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CHAPTER 1

Selective Consumption Taxes in Historical Perspective

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Imposts, excises, and, in general, all duties upon articles of consumption, may be compared to a fluid, which will, in time, find its level with the means of paying them. The amount to be contributed by each citizen will in a degree be at his own option, and can be regulated by an attention to his resources. The rich may be extravagant, the poor can be frugal; and private oppression may always be avoided by a judicious selection of objects proper for such impositions. . . .

It is a signal advantage of taxes on articles of consumption, that they contain in their own nature a security against excess. They prescribe their own limit; which cannot be exceeded without defeating the end proposed, that is, an extension of the revenue. When applied to this object, the saying is as just as it is witty, that, "in political arithmetic, two and two do not always make four."

If duties are too high, they lessen the consumption; the collection is eluded; and the product to the treasury is not so great as when they are confined within proper and moderate bounds.

—*Alexander Hamilton, Federalist No. 21*

Until the ratification of the Sixteenth Amendment to the US Constitution in 1913, which authorized the collection of taxes on incomes, the federal government of the United States relied heavily on indirect taxes (import duties and selective excises) to generate revenue.¹ In 1912, for example, internal tax receipts (90.4 percent of which were generated by various excise taxes) represented just over half (50.8 percent) of all federal revenues; customs duties accounted for most of the rest (40.8 percent of the total) (Yelvington 1997, 44, 47). As a matter of fact, until 1862, following the outbreak of the War between the States in April 1861 and the disruption of the nation's international trade triggered by the secession of the Confederacy's thirteen member states, import duties comprised all or nearly all of the US government's revenues (Yelvington 1997, 45–46).

That source of revenue began drying up from 1914 onward as the income tax rose in importance and two global wars, the Great Depression, and protectionist trade policies (e.g., the Smoot-Hawley tariff and international retaliation to it) caused customs duties to fall off the fiscal cliff.² Taxes on foreign goods imported into the United States nowadays produce only about 2 percent of the federal government's total revenues; excise taxes account for roughly twice that percentage. Except for intermittent one-off proceeds from sales of federal lands and auctions of parts of the radio spectrum and of drilling rights to energy producers both offshore and on, taxes on individual and corporate incomes combined are responsible for the bulk of current federal gross receipts.

The fiscal stances of the US states differ markedly on the revenue side of the ledger from that of the federal government. In 2014, the latest year for which data on tax receipts are available from the US Census Bureau's *Annual Survey of State Government Finances*, the fifty states collected more than \$865.8 billion in total taxes altogether, of which "general sales and gross receipts taxes" accounted for 31.3 percent and "selective sales and gross receipts taxes" accounted for 16.2 percent.³ Individual income and corporate net income taxes accounted for another 41.2 percent of total state tax revenues, with license fees and all other taxes (e.g., severance taxes, property taxes, death and gift taxes, documentary and stock transfer taxes) completing the picture.

Those revenue sources vary considerably both across states and over time. Some states do not tax individual incomes at all, and some do not levy general sales taxes. Some states run lottery games or tax land- or water-based casinos; gambling is illegal in others. Taxes imposed at the wholesale level or retail markups on wholesale prices brought in just under \$7.5 billion in revenue in

the 15 states that operate state liquor store monopolies. Taxes levied at local (city and county) levels of government also vary a great deal, defying efforts to summarize neatly the extent to which subnational governments in the United States rely on selective consumption taxes. For that reason, this chapter focuses on tax policies at the federal level. In the sections that follow, I supply a thumbnail sketch of the evolution of the selective sales and excise taxes from colonial times to the present day.

COLONIAL EXCISES

Americans have paid selective excise taxes since colonial times.⁴ Such taxes initially were imposed on the colonists by Great Britain's King George III as a means of helping defray the costs of the British troops deployed to America. These troops were used to protect his subjects from the death and destruction wreaked by Native American tribes in response to the pressures on their customary ways of life inflicted by colonists inexorably moving west to occupy and settle Indian homelands.⁵ Although the excise tax on tea (and the Boston Tea Party in reaction to it) is perhaps better known, the Stamp Act of April 1765—the first internal, indirect tax levied on the colonies by Westminster—was in fact the flashpoint that eventually triggered the American Revolution (Watkins 2016, 47). That law required the colonists to buy special paper embossed or imprinted with an official symbol for documenting legal and commercial transactions (e.g., marriage licenses, bonds, contracts, deeds, and bills of sale) in order for them to be recognized and enforceable in a British colonial court; it in essence imposed a tax on paper goods, including newspapers and playing cards (Smith 2011a).⁶

The colonists' reaction to the Stamp Act echoed Samuel Johnson's definition of *excise* in his justly famous *Dictionary of the English Language* as "a hateful tax levied upon commodities, and adjudged not by common judges of property, but by wretches hired by those to whom the excise is paid" (quoted in Yelvington 1997, 33).⁷ Witnessing the same heavy-handed tax-law enforcement some colonists had seen before emigrating from England, mob violence erupted in Boston seven months before the Stamp Act was scheduled to go into effect; it soon spread to the 12 other colonies. The mobs targeted the local officials granted authority to distribute stamped paper, pressuring them to resign their offices to avoid a hangman's noose (Smith 2011a). The mobs destroyed property, including warehouses and the home of Thomas Hutchinson, Massachusetts's lieutenant governor and chief justice. By the time

the law went into effect on November 1, 1765, only Georgia's stamped paper distributor remained in place; he resigned just two weeks later (Smith 2011b).

