

# THE FAILURES OF SUMPTUARY TAXATION

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*ABSTRACT: There are several goods and services which "society" has deemed harmful to the harmonious interactions of individuals. Goods such as alcohol and cigarettes are viewed as destructive because of their ill effects on health and their potentially addictive qualities. Some have suggested taxation of these goods as a way to decrease their appeal. This paper examines the harmful effects of sin tax policy. Sin taxes cause distortions throughout the productive economy, and ultimately fail to curb the very behaviors for which they are imposed.*

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## I. INTRODUCTION

Taxation can be defined as a coercive, non-contractual transfer of physical assets from one party to another.<sup>1</sup> A sumptuary tax is a specific category of Pigouvian taxes which is levied with the twin goals of raising government revenue and manipulating social behavior to prevent or reduce negative externalities.<sup>2</sup> Pigouvian taxation schemes focus primarily on how taxation of production can reduce negative externalities, such as pollution, which physically affect the property of a third-party. Sumptuary taxes, a subset of Pigouvian tax schemes, target more arbitrary “harms” which are inflicted by members of society. Behaviors that are generally considered undesirable include excessive consumption or use of alcohol, cigarettes, drugs, pornography, or even “unhealthy” foods. Some argue that addicts need every incentive to quit their habit; others argue that addicts, such as alcoholics, have an obligation to mitigate the costs they have imposed on society.<sup>3</sup> In actuality, the imposition of a sin tax is likely to impose greater costs to society than is the consumption of the “sinful” good.

The focus of this paper will be on the “sin tax” commonly levied on goods which are generally deemed to have socially detrimental effects.<sup>4</sup> As such, the sin tax is a form of the partial excise

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1 HANS-HERMANN HOPPE, *ECONOMICS AND ETHICS OF PRIVATE PROPERTY: STUDIES* (2d ed. 2006).

2 James R Hines, *Taxing Consumption and Other Sins*, 21 *JOURNAL OF ECONOMIC PERSPECTIVES* 49, 49-50 (2007).

3 Rachel E. Morse, *Resisting the Path of Least Resistance: Why the Texas “Pole Tax” and the New Class of Modern Sin Taxes Are Bad Policy*, 29 *B.C. THIRD WORLD L.J.* 189 (2009).

4 Adam Hoffer, *Spatial Dependence in Tobacco Excise Taxation: An Analysis of Special Interest and Tax Competition*, *PUBLIC CHOICE SOCIETY* (2011).

tax, which is a tax levied on some, instead of all, commodities in a market.<sup>5</sup> Economic analysis of sin taxation exposes various tax-created market distortions. In short, the imposition of a sin tax causes distortionary secondary effects, while often failing to achieve its primary objective—the eradication of undesirable behavior

While many economists argue that sin taxes fail in their objective of raising government revenue, that investigation will not be the focus of this paper. Instead, this paper will examine not only how sumptuary taxation fails to eradicate culturally objectionable behaviors, but also how it creates harmful and distortionary secondary effects. These secondary effects include distortion of the capital structure that often adversely affects individuals far removed from the “sin,” shifting to substitutes, emergence of black market activity, disproportionate harm to the poor, and incentives to rent-seeking behavior. Furthermore, it is impossible to reconcile the fiscal and non-fiscal ends of sumptuary taxation; they are fundamentally at odds.<sup>6</sup>

## II. OVERVIEW OF TAXATION

Before examining the specific case of sin taxation, it is important to note some general effects of any taxation scheme imposed on the unhampered market economy. Taxation constitutes an intervention on the market and, as such, reduces the amount of

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5 MURRAY NEWTON ROTHBARD, *MAN, ECONOMY, AND STATE A TREATISE ON ECONOMIC PRINCIPLES; WITH POWER AND MARKET: GOVERNMENT AND THE ECONOMY* (2004).

6 LUDWIG VON MISES, *HUMAN ACTION: A TREATISE ON ECONOMICS* (1998).

income an individual can expect to receive through appropriation (such as homesteading), production, or contract. Because all these activities require the use of scarce resources—at the very least, labor and land—which could have been employed in leisure or consumption, taxation raises the opportunity cost of productive enterprises. The marginal utility of leisure increases, while the marginal utility of production falls. Thus, taxation also reduces the present incentive for future production, thus decreasing future income and future consumption. Because taxes cannot simply be levied on consumption without distorting time preferences, any tax has a profound effect on production itself. The ultimate effect of taxation is to reduce societal standards of living below where they would have been in a free market.<sup>7</sup>

This general analysis of taxation has focused on the expropriation of private revenue. However, most tax analysis assumes that tax monies are subsequently spent by the government. As such, the government is effectively a consumer. Unless the state spends its new revenue in exactly the same patterns as consumers on the market, the effect will be to shift demand throughout the economy. For example, if the government taxes cigarette producers in order to increase expenditures on armaments, cigarette producers experience a drop in demand (or at least the equivalent through a decrease in net revenue), while the arms manufacturers experience an increase in demand.

