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FROM THE EDITORS' DESK

Taxes on Alcohol & Cigarettes

Deeksha Trehan & Aditi Singh

History reveals that commodities which are considered sinful or unhealthy traditionally attract the heaviest duties. In this article, we shall look particularly at alcohol and cigarettes. We shall call those who consume them 'the sinners' and those who abstain from them 'the saints'. The duties levied for the good of our physical and moral well-being we call 'sin taxes'.

The government wishes to curb smoking and drinking because it thinks that society incurs a huge cost due to them. However, this is a myth. The studies which tell the cost that society incurs, known as cost of vice studies, often present grossly exaggerated figures. The temperance group Alcohol Concern, for example, insists that "the cost of alcohol to society is estimated at £17-22 billion, or even as high as £55 billion". The anti-smoking group Action on Smoking and Health says that "the annual cost of smoking to the national economy is £13.74 billion". As Sloan *et al.* note in their book *The Price of Smoking*, "Using the willingness-to-pay value of lost lives, some estimates of smoking-attributable cost have exceeded the gross domestic product of the U.S. manufacturing and health sectors, which is implausible". These studies are dominated by 'costs' which are neither financial nor borne by the taxpayer like intangible costs of premature mortality and emotional distress, lost productivity due to absenteeism, sickness and death and expenditure on the product itself. All these

costs are borne by the 'sinner' himself. The myth that smokers and drinkers are leeches on the taxpayer's arteries persists because the government has no incentive to tell the public that these groups are being exploited and the affected industries dare not advertise the savings that come from lives being cut short by excessive use of their products.

The case of alcohol differs from that of tobacco and 'unhealthy' food in so far as there are additional externalities relating to violence, drink-driving and property damage, but these are covered by existing alcohol taxes with several billion pounds to spare. Even if we use the broadest estimates offered to us in British cost-of-vice studies, the publicly borne costs of drinking amount to less than £7 billion a year. Notwithstanding the fact that these figures exclude the benefits of alcohol, this is less than the £9 billion received by the state each year in alcohol taxes.

The intention behind sin taxes is not always genuine. It is seen that governments increase taxes on cigarettes and alcohol when they are in need of quick cash. The USA fought both the World Wars, the Civil War and the War of 1812 on the back of alcohol taxes. In Germany, taxes on cigarettes rose dramatically during the Second World War, until they made up 80 to 95 per cent of the price of a pack. More recently, faced with his own budget deficit in 2009, Barack Obama raised the federal cigarette tax by 156 per cent, despite having promised a year earlier that "no family making less than \$250,000 a year will see any form of tax increase". Even during election times, when it comes to balancing budgets, voters prefer raising tobacco taxes to other tax increases or cutting crucial programs such as education and public safety. They are easier to collect than income taxes and less visible than direct taxes. Moreover, tax increases on 'sinful' items are considered to be 'righteous'. These taxes are also motivated by base financial considerations. Various US states and several EU countries have purposefully

lowered alcohol and tobacco duties so as to attract foreign companies.

It is often argued that people who consume alcohol and cigarette put pressure on the existing resources, involve in crimes and cost the government too much by deteriorating community health. But smokers and alcoholics die early. 'Saints', on the other hand, require greater expenditure in pensions, nursing care and welfare payments. Lippiatt (1990) found that every 1 per cent decline in US cigarette sales increased life expectancy by 1.45 million years. But these 1.45 million years added \$405 million to the nation's medical costs, whereas a 1 per cent increase in cigarette sales saved \$480 million. In truth, the choice is not between vice-related disease and infinite health, but between "relatively cheap lethal diseases or rather expensive chronic ones", as van Baal *et al.* (2008) put it.

The demand of cigarettes and alcohol is highly inelastic. The price elasticity of cigarettes, for example, is generally held to be between -0.3 to -0.5. The consumption price elasticity of alcohol is at around -0.44. Anti-smoking advocates are, however, less interested in the consumption elasticity (how many units are sold) than in the participation elasticity (how many smokers quit altogether). Price rises are less effective in reducing smoking prevalence than in reducing the number of cigarettes smoked. The participation elasticity for cigarettes is around half of the consumption elasticity at -0.1 to -0.3, meaning that a 10 percent price rise should make 1-3 per cent of smokers quit. If the government increases the prices by levying taxes on them, the fall in demand will be very small. Thus, increasing taxes is far more likely to impoverish consumers than it is to turn them into abstainers. Such levies are better seen as stealth taxes than sin taxes.

These taxes are also doubly regressive because they hit the poor harder. Sin taxes are not normally value added in nature meaning that expensive, high-quality products purchased by the wealthy

comprise of a much smaller proportion of their incomes in the real sense, but are a major proportion of the incomes of the poor. So, the poor end up paying a greater proportion of taxes. Hence, sin taxes lead to rising income inequalities. A study by RTI International shows that cigarette taxes are financially hurting low-income smokers rather than making them more likely to quit. The survey, which looked at more than 13,000 people living in New York state, found that lower-income smokers in the state spent nearly a quarter of their household income on cigarettes compared with an average 2 percent spent by wealthier New York smokers.

If taxes are increased too much, it will be more likely that people will involve in smuggling cigarettes and alcohol illegally and avoid paying the tax, which will in turn, reduce the revenue and deteriorate health at the same time. Moreover, sin taxes fail to affect consumers' behaviors in the way that tax proponents suggest, for instance increasing smokers' propensity to smoke high-tar, high-nicotine cigarettes when the per-pack price is raised and increasing the rate of people mixing their own drinks rather than buying pre-mix alcoholic spirits.

