THE INCREASING FEDERAL PERSONAL TAX BURDEN

A Report

Presented to

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CONTENTS

TABLES

Table | Page

Chapter 1

INTRODUCTION

Most taxpayers would agree that the tax burden is becoming heavier and heavier and that the cost of government is growing by leaps and bounds. Fortunately, it appears that public resistance to bigger and bigger government and increasingly larger give-away programs is beginning to influence more political leaders. Less government and more competition could have a beneficial effect on the economy of the United States and would decrease the tax burden. A mass of empirical data confirms that the federal government has been inefficient in expenditures and increasingly interferes in practically all aspects of the economy. Business and individual initiative and efficiency have been stifled as a result. More government, as has been ably demonstrated, is not better government. Adam Smith noted this when he wrote:

> The duties of the state will be restricted to defending the society against external aggression, to administering justice, and maintaining certain public works which it is not to the interest of any private individual to construct.[1]

As aptly expressed by noted economist Milton Friedman in 1972, what government needs to do is to leave more of our incomes for us to

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[1]Adam Smith, cited by Glenn R. Morrow, The Ethical and Economic Theories of Adam Smith (New York: Augustus M. Kelley, 1967), p. 63.

spend in accordance with our own values and to reduce the extent to which our Big Brother in Washington runs our lives for us.[2]

This paper will concentrate on the impact that inflation has on the tax burden. First, the empirical statistics on inflation and personal taxes will be presented. The changes in the rate of inflation are based on statistics available for the consumer price index, the wholesale price index, and the implicit price deflator for gross national product. Students of economics are aware of the limitations and possible inaccuracies of these devices; however, they are adequate for the purpose of this paper. Only two of the many personal taxes will be examined closely; namely, the personal income tax and social security "contributions." Corporation, excise, and other taxes, including other personal taxes, will not be examined in this paper. This should not affect the conclusions presented as personal income and social security taxes have constituted about seventy-five percent of all taxes in recent years. They are, therefore, the major tax burden for most individuals. The problem of different types of personal income with different tax rates will be avoided by assuming that all personal income is derived from wages or salaries.

Based on the data on inflation and personal taxes, the inflationary distortion of the tax rate structure and the tax base will be explained. Some of the reasons for the increase in personal

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[2]Milton Friedman, An Economist's Protest: Columns in Political Economy (New Jersey: Thomas Horton and Company, 1972), p. xvi.

taxes will be mentioned briefly, and implied income redistribution because of the shifting of taxes will be addressed. Redistribution of income because of direct effects of inflation, other than its effect on personal tax structure, is beyond the scope of this paper. The expansion of the money supply as a political alternative to legislating higher taxes or an increase in the government deficit through borrowing, while closely linked to inflation, are also beyond the scope of this paper.

Because of the complexity of the Internal Revenue Code and associated tax rulings, plus the effects of inflation on various taxes, an in-depth analysis will not be attempted. Rather, this paper will conclude with a general discussion of the impact of the increasing tax burden on the economy.

Chapter 2

EMPIRICAL DATA: INFLATION AND PERSONAL TAXES

This section consists mainly of tables of empirical data on inflation and personal taxes. As previously stated, consideration of personal taxes will be limited to the personal income and social security taxes.

Inflation

Available historical data consists of time series on the consumer price index (CPI), the wholesale price index (WPI), and the implicit price deflator for gross national product.[3] While these indices generally show the same trends, even though their bases are different, it is useful to be able to see at a glance how inflation affects different indices and sectors of the economy.

The evidence on inflation from 1935-1975 is shown in Table 1. All data has been adjusted to the same base year, 1967. It is evident that inflation has been with us for an extended period, although not at the high level of recent times. According to the CPI, Table 1, prices to the consumer increased by thirty-one percent from 1935-1945; by forty-nine percent from 1945-1955; by eighteen percent from 1955-1965; and by seventy-one percent from 1965-1975. Over the

[3]Hereafter referred to as CPI and WPI, respectively.

Table 1

Consumer Price Index, Wholesale Price Index, and Implicit Price Deflator for Gross National Product: 1935-1975. Index Numbers, 1967=100

Year	Consumer Price Index	Wholesale Price Index	Implicit Price Deflator
1975	161.2	174.9	160.1
1974	147.7	160.1	146.4
1973	133.1	134.7	133.1
1972	125.3	119.1	125.8
1971	121.3	113.9	120.8
1970	116.3	110.4	114.9
1969	109.8	106.5	109.0
1968	104.2	102.5	104.0
1967	100.0	100.0	100.0
1966	97.2	99.8	96.9
1965	94.5	96.6	94.3
1964	92.9	94.7	92.5
1963	91.7	94.5	91.1
1962	90.6	94.8	89.9
1961	89.6	94.5	88.9
1960	88.7	94.9	87.8
1959	87.3	94.8	86.4
1958	86.6	94.6	85.0
1957	84.3	93.3	82.9
1956	81.4	90.7	79.9
1955	80.2	87.8	77.3
1954	80.5	87.6	76.2
1953	80.1	87.4	75.1
1952	79.5	88.6	74.4
1951	77.8	91.1	72.8