Excises were hated in England and in its American colonies owing to the system used to collect them. Tax collectors were supplied with incentives to collect as much revenue as possible;⁸ they had authority to enter private homes, cargo ships, and warehouses to search for and seize contraband goods for non-payment of taxes. Britain's colonial revenue agents, sometimes accompanied by armed British soldiers, predictably abused that authority. In the words of the Declaration of Independence, besides imposing taxes on the colonies without colonial representation in Parliament or their representatives' consent, King George had "erected a multitude of New Offices, and sent hither swarms of Officers to [harass] our people, and eat out their substance."

Their victory eventually won at Yorktown with General Charles Cornwallis's surrender to troops led by the Marquis de Lafayette on October 19, 1781,⁹ the citizens of the newly independent United States of America might have felt considerable relief and satisfaction from throwing off the yoke of the hated British excise tax. If so, subsequent history was not very kind to US taxpayers. The original thirteen colonies, now the thirteen states, ended the Revolutionary War with massive debts incurred to mobilize and provision the troops that General, now President, George Washington had enlisted to defeat George III's army. That accumulated debt was a key concern of Alexander Hamilton, the new nation's first treasury secretary. To prevent unraveling of the Constitution agreed to at Philadelphia in 1786—a document he, in collaboration with James Madison and John Jay, had supported strongly in contributions to the *Federalist Papers*—Hamilton lobbied vigorously for the new federal government to take responsibility for paying them. But from whence was the revenue to be raised?

Under the Articles of Confederation that prior to 1787 governed the thirteen states, the central government had no taxing authority; it could only requisition funds from the Confederation's members to support general spending requirements, with no power to compel payment of what essentially were voluntary contributions (Watkins 2016). Seen as one of the Articles' major defects, taxing authority was granted to the US Congress in Article I, Section 2, of the Constitution, which provides for the collection of "direct taxes . . . apportioned among the several States" on the basis of their respective populations. That constitutional provision meant that any direct taxes levied by the national government had to be "uniform," a restriction that "was taken seriously" at the time (Gifford 1997, 61).

THE FEDERAL EXCISE TAX ON DISTILLED SPIRITS AND THE WHISKEY REBELLION

Treasury Secretary Hamilton's first measure to raise the revenue required to pay off the states' Revolutionary War debts was to impose a selective federal excise tax on whiskey. Submitted to Congress in June 1790, the whiskey tax bill elicited vigorous opposition, not only because the hated excise had returned to America when the Constitution's ink barely was dry, but also because the tax had consequences that were perhaps unintended, although foreseeable.

The tax collection system became a particular source of grievance after the whiskey tax's implementation in 1791. As in ancien régime France, authority to collect the tax on whiskey was placed in private hands—those of tax farmers who paid lump sums into the federal treasury in return for the right to assess and gather tax payments owed by the distillers operating within defined taxing jurisdictions. The office of tax farmer was valuable to the extent that the tax collectors were able to keep any payments collected from taxpayers over and above the amounts paid for tax collection rights. Not surprisingly, the tax farmers worked assiduously, often abusively violating private property rights by entering barns and cellars to harvest as much tax revenue as humanly possible, including a 4 percent take on any bootleg whiskey they uncovered and seized. The tax farmers were hated, and some were tarred and feathered (Adams [1993] 2001, 321–26; Yelvington 1997, 34) as had been done to colonial sympathizers of the British Crown by the rebels prior to Independence (Roberts [1940] 1999).

The tax redistributed wealth interregionally (from the South and West to the East) and within the whiskey distilling industry itself (from distillers of relatively low-quality spirits, which tended to be small, to larger distillers producing and marketing higher quality whiskey). Grain farmers located on the western borders of Pennsylvania, Virginia, and North Carolina were especially hard hit by Hamilton's whiskey tax. Prior to its implementation in 1791, the farmers there had concluded that distilling whiskey locally and shipping spirits to markets in the East was more profitable than bearing the cost of transporting bulky, low-value-to-weight grains to those same markets over the Allegheny Mountains on poor roads. Paying the new whiskey tax ate substantially into those profits. The distillers in the West and South also produced whiskey of lower quality and in smaller batches than did the larger distillers located in the eastern United States. A uniform tax levied per gallon of whiskey, regardless of quality, effectively reduced the relative prices of Eastern spirits (Gifford 1997, 61, citing Barzel 1976; also see Razzolini et al. 2003).¹⁰

The sectional grievances created by the first federal excise tax ignited what has since been called the Whiskey Rebellion, which erupted in 1794, when grain farmers in western Pennsylvania refused to pay it. The uprising was quelled by militia units dispatched there by President Washington, fortunately without bloodshed, after the rebels agreed in the face of guns pointed at their heads to comply with the federal tax collectors' demands. A federal excise tax on whiskey and other alcoholic beverages has been in effect since 1791, except during Prohibition, which began in January 1920, following ratification of the Eighteenth Amendment to the US Constitution, and ended in 1933 with repeal of that constitutional provision by the Twenty-First Amendment.¹¹

