The High Costs of Taxing Wealth

By Adam N. Michel

Gov. Gavin Newsom fears that a wealth tax will chase away California's billionaires. But capital flight is only the most visible consequence, and taking the wealth tax national would result in reduced investment, less innovation, and slower wage growth to the detriment of everyone.



Sen. Bernie Sanders (I-VT) campaigns for California's proposed wealth tax during an event in Los Angeles earlier this year. (Photo by Jason Armond/*Los Angeles Times* via Getty Images)

The debate over California's Proposition 40, a proposal for a one-time tax of 5 percent on billionaires' assets, highlights a revealing tension in the politics of taxing wealth. Gov. Gavin Newsom opposed the measure, arguing that wealthy Californians could easily leave the state and take their taxable income with them. Instead, he proposed a national billionaire tax.

To a wealth tax skeptic, Newsom's logic may seem backward. If the concern is that a wealth tax imposes high economic costs, applying it to more taxpayers would simply amplify those costs, not eliminate them.

Newsom is implicitly acknowledging the problem that Mark Cuban put more colorfully when he warned that the new California tax would push entrepreneurs and investors to other states: "If this passes, only idiot startup founders stay in Cali."

The Newsom two-step illustrates an important political economy insight. A California wealth tax would concentrate its consequences in California. As taxpayers and businesses leave the state, taking

"The renewed enthusiasm for taxing wealth overlaps with a broader political agenda that promises a much larger government funded exclusively by taxes on a narrow set of wealthy individuals and large corporations."

their economic activity and employment opportunities with them, the costs of policy failure would be unusually visible.

Supporters sell these taxes as a virtually costless way to raise substantial revenue. Yet they also repeatedly push for upward harmonization: from states to the national level, and from individual countries toward international coordination. The desire to limit mobility implicitly recognizes that taxpayers, investment, and businesses respond to taxes.

Limiting taxpayers' ability to exit doesn't make the tax costless. It simply makes the costs harder to see. Instead of newsy headlines about billionaires moving to Florida or Panama to cut their tax bill, the costs accumulate less visibly in the form of reduced investment, fewer entrepreneurs with unicorn startups, slower productivity growth, and ultimately fewer jobs and lower wages.

The Golden State's Experiment

There are plenty of reasons to be skeptical of the California proposal.

A wealth tax applies to a stock of assets rather than a flow of earnings, regardless of whether the assets produce any income. Someone can own a business that is valuable on paper without receiving even a small percentage of that value in cash each year. To pay the tax bill, many paper billionaires may end up selling shares or forcing their business to distribute money that otherwise could have financed its growth.

At California's proposed wealth tax rate of 5 percent, any asset earning less than a 5 percent annual pretax return would face marginal effective income tax rates above 100 percent, even *before paying other taxes*.

Determining the value of taxable wealth is no small task either. Publicly traded stock has a market price. Most of the other assets owned by the superwealthy—closely held businesses, partnership interests, intellectual property, artwork, and unique real estate, to name a few—are harder to value. California's proposal acknowledges some of these valuation problems with unusually rigid, formula-driven rules for valuing hard-to-price assets. By substituting administrative convenience for actual market values, this system can increase economic costs by creating a large gap between actual and assessed values in most cases.

One illustration of how large these discrepancies can be is the Michael Jackson estate, which spent more than a decade



About a third of California's billionaires live in San Francisco, the tech capital of the world. (Photo by Tayfun Coskun/Anadolu via Getty Images)

litigating with the IRS after his death. Jackson's estate valued his name and likeness at just $2,105 in 2009. The IRS said it was worth $434 million. In 2021, the Tax Court ultimately settled on $4.2 million. A national annual wealth tax would re-create this sort of dispute across potentially tens of thousands of taxpayers, every single year.

Given the economic and administrative burdens of wealth taxes, the California proposal will include strong incentives to move out of the state. The state's own legislative analyst expects Proposition 40 to raise tens of billions of dollars in temporary revenue, while also reducing state income tax revenues on an ongoing basis as wealthy taxpayers move away.