The short-run effects of this intervention will be decreased profits (or potentially losses) for the cigarette producer, and profits

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7 HOPPE, *supra* note 1.

(or increased profits) for the armaments producer. These producers will, in turn, increase (decrease) their demands for factors of production, thus re-distributing incomes to non-specific factors, and perhaps permanently increasing (decreasing) the demand for specific factors of production. Because these are the general effects of any taxation scheme, there is no such thing as the neutral tax.<sup>8</sup> While the partial excise tax is often viewed as relatively neutral (supposedly affecting only consumption, not the production structure), this view is proven fallacious in the following section.

### III. INCIDENCE OF PARTIAL EXCISE TAXATION

It is essential to include an analysis of tax incidence to show that the government's objective of punishing consumption must fail, to some extent, beginning with the very imposition of the tax. While shortsighted politicians conceive the sin tax as a panacea for many social ills, economists argue that the burden of the tax will not fall solely on consumers.

For many economists, the sin tax vividly highlights the inability to tax consumption. Legislators may intend for the imposition of the sin tax to only penalize consumption and leave income and capital unscathed. In fact, all three categories of economic activity are impinged by the levying of a sin tax. All excise taxes are ultimately income taxes, though haphazardly applied. As such, sin taxes have the potential to affect rents to land, interest to capitalists, wages to labor, and profit to entrepreneurs. The direct impact of the tax is to lower the revenue of sellers by the amount

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8 ROTHBARD, *supra* note 5.

of the tax. The tax is "shifted backward" to interest earned by capitalists, wages earned by labor, or rents earned by land-owners. In addition, it will reduce the profit that the entrepreneur is earning. The tax ensures that the firm will receive a lower price because it must now subtract the tax from the price consumers pay in order to fulfill its obligation to the state. Because entrepreneurs are now correctly forecasting lower prices, they will begin decreasing the amount that they are willing to bid for original factors of production. Income to these factors will decrease.<sup>9</sup>

This analysis demonstrates that it is economically naïve to believe that only consumers of certain goods will be punished in the form of higher prices, which firms have escaped by "shifting them forward." While specific incidence will vary according to the particulars of the situation, it is likely that labor employed in this industry will experience a drop in wages. Additionally, rents that are paid to land-owners in this line of production will also decline. Thus, the sin tax reduces incomes of workers, land-owners, and capitalists—none of whom are necessarily consumers of the good.

Because the price of the good cannot be increased by the amount of the tax, marginal firms and entrepreneurs will be driven out of the business in search of other opportunities. Highly specific factors of production will be hit hardest by the partial excise or sin tax because it is difficult for them to find any streams of income outside the production of the now-taxed good.<sup>10</sup>

This examination reinforces the crucial concept that it is

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9 *Id.*

10 *Id.* at 1162-64.

impossible for the sin tax to behave neutrally—that is to say, it cannot simply “punish” consumers without adversely affecting the income of producers of a good, even those far removed from the consumer good in the structure of production.

The above analysis has examined the distortionary effects of taxation more broadly, the incidence of partial excise taxes, and the effects of partial excise taxation on production and incomes. It should also be noted that there is a fundamental conflict to which sumptuary taxation falls prey. If the goal is to yield the greatest revenue to the state, then only empirical analysis of a specific market can reveal the “ideal” level of taxation. However, if the goal of the tax is to reduce sales and consumption of a good—as is often the stated justification—then it follows that the higher tax rate is more effective. If the tax is to fully achieve its non-fiscal objective of weaning people from a certain good, then the revenue will eventually fall to zero.<sup>11</sup>

#### IV. CONFLICTING GOALS OF PATERNALISTIC TAXATION

Not only do sin taxes reduce the income of individuals who are not engaged in consumption of the “sinful” good (such as wages to labor), but even when the goal of the state is largely non-fiscal, sin taxes often simply fail to reduce consumption of the desired good. Sin taxes are imposed from a paternalistic worldview, which assumes that government can more effectually ensure lifelong utility of its citizens better than those individuals themselves. Excessive consumption of certain goods—alco-

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11 MISES, *supra* note 6.

