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Norman B. Ture addressed the American Legislative Exchange Council (ALEC) at its Nashville, Tennessee conference on July 8, 1988. Ture explained in his presentation why selective excise taxes are generally bad tax policy, contrary to the claims of those who want to make them a large revenue source.

At the time, Norman B. Ture was President of the Institute for Research on the Economics of Taxation (IRET).

With Dr. Ture's permission, *Tax Notes* later printed his address (*Tax Notes*, August 15, 1988, pp. 737-740).

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Social Policy And Excise Taxes

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Introduction: What's on the Fiscal Horizon?

Presidential election politics have taken center stage and have obscured the national policymakers' concern with longstanding fiscal problems. Standing in the wings, however, is the National Economic Commission and its mandate from the U.S. Congress to report its recommendations for reducing the Federal budget deficit while encouraging saving and capital formation. Moreover, early next year a new President and a new Congress will be eager to put their stamp on public policy, hence to initiate new programs. Any significant increases on the spending side of the Federal budget virtually guarantees tax changes. Tax policy again will occupy much of the attention of Federal public policymakers; it will continue to be an important concern of state legislators and governors.

In this setting, many of the long-standing issues of tax policy will emerge again, perhaps with a new twist, and very likely with a new urgency. At the Federal level, the driving force that will define the concerns undoubtedly will be what kinds of taxes should be raised and by what amount, ostensibly to reduce the Federal budget deficit. For the states, the same questions will be uppermost, although the occasion for them will be to identify the means for funding the allegedly growing demands for public services. In fact, the differences in concerns between the two levels of government will be more apparent than real. Both history and analysis tell us that the reason for raising taxes is to allow governments to spend more, not less.

Note, if you will, that there are two distinct dimensions that will, as usual, delineate the decision-making challenges facing policymakers. The "how much" question, in a very real sense, is the principal focus of interest; the answer to it defines the magnitude of the increase in government claims on the economy's resources and in government's power to transfer income among groups of the population. It is the very essence of why public policymakers are public policymakers -- to do "good" things for their constituents who, in gratitude, will return them to office to continue to exercise power.

Resolving the "how much" question necessarily entails coming up with answers to the question about what kinds of taxes to raise. One can only wish that policymakers would come up with answers that were based on a careful examination of the consequences of differing tax hikes for the fairness of the tax system, the efficiency with which our free market system operates, the costs of administration, enforcement, and compliance, and the effectiveness of the tax system as a means of pricing out the activities of the government. Here, too, both history and analysis tell us that, regrettably, these criteria have precious little to do with the answer, rhetoric to the contrary notwithstanding. For the most part, the answer to what kind of tax hikes is based on assumptions about which taxpayers are most vulnerable, hence least capable of mounting a sturdy and effective defense against having their ox gored even more deeply.

What all this leads up to, of course, is that if tax increases are to be the fiscal order of the day in 1989, the likely targets are upper-income individuals, corporate businesses, and producers, sellers, and consumers of tobacco products, alcoholic beverages, and gasoline. It is on the latter category of taxes -- excises -- that I want to focus my remarks.

The Rudimentary Economics of Excise Taxes

All taxes ever devised have in common the fact that they change the price(s) of something(s) relative to the price(s) of something(s) else. This tax-imposed distortion of relative prices is commonly referred to as the "excise" effect of taxes. This is, indeed, the outstanding attribute of selective excise taxes; they increase the relative price of the taxed product, service, or activity compared to what that relative price otherwise would be. Because nature abhors a zero price elasticity as much as a vacuum, the increase in the relative price of the excise-taxed thing results in a decrease in the quantity of it demanded or supplied, and an increase in the demand for or supply of other things. Those who were specialized in the production of the things subject to the selective excise tax lose jobs and income, at least until they develop other usable skills and can find employment in the production of other products or services. Suppliers of capital to the firms producing the taxed products or services incur the same kinds of income losses, until the capital can be freed up and transferred to other uses. The ultimate consequences of the imposition of selective excises are a distortion of the allocation of production resources among alternative productive uses, hence a loss of production efficiency, a change in the composition of consumption, and a loss of consumer satisfaction.

If one follows this line of analysis, it becomes apparent that one cannot generalize about whether any given selective excise tax is regressive, that it more severely burdens the poor than the rich. It is not enough to know the economic status of the consumers of the thing that is subject to the tax; one must also know the economic status of the producers of the thing that is taxed and of those who supply the productive services used to produce it. As difficult as it is to obtain the first set of information, it is even more difficult to obtain the latter.