Other estimates are more striking. A Hoover Institution analysis estimates that nearly 30 percent of the anticipated tax base had already left California before the initiative qualified for the ballot. This finding undermines proponents' claims that they've designed a one-time retroactive tax that will not affect taxpayer behavior.

After accounting for the lost income taxes from departing billionaires, the Hoover authors estimate that Proposition 40 could eventually reduce net state revenue by $25 billion over time. And these estimates are likely conservative, as they assume only billionaires would respond, not the many other entrepreneurs and investors who might reasonably expect future wealth



Protesters hold French national flags and a sign that reads "Tax the rich" in Bordeaux, France, on September 18, 2025. (Photo by Christophe Archambault/AFP via Getty Images)

taxes to reach them. Nor do they account for the Californians at all income levels who may flee the state as reduced investment depresses wages and job prospects.

Europe Already Ran This Experiment

Annual wealth taxes were once common in Europe. Twelve European countries collected annual individual net wealth taxes in 1990. Today, only three do: Norway, Spain, and Switzerland. Wealth taxes were systematically repealed due to the high administrative costs, widespread capital flight, political unpopularity, economic damage caused, and limited revenue raised (or even net revenue lost).

France abolished its broad wealth tax in 2018 over concerns that wealthy entrepreneurs and celebrities were fleeing the country. The government estimated that about 10,000 people with €35 billion worth of assets left France over a 15-year period. An independent analysis concluded the French wealth tax raised €3.5 billion a year, but the government still lost about €7 billion a year in other tax revenues as the wealthy left the country. Sweden abolished its wealth tax in 2007 after Ikea founder Ingvar Kamprad and other prominent entrepreneurs moved abroad.

Norway recently went in the opposite direction, increasing its wealth tax rate in 2022. A widely reported exodus of wealthy residents followed, and the Norwegian Ministry of Finance estimated billions of dollars in deferred capital income left the country.

Spain also retains a wealth tax with a history that's particularly applicable to the California proposal. When Madrid effectively eliminated its regional wealth tax, taxpayers moved there from other regions of Spain. Regions outside Madrid lost roughly six times more in personal income tax revenue than they gained from the wealth tax on remaining taxpayers. In response, the national government overrode local policy to stop regional competition, an explicit admission that wealth taxes have strong effects on taxpayer behavior.

Advocates have addressed the challenge of sustaining wealth taxes in the face of taxpayer mobility using the same playbook as Gov. Newsom. Alongside Brazil's G20 presidency, Gabriel Zucman, the leading academic proponent of wealth taxation, proposed a globally coordinated minimum wealth tax. The proposal concedes that taxpayers will change their behavior in response to new, overly burdensome taxes. Harmonizing the regime to higher levels of political power does not eliminate the economic response; it will simply shift where it shows up. If taxpayers cannot escape the tax by moving, they can still respond by saving and investing less and changing how they start, run, own, and finance businesses. Limiting avoidance and mobility can amplify the real effects on the economy.

"Our public policies telegraph a message about our culture, our institutions, and what we value. A wealth tax says: 'Don't get too successful here.'"

Wealth Isn't Piles of Gold

Part of the political appeal of wealth taxes is built on a misunderstanding of wealth. It is often imagined that the largest American fortunes are piles of gold in a vault somewhere, taken from the rest of us and hoarded by a few families, passed down for generations. But the overwhelming majority of top-end American wealth is productive capital that benefits all of us. And that wealth is mostly built by entrepreneurs, not inherited by them.

Among the richest 0.1 percent of households, 73 percent of net wealth is equity in privately held or publicly traded companies. Among billionaires, homes and personal assets such as cars, airplanes, artwork, and jewelry account for only a couple of percentage points of total wealth.

As Jeff Bezos's wealth grows because Amazon is more valuable, his fortune does not mechanically make everyone else

"It is overwhelmingly productive capital, not idle piles of cash, that supports millions of jobs, new innovations, and higher living standards. When governments tax that productive wealth, it hurts all of us."

poorer. The company's value—and thus much of Bezos's wealth—reflects the firm's expected future earnings, which are a function of how much consumers value the goods and services it provides. As my colleague Marian Tupy recently noted in the *Wall Street Journal*, Bezos has captured only a small fraction of the value his company has created for global consumers.

