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TAXING SIN

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Sin taxes in modern economic terms amount to excise, or per unit, taxes that are chiefly designed to reduce specific behaviors thought to be harmful to society.[1] Sin taxes have played roles of varying importance throughout U.S. tax history. The ever-expanding list of taxable "sins" proposed by governments includes cigarettes, alcoholic beverages, gasoline, bullets, and, more recently, sugary soft drinks and fatty snacks.

In 1790, Alexander Hamilton proposed the first excise tax on whiskey to refund Revolutionary War debts, following Adam Smith's direction in the Wealth of Nations.[2] Made immortal by the rebellion it spawned, Hamilton's whiskey tax was subsequently rescinded, but selective excise taxes have hardly disappeared. History reveals that federal excise taxes have been predominantly enacted as wartime emergency measures, and the majority of the taxes were customarily repealed when hostilities ended. Recently, however, the arguments for imposing new excise taxes and increasing existing ones have reemerged across party lines and have spawned several myths about the efficacy of sin taxation.[3]

MYTH 1: SIN TAXES DISCOURAGE UNHEALTHY BEHAVIORS

State and local governments are increasingly imposing sin taxes as political activists try to force Americans to adopt their own version of "clean living."[4] These taxes are designed to raise prices so that "sinful" goods become so expensive that consumers will give them up for something healthier. However, this rarely happens.

Research has shown that when the price of a "sinful" good increases, consumers often substitute an equally "bad" good in its place. For example, two studies found that teen marijuana consumption increased when states raised beer taxes or increased the minimum drinking age. Another study found that smokers in high-tax states are more likely to smoke cigarettes that are longer and higher in tar and nicotine than smokers in low-tax states. Specifically, they discovered that young adults aged 18–24 are much more responsive to tax changes than older smokers. For young smokers, the switch to cigarettes with higher tar and nicotine is so large that tax hikes actually increase average daily tar and nicotine consumption.[5]

The federal government has also attempted to impose "hefty" taxes on sugared sodas and sports drinks to reduce obesity in the United States.[6] The assumption is that this sin tax would reduce caloric intake because consumers would stop drinking high-calorie drinks and/or switch to lower-calorie drinks. However, as table 1 shows, if consumers respond to the proposed sin tax on sodas and sports drinks by switching to some of the potential substitute drinks, their caloric intake would either remain the same or actually increase.

MYTH 2: SIN TAXES ARE A GOOD WAY TO RAISE REVENUE

TABLE 1: CALORIES PER CUP OF POPULAR DRINKS

DRINK	CALORIES PER CUP
Gatorade	63[1]
Coca-Cola	97[3]
Orange juice	105[1]
Apple juice (unsweetened)	117[1]
2% milk	120[2]
Homemade cocoa with skim milk	135[1]
Sweetened lemonade	131[5]
Whole chocolate milk (4%)	208[4]
Red wine	200[2]

Sources: (1) http://www.dietbites.com/CalorieIndesDrinks.html/, (2) http://caloriecount.about.com/calories-wine-table-red-i14096/, (3) http://caloriecount.about.com/calories-coca-cola-classic-i98047/, (4) http://caloriecount.about.com/calories-milk-chocolate-fluid-commercial-i1102/, (5) http://www.thedailyplate.com/nutrition-calories/food/generic/lemonade/.

Although the underlying rationale for sin taxes is to discourage consumption of "sinful" products, it is often argued that the tax would also help raise revenue that would, in turn, be used to finance projects like federal health insurance. The problem with this argument is that these regulatory and revenue-raising justifications work at cross-purposes. If the tax is actually effective at discouraging consumption of a "sinful" good, after all, then there would be very little revenue raised because people would purchase much less of the more expensive good in question.

To help solve the obesity problem, some localities have already begun to impose "hefty" taxes on sugared sodas and sports drinks to reduce obesity in the United States.[7] This appears to be most true for cigarette taxes as many continue to purchase cigarettes at the higher taxed prices.[8] Recent antismoking initiatives at the federal, state, and local levels have gained unprecedented popular support, probably because of their ability to raise revenue. For instance, President Obama recently signed a law that increased federal tobacco excise taxes on a pack of cigarettes from $0.39 per pack to $1.01.[9] However, as we shall see, the revenue raised is hardly ever used for its proposed purpose.

