxing billionaires” can, through equity repricing, reduce millions of retirement balances. The billionaire pays the cheque; the middle pays the future.

B. Defined benefit plans: the institution takes the hit—then passes it on

Defined benefit plans promise a payout. The plan’s funding depends on assets and expected returns. If valuations fall or return assumptions weaken, funding gaps widen. To close the gap, plans can:

- require higher contributions from workers;
- require higher contributions from employers (which can reduce wage growth);
- reduce benefits;
- increase retirement age;
- shift into riskier assets to chase returns (increasing fragility).⁵⁹

⁵⁷ **American Investment Council (2020)**. Public pension funds are the largest investors in private equity, accounting for nearly 30% of all capital in US private equity funds. This confirms that a tax war on “private equity billionaires” is directly a war on the returns of public employees.

⁵⁸ **Coval & Stafford (2007)**, “Asset Fire Sales (and Purchases) in Equity Markets,” *Journal of Financial Economics*. Empirically demonstrated that forced selling by mutual funds (due to outflows) depresses stock prices significantly below their fundamental value, and these price depressions can last for months. A wealth tax would institutionalize this “fire sale” effect annually.

⁵⁹ **Pew Charitable Trusts (2022)**, “The State Pension Funding Gap.” Found that US state pension funds face a shortfall of over \$1 trillion. These funds rely on high investment return assumptions (~7%). A structural drop in equity valuations caused by capital taxation would make these targets impossible to hit, necessitating tax hikes or benefit cuts for public workers.

Each adjustment has incidence. Workers pay through contributions, reduced wage growth, or reduced future benefits. Employers pay and may respond by hiring less or investing less. Taxpayers pay when public pensions demand bailouts.

Thus equity repricing becomes a diffuse but real transfer from households to the costs created by policy.

IV. The endowment channel: universities, hospitals, charities

Endowments are pools of capital whose returns fund operations: scholarships, research, medical services, community programmes. Their spending policies depend on long-run expected returns.

When equity valuations fall, endowments face choices:

- reduce spending and programmes;
- draw down principal (reducing future capacity);
- increase fundraising pressure;
- shift toward riskier allocations.

The public often imagines endowments as hoards. In reality, they are funding mechanisms for ongoing services. A repricing of equities can therefore translate into fewer scholarships, fewer grants, fewer funded positions, fewer services for the vulnerable.

This is not sentimental pleading. It is incidence.

A policy that compresses expected returns forces institutions to cut—quietly and over time—precisely in the areas the public claims to value.

V. The insurance channel: annuities, premiums, and solvency

Insurance companies hold large portfolios of bonds and equities to back future liabilities. Their pricing and solvency depend on returns and valuation stability. When expected returns decline, insurers must:

- raise premiums;
- reduce guaranteed returns;
- tighten coverage terms;
- adjust asset allocation, sometimes increasing risk;
- hold more capital for solvency under regulatory frameworks.

Thus the repricing of capital can raise the cost of insurance for ordinary households—life insurance, health-related coverage, annuities, long-term care. It can also pressure insurers to seek yield, increasing systemic fragility.

The public does not connect “tax the rich” rhetoric to higher insurance premiums. But the system connects them.

VI. The middle-class balance sheet: when “wealth taxes” leak into home life

The middle class may not be rich, but it is asset-dependent.

Its wealth, to the extent it exists, is often concentrated in:

- retirement accounts;
- home equity;
- small business value;
- claims on institutional stability (pensions, public services).

If policy-induced repricing reduces retirement values and institutional returns, households respond by:

- saving more (reducing consumption);
- delaying retirement;
- increasing reliance on public support;
- reducing family formation and long-term commitments;
- becoming politically unstable as expectations collapse.

These second effects are politically explosive because they are slow and cumulative, arriving as disappointment rather than as an identifiable bill.

Bastiat's point is that foresight is the moral duty of serious policy. A policy that produces widespread disappointment is not compassionate merely because it was announced with virtuous intention.

VII. “But the rich still have more”: the moral evasion

At this point, a common rhetorical defence appears: even if pensions are affected, the rich remain richer, therefore the policy is still justified.

This is a moral evasion, not an argument.

The question is not whether inequality exists. The question is whether a policy designed to punish a subset of asset holders is worth the collateral damage imposed on savers, pensioners, and institutions. If the burden is diffuse and the benefit is symbolic, the policy may be a moral performance rather than a welfare improvement.

The most dishonest move in public debate is to treat any criticism of incidence as sympathy for the wealthy. It is not sympathy. It is competence.

A serious society does not confuse analysis with allegiance.