And the wealthy often don't build just their own businesses; they risk their wealth to fund new ones started by others. Apple, Amazon, Google, Nvidia, Moderna, BioNTech, and countless other groundbreaking companies depended, at critical stages, on investors willing to risk their wealth to fund uncertain ideas.

These stories of innovation and entrepreneurship show how capital and labor are most often complements in production. More investment in capital makes workers more productive, and higher productivity is a key reason workers can demand higher wages.

Our public policies telegraph a message about our culture, our institutions, and what we value. A wealth tax says: "Don't get too successful here. We want only middling ideas. If you have a really good idea, certainly don't sell it to too many people." That message doesn't just stunt the lifestyles of the rich. Its broader costs fall on everyone through the jobs never created, cures never discovered, and technological breakthroughs never pursued.

There Isn't Enough at the Top Anyway

The renewed enthusiasm for taxing wealth overlaps with a broader political agenda that promises a much larger government funded exclusively by taxes on a narrow set of wealthy individuals and large corporations.

The Democratic Socialists of America (DSA), which has grown from roughly 5,000 dues-paying members in 2016 to more than 120,000 today, provides the clearest example of this trend. Its platform calls for government-funded health care, housing, higher education, expanded retirement benefits, paid leave, guaranteed jobs, large green-energy investments, and reparations, among other expensive commitments. In my recent work, I estimated that the nine most expensive proposals could cost between $71 trillion and $212 trillion

in additional federal spending over 10 years. That would require roughly doubling federal revenue at the low end or quadrupling it at the high end.

The DSA suggests that the richest Americans and corporations will pay for it all. The problem is that there simply aren't enough resources at the top to make this plan work.

The 400 wealthiest Americans were worth about $6.6 trillion in 2025. Confiscating every dollar of that wealth—an obviously impractical proposal that could happen only once—would cover less than one year of the low-end DSA spending and less than four months at the high end. Sen. Bernie Sanders's wealth tax would raise less than $2.3 trillion over a decade.

The existing federal tax system is already overly reliant on high earners for federal revenue. By one measure, we have the most progressive tax system in the developed world. US Treasury data show that the average effective federal tax rate for the top 0.1 percent of households is just above 33 percent, the rate for the middle is 12 percent, and the tax rate for the bottom 20 percent of households is near zero.

Due in part to this existing structure, government economists recently concluded that raising top federal income tax rates would not bring in much additional revenue. Revenue-maximizing top income tax rates would raise less than 0.1 percent of GDP, or roughly $400 billion over a decade. That's a vanishingly small share of the hundreds of trillions in new spending some on the left have proposed.

There is no way around the fact that funding big governments requires high taxes on citizens at every income level. The European welfare states demonstrate this clearly. They impose high income, payroll, and consumption taxes not only on millionaires and billionaires but also deep into the middle class.

Will We Learn the Lesson?

Gov. Newsom's objection to Proposition 40 highlights a lesson learned decades ago by other countries. His concern is that wealth is mobile and that taxpayers will respond to new taxes. That concern is well grounded in historical experience.

He is wrong, however, that nationalizing such a tax would improve it or limit its costs. The escape valve of federalism may change how quickly those costs become visible, or the channel through which they show up. But, if people can't relocate to avoid the tax, costs will show up in more material ways—through less saving, investment, and entrepreneurship. The economic costs of taxing productively invested wealth have to go somewhere.

The simplest way to state the lesson here is that wealth is good. It is overwhelmingly productive capital, not idle piles of cash, that supports millions of jobs, new innovations, and higher living standards. When governments tax that productive wealth, it hurts all of us. ✦

ABOUT THE AUTHOR

Adam N. Michel is director of tax policy studies at the Cato Institute, where his research focuses on how the tax code shapes investment, wages, and the federal budget.