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RESEARCH SUMMARY

REGRESSIVE EFFECTS
Causes and Consequences of Selective Consumption Taxation

Governments often impose selective taxes on goods deemed to be unhealthy or poor choices. These taxes are often referred to as “sin taxes” in the academic literature and in policy circles. They may target items such as sugary drinks, candy, alcohol, and tobacco, and are designed to mitigate the social cost of consuming these goods. The question for policymakers is whether these taxes are beneficial to consumers and to society as a whole.

In a new study for the Mercatus Center at George Mason University, scholars Adam Hoffer, Rejeana Gvillo, William F. Shughart II, and Michael D. Thomas show that selective consumption taxes may do little to change behavior and that the poor spend a far greater percentage of their disposable budgets on these selective consumption taxes. The study concludes that selective consumption taxes are both ineffective and regressive, and that improving education and increasing the availability of healthier goods may be better steps than raising taxes on those who can least afford them.

DESIGN AND THEORY

The study explores how consumption of 12 goods varies across incomes by calculating the goods’ income-expenditure elasticities (whether income affects consumers’ demand for the goods). The 12 goods are alcohol, cigarettes, fast food, items sold at vending machines, purchases of food away from home, cookies, cakes, chips, candy, donuts, bacon, and carbonated soft drinks. Data come from the Bureau of Labor Statistics Consumer Expenditure surveys for 2009 through 2012.

Price Elasticity vs. Price Inelasticity
Goods can range from very price elastic (as prices increase, demand will decrease substantially) to very price inelastic (as prices increase, demand will stay relatively the same). Some of the goods examined simply do not have healthier substitutes, or consumers are not willing to substitute.

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Theory Behind Selective Taxes

Selective taxes will increase the market prices of the targeted goods. This being the case, the quantities of the taxed goods consumers buy will fall and the quantities of untaxed or lesser-taxed goods consumers buy will rise. Consumption of disfavored goods, such as sugary beverages or cookies, can lead to health-related problems. Theoretically, then, reducing the quantity of these goods that consumers buy could provide a health benefit to society. However, a review of the academic literature shows that the goods studied are price inelastic and consumers who switch to substitutes tend to switch to goods equally high in calories.

KEY FINDINGS

Selective Taxes are Regressive

People with lower incomes tend to spend a much larger percentage of their budgets on disfavored goods than wealthier people do.

- Searching for adequate substitutes for certain goods can be time-consuming, costly, or otherwise undesirable. For example, switching from potato chips to apple slices may sound like a great idea, but if for whatever reason the apple slices are more expensive or more difficult to get, consumers will not switch. Moreover, some substitutes may not be healthier than the original good. A good example of this would be switching from soft drinks to fruit juice even though such a switch may not reduce calories in the daily diet.

- Approximately 2.3 million American families live more than a mile away from a grocery store and do not own a car. Areas without a grocery store within walking distance are called "food deserts" and include many lower-income neighborhoods. Lack of access to the full range of food choices limits some consumers, particularly lower-income consumers, in their ability to choose healthier substitutes for taxed goods.

Selective Taxes are Ineffective

Quantities purchased of the 12 considered goods decrease little in response to increases in their prices, including increases caused by imposing new selective sales or excise taxes or raising existing tax rates.

The evidence shows that the link between selective taxes and consumption of alcohol, sugary drinks, snack food, and other elements of poor diets is weak. This being the case, selective consumption taxes are unlikely to slow or reverse the ongoing obesity "epidemic."

CONCLUSION

Individuals who continue to purchase "unhealthy" items after a tax has been levied or raised will see a decline in their disposable income—the money they have available for spending on other goods—making it more difficult for them to climb out of poverty. Stuck in poverty, these individuals will also be unable to adopt healthier diets, or to change their behaviors in the ways desired by the supporters of selective consumption taxes. Because the types of goods targeted by these taxes have relatively inelastic demand—meaning consumers will keep purchasing them regardless of increases in price—the taxes are regressive in nature. A better way to reduce unhealthy eating habits would be to introduce healthy alternatives in areas where none were available previously and to educate people regarding healthy choices in their daily diets. These are less intrusive ideas that do not involve raising taxes on the poor.