In addition to Hamilton's revenue-raising aims, the nation's first Treasury secretary seized the moral high ground to justify the federal levy on whiskey, as many proponents of selective sales and excise taxes frequently have done both before and since. Hamilton argued that whiskey constituted a "luxury" good and, moreover, that

the consumption of ardent spirits particularly, no doubt very much on account [of] their cheapness, is carried out to an extreme, which is truly to be regretted, as well as in regard to the health and the morals, as to the economy of the community. (Cooke 1964, 64; quoted in Yelvington 1997, 33)

We thus see here three recurring themes in the history of selective sales and excise taxes in the United States. The first is a politician's or policy-maker's claim of needing additional revenue to finance an essential public spending program, such as extinguishing Revolutionary War debts incurred by the states. Second, selective tax policies almost always create winners and losers, each affected group therefore having strong interests in the outcome of a tax policy debate, either so as to capture financial benefits for themselves or to avoid higher tax bills by shifting the burden onto the shoulders of other, less politically effective groups. Last, but not least, are appeals to higher moral purposes (the public health or other social benefits claimed to flow from the imposition of a new tax or from increasing an existing one) joined with the more parochial interests of groups who stand to gain from a particular selective tax, either by capturing shares of the tax revenue collected from disfavored constituencies and then redistributing it to favored ones or by bringing political influence to bear so that the tax differentially burdens competitors. This last justification applies the "Bootleggers and

Baptists” model of regulation (Smith and Yandle 2014) to the realm of selective tax policy.¹²

MAY THE EXCISE BE WITH YOU ALWAYS

Despite igniting the Whiskey Rebellion in 1794, a new federal excise tax was imposed on horse-drawn carriages, a more plausible luxury good, that same year. The federal excise tax regime soon was extended to include “certain liquors,” snuff, salt, and the proceeds from auction sales. Owing to the high cost of collecting those levies, though, Thomas Jefferson campaigned for the presidency on a platform plank pledging to repeal all the nation’s internal taxes. Except for the tax on salt, which was not rescinded until 1802, Jefferson kept his campaign promise soon after being sworn into office in 1801 (Yelvington 1997, 34–35).

The War of 1812

Wars and other national emergencies supply cover for politicians seizing opportunities to impose new taxes to finance the expenses of mobilizing troops and equipping and deploying them to the battlefield. New federal excise taxes were enacted during the War of 1812, but were short lived; they were temporary revenue measures and passed under a law promising they would expire—and actually did lapse—the next year. Those excise taxes did not elicit strong opposition for two reasons: the war was popular on the home front, and the treasury’s tax farmers had been replaced with a professional tax-collecting federal bureau, a predecessor to today’s Internal Revenue Service (Yelvington 1997, 35; Adams 1998, 81).

The War between the States

From then on, as mentioned previously, taxes on foreign trade—tariffs—returned and remained the national government’s chief source of revenue. Moreover, from 1817 until 1857, the federal government’s budget usually was in the black; those budget surpluses meant that proposals for new sources of tax revenue from internal sources would go unheeded (Yelvington 1997, 37). Washington’s fiscal stance changed dramatically as sectional differences over tariff policy and the issue of slavery boiled over into war in April 1861, when President Abraham Lincoln ordered federal reinforcements to Ft. Sumter (in Charleston, South Carolina’s harbor), which had been encircled onshore and

subsequently bombarded by rebel artillery units commanded by General P. G. T. Beauregard.

Because war interrupted international trade once again, the Union's customs duties declined precipitously, and new sources of revenue were needed to finance President Lincoln's decision not to let secession succeed. The Internal Revenue Act of 1862, signed by the president on the same day (July 1) Congress passed it, imposed the first income tax in US history, although that tax was of doubtful constitutionality and would be repealed 10 years later.¹³ The 1862 law also created an inheritance tax and resurrected "all of the excise taxes, license fees and stamp duties levied by the federal government during the War of 1812" (Yelvington 1997, 37). The stamp duties of 1862 covered a larger set of legal documents and financial transactions than had been taxed in 1813. Every manufactured item was taxed. Ad valorem rates of between 0.3 percent and 1.5 percent were imposed on the gross receipts of various transportation companies (including railroads, ferries, and steamships), of toll bridges, and of advertisers (Yelvington 1997).

As the budgetary cost of the War between the States continued to mount, the Internal Revenue Act of 1864 raised existing federal excise taxes sharply. Tax rates on distilled spirits rose from \$0.20 per proof gallon to \$1.50 (and climbed further to a top rate of \$2 per gallon the next year). The federal tax on loose tobacco more than doubled, and the tax on cigars went from \$3.50 per thousand to \$40 per thousand (Yelvington 1997).

The First World War

All but the 1864 federal liquor and tobacco taxes were repealed either in 1867 or 1870 (Yelvington 1997, 37). But, in any case, as had been true in 1813, raising revenue to finance war spending (rather than social control) was the primary justification for the new federal taxes enacted earlier in the decade. The same reasoning lay behind proposals for imposing new taxes, resurrecting old ones, or increasing existing tax rates in every major conflict the United States later entered as a belligerent. The War Revenue Tax Act of 1913 reauthorized all federal excise taxes of the Civil War period and expanded the list to include theater admissions, jewelry, toilet articles, luggage, and chewing gum. The selective taxes enacted the year before the outbreak of the First World War in August 1914—2 years before the American Expeditionary Force was dispatched to bleed and die in the mud of Belgium and France—eventually were repealed by laws passed in 1924 and 1928. The tobacco, liquor, and stamp duties remained in effect, though (Yelvington 1997, 38).

