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Indexing the Federal Tax System: A Cost-of-Living Approach

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Abstract

In this article, we analyze the indexation of federal taxes, using an approach based on cost-of-living measurement. We use our Tax and Price Index methodology and data base to study an indexed system historically, comparing indexation with the Consumer Price Index (CPI) to actual tax policy, a tax system with constant parameters, and an “exact” indexing scheme. We reach three main conclusions: (a) The sequence of tax reductions implemented between 1967 and 1985 have fallen short of mimicking indexation, (b) wealthier households would have benefited relatively more than lower-income households, and (c) the tax system would have been completely eliminated if indexation had been implemented.

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