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I was asked recently by an email correspondent if a government that uses taxes to control inflation will always end up taxing the middle class rather than the wealthy.

The argument put to me was simple and, at least loosely, based on modern monetary theory. If tax is used to take spending power out of the economy, and if governments are obsessed with short-term political survival, it was argued that they will target the taxes that influence the prices that matter tomorrow morning. That means that food, energy, rent, and transport might be targeted.

However, because the wealthy do not spend their extra income on those things, the claim was that taxing them would not reduce the sort of inflation that brings governments down. Middle-class incomes, by contrast, are thought to have a more immediate impact on these prices. The suggested conclusion was that governments, seeking short-term stability, will always tax the middle classes and almost never tax the rich.

It is an argument with just enough economic logic in it to sound plausible. But it is also wrong in all the ways that matter.

The basics

First, the basics are right. Tax does not fund government spending. Spending comes first; taxes come second. Tax helps control inflation by withdrawing some of the spending power the government has put into the economy.

And it is true that governments with short-term time horizons are particularly sensitive to price rises in the essentials of life. A government that lets food and energy inflation rise will face public anger.

It is also true that very wealthy households are not the cause of increasing grocery prices. No one becomes a billionaire and celebrates by panic-buying 300 tins of baked beans. That, though, is not the whole story.

The wealthy drive inflation

The conclusion is wrong because it misunderstands how inflation actually works. The leap from “the wealthy do not spend their extra income on food and fuel” to “taxing the wealthy cannot reduce inflation” does not hold true. This argument treats inflation as if it only happens in supermarket aisles, when in reality it originates across many parts of the economy, including those where the wealthy have disproportionate influence.

There are at least four major channels through which concentrated wealth creates inflationary pressure.

1. Asset price inflation drives real-world inflation.

Inflation is not only about the price of essential household commodities. It is also, and increasingly, about the cost of living in a system where asset prices have been allowed to run out of control.

So, when house prices rise, rents rise. When rents rise, businesses face higher premises costs and pass them on. Households facing higher rents cut back elsewhere or increase their debt. All of this feeds directly into consumer prices.

Asset inflation, as a result, becomes general inflation. And it is driven not by middle-class consumption but by those with the means to accumulate second homes, property portfolios and speculative assets.

2. The wealthy also bid up the price of scarce resources.

Inflation occurs whenever too much money chases too few resources. The wealthy chase scarce resources all the time; they simply are not the items in the supermarket.

They bid up the price of skilled labour in finance, consultancy, private medicine, law and technology.

They also bid up the price of the goods they buy to display their wealth; their so-called conspicuous consumption, and people have to make those items, however little they really add to the sum lot of human well-being.

And when private equity operations and multinational firms that target the wealthy raise some pay packages, the public sector and smaller businesses cannot compete. This alters relative wages across the whole labour market, and labour-market inflation can drive overall inflation (even if it does not always), meaning that taxing the wealthy can reduce some of the upward pressure they exert on these scarce resources.

3. Inequality forces others into debt, and debt-fuelled consumption is inflationary.

When too much income flows to the wealthy, many in the rest of society are forced to borrow to cope with the basics. Debt does not create more goods or services; it creates purchasing power without the capacity to pay. That is inherently inflationary.

Taxing the wealthy reduces the distortions that force households into this cycle, reducing an important inflationary driver.

4. Wealth concentration distorts investment and weakens productive capacity.

When too much wealth accumulates in the possession of relatively few people, it is rarely invested in productive activity. It is diverted into speculation, buy-to-let properties, financial engineering and activity focused on short-term gains.

This has serious consequences. Under-investment in productive capacity is one of the deepest causes of inflation: if the economy cannot produce the goods and services people need, prices will rise no matter how little the middle classes spend.

Taxing speculative gains and rents would shift investment toward productive, inflation-reducing activity instead.

In short, inflation is not simply the consequence of middle-income households buying too many basic commodities. It is shaped by the structural imbalances created by wealth concentration. Taxing those imbalances is therefore an essential tool for controlling inflation.

The real reason governments do not tax the wealthy is political, and not economic

The idea that middle-class taxation is an economically rational way to manage inflation is a convenient myth. The truth is more straightforward. It is that middle-class households are politically easier to tax.

They do not fund political parties. They do not employ battalions of accountants and lawyers. They do not relocate to Monaco. They do not dominate the networks of influence in which political decisions are made.

In contrast, the wealthy do such things. And successive governments, of all political colours, have been unwilling to confront that power.

So the pattern we see, of middle-class taxpayers squeezed ever harder while the wealthy enjoy extraordinary reliefs, is not about inflation control. It is about political convenience.

What a rational tax system would do

If we genuinely wanted a tax system that contributed to low inflation, social stability and economic fairness, it would look very different to the one we have. It would:

*
Tax wealth properly, because wealth is where the inflationary pressures of housing, land and asset bubbles begin.

*
Tax rents over work, because unearned income inflates costs while productive labour does not.

*
Lighten the tax burden on middle and lower incomes, because they already pay disproportionately.

*
Regulate essential sectors directly, because investment, price controls and public ownership stabilise essential goods far more effectively than taxing income ever could.

*
Close the loopholes and reliefs that fuel speculation, from pension tax distortions to the preferential treatment of capital gains.

This is not radical economics. It is simply rational economics.

Conclusion

The idea that governments are forced to tax the middle class to control inflation is wrong. They do so because the middle classes are easier to tax and less able to resist.

A government serious about inflation, inequality, and stability would tax the wealthy because doing so works economically, socially, and fiscally.

The obstacle is not economic reality. It is political will.

Taking further action

If you want to write a letter to your MP on the issues raised in this blog post, there is a ChatGPT prompt to assist you in doing so, with full instructions, **here.**

One word of warning, though: please ensure you have the correct MP. ChatGPT can get it wrong.

Comments

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