

IRET Congressional Advisory

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SHAME ON THE SENATE FINANCE COMMITTEE!

In a mindless search for additional tax revenues to finance increased spending on children's health care and to ease the increase in the dreadful excise tax on airlines, the Senate Finance Committee proposes to increase the cigarette excise tax by 20 cents a package. This action is additional evidence that the critically important job of writing the nation's tax laws is in the hands of technicians who either are unfamiliar with the basic economics and principles of taxation appropriate for a free society or choose not to be guided thereby.

If the latter is correct, let's forget about ever having an acceptable tax system, one that will help our market system to operate more effectively. We have long relied on a tax system that elicits praise or defense from no one, except perhaps from tax practitioners in the privacy of their chambers. This tax system has contributed to wasteful uses of the Nation's production resources, limited the advances in our productivity and living standards, underwritten the growth in submarginal government spending, imposed on us hundreds of billions of dollars of dead-weight losses in compliance with and administration and enforcement of incomprehensible statutes and regulations, and

fostered division and rancor between highly productive and less economically capable members of our society.

Somehow or other, the U.S. economy has been able to overcome this tax-imposed abuse and to progress, although clearly not to the extent it otherwise might have. The question is why our policy makers should choose to add to the tax distortions and impediments to economic efficiency and progress.

Few, if any, public finance specialists, irrespective of their ideological or philosophic preferences, defend excise taxes. These taxes, are, instead cited to illustrate how taxes distort the information the market's operations provide us about the most productive uses of our labor, capital, and other production resources, induce us as a result to use those resources less productively than we otherwise would, and deprive us of some of the more valuable output we would otherwise enjoy. Good tax policy dictates that we should eliminate or at least reduce the excise taxes in the existing tax system. There is no legitimate defense for increasing the cigarette or any other excise, except for the utterly cynical Willy Sutton rationale, to wit, that's where the money is.

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What defense can the Congressional tax writers advance on behalf of hiking the tax on cigarettes? What reasoning justifies increasing the tax on cigarettes in order to reduce the one on aviation? Presumably the latter isn't a tax at all but a user fee, imposed to defray the FAA's expenses in assuring proper repair and maintenance of our commercial airlines. Never mind whether that's a proper function of a government agency; assuming the user fee had been appropriately calculated in the first place, what's the justification for reducing it now? Even if the FAA's budget outlays are deemed by consensus to

be worthy, why should the government rely on the cigarette excise — one of the worst taxes — in the tax system to finance it?

The usual rationale is that it's O.K. to raise the cigarette tax because people shouldn't smoke, and the higher excise on cigarettes and the consequent increase in the price of cigarettes will lead them to cut back on cigarette consumption. It is certainly true that given their incomes, people will buy fewer cigarettes if the excise is increased and cigarette prices are raised. But this isn't and should not be the issue. Rather, the issue is what business is it of the government to dictate to us what products or services we may or may not consume and in what amount. The thrust of public policy endorsed by the Republican leadership in the Congress and even by the White House in the last several years has been to curtail government's "big brother" role in our lives; isn't that what the drive for smaller government is all about? Consistent with this view, it is certainly appropriate for government to give us all of the reliable information it can gather about the bad things smoking may do to us, but it certainly doesn't follow that it's appropriate for government to use its taxing powers to make smoking prohibitively expensive.

A collateral argument is that the health consequences of smoking impose costs on the society as a whole and that it is, therefore, quite appropriate for government to recoup those social costs by taxing smokers. Apart from the fact that there is little if any substance to this allegation, doesn't this argue for applying the same "reasoning" to, say, fatty foods? With not much effort, one could compile a very substantial list of products and services on which new or additional excises should be imposed to defray social costs.

Apart from these fundamental issues, there are a number of mundane questions that tax legislators

should but never do consider. One of these is what's the net increase in federal tax revenues that the excise will generate. The conventional estimate on which policy makers rely attempts to take into account the reduction in sales volume that will result as the excise increase raises the price of cigarettes; this will erode the increase in revenue that would otherwise occur as a result of the higher tax rate. This estimate, however, is incomplete. It does not adequately account for the loss of payroll and income tax revenue resulting from the decrease in cigarette manufacturing employment. While in time the displaced labor and capital resources will find employment in other production activities, it must be assumed that these alternatives will be less rewarding or they would earlier have attracted some of those production inputs.

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The conventional estimate also fails to account for the cutback in other private sector production for private sector use that must result. Nothing about the cigarette excise increase adds to anyone's income. The consensus among those who have studied the cigarette market is that the price elasticity of demand for cigarettes is substantially less than one, perhaps as low as .5 or even less. Unless the price elasticity of demand for cigarettes exceeds 1, however, the higher price of cigarettes resulting from the excise hike must result in a larger amount of smokers' incomes being devoted to cigarette purchases; a smaller amount of their incomes, therefore, must go to the purchase of other products and services. By the same token, less of their incomes very likely will go into saving. Depending on what government does with the additional cigarette excise revenues, the loss in income may be in whole or in part offset, but in any event a less satisfying mix of output than is realized under existing tax law, bad as it is, will result.

The proposed cigarette excise increase is certainly not the only flaw in the tax packages that the White House and the two Congressional tax

writing committees have thrown together. Coming on top of the enormous tax increase, barely and poorly disguised in the States' attorneys general exactions from cigarette manufacturers, enactment of the proposed excise increase represents further entrenchment of the federal government's big brother control over American society. We have to hope that at some not distant point the public will

say "Hold, enough!", find some way to roll back government dictates, and give us back the freedom and responsibility to rely on our own common sense.

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