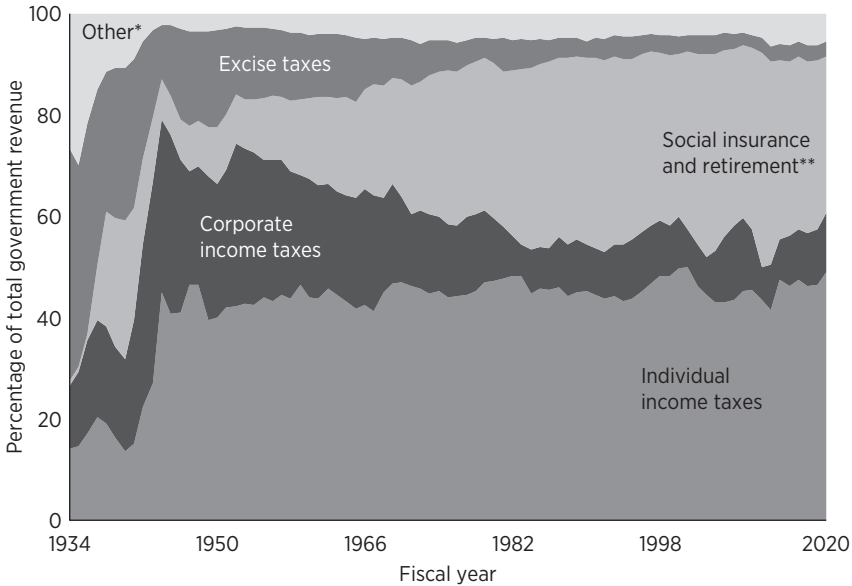
The Great Depression and the Second World War

Selective sales and excise taxes also were important sources of revenue during the Second World War and then the Korean War, as we shall see later. But before Japanese aircraft bombed the US naval base at Pearl Harbor, Hawaii, on December 7, 1941, President Franklin Delano Roosevelt oversaw the return to discriminatory consumption taxation as part of his policy agenda rushed through Congress in response to the Great Depression, during which the US economy collapsed, hitting bottom in 1933, and did not return to normalcy until after the Second World War had ended in 1945.¹⁴ The economy's collapse also meant that federal income tax receipts had declined sharply, along with the revenues from all other taxes linked to economic activity. Prohibition likewise had driven selective taxes on alcohol down to zero as thirsty consumers switched to homemade "bathtub" gin or to the booze supplied illegally by the bootleggers who smuggled Canadian whiskey into the United States.

FDR campaigned for election to the White House in 1932 on a platform that promised in part to support repeal of the Constitution's Eighteenth Amendment, thereby allowing beer, wine, and whiskey to be produced and sold legally in the United States—and then of course taxed again by the federal government as it was before passage of the National Prohibition (Volstead) Act on October 28, 1919. The Twenty-First Amendment, repealing the Eighteenth, was ratified on December 5, 1933, just 8 months after FDR had been inaugurated, and the pre-Prohibition alcohol tax rate of \$1.10 per proof gallon was raised soon thereafter to \$2 (Yelvington 1997, 40).¹⁵

FDR's New Deal imposed federal excise taxes on the manufacturers of "automobiles, trucks, buses, [household] appliances, and other consumer durables" (Yelvington 1997, 40). For the first time, selective consumption taxes were imposed on telephone calls and gasoline. Both of those taxes were passed as temporary revenue measures, but the federal excise tax on long-distance telephone calls—reauthorized by Congress twenty-nine times and eventually applied to local calls—was not repealed until mid-2006, and then only in part.¹⁶ Excise taxes on motor fuels at both the state and federal levels, along with those on alcoholic beverages and tobacco, have, of course, become permanent parts of Americans' daily lives.

Yelvington (1997, 42–49) supplies information on various components of US federal tax receipts from 1791 through 1993, including the totals and percentages accounted for by customs duties and excise taxes. Similar, but not fully comparable, data are reported here in figure 1 for each year running from 1934 through 2020 (the latter of which is estimated).¹⁷ Nevertheless,

Figure 1. Composition of US Federal Receipts by Source

Source: US Office of Management and Budget (n.d.), Historical Table 2.2.

* "Other" comprises principally estate and gift taxes, customs duties and fees, and miscellaneous receipts; for details, see US Office of Management and Budget (n.d.), Historical Table 2.2.

** Payroll tax receipts funding Old Age, Survivors and Disability Insurance plus Medicare. The percentages shown are based on the total amounts generated by payroll taxes, which since 1937 have been divided into "on-budget" and "off-budget" percentages, the latter supposedly being redirected to so-called trust funds. Also see table 1 in this chapter.

the importance of excise tax receipts and the relative unimportance of income taxes to the federal budget during the Depression years of 1934 through 1946 or 1947 stand out clearly.¹⁸

The modern high-water mark of selective federal sales and excise taxes was reached during the New Deal. Such taxes generated between 30 percent and 45 percent of total federal revenues then, a share that fell to 20 percent during the Second World War. The relative contributions of the selective taxation of various goods and services waned, owing primarily to federal income tax increases enacted in response to December 7, 1941 (Yelvington 1997, 41).

