

considered, but ranges from as low as 0.46 percent for farms to as high as 2.66 percent for local, suburban, and highway transportation. Column 3 presents the same information as column 2, but subtracts the average percentage from each industry percentage to underline that some industries suffer "overtaxation" and others enjoy "undertaxation."

Estimates of the cost of the tax distortion, based on two probably unrealistic but computationally helpful assumptions, appear in column 4. These two assumptions are (1) that employers pass the tax forward in the form of price adjustments, and (2) that the price elasticity of demand approximates unity in all industries concerned. Granted these assumptions, it follows that, because the tax-induced change in price results in an equal percentage change in quantity in the opposite direction, production will be higher in an undertaxed industry, and lower in an overtaxed industry, than under neutral taxation.

Harberger has demonstrated that the cost of distortion, given the two preceding assumptions, can be approximated as follows:

Under neutral taxation, consumers could buy previously overtaxed products for a lower price and would have to pay more for previously undertaxed products. Assuming an approximately even distribution of consumer preferences, the cost of distortion can be represented graphically by a triangle whose height equals the percentage in column 3 of table 4 times the initial price, and whose base is this same percentage times the initial quantity. For example, in the case of the contract construction industry, the area of this triangle equals $(0.0043)(0.0043)(0.5) = 0.00092$ times the value added in the industry, \$24.2 billion. The result of the computation, \$22.3 million, is shown in column 4.

All told, the uneven taxation illustrated in table 3 resulted in an underproduction in some lines and overproduction in others, for a total cost of distortion of roughly \$660 million.

On the heels of such apparent precision, I wish to reiterate that the figures in table 4 are meant to do no more than indicate order of magnitude, particularly with reference to the current situation. Quite aside from the conceptual limitations of the mathematical approach,¹⁵ there is the further problem that since 1963 the relationships shown in column 2 have changed, primarily because the ceiling on the social security tax base has risen from \$4,800 to \$6,600 and the rate, from 3.625 to 4.4 percent. Nonetheless, the basic point of the table cannot be brushed aside: while the exact amount remains vague, undoubtedly the social security tax results in some degree of wasteful application of the economy's resources.

III. THE TAX ON THE EMPLOYEE

IMPACT ON FAMILY BUDGETS

For many taxpayers, the portion of tax levied on the employee resembles an income tax in a very peculiar version. For lower and median income ranges, the OASDHI tax often takes a larger fraction of the family budget than the Federal income tax, especially when

¹⁵ See Harberger, "The Corporation Income Tax: An Empirical Appraisal", *op. cit.*, pp. 235-236.