hol and cigarettes for instance—can lead to lower lifespans. Thus, governments impose taxes on these goods in an attempt to raise the price and lower quantity demanded.<sup>12</sup>

However, it is important to note that several studies have shown that demand for goods with addictive qualities is highly inelastic (relatively unresponsive to changes in price). A recent working paper published by the National Bureau of Economic Research highlighted the failure of sin tax policy to address the heterogeneous nature of alcohol consumers. While there had been studies showing that price can negatively affect the quantity of alcohol consumed, this analysis often failed to account for differences in demographics and also the average amount of alcohol consumed before the tax was imposed. When these variables are accounted for, demand for alcohol is highly inelastic among heavy drinkers. Thus, the demographic that might impose the greatest harm on society is the group which is least responsive to increases in price. The study found this effect to be even stronger among older drinkers.<sup>13</sup>

Thus, the imposition of the sin tax may succeed in raising government revenue if it is levied on a good for which there is relatively inelastic demand, but it will concurrently fail to reduce consumption of the “sinful” good; in fact, this often serves as an additional justification for the imposition of excise taxes on goods with inelastic demand, goods which are also often considered

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12 Kaisa Kotakorpi, *Paternalism and Tax Competition*, 111 SCANDINAVIAN JOURNAL OF ECONOMICS 125 (2009).

13 Padmaja Ayyagari, Partha Deb, Jason Fletcher, William T. Gallo & Jody L. Sindelar, *Sin Taxes: Do Heterogeneous Responses Undercut Their Value?* (Working Paper No. 15124, 2009).

“sinful.” Known as the Ramsey rule, this proposition states that taxes should be levied inversely with elasticity so as to minimize social cost.<sup>14</sup> The existence of the Ramsey rule demonstrates the conflicting nature of selective excise taxation—government revenue or the tradeoff of reduced consumption.

One study found that the demand for cigarettes, perhaps counter intuitively, is even less elastic in less-developed countries than it is in more-developed nations. This demonstrates that it is not simply high levels of affluence which stabilize demand in the face of increasing prices.<sup>15</sup>

#### V. CROSS-BORDER SHOPPING

Consumers will often find many ways to evade the higher prices that come with the imposition of a sin tax. One such evasion method was studied in Scandinavian countries. It was known that “tax competition” between countries could erode one nation’s tax base at the expense of another. Similar analysis shows that paternalistic tax policies might induce “cross-border shopping” that undermines a government’s attempt to control the harmful behavior which it is trying to reduce. When one country adopts a highly paternalistic tax policy and its neighbors do not, the objective of the paternalistic government is undermined. The lower the transportation costs from one country to another, the greater will be the purchases in the country with a freer tax policy. Economet-

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14 William F. Shughart, *The Economics of the Nanny State*, in *TAXING CHOICE: THE PREDATORY POLITICS OF FISCAL DISCRIMINATION* 13 (1997).

15 P. Lance, J. Akin, W. Dow & C. Loh, *Is Cigarette Smoking in Poorer Nations Highly Sensitive to Price? Evidence from Russia and China*, 23 *JOURNAL OF HEALTH ECONOMICS* 173 (2004).

ric analysis of Finland, Denmark, and Estonia revealed that the effect of tax competition between nations was to heavily reduce the impact of paternalistic taxation, but not to eliminate it altogether. In October of 2003, Denmark reduced its excise duty on spirits by 45% in response to the relatively low prices of alcohol to be found in Germany in order to reduce cross-border shopping. Likewise, alcohol taxes in Finland were cut on average by 33% in 2004 due to the availability of cheaper alcohol in Central Europe and Estonia. Estonia had reduced its restrictions on alcohol, and the Finnish government realized that this development would reduce their ability to control alcohol consumption via domestic sin taxation. The EU itself has recognized the ineffectiveness of paternalistic taxation in the presence of cross-border shopping, and thus has imposed minimum rates for excise duties on most types of alcohol for member states.<sup>16</sup>

In short, cross-border shopping will occur (either between nations or states) if the costs associated with shopping are outweighed by the benefits of obtaining the good at a lower price. Costs commonly associated with shopping include transaction costs, information costs, and the cost of time. Even a relatively large price differential between states will likely be outweighed by the costs associated with crossing state lines—if the consumer purchases the same quantity he would have in the absence of the tax. However, because transaction, information, and time costs are constant, the consumer can act so that his marginal benefit outweighs his marginal cost by purchasing a greater quantity of the

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16 Kotakorpi, *supra* note 12.