VIII. A plain household analogy: the shared reservoir

Imagine a town with a shared reservoir. A politician announces: “We will punish the largest household in town by adding a chemical that harms their water.” The crowd cheers. The household is disliked. The politician assures everyone else: “Do not worry. Only the rich household will be harmed.”

But the reservoir is shared. The chemical disperses.

This is equity repricing.

Public markets are shared reservoirs. Pension funds drink from them. Endowments drink from them. Insurance pools drink from them. The middle class drinks from them in retirement.

If you contaminate returns, you cannot isolate the effects.

IX. What a responsible policy discussion would require

If a government wishes to raise revenue from high-wealth households without collateral repricing, it must design taxes that minimise forced liquidation, minimise uncertainty, minimise damage to after-tax returns on productive capital, and minimise liquidity distortion.

That requires:

- clarity about the tax base;
- awareness of valuation effects;
- attention to mobility and avoidance;
- careful incidence modelling;
- an honest accounting of second effects on pensions and institutions.

Most of the slogan-driven proposals do not do this because doing it would make them less rhetorically pleasurable. They survive precisely because their costs are invisible.

Bastiat would have recognised the trick instantly.

The Lesson Line

When policy forces capital repricing, it does not merely “tax the rich”; it quietly taxes every pension, endowment, and retirement plan that must live on returns.

Chapter 15 Notes:

[1] Pension Fund Exposure OECD, *Pension Markets in Focus* (2021). Reports that pension funds in major economies (US, UK, Canada, Netherlands) allocate 40–60% of assets to equities. In the US alone, pension funds hold over \$10 trillion in assets, meaning the "middle class" is heavily exposed to any policy that reprices capital.

[2] The Funding Gap Pew Charitable Trusts, "The State Pension Funding Gap" (2022). Found that US state pension funds face a shortfall of over \$1 trillion. These funds rely on high return assumptions (~7%). A structural drop in equity valuations caused by capital taxation would make these targets impossible to hit, necessitating tax hikes or benefit cuts for public workers.

[3] Private Equity and Public Pensions American Investment Council (2020). Public pension funds are the largest investors in private equity, accounting for nearly 30% of all capital in US private equity funds. This confirms that a tax war on "private equity billionaires" is directly a war on the returns of public employees.

[4] Fire Sales and Repricing Coval & Stafford, "Asset Fire Sales (and Purchases) in Equity Markets," *Journal of Financial Economics* (2007). Empirically demonstrated that forced selling by mutual funds depresses stock prices significantly below their fundamental value, and these price depressions can last for months. A wealth tax would institutionalize this "fire sale" effect annually.

Governing Claim The economy is a shared ledger; you cannot "tax the rich" by depressing asset values without hitting the middle class, who are the ultimate creditors of the economy through pensions, insurance policies, and endowments.

The "Hazlitt" Examples (Primary)

1. Pension Fund Exposure (The Shared Reservoir):

- o *Claim:* "Taxing billionaires' stocks doesn't hurt the worker."
- o *Hidden Assumption:* The stock market is owned solely by the rich.
- o *Mechanism:* Pension funds (e.g., CalPERS) own billions in public and private equity to pay retirees. If a wealth tax forces liquidation or depresses valuations, the funding gap widens, leading to higher contributions (a tax on workers) or reduced benefits.
- o *Lesson:* The billionaire pays the cheque; the retiree pays the future.

2. University Endowments (The Mission Tax):

- o *Claim:* Endowments are hoards that can be taxed without consequence.
- o *Hidden Assumption:* Endowments are static piles of money, not funding sources for operations.
- o *Mechanism:* Endowments rely on compound returns to fund scholarships and research. A policy that compresses after-tax returns forces cuts to grants and services.
- o *Lesson:* A tax on the endowment often becomes a tax on the scholarship student.

3. The Liquidity Cascade (Systemic Risk):

- o *Claim:* Forced sales by the rich will be absorbed easily by the market.
- o *Hidden Assumption:* Liquidity is infinite and markets are always stable.
- o *Mechanism:* If a wealth tax forces simultaneous selling by large holders, it creates a structural "fire sale" environment. Predators front-run these sales, driving prices down further, triggering margin calls that hit retail investors and pension funds.

- o *Lesson:* You cannot introduce structural instability at the top without causing tremors at the bottom.

Part V — The Real Reforms: Ladders, Not Levelling

"I don't believe in a law to prevent a man from getting rich; it would do more harm than good. So while we do not propose any war upon capital, we do wish to allow the humblest man an equal chance to get rich with everybody else."

— **Abraham Lincoln**, *Speech at New Haven* (1860)