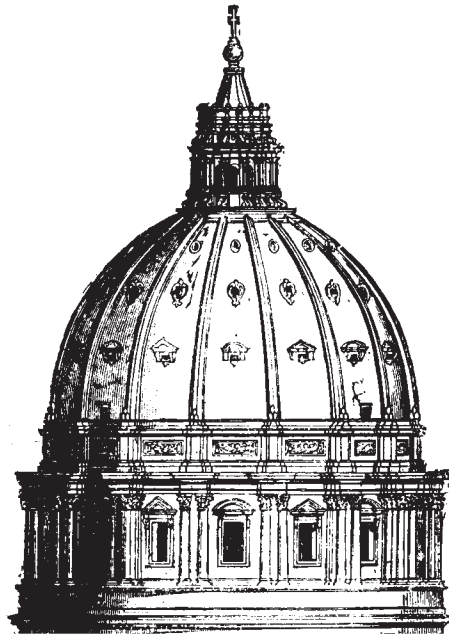


ISSUE BRIEF #4/2010



The Consumer Police and Sin Taxes

BY DAVID WILLIAMS AND
SEAN KENNEDY



1301 Pennsylvania Avenue, N.W.
Suite 1075
Washington, D.C. 20004

1-800-BE-ANGRY

www.cagw.org

CITIZENS AGAINST GOVERNMENT WASTE

Citizens Against Government Waste (CAGW) is a private, nonprofit, nonpartisan organization dedicated to educating the American public about waste, mismanagement, and inefficiency in the federal government.

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Washington, DC 20004
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INTRODUCTION

There have always been and will always be some people that believe they know what is best for everyone, so they try to force their will on the rest of society. This attitude is very much at odds with the philosophy that liberty should be maximized and that people should be allowed to live their lives as they would like as long as they are not infringing on the rights of others.

In recent years, this “we know best” crowd has expanded the number of activities that they believe need policing far beyond the traditional sins that have been targeted for decades and even centuries. These “consumer police” are particularly fond of identifying products that they have decided are bad for people and/or society. The favored method of going after the offending product is through onerous levels of taxation.

Two primary arguments are used to justify efforts to either impose a new tax where none exists or increase an existing tax. First, the tax will discourage the use of the offending product so that individuals will live healthier lives and society will benefit. Second, the tax penalizes bad behavior but doesn't tax the good people who abstain from using sinful products, so taxing these products also turns out to be a great source of revenue to pay for all sorts of wonderful government programs.

This is the second in a series of Citizens Against Government Waste (CAGW) issue briefs demonstrating that government programs and policies purportedly based on good intentions instead result in unexpected and undesirable consequences. This issue brief examines the consequences of existing and proposed sin taxes for a number of consumer products, including alcohol, tobacco, sweetened beverages, high fat foods, candy, and salt.

ORIGINS OF THE SIN TAX MOVEMENT

The sin tax epidemic infects all levels of government, and it is certainly not a new concept. Federal, state, and local governments have been taxing alcohol and tobacco since the first excise tax in the United States was placed on whiskey in 1791.¹

At that time, the federal government was looking for revenue sources in addition to tariffs. It didn't take long after the whiskey tax was adopted before excise taxes were extended to include additional products, such as other liquors, snuff, sugar and salt, similar to today's primary list of sinful products targeted by the consumer police.² Congress learned that “taxes on articles of consumption could be successfully imposed if the articles themselves were portrayed as luxurious or if their use were pronounced harmful to individuals or the economy as a whole.”³

¹ Brenda Yelvington, “Excise Taxes in Historical Perspective,” in William F. Shughart II, ed., *Taxing Choice: The Predatory Politics of Fiscal Discrimination*, New Brunswick, N.J.: Transaction Publishers, Rutgers -The State University of New Jersey, 1998, p. 33.

² *Ibid.*, p. 35.

³ *Ibid.*, p. 34.

TRADITIONAL SIN TAX TARGETS

At the present time, the main sin tax targets of federal, state and local governments are alcohol and tobacco products. Proponents of selective tax increases or the enactment of new targeted taxes believe that “the consumption of certain products, such as alcohol and tobacco, imposes costs on society that the consumers do not themselves bear and which they consequently do not take into account when making decisions about how much to consume.”⁴

Alcohol has always been a relatively easy product to target. From a public health perspective, the tax “deters consumers from exposing themselves to the serious health hazards associated with alcohol abuse.”⁵ There is a public safety argument that drunk drivers can cause harm to others. Temperance advocates also target alcohol.

The federal government and state and local governments impose excise taxes on alcoholic beverages, using varying tax rates based on whether the product is a distilled spirit, wine, or beer. Also, the tax rates on the various products differ widely from state to state. For example, distilled alcohol taxes can be 350 percent higher in the highest taxing states than in the lowest taxing states. Wine and beer tax rates have less variation, with rates in the highest taxing states as much as 30 times greater than the lowest taxing states.