good, thereby diluting his costs. Thus, the effect of differing sin tax rates between states is for consumers to acquire a larger quantity of the good than they would have were they able to purchase the good in-state at the same price. Purchasing a larger quantity becomes more economically efficient.<sup>17</sup>

## VI. SUBSTITUTES, RELATIVE PRICES, AND COMPENSATING BEHAVIOR

A second way that the sin tax fails to stamp out consumption of a product is through consumers shifting to substitutes—often with perverse results. Like all excise taxes, sin taxes are levied per unit. Thus, the tax only addresses one risk factor that is associated with cigarette smoking: average daily consumption. It fails to address other determinants of health such as daily intake of tar from the consumption of cigarettes. Smokers who desire to purchase fewer cigarettes at the higher prices, but also wish to maintain their current level of tar or nicotine intake “might take longer drags or reduce the time between puffs.”<sup>18</sup> Another way for smokers to maintain nicotine intake is to switch to longer-lasting versions of their favorite brand.<sup>19</sup> A 1998 econometric study found that taxes do indeed reduce consumption of cigarettes; however, this reduction was *more* than offset by the increase in tar and nic-

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17 Richard K. Vedder, *Bordering on Chaos: Fiscal Federalism and Excise Taxes*, in *TAXING CHOICE: THE PREDATORY POLITICS OF FISCAL DISCRIMINATION* 271 (1997).

18 William N. Evans & Matthew C. Farrelly, *The Compensating Behavior of Smokers: Taxes, Tar, and Nicotine*, 29 *THE RAND JOURNAL OF ECONOMICS* 179 (1998).

19 *Id.* at 578.

otine consumption. Furthermore, smokers who prefer lower tar cigarettes did not quit in disproportionate amounts.<sup>20</sup>

The same study examined the widely held view among economists and other experts that sin taxes would create a disproportionate disincentive to smoking among young adults—the very demographic containing the highest number of new smokers. If this view were correct, it could presumably provide long-term health benefits. To the contrary, Evans and Farrelly found that the “compensation effect” was stronger among those aged 18-24. In the face of the sin tax, nicotine and tar consumption actually increased.<sup>21</sup>

A closely related way that sin taxes may encourage perverse outcomes is through the changing of relative prices. With the imposition of the sin tax, the price for a particular good will increase, other things constant. When a tax is placed on a product, its price will change relative to substitutes that may be more expensive. However, consumers are more responsive to relative prices than they are to nominal prices. As an example, 1920's Prohibition in the United States saw a dramatic increase in the potency of the alcohol that was being illegally manufactured. Relative prices explain this phenomenon.

Suppose that one (more potent) beverage is twice as expensive as a (less potent) substitute. Prohibition effectually imposed a “tax” on this market by increasing the cost of production in the form of the risk posed by law enforcement. This “tax” decreases

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20 *Id.* at 584-87.

21 *Id.* at 587-89.

the relative price of the high potency alcohol in relation to its low potency counterpart because the same "cost" has been placed on both. Unsurprisingly, consumption of stronger drink increased during Prohibition and declined dramatically shortly after the repeal of Prohibition. By the same measure, there has been a steady increase in the potency of illegal drugs and a concurrently steady decrease in the potency of legal drugs. A tax works in the same way to change the spread of relative prices. Thus, a per-unit sin tax levied on cigarettes is likely to induce a shift from low-potency cigarettes to more expensive (but now relatively cheaper) higher-potency substitutes.<sup>22</sup>

Producers can also shift their production in the face of a per-unit excise tax. Product optimization occurs over a wide variety of margins, and a partial excise tax is not likely to cover all these margins. For instance, if a tax is imposed on a certain commodity with  $n$  characteristics, the producers will substitute more of the non-taxed characteristics into the production of the good. As one example, excise taxes tend to increase the level of tar and nicotine in cigarettes. Hence, the effect of an excise tax is not only to induce consumers into higher potency cigarettes, but also to encourage producers to supply higher potency products.<sup>23</sup>

## VII. BLACK MARKETS

An additional way that the sin tax fails to reduce undesirable behavior is through the emergence of black markets. This

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22 MARK THORNTON, *THE ECONOMICS OF PROHIBITION* (1991).

23 *Id.* at 94-95.