Additionally, it can be proved that sin taxes are not efficient. To take a scenario roughly analogous to Britain in 2012, let us say that there are ten million smokers paying £7.00 per pack. These ten million people represent 21 per cent of the population. A typical estimate of participation elasticity is -0.23, which means that a 10 per cent price hike should reduce smoking prevalence by 2.3 per cent. Persuaded by anti-smoking campaigners that raising prices is the most effective way of cutting the smoking rate, the government duly enacts a 70p (10 per cent) tax increase. Following the elasticity model, 2.3 per cent of smokers find that they can either no longer afford their habit or no longer find that the benefits outweigh the cost. They quit, thereby reducing the smoking population from 10,000,000 to 9,770,000. 230,000 people have become ex-smokers, but at a great cost to the remaining

9,770,000. Since the average smoker consumes thirteen cigarettes a day, the 70p tax hike will cost them an extra £1.6 billion per year, in addition to existing tobacco taxes. The cost of getting each of the 230,000 smokers to quit is therefore £7,055 each—and this is not a one-off payment, it must be paid every year indefinitely. At an annual cost of £1.6 billion, the smoking rate has dropped from 21 per cent to 20.5 per cent. At best, this would eliminate 2.3 per cent of the cost of smoking, but even if we take the most grossly inflated estimate of what that cost might be, it would be a saving of less than £1 billion. The intervention, therefore, would be loss-making. It is surely plausible that there are more efficient ways of helping people to stop smoking than by transferring large sums of money from the target group to the government. Furthermore, the government has no moral claim to this money on remunerative grounds and the tax fails to modify the behavior of 97.7 per cent of the target group.

Sin taxes, however, have been found to reduce smoking prevalence among the youth. Since young drinkers are more price-sensitive, tobacco tax increases are one of the most effective ways to reduce smoking and other tobacco use. However, the harms from levying sin taxes greatly outweigh the benefits. So, we need to look for alternative methods. One could be the introduction of awareness programs on smoking and drinking, especially in schools and colleges. Furthermore, we can argue that sin taxes will benefit society only if the revenues are used in the direction of alleviating health distress through increased enforcement, health promotion and community action, research and treatment, and not as other taxes are used. Dr K Srinath Reddy from the Public Health Foundation of India said in reference to the introduction of a designated sin tax during the 12th five year plan in India, "It can only work if the sin tax collected does not go into the general revenue pool. It's a good idea and will lead to reduced consumption, especially among people with low disposable income, due to

increased prices. The first budget of the National Rural Health Mission actually came from taxes from tobacco." Another, as suggested by Dr. John Spangler of Wake Forest Baptist Medical Center, is that the tax money could be used to distribute low-cost or free smoking cessation medication, or to ramp up tobacco-prevention programs.

A more efficient way would be basing the alcohol excise system on the actual alcohol content in beverages (volumetric tax). If the excise rate is increased for alcohol products generally, then, it should be reduced for low-alcohol products. This would encourage increased marketing of low-alcohol products, which could help in reducing alcohol-related harm.

To conclude, we would just like to say that from an economic point of view, sin taxes are self-defeating in nature. They are only helpful in small amounts of taxes so that the consumption is reduced by small amounts, because if the policy works too well, it will be a problem for the government because it shall lose its revenue source. So the government might like to improve public health, but at the same time, it would not like to improve it too much because of the fear of reducing the revenue earned and the concern for balancing budgets.

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Taxes on Fuel & Plastic Bags

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A fuel tax (a petrol, gasoline or gas tax or a fuel duty) is a form of excise tax imposed on the sale of fuels which are intended for transportation, in most countries. Fuel tax rates vary from one country to another due to varying policies. In this segment, we will analyze the consumer behavior associated with it.

Reasons for imposing Fuel taxes

Environment Protection

Due to the increasing problems of climate change and global warming, policy makers around the world have realised that something needs to be done. Fuel consumption is increasing rapidly (at the rate of approximately 4% in India); a major cause being vehicles. They are a leading source of air pollution, generating 13% of global emissions of greenhouse gases. Thus, a reduction in fuel use is needed. This can be ensured by a rise in fuel prices via taxation. Higher taxes can spur cuts in driving, fuel-efficient vehicles, and consequently a reduction in polluting emissions, congestion, and traffic accidents.

Although environmental taxes are often considered politically infeasible, Western Europe has experimented with fuel taxes and they did have a significant environmental impact. Fuel prices, and the external environmental costs of energy consumption are predicted to increase significantly in the future due to growing demand and rising production costs, so higher fuel taxes in the present are justified to increase transport system efficiency so that future economy is less burdened by excessive fuel costs. The important question to ask is the extent to which households will alter their behavior when they face higher fuel prices?

Revenue Generation

The governments of many countries impose fuel taxes as a source of revenue generation. This revenue is diverted towards filling up the fiscal deficits due to the fuel subsidies provided to some sections of society. They help finance transportation programs. Some economists even suggest increasing fuel taxes as part of a revenue-neutral tax shift, which means increasing taxes on resources such as fuel to fund reductions in more economically harmful taxes, such as those on income and investments.

Behavioral impact on consumers and distributive effects of fuel taxes

Fuel taxes have sometimes been criticized on distributional grounds due to a perception that fuel taxes are regressive as they impose a larger burden on poor people. Some studies contradict this argument saying that fuel taxes are in fact progressive. These studies have shown to be varying according to the developmental and income status of countries. We are going to analyze the distributional effects of fuel tax in both developed and developing nations with the help of specific case studies.