After America entered the Second World War (with FDR's New Deal excise taxes still in effect), many existing tax rates were raised, and new ones were introduced. The federal excise tax on alcohol was increased from \$2 to \$9 per proof gallon mainly because the wartime conversion of distilleries to the production of grain alcohol had created a shortage of drinkable spirits on the home front; upward pressures on their market prices may have been seen

by Washington as an opportunity to disguise a major increase in the tax. The rationing of many consumer goods—automobiles (which no longer were being produced at all), gasoline, tires, tubes, leather goods, and refrigerators—was combined with new excise taxation to shift more such products and the inputs used to manufacture them to the war effort. Taxes on admissions and organizational dues also were enacted; “luxuries,” such as “furs, toilet preparations, jewelry, and luggage” were added to the federal excise tax base (Yelvington 1997, 38, quoting Anderson 1951, 409).

Korea and More Modern Times

Consistent with explaining them as temporary war measures, Congress planned to reduce the Second World War’s excise taxes dramatically in the Revenue Act of 1950, thereby reducing federal revenues by \$910 million. But President Truman’s launching of a “police action” in Korea prompted Congress to replace the law’s excise tax cuts by tax increases amounting to \$55 million. Televisions, deep freezers, and diesel fuel were taxed for the first time. Although the existing federal taxes on alcohol and tobacco generated nearly half (47 percent) of Washington’s total excise tax receipts, at least one commentator observed that excise taxpayers had become so comfortable with such levies that considering eliminating them “is not worthwhile. . . . [C]onsumption of . . . particular commodities warrant[s] the payment of a high tax penalty” (Yelvington 1997, 39, quoting Due 1956, 206–7). Put differently, taxpayers then and in more recent times have become “state-broken,” that is, accustomed to a strong government hand (McGraw 2007, 365).¹⁹

The Korean War’s excise tax regime was scaled back and returned to pre-war levels in April 1956. A few years later (in 1965), liquor, tobacco, and gasoline were the major sources of Washington’s excise tax receipts. The justification for collecting the last of those “Big Three” federal excise taxes (on gasoline) was reinvigorated in 1956 when the revenue generated by it, along with the taxes on diesel and other motor fuels, were earmarked for the Highway Trust Fund, created to finance construction and maintenance of the interstate highway system (launched during the Eisenhower administration) and other federal roads. (Federal excise tax revenue from tires and the operations of heavy trucks and buses on federal highways and byways were dedicated to the same fund.) An Airport and Airway Trust Fund was created for similar purposes in 1970, to be financed by federal excise taxes on aviation fuel; commercial airline passengers; and, more recently, by taxes on domestic and international airport departures and arrivals. (Table 1 shows total receipts for all

Table 1. Composition of Social Insurance and Retirement Receipts and of Excise Taxes, Millions of Current Dollars, 2014 (Actual), 2015 (Estimated), and 2018 (Estimated)

	2014	2015	2018
Federal funds			
Alcohol	9,815	9,589	10,547
Tobacco	15,562	15,257	29,019
Crude oil windfall profit ^a	—	—	—
Telephone	611	586	—
Ozone-depleting chemicals/products ^b	—	—	—
Transportation fuels	-3,509	-3,398	-1,026
High-cost health insurance coverage	—	—	736
Health insurance providers	7,987	11,125	14,300
Indoor tanning services	92	95	106
Medical devices	1,977	2,068	2,310
Other	1,705	2,439	2,444
<i>Subtotal</i>	32,240	37,761	58,436
Trust funds			
Transportation	39,049	39,261	39,882
Airports and airways	13,513	13,138	15,987
Black lung disability	579	568	577
Inland waterways	82	97	109
Hazardous substance superfund	—	—	1,064
Post-closure liability (hazardous waste) ^c	—	—	—
Oil spill liability	436	501	770
Aquatic resources	569	534	545
Leaking underground storage tanks	173	205	206
Tobacco assessments	1,140	278	—
Vaccine injury compensation	243	242	262
Supplementary medical insurance	3,209	2,940	4,098
Patient-centered outcomes research	135	373	443
<i>Subtotal</i>	59,128	58,137	63,943
<i>Total Excise Taxes</i>	93,368	95,898	122,379

Source: US Office of Management and Budget (n.d.), Historical Table 2.4.

^a In effect from 1980 through 1986.

^b In effect from 1990 through 2001.

^c In effect from 1981; the fund ran deficits beginning in 1986, which continued through 1990.

major federal excise taxes as of 2014, along with estimated excise tax revenues for 2015 and 2018.)²⁰

The earmarking or dedication of excise tax revenues for specific spending programs like the two trust funds mentioned above is a relatively recent justification for imposing such taxes in the first place. Tax revenue earmarking, especially if the spending program it helps finance is deemed worthy, tends to overcome resistance to a new tax or to an increase in an existing one (Lee 1997). What driver, after all, can complain about paying a tax to finance the

building or repairing of the roads on which he or she travels, thereby adding to the wear and tear on the roads' asphalt or concrete surface? Earmarking seemingly transforms the tax into a user fee, one that imposes heavier charges on people who drive more miles per day, per month, or per year. Similar arguments have been advanced for taxing cigarettes, whose consumers access more public healthcare services for treating smoking-related diseases (but see Viscusi 1994), and for drinkers of alcoholic beverages, who are responsible for disproportionate numbers of highway injuries and deaths.