The excise tax situation is similar for tobacco products. The federal, state, and local governments impose excise taxes as well as varying rates of taxation based on whether the products are cigarettes, cigars, or a smokeless product, such as chewing tobacco. The rates of taxation on tobacco also vary widely from state to state.

MASSIVE EXPANSION OF THE SIN TAX TARGETS

Beyond the traditional sin tax targets, alcohol and tobacco, the consumer police have succeeded in expanding the list of targets subject of their ire. At the federal level, the Obama administration proposed a tax on sweetened beverages in order to help pay for the Patient Protection and Affordable Care Act, although the tax was not enacted. However, since the Congressional Budget Office determined that the proposal could raise \$20 billion annually, it is certain to be revisited anytime a new program requires a new source of revenue.

Although few state and local governments have imposed selective excise taxes on sweetened beverages, candy, and so-called high-fat foods, such taxes have been proposed or are being actively considered across the country.

New York City Health Commissioner Thomas R. Frieden and Kelly D. Brownell of Yale University co-authored an article in the New England Journal of Medicine in 2009 advocating “hefty” taxes on sodas and sports drinks containing sugar, which they argued “could be the biggest boon to public health since tobacco taxes.” They contended that a tax of one cent per ounce could reduce

⁴ William F. Shughart II, “The Economics of the Nanny State,” in *Taxing Choice*, p. 21.

⁵ Paula A. Gant and Robert B. Ekelund, Jr., “Excise Taxes, Social Costs, and the Consumption of Wine,” in *Taxing Choice*, p. 248.

consumption by more than 10 percent and raise \$1.2 billion a year in New York State alone.⁶

Consumer police like Brownell and Frieden, who have also led campaigns to ban trans fats and post calorie counts in restaurants in New York City, believe that sodas are the most important target in reducing childhood obesity. They ignore the fact that soft drink sales have been declining for much of this decade, while at the same time obesity rates have been rising, demonstrating the futility of singling out one product as a unique contributor to obesity.

There have been frequent calls for some sort of tax on foods that are deemed to be high in fat content. Also, a consortium of cities, states and health organizations, led by New York City, has announced an initiative aimed at encouraging food manufacturers to voluntarily reduce the amount of salt in processed foods.⁷

This is likely only the first step in this particular consumer police crusade. Inevitably, they will express dissatisfaction with either the reductions proposed by manufacturers or the speed with which the changes are being implemented and demand that excise taxes be imposed in order to address the “crisis.”

As is so often the case in consumer police campaigns, proponents of the new tax burdens rarely consider the impact on consumer preferences, product standards or the fact, for instance, that salt may be a necessary component in the process of manufacturing many foods, such as cheese.

In 17 of the states where legislation seeking to penalize the use of certain consumer products was introduced in 2010, soft drinks or sweetened beverages are targeted for taxation, an indication that these products have become the number one target beyond alcohol and tobacco. Candy seems to be number two, with legislation targeting it for taxation in 11 states. In four states, snacks are specifically targeted and caffeine is targeted in one state.

Three states, however, have legislation that would expand the reach of the consumer police beyond the wildest dreams of the most extreme authoritarian. Legislation introduced in Massachusetts would modify the definition of food under the sales tax exemption to include only whole grain cereals, fruits, vegetables, beans, nuts and seeds. The legislation would specifically delete the existing exemption for soft drinks, candy and confectionery, in addition to all milk products, sugar and sugar products, herbs, spices and salt. That would take the spice out of life.

In New Mexico, there is legislation that would remove the gross receipts tax exemption from soft drinks, sweetened beverages and candy, in addition to potato and corn chips, pretzels, cheese puffs or curls, pork rinds, popped popcorn, cookies, cakes, pies, donuts and other pastries.

Not to be outdone, legislation in Vermont would impose a tax on “high caloric foods with low nutritional value.” The target list includes most of the products targeted in the New Mexico legislation, but adds salsa, beef jerky, roasted nuts, granola and breakfast bars, ice cream, frozen yogurt, sherbet, sauces and syrups, ready-to-eat pudding, processed fruit snacks, fruit rolls, and fruit bars.

⁶ <http://www.nytimes.com/2009/04/09/health/09soda.html/>.

⁷ <http://www.idfa.org/news--views/details/4509>.

If the legislation introduced in these three states is any indication of where the consumer police movement is heading, it appears that they will not stop until they succeed in taking all the joy out of living by restricting free choice of consumer products, or at least penalize anyone for enjoying such consumption.

