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INTEREST AS A SOURCE OF PERSONAL INCOME AND TAX REVENUE*

A Report of the National Bureau of Economic Research

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INTRODUCTION

CHANGES in interest rates in recent years have sometimes given rise to heated controversies about their economic effects and the public policies involved. The present study was not undertaken because of any special concern with such controversies but as part of a larger analysis of income taxation in the United States. Nevertheless, some of the facts revealed may be useful to those who debate policy.

For example, it is relevant to know something about the distribution of interest income in discussing debt management or tax policy. A once popular belief was that the bulk of interest goes to a class of wealthy investors who are enabled to live by clipping bond interest coupons and receiving interest on mortgages rather than by more direct contributions to production. How far this assumption is from the present situation in the United States is indicated by some of the figures contained in this report. It will be found, for example, that the importance of interest as a source of personal income has shrunk strikingly in recent years and that much the greater part of the total interest income re-

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ceived by individuals is received by those with small and moderate incomes.

Another subject of debate is the influence of tax policy on the choice of investments, that is, on the inducement to invest in relatively safe interest-bearing securities as against possibly risky equities, or vice versa. This study offers some revealing evidence in this connection, indicating, among other things, the great importance of the prevailing expectations with respect to the possibilities of capital gains.

Is the tendency to higher interest rates which has been in evidence since 1946, despite some interruptions and reversals, likely to continue, and, if so, are interest rates likely to rise to former peaks? On these questions, too, some light is thrown by analysis of the statistics and related considerations.

It will doubtless surprise many persons to learn that only about one-fourth of the interest income estimated to have been received by individuals in the years 1930-1950 was reported on taxable income tax returns, despite the sharp decreases during the 1940's in the level of personal exemptions and the huge increase in the number of taxable returns filed. What are the important reasons for this fact?

It is the aim of the National Bureau of Economic Research, in this as in its other studies, not to take a position on disputed issues of public policy but rather to make available empirical evidence and impartial analysis for whatever uses may be appropriate.

The present paper begins by tracing the changing absolute and relative importance of personal interest receipts and their changing distribution as between higher and lower income groups. Then it examines the principal causes of the long decline in personal interest income after 1929 and attempts to account, so far as possible, for the fact that only about one-fourth of total personal interest receipts have been reported on taxable individual income tax returns in recent years. The third section of the paper presents some measures of the importance of interest income as a source of tax revenues. The fourth discusses the effects of the progressive income tax rate structure upon interest yields and interest income after taxes and the resulting influence upon incentives to individuals to invest in taxable fixed-interest securities. A final section considers some probable future trends in personal interest income.

I. THE SHIFTING IMPORTANCE OF INTEREST AS A SOURCE OF PERSONAL INCOME

1. *Substantial fluctuations in the absolute and relative importance of interest have occurred since 1913*

Although interest has the reputation of being a relatively stable