It turns out, though, that trust funds and other spending programs financed by dedicated excise tax revenues frequently are raided by the politicians who have created them (Hoffer et al. 2014, 2015). The accumulated balances in state and federal highway trust funds have in large part been reallocated to financing public transit systems, including high-speed rail transportation initiatives in California and Florida, thereby breaking the link between taxes paid by motorists and road quality. An overwhelming majority of the payments received by the states in their Master Settlement Agreement with the nation's major tobacco companies has been spent, not as intended to help offset the public sector's costs of treating smoking-related diseases, especially those incurred by Medicaid-eligible patients, but rather to fund more pressing budget priorities (Stevenson and Shughart 2006). Such political redeployment of tax revenues means that tax earmarking rarely results in increases in revenue for the programs to which tax receipts have been dedicated (Crowley and Hoffer, chapter 6, this volume).

Some of the newer federal excise taxes listed in table 1, such as the levies on health insurers, high-cost (so-called Cadillac) health insurance policies, medical devices, and indoor tanning services, were enacted by Congress in 2010 to help pay the Affordable Care Act's estimated \$940 billion price tag (though 2019). (Table 2 reports information on the selective tax rates in effect for selected years from 1944 through 2008.) In 2010, the selective ad valorem tax (10 percent) on the bills of tanning salon customers was projected to raise \$3 billion in new revenue over the next decade. It will raise barely one-third of that amount because, by 2014, more than half (52 percent) of the tanning salons operating in 2010 had gone out of business. The lingering effects of the Great Recession and rising public concerns about skin cancer surely help explain the carnage visited on tanning salon owner/operators (70 percent of whom are women), but the negative effects of a 10 percent tax on the gross revenues of those small businesses was one of the key factors (Faler 2015).²¹

The foregoing summary of the history of selective sales and excise taxation in the United States teaches several lessons. First, combined with customs duties,

Table 2. Federal Selective Tax Rates, Selected Years, 1944–2008

	1944	1954	1964	1990	1995	2000	2002	2003	2008
Liquor									
Spirits ^a	\$9	\$10.50	\$12.50	\$13.50	\$13.50	\$13.50	\$13.50	\$13.50	\$13.50
Still wines ^b									
≤ 14%	15¢	17¢	17¢	17¢	\$1.07	\$1.07	\$1.07	\$1.07	\$1.07
> 14%–21%	60¢	67¢	67¢	\$1.57	\$1.57	\$1.57	\$1.57	\$1.57	\$1.57
> 21%–24%	\$2	\$2.25	\$2.25	\$2.25	\$3.15	\$3.15	\$3.15	\$3.15	\$3.15
Beer ^c	\$6	\$9	\$9	\$9	\$18	\$18	\$18	\$18	\$18
Tobacco^d									
Small cigars	75¢	75¢	75¢	75¢	\$1.125	\$1.594	\$1.828	\$1.828	\$1.828
Large cigars ^e	\$2.50–\$20	\$2.50–\$20	\$2.50–\$20	8.5% up to \$20	\$30	\$42.50	\$48.75	\$48.75	\$48.75
Cigarettes	\$3.50	\$4	\$4	\$8	\$12	\$17	\$19.50–\$40.95	\$19.50–\$40.95	\$19.50–\$40.95
Pipe tobacco ^f	10¢	10¢	10¢	—	—	95.67¢	\$1.10	\$1.10	\$1.10
Manufacturers									
Gasoline ^g	1.5¢	2¢	2¢	9.1¢	18.4¢	18.4¢	18.4¢	18.4¢	18.4¢
Tires	7%	10%	10%	15¢–50¢	15¢–50¢	15¢–50¢	15¢–50¢	15¢–50¢	(h)
Trucks	11%	11%	11%	12%	12%	12%	12%	12%	12%
Firearms ⁱ	11%	11%	11%	11%	11%	11%	11%	11%	11%
Handguns	11%	11%	10%	10%	10%	10%	10%	10%	10%
Bows	—	—	—	11%	11%	11%	11%	11%	11%
Arrow shafts	—	—	—	—	—	—	—	—	42%
Fishing gear	—	10%	10%	10%	10%	10%	10%	10%	10%
Gas guzzlers ^j									
Miscellaneous									
Local calls	15%	10%	10%	3%	3%	3%	3%	3%	3%
Long distance	25%	10%	10%	3%	3%	3%	3%	3%	—
Air passengers	15%	10%	5%	8%	10%	(k)	(l)	(m)	(n)
International departure	—	—	—	\$6	\$6	\$12.40 ^o	\$13.20 ^o	\$13.40 ^o	\$15.10 ^o
Air freight	10%	10%	10%	5%	6.25%	10%	6.25%	6.25%	6.25%
Wagers ^p	10%	10%	10%	2%	0.25%	0.25%	0.25%	0.25%	0.25%
Accepting bets ^q	—	\$50	\$50	\$50	\$50	\$50	\$50	\$50	\$50
Foreign insurance									
Life insurance	1%	1%	1%	1%	1%	—	—	—	—
Other insurance	4%	4%	4%	4%	4%	—	—	—	—