One might well ask, if these undesirable attributes are known by policymakers, how do they justify imposing selective excises? The rationale is seldom if ever the straightforward explanation: "They got it; let's get it." Instead, policymakers often identify major social or economic policy goals that are alleged to justify, indeed to demand, levying or increasing one or another excise. In most such cases, two issues arise. One is whether the policy goal itself is an appropriate one for the government to pursue, and the other is whether the proposed excise or excise increase is an effective means for pursuing it.

Excise Taxes and Social Policy

While most of the rationales for imposing or increasing excises have a common theme, some differences among these arguments should be noted. The common theme is that the production or use of the thing to be taxed imposes costs on society as a whole and these social costs are not fully embodied in the producers' or users' costs. Imposing an excise in such cases, it is maintained, requires either the producers or the users or both to internalize these externalities, i.e., to take into account these social costs. The result is that producers will produce less of the product and users will buy less of it, thereby reducing the costs imposed on the society as a whole. Please note for future reference that this result depends on a significantly elastic demand for the product.

In the abstract, one cannot deny the possible existence of such externalities and the failure of the free market system to internalize them -- to require those who generate them to bear their full burden. But like beauty, many of these externalities are in the eye of the beholder. Free markets are not necessarily perfect; some of them may sometimes fail to determine optimum volumes of production and sales at prices that fully reflect the costs of that production. Far more often, however, markets will be found to have done a pretty fair job of internalizing social costs, at least to the extent that the gains to be expected from government intervention are less than the costs such intervention entails. It is far simpler to claim market failure and to assert the existence of a social cost than it is to find public policy means for efficiently internalizing that cost.

A case in point is the argument that excises on tobacco products and alcoholic beverages are consistent with the social goal of reducing the consumption of these items in order to reduce the health hazards and social costs they impose. The argument depends, clearly, on whether public policy should be concerned with smoking and the consumption of alcoholic beverages, which, in turn, depends on showing that the production, sale, or consumption of these products imposes costs on others. It also depends on demonstrating that imposing excises on the production or sale of these products effectively addresses the alleged social cost problem.

Consider smoking, first, in this connection. However good or bad the evidence that smoking causes any particular disease, or is an important cause of death is not at issue. The issue is, instead, whether smoking imposes social costs. The standard argument that it does is that smokers lose more hours of work than nonsmokers and that their working lifetimes are shortened by their smoking. Perhaps the facts are right, but granting that smokers' lifetime earnings are lower and less reliable than nonsmokers' does not establish that smokers impose costs on society. The lost time at work, the lost pay, the lost vacation time, the higher medical bills, if any, are costs the smoker bears; they are not costs for society. Public policymakers may choose, mistakenly, I believe, to have the entire body politic assume responsibility for defraying some or all of these private costs, but this decision does not transform these private costs into social burdens.

Maybe there are real social costs that can be associated with smoking. If so, appropriate public policy would be to find some means for requiring those smokers who impose these costs to internalize them. An excise on tobacco products is far too crude a device to assure any such internalization. The usefulness of this sort of tax measure for this purpose would depend on showing that all smokers impose social costs, irrespective of their smoking proclivities and habits. It would also depend on showing that the excise-induced increase in the private costs incurred by smokers, retailers, wholesalers, manufacturers, and tobacco growers was less than the resulting reduction in the social costs of smoking.

With respect to alcoholic beverages, the social cost argument rests primarily on the drunk driving case and the family breakdown which leads to public dependency resulting from alcoholism. There is little reason to dispute the view that drunkenness is an important source of traffic injuries and fatalities, often imposing costs on people other than the drunk drivers. There is little reason to doubt that alcoholism frequently results in loss of work hours, loss of jobs and of income, and of the ability to discharge one's responsibilities to one's family, often turning them into public charges. There is, however, substantial reason to doubt that raising the cost of alcoholic beverages will zero in only, or even primarily, on those who abuse alcohol. There can be little question that the excise tax, by raising the prices of alcoholic beverages, reduces the consumption of these products compared to the amounts that would otherwise be consumed. For those who do not abuse alcohol, whose health is not impaired by their use of alcoholic beverages, this results in a private loss. The case for the excise in this connection, therefore, rests on a showing that alcoholics, actual or potential, reduce their consumption to nonabusive amounts as a result of the higher price of the product. No such showing has been made.

I asked, earlier, that you note that the social-cost rationale for these excises implies the assumption of a significant price elasticity of demand for the taxed products. In this light, it is intriguing to take account of another of the arguments frequently advanced for increasing the excises on alcoholic beverages and tobacco products. This argument is that these products are not necessities, that their purchase is discretionary, and that, therefore, raising their price by subjecting them to higher and higher excises will not really injure smokers and drinkers. Bear with me while I attempt to expose the frailty, indeed the inconsistency, of this argument.