Furthermore, if the object is to raise the most revenue, economists generally prefer broad-based taxes to narrow-based "sin" taxes on efficiency grounds. In other words, economists have generally argued that the welfare loss resulting from excise taxation is significant enough to justify "spreading" taxes across many commodities.[10]

MYTH 3: PRIMARY SUPPORT FOR SIN TAXATION COMES FROM CIVIC-MINDED CITIZENS

Generally speaking, people support taxes that benefit them directly; that is, they lobby for taxes to receive "rents." In many cases, two dissimilar groups may support taxes for completely different reasons and be wooed by revenue-hungry politicians. Bruce Yandle calls this phenomenon "Bootleggers and Baptists," an expression derived from an unlikely alliance that formed during Prohibition.[11] Bootleggers, or those who smuggled alcohol illegally, gain business at the expense of their legal competitors, while Baptists, who sought to reduce alcohol consumption, see their moral goals legislated. For the result to be durable, both parts of the coalition must remain in place. For instance, the cooperation of "Baptist" government officials and ethanol producers have kept ethanol subsidies in place.

Another example of rent seeking is the 1987 lobbying effort by a coalition of nonprofit organizations to more than triple California's cigarette tax from 10 to 35 cents a pack.[12] The tax was expected to raise over $500 million annually, much of which would ostensibly go to these very organizations for research, indigent medical care, and antismoking "education" campaigns. This obviously represents a huge conflict of interest for the nonprofit organizations: Are their lobbying efforts directed at the cause they fight or merely at raising funds for their organizations? When tax receipts first became available, the president of one of these nonprofits, the California Medical Association, actually admitted to legislators that his organization and the health charities were "fighting for this money like jackals over a carcass."[13]

Nonprofits fighting for a particular cause also have to fear competition from the government. Often, they end up having to fight against politicians who are first and foremost interested in increasing government funding. For instance, a coalition of California nonprofit antismoking organizations, directed by the umbrella group Americans for Nonsmokers' Rights, brazenly sued Governor Pete Wilson for "illegally diverting" more than $165 million that supposedly should have been spent on "education" programs and instead was "improperly used for health screening and immunization of poor children.[14] In fact, there is never any guarantee that tax funds will be used as advertised, and there is very little public control. These funds usually go into the general fund or toward other politically favored causes.

MYTH 4: SIN TAXES ARE FAIR

Sin taxes are regressive, falling disproportionately on consumers at the lower end of the income distribution.[15] Not only do "lower income classes tend to lose slightly more of their total income than higher income classes..." on a wide range of excise-taxed products, but Daniel Suits actually found that excise taxes are the most regressive form of taxation.[16]

A significant number of studies, though somewhat controversial, argue that excise taxes have negative health consequences because they crowd out private expenditures, a portion of which would have been spent on private health and safety measures. This means that by instituting sin taxes, the government is effectively preventing people from spending their own money on things like safer cars, preventive medical check-ups, baby gates, and smoke detectors. Evidence shows that for every $15 million taken out of the hands of consumers, there is one statistical death.[17] Another paper finds statistical evidence that the poor suffer more on the health front from dollars being crowded out by government policies.[18]

MYTH 5: SIN TAXES ARE THE BEST WAY TO CHANGE UNDESIRED BEHAVIOR

If the objective of sin taxation is to alter "objectionable" behavior, less-costly options exist in the private sector. For example, a coalition of scientists, academics, health organizations, food producers, and retailers developed the Smart Choices Program to better inform consumers about the nutritional characteristics of food.[19] Through its front-of-pack labeling program, Smart Choices identifies healthier food and beverage choices within specified product categories. Unlike coercive government measures to tax unhealthy foods and beverages, this program provides the information people need to stay within their recommended caloric intake and make product-by-product nutritional comparisons at their discretion.

Another example is given by the Phoenix Companies Inc. insurance company, which has started offering discounts to customers who maintain a low Body Mass Index (BMI).[20] Their program offers discounts up to 20 percent on life insurance policies to customers whose BMI is verified by a doctor to be between 19 to 25.[21] In fact, most insurance companies already provide a discount for customers who do not smoke or drink.[22] Private market programs and products like these that encourage and reward healthy lifestyles instead of punishing personal choices are more efficient solutions to curbing obesity than sin taxes on unhealthy products.

So-called sin taxes, even those passed with the best of intentions, have undesirable consequences because they contradict basic principles of economics, finance and, most importantly, free choice.

CONCLUSION

So-called sin taxes, even those passed with the best of intentions, have undesirable consequences because they contradict basic principles of economics, finance and, most importantly, free choice. In general, since proposals to tax lifestyle choices are concentrated on narrow consumer choices, they are rarely efficient. What's more, taxing sin usually does not end up significantly altering the "sinful" behavior but rather rewards the very private organizations or politicians who have lobbied for the tax. Also, sin tax revenue is collected primarily at the expense of the poor and crowds out private expenditures on health care.