\$1,000–\$7,700

such taxes generated the bulk of Washington's revenue until the authorization of federal taxes on individual (and, later, corporate) incomes in 1913. Second, war and other national emergencies, such as the Great Depression, frequently have afforded opportunities for imposing new federal taxes on the consumption of particular goods and services and raising the rates of existing ones. Third, although selective excise taxes on the traditional "sins" of drinking, smoking, and gambling have been in place since colonial times, the collection of gasoline and motor fuel taxes received a fresh justification in 1956, when their proceeds were earmarked for the Highway Trust Fund, morphing those taxes into so-called user fees, whereby the consumers of the nation's federal road network supposedly pay for the benefits they receive and, moreover, are charged for the environmental damage caused by their tailpipe emissions. Policies dedicating tax revenue for specified spending programs, such as health-care, expanded thereafter. More recently, however, consumers' own choices have become matters of public policy concern following the publication of evidence (and the emergence of political lobbying) by groups claiming that purchasing certain goods and services, such as sugar-sweetened soft drinks and tanning salons, not only harms third parties but also compromises the well-being of consumers themselves. Those new justifications for selective sales and excise taxes are discussed next.

CONCLUSION

Selective consumption taxes are age-old. Customarily levied on the so-called sins of smoking, drinking, and gambling, such taxes mainly are justified on two heads: first, as correctives for the market's "failure" (Bator 1958) to price the external costs (or benefits) of consumption not borne (or captured) by consumers themselves (Pigou [1920] 1952), thereby forcing them to internalize the externalities. Second, they are justified by observing that the demands for those goods tend to be inelastic (meaning that increases in their after-tax prices cause the quantities consumers are willing and able to buy to decline less than proportionately). Such taxes are more efficient (create smaller excess burdens) than those imposed on goods for which consumers are more sensitive to changes in price (Ramsey 1927). Selective taxes on the purchases of sin goods therefore are revenue engines for the public sector because, by their very nature, such taxes do not reduce the consumption of the taxed goods and services very much.

More recently, though, selective sales and excise taxes have been imposed at the US state and federal levels of government not to reduce the purchases

of goods and services plausibly generating negative externalities—that is, harm to innocent third parties (battered spouses and the victims of drunk drivers, for example)—but instead with the aim of protecting the health and welfare of consumers themselves, or what might be called “internalities” (Hoffer and Shughart, chapter 3, this volume). We therefore see taxes imposed on sugar-sweetened beverages and junk food so as to reduce the incidences of obesity-related diabetes and heart disease for consumers’ own good. But, if the demands for such goods also tend to be inelastic, as the econometric evidence suggests they are, taxing those food items will not achieve public health professionals’ stated goal of reducing consumption significantly. Moreover, because all consumption taxes are regressive, the tax burden will fall most heavily on low-income households (Novak 2012; Hoffer et al. 2017; Hoffer and Shughart, chapter 3, this volume).

The elasticity of demand for any taxed good hinges on the availability of substitutes for that good. The substitution possibilities available to consumers, in turn, depend largely on income (which supplies another reason poorer people tend to bear the burden of selective consumption taxes), and on how broadly or narrowly the selective tax base is defined. Berkeley, California’s first-in-the-nation excise tax on sugary soft drinks apparently is being widely avoided by cross-border shoppers, as was Denmark’s first-on-the-planet “fat tax” (also see Shughart 1997; Vedder 1997; Kliff 2012; and Coons and Weber 2013).

Support for selective sales and excise taxation has been reinforced in recent times by the findings reported by behavioral economists and psychologists who claim that consumers’ decision-making is beset by cognitive anomalies inconsistent with the models and predictions of neoclassical economic theory. A fatal flaw in the new behavioral approach to taxation and other governmental interventions in private markets is that the behaviorists neither ascribe those same cognitive failures to public policymakers (Mannix and Dudley 2015; Viscusi and Gayer 2015), nor do they recognize that even if politicians and bureaucrats somehow were immune to such failures, the public policy process is by and large driven by special-interest group influence and not by vague notions of the public’s interest.

NOTES

1. According to one textbook definition, “direct taxes are levied in factor [i.e., input] markets, indirect taxes are levied in [final] product markets” (Hillman 2009, 252).
2. Four years earlier (1910), liquor taxes had accounted for 30 percent of federal revenues (McGirr 2016, 23).