SIN TAXES' UNINTENDED CONSEQUENCES

Imposing new excise taxes or increasing existing excise taxes has not led to the benefits for society that have been predicted. This has been demonstrated by the results of the numerous tobacco excise tax increases that have been enacted by the states in recent years.

Of the 57 excise tax increases that states implemented between 2003 and 2007, only 16 met or exceeded state revenue projections. New Jersey's 2007 cigarette excise tax increase not only failed to meet revenue projections; it also resulted in a revenue loss of \$22 million. Similarly, in 2009, when Washington, D.C. enacted a cigarette excise tax increase, the result was a revenue loss of \$7.6 million.⁸

The state of Maryland enacted a \$2.00 per pack cigarette excise tax that went into effect in 2008. While the number of packs legally sold in Maryland dropped significantly between 2007 and 2009, cigarette sales increased in the neighboring states of Pennsylvania and West Virginia, both of which have lower tax rates.⁹

The failure of so many states to achieve the revenue results projected from cigarette excise tax increases should not come as a big surprise, because the tax increases promote purchases through untaxed or lower-tax venues and also create incentives for contraband cigarette trafficking. These alternative venues include Native American territories and the Internet, where state excise taxes may be avoided or evaded illegally, or neighboring states with lower state and local tax rates.

Nationally, almost 40 percent of the population lives in a jurisdiction bordering another state, including a Native American territory, Canada, or Mexico. In fact, there are only 13 states in which less than one-third of the population lives in a border county or jurisdiction. In 40 states, at least one-fourth of the population lives in a border jurisdiction, and in 22 states, more than half of the population lives in a border jurisdiction.¹⁰

In the case of alcohol and tobacco products, because of the dramatic variation in excise tax rates from state to state and the proximity of so many Americans to lower tax jurisdictions, many consumers save significant amounts of money on alcohol and tobacco by purchasing their products somewhere other than their home state. Avoiding taxation in this manner is just as likely for other consumer products, possibly even greater in cases where one state imposes a new tax on sweetened beverages, for instance, and a bordering state has no tax at all on that particular product.

⁸ <http://www.atr.org/state-tax-trends-overview-changes-spending-a4217>.

⁹ Marc Kilmer, "Did Cigarette Tax Increase Do More Harm Than Good," *Baltimore Sun*, March 17, 2010.

¹⁰ Richard K. Vedder, "Bordering on Chaos: Fiscal Federalism and Excise Taxes," in *Taxing Choice*, p. 276.

Another underreported consequence of excise taxes is that they are highly regressive, disproportionately impacting lower-income consumers and those living on fixed incomes. The regressive nature of excise taxes is accentuated if the taxed product is consumed disproportionately by the lower income portion of society.¹¹

More than state revenues are impacted by the fact that excise taxes encourage individuals to seek alternative venues to purchase the taxed product. It also turns more people into criminals by encouraging involvement with smuggling, counterfeiting, and other illegal activities, all in an attempt to avoid the excise tax. The excise tax will often result in fewer legal sales and at the same time create troublesome problems for society.¹²

There are other consequences of excise taxes that are less obvious. Using cigarettes as an example again, one study determined that smokers in the high-tax states are more likely to smoke cigarettes higher in tar and nicotine. The study also found that smokers between the ages of 18 and 24 increased their total daily tar and nicotine intake after a tax hike.¹³

This phenomenon is easily transferable to other products. One can expect that lower-income people (including the youngest) would be more responsive to tax increases for alcohol and would then purchase products with higher alcohol content after a tax hike. While this phenomenon may be less apparent with other products, it is also quite likely that consumers of sweetened beverages would simply purchase the product in larger quantities because the product would then be relatively less expensive, likely resulting in greater overall caloric consumption among some consumers.

CONCLUSION

Although the consumer police seem to have a never-ending list of targets they believe should be subject to a sin tax, seldom does the imposition of the tax accomplish its intended objective.

In more cases than not, in fact, sin taxes do not produce the revenue that is projected. And, while they disproportionately penalize the lower income population, they also encourage activities such as smuggling and counterfeiting to circumvent the tax, which produces new criminal members of society and new costs for the state.

It is time for policymakers, whether they are in federal, state or local governments, to just say no to more and higher sin taxes and to instead cut wasteful spending in order to address their fiscal woes.

¹¹ Gant and Ekelund, in *Taxing Choice*, p. 253.

¹² Bruce L. Benson and David W. Rasmussen, "Predatory Public Finance and the Origins of the War on Drugs: 1984-1989," in *Taxing Choice*, p. 197.

¹³ William N. Evans and Matthew C. Farrelly, "The Compensating Behavior of Smokers: Taxes, Tar, and Nicotine," *The RAND Journal of Economics*, Volume 29, No. 3 (Autumn, 1998), pp. 578-595.