For one thing, there is no meaningful distinction between a necessity and a discretionary purchase, i.e., a luxury, defined by one of my former professors, Henry C. Simons, as something that some people think other people should do without. The distinction is a ploy relied upon by elitist public policymakers to justify imposing their preferences on others. The free market makes no such distinction.

Sometimes those who offer this argument seek to distinguish between necessities and luxuries in terms of differences in their respective elasticities of demand. Ostensibly, the amount of necessities people buy responds little to changes in their prices while the amount of luxuries people purchase is much more sensitive to price changes. If this were the case, it is clear that the social cost argument for hiking excises on alcoholic beverages and tobacco products would require a showing that the demand for these products is highly elastic. It is widely assumed, on the contrary, that the price elasticity of demand for cigarettes and for at least some alcoholic beverages is very low. Suppose it were zero, that is that people would buy the same amount of these products no matter what their price. On this assumption, obviously, raising the excises on these products would be utterly ineffectual in dealing with the problem to which the tax hikes are addressed.

Proponents of increasing the gasoline excise profess to be concerned with the need for conservation of energy resources. The implication is that the private market system fails to set the "right" price for petroleum products, particularly gasoline, resulting in "overconsumption," too little domestic exploration and development of petroleum resources, excessive dependence on foreign supplies, hence a potential national defense vulnerability. Here, too, it is alleged market failure that requires the government to intervene.

Such allegations are not supported by either fact or analysis; they rest, in large part, on gross misapprehension about conservation and the effectiveness of the private market system in facilitating conservation. Conservation is not, as those who advocate raising gasoline excise taxes seem to believe, a matter of not consuming. Conservation, instead, concerns the optimum timing of production and consumption of exhaustible, nonreproducible resources. At issue, therefore, is whether the private market casts up correct or misleading signals concerning the costs of producing today and possibly storing some of today's production for future sale compared with production costs in the future, and concerning the price at which various quantities of the resource can be sold today compared with the price in the future. Those who propose raising the gasoline excise in order to conserve gasoline should be required to demonstrate that the market system fails to cast up the correct cost and price data and that any proposed gasoline excise hike will result in, at least, a more nearly "correct" price for consumers to confront. It challenges credulity that the tax-writing public policymakers have better information for producers and consumers to rely on in their respective decision making than is provided by the extremely efficient and sophisticated private petroleum market.

What proponents of a higher gasoline excise overlook is that this would raise the market prices of all energy supplies. The result would be an increase in production costs for virtually every business in the country, with attendant losses of output, employment, and income. Moreover, these cost increases would be more burdensome in some parts of the country than in others; increasing the gasoline excise would discriminate against the West compared with the East. We would very likely import smaller amounts of petroleum products; we would, however, pay a very stiff price for whatever benefit we might attribute to that cutback.

The underlying reason for raising any of these excise taxes, of course, is the same as that for raising any tax -- to allow the government to spend more. At the Federal level, this must be elaborated to take account of the embarrassment the budget deficit causes policymakers. Federal policymakers want more tax revenues to finance more spending without noticeably increasing the deficit. For the most part, of course, they do not acknowledge the impulse for new spending initiatives, and insist that additional taxes should be assigned to reducing the deficit. If we are to raise taxes to reduce the deficit, it should be because we believe and can demonstrate that budget deficits are economically injurious for the country as a whole. If there is merit in the argument that budget deficits injure the economy, reducing the deficit presumably would benefit everyone, not merely selected groups in the economy. Reducing the deficit will not benefit merely smokers, consumers of alcoholic beverages, and motorists. Unless this were the case, however, why should we ask these groups to pick up the fiscal chips for all of us? If we are to reduce the deficit by raising taxes, everyone should share the additional tax burden.

Any tax increase should have the broadest possible reach in the population, and its burden should be clearly identifiable by those paying the additional taxes. Taxes that are paid only by some of us or are hidden from us cannot effectively perform the basic function of taxes -- to price out government services and activities. These considerations, along with their distortionary economic effects, should rule out any and all excise increases. A constructive public policy focus, instead, should be to reduce, if not entirely eliminate, our fiscal dependence on excises at all levels of government.

Conclusions

The most fundamental issue raised by all of the proposals for raising excise taxes is one that is seldom articulated in the public policy forum, viz., where should the locus of social responsibility be found? Virtually all of the social cost arguments imply that the individual should not be asked to assume responsibility for his or her own welfare or does not have the capability for doing so, that it is government's responsibility to make sure that each individual acts in his or her own best interest, as identified, of course, by the public policymaker. The seriously adverse consequences for personal freedom and self-reliance of resolving this issue as we have increasingly seen since the early 1930s should be apparent, one would think, to all policymakers. Unhappily, these consequences seldom are given appropriate weight in public policy decisions.