3. Available at <http://www.census.gov/govs/statetax/>. According to the Census Bureau's definitions, selective sales and gross receipt taxes include taxes on alcoholic beverages, tickets or charges for admission to "amusement businesses," insurance companies, motor fuels, pari-mutuel betting, public utilities, tobacco products, and other selective levies (e.g., on margarine and lubricating oils).
4. As defined by Hoffer and Shughart (chap. 4, this volume), sales taxes are levied ad valorem, that is, as percentages of a good's pre-tax retail or wholesale price. Excise taxes, by contrast, are levied as so many cents or dollars per unit purchased. Obviously, the consumer's sales tax bill rises in absolute dollar terms as the taxed good's pre-tax price rises—7 percent of \$1 is less than 7 percent of \$10, for example. An excise tax rate, say 48 cents per gallon of gasoline, is the same on every unit purchased.
5. The bloodshed in North America was called the French and Indian War in the colonies and the Seven Years' War, involving England, France, and Spain, elsewhere.
6. Gifford (2007, 72–74) contends that the excise tax on newspapers was meant to suppress criticism of King George III and that newspaper publishers predictably led opposition to the tax. Such a tax had been imposed in England as early as 1756, was increased several times afterward, up to four pence in 1815, and was not repealed until 1861.
7. Excise taxes also had been imposed in England on liquor; coffee; soap; salt; and, predictably, tea (Yelvington 1997, 33; Adams [1993] 2001, 261–62). For more on the importance of Samuel Johnson's dictionary to the development of the English language, see Reksulak et al. (2004).
8. See more on tax farming in the next section.
9. The victory was formalized by the Treaty of Paris, signed on September 3, 1783.
10. Gifford (1997, 61) notes that if Hamilton's whiskey tax had been levied ad valorem rather than per gallon, distillers in the West would have been favored, because the pre-tax prices of Eastern distilled spirits were roughly twice those of the Western distillers. Assuming that the tax fully had been passed on to consumers, applying the same percentage tax markup uniformly to all whiskey thus would have made Eastern whiskey relatively more expensive.
11. For relevant historical details, see Okrent (2010) and McGirr (2016).
12. Bruce Yandle (1983) coined the phrase "Bootleggers and Baptists" to signify the coalition succeeding in convincing many jurisdictions in the American South to ban alcohol sales on Sunday. Both interest groups gained from such regulations—Baptist preachers from making the Lord's Day "dry" and bootleggers from selling booze illegally to thirsty parishioners. "Methodists and Moonshiners" might be more accurate in the case of national Prohibition (McGirr 2016).
13. Fast forward to the mid-1890s: members of President Grover Cleveland's own Democratic Party introduced and passed legislation resurrecting Lincoln's income tax to offset tariff revenues that were shrinking, not because of war but rather because of domestic economic crisis (the Depression of 1893). The president opposed the measure but allowed the law to take effect without his signature; the income tax was declared unconstitutional in 1895 (Higgs [1987] 2012, 98, 102).
14. It is a (Keynesian) mistake to think that the Great Depression ended in 1941 as America mobilized for the Second World War. The unemployment rate did then decline quickly from double to single digits, but that was only because 8–12 million men eventually were drafted to serve on the front lines and thus no longer stood in soup-kitchen lines. The period from 1941 until 1945 was a command economy ("war socialism") rather than a consumer economy; comparisons with the postwar years thus largely are meaningless (see Shughart 2011, with special attention to the work of Robert Higgs cited therein).
15. During his first weeks in the White House, FDR instructed his advisors to do "something about beer." The "beer bill" the new administration formulated moved swiftly through Congress; beer sales were "relegalized on April 6 [1933]" (McGirr 2016, xiii).

16. Local telephone calls continue to be subject to federal tax, provided that the consumer's tax bill is computed based on the call's length, but not on its distance (see IRS Notice 2006-50, 2006 I.R.B. 25, dated May 25, 2006).
17. Customs duties and fees, for example, are included in "Other," which also includes revenue from estate and gift taxes along with miscellaneous tax receipts. Also shown in figure 1 are payroll tax receipts, levied and collected to finance transfers to social-insurance-eligible recipients—the Old Age, Survivors and Disability Insurance and Medicare programs—which nowadays account for roughly 30 percent of the federal government's total revenue, a fraction that has been rising for a decade and will continue to rise as the population ages and more of the members of the so-called baby boom generation retire from the nation's workforce. As the number of payroll taxpayers per retiree falls, pressures for reforms—such as higher payroll tax rates, cuts in pension benefits, and delays in the ages at which full retirement benefits can be claimed—will mount.
18. Yelvington's (1997, table 2.2, 43) numbers indicate that excise tax receipts represented the following percentages of total "federal internal tax collections" in the 5 years preceding 1934: 15.6 (1929), 15.4 (1930), 18.8 (1931), 26.3 (1932) and 44.4 (1933). Customs duties ranged from 17 percent of total internal tax receipts in 1929 to 13.4 percent in 1933 (Yelvington 1997, table 2.3, 48).
19. Due (1956, 307) writes that Congress would have supported the "retention of an excise on bread and milk if one had been levied during the war" (quoted by Yelvington 1997, 39).
20. Some of the excise taxes listed in table 2, such as the tax imposed in 1980 to clean up hazardous waste disposal sites (the Hazardous Substance Superfund), the tax on ozone-depleting chemicals and the Crude Oil Windfall Profits Tax, are no longer in place. Newer federal excise taxes like the 10 percent federal ad valorem tax levied on the bills of the customers of tanning salons are discussed further below.
21. Former Congressional Budget Office Director Douglas Holtz-Eakin likened the effects of the tanning salon tax to a luxury tax on yachts, imposed as part of a 1990 budget-cutting deal between Congress and President George H. W. Bush, which ended up destroying the US yacht industry (Faler 2015).

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