Sin tax activists strongly believe that most citizens are inherently incapable of making consumption decisions for themselves. Carried to its logical extreme, "the notion that any product or lifestyle choice that even remotely contributes to health care costs should be taxed to help finance public spending would leave nothing untaxed."[23] Once it becomes "legitimate for government to protect individuals from their own follies,"[24] there is no way to establish limits to governmental powers. As Nobel Prize winner James Buchanan pointed out, any attempt of a government to restrict private consumption choices with sin taxes is nothing but a "meddlesome preference."[25]

ENDNOTES

1. Adam Gifford, Jr., " Whiskey, Margarine, and Newspapers: A Tale of Three Taxes," in William F. Shughart II, ed., *Taxing Choice: The Predatory Politics of Fiscal Discrimination* (New Brunswick, NJ: Transaction Publishers, Rutgers—The State University of New Jersey, 1998), 57–77.

2. Gary M. Anderson, "Bureaucratic Incentives and the Transition from Taxes to Prohibition," in William F. Shughart II, ed., *Taxing Choice*, 139–161. There were, of course, numerous inconsistencies in Smith's discussion of the revenue maximization objectives of government, despite the extensive application of his ideas to promote the revenue-generating power of taxes on "sin" even today. See Kelly D. Brownell and Thomas R. Frieden, "Ounces of Prevention—The Public Policy Case for Taxes on Sugared Beverages," http://www.yaleruddcenter.org/resources/upload/docs/what/industry/SodaTaxNEJMApr09.pdf/.

3. Breanda Yelvington, "Excise Taxes in Historical Perspective," in William F. Shughart II, ed., *Taxing Choice*, 31–56.

4. Thomas J. DiLorenzo, "Taxing Choice to Fund Politically Correct Propaganda," in William F. Shughart II, ed., *Taxing Choice*, 117–138.

5. William N. Evans and Matthew C. Farrelly, "The compensating behavior of smokers: taxes, tar and nicotine," *The RAND Journal of Economics* 29, no. 3 (Autumn 1998): 578–595, http://www.jstor.org.mutex.gmu.edu/stable/pdfplus/2556105.pdf/.

6. Anemona Hartocollis, "New York Health Official Calls for Tax on Drinks with Sugar," *The New York Times*, April 8, 2009, http://www.nytimes.com/2009/04/09/health/09soda.html/.

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9. National Conference of State Legislatures, "2009 Proposed State Tobacco Tax Increase Legislation," http://www.ncsl.org/programs/health/Tobacco_Tax_bill09.htm/ (updated May 21, 2009).

10. Harold Hotelling, "The General Welfare in Relation to Problems of Taxation and Railway and Utility Rates," *Econometrica* 6 (July 1938), 242–69, in Paula A. Gant and Robert B. Ekelund, Jr., "Excise Taxes, Social Costs, and the Consumption of Wine," in William F. Shughart II, ed., *Taxing Choice*, 247–269.

11. Bruce Yandle, "Bootleggers and Baptists in Retrospect," *Regulation* 22, no. 3 (1999).

12. The coalition consisted of the American Cancer Society (ACS), American Lung Association (ALA), American Heart Association (AHA), and California Medical Association (CMA).

13. Thomas J. DiLorenzo, "Taxing Choice to Fund Politically Correct Propaganda," in William F. Shughart II, ed., *Taxing Choice*, 117–138.

14. Yelvington, "Excise Taxes in Historical Perspective," 31–56.

15. Ibid.

16. Daniel B. Suits, "Measurement of Tax Progressivity," *American Economics Review* 67, September 1977: 742–52, in Gant andEkelund, "Excise Taxes, Social Costs, and the Consumption of Wine," in William F. Shughart II, ed., Taxing Choice, 247–269.

17. Randall Lutter, et al., "The Cost-Per-Life-Saved Cutoff for Safety-Enhancing Regulations," *Economic Inquiry* 37 (1999): 599.

18. Jackie Teague, Don Anderson, and Fred Kuchler, "Health Transfers: An Application of Health-Health Analysis to Assess Food Safety Regulations," *Risk*, 1999.

19. Smart Choices Program, "About the Coalition," http://www.smartchoicesprogram.com/about.html/.

20. MSNBC, "Shrink your BMI—and your insurance bill: Insurers offers discounts on policies for slender customers," http://www.msnbc.msn.com/id/17385151/.

21. BMI is a measure of body fat that based on an individual's height and weight. The Centers for Disease Control and Prevention defines obesity as a BMI of 30 or more; people between 25 and 30 are considered overweight. See Office of the Surgeon General, *The Surgeon General's Call to Action to Prevent and Decrease Overweight and Obesity 2001* (Rockville, MD: U.S. Department of Health and Human Services, 2001), http://www.surgeongeneral.gov/topics/obesity/calltoaction/CalltoAction.pdf/.

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23. William F. Shughart II, "Introduction and Overview," in William F. Shughart II, ed., *Taxing Choice*, 1–9.

24. Thomas J. DiLorenzo, "Taxing Choice to Fund Politically Correct Propaganda," in William F. Shughart II, ed., *Taxing Choice*, 117–138.

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