“underground” activity does not always emerge, but a higher tax rate makes its appearance more probable. During the 1980s, Canadian lawmakers began to view cigarette taxation as both an important source of revenue as well as a way to discourage smoking. Between April and June of 1985, the federal excise tax on a cigarette carton was increased from \$6.01 to \$9.18. By 1991, this had increased to \$19.14 per carton. After a series of tax decreases, the Canadian government introduced the Federal Tobacco Control Strategy which aimed for reduced smoking rates. As a result, July of 2002 saw federal taxes as high as \$15.85 per carton.<sup>24</sup> Analysts have noted the correlation between the level of the excise tax and the size of the underground cigarette market. During the tax rate reduction of the late 1990s, underground activity fell markedly, but with the imposition of the latest round of draconian rates, there has been a sizeable resurgence in black market activity.<sup>25</sup> Among the illegal suppliers are “above-ground” sellers who distribute cigarettes from a legal store-front but under the counter. In addition, “underground” suppliers distribute cigarettes in public venues.<sup>26</sup>

The Canadian black market also developed a phenomenon known as “returning exports.” This form of evasion involved legally exporting cigarettes directly across the border to avoid the tax, and then immediately smuggling the cigarettes back into the market where they could be sold tax-free. Several tobacco companies were involved in this scheme as they sought to flood the

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24 Nachum Gabler & Diane Katz, *Contraband Tobacco in Canada: Do Excise Taxes Encourage the Black Market?* (2010).

25 *Id.* at 8.

26 *Id.* at 5-6.

Canadian market with cigarettes, thereby lowering both the lawful and unlawful price, increasing the quantity demanded, and thus, sales.<sup>27</sup>

There are several detrimental effects that black market activity imposes on society. It is likely the product will be scarce and also costly to cover the risks that producers face by violating the law. Illegality also hinders the process of information distribution, and the result will be a less efficient market, both in terms of arbitraging effects that would naturally occur and in the quality of the product produced. The secrecy of the black market decreases the ability of large-scale companies to operate, reducing the productive advantages gained from economies of scale. This further reduces market efficiency. A high enough tax may also bestow a monopolistic grant to black marketeers.<sup>28</sup> Additionally, entrepreneurs that enter the black market are likely to possess a different skill-set from those that succeed on the legal market. Successful black marketeers are likely skilled criminals who possess a premium on bypassing the law instead of a premium on successfully satisfying consumer demand.<sup>29</sup>

In addition, black market production tends to be of inferior quality compared to legal production. Consumer sovereignty is diminished because there is nowhere else to obtain the good. Buyers and sellers are more concerned with avoiding detection than

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27 *Id.* at 5-7.

28 Ironically, this may somewhat accomplish the goal (albeit indirectly) of paternalistic taxation: reduced consumption. After all, monopolies restrict output to raise price and increase profit. See THORNTON, 137.

29 Rothbard, *supra* note 5.

testing for product quality.<sup>30</sup> The combination of these black market effects may be much more detrimental to the consumer than simply consuming the "harmful" product unhindered.

In the case of a high per-unit sin tax, black market suppliers can make a large profit margin by selling slightly below the legal market price. This large profit margin is often put to use bribing bureaucrats or enticing police into selective enforcement.<sup>31</sup> Economic theory would also predict violence among underground sellers as a way to enforce contracts, gain market share, or defend territory.<sup>32</sup> The Canadian experiment with high excise taxes has empirically verified this analysis as one study directly linked organized crime with the re-importation scheme of contraband tobacco. In fact, one of the stated goals of the Canadian legislature during the first repeal of taxes was to reduce the crime associated with underground trafficking.<sup>33</sup> Consequently, high sin tax rates can increase incentives to crime, adversely affecting all members of society.

#### VIII. SIN TAX REGRESSIVITY

While sin taxes are often imposed with the goal of helping citizens, especially low-income individuals, to quit their destructive habit, the result is often detrimental to the very persons who are ostensibly aided through the sin tax. If demand for a good is

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30 Mark Thornton, *Prohibition: The Ultimate Tax*, in TAXING CHOICE: THE PREDATORY POLITICS OF FISCAL DISCRIMINATION 171 (1997).

31 THORNTON, *supra* note 22.

32 *Id.* at 111-12.

33 Gabler, *supra* note 24.

inelastic, the higher price brought about by the tax will only serve to reduce the income of those who consume it. The regressive nature of partial excise taxation ensures that the poor will be hurt disproportionately compared to the wealthy. A regressive tax is one that reduces a greater percentage of the income of the poor than it does of the wealthy.

The cigarette tax is particularly regressive because cigarette consumption is negatively correlated with income. Between 1976 and 1994, smoking rates in the lowest income group in the United States fell by 4.6%, but the same rate fell by 14% among the highest income group. Thus, cigarette taxes are regressive in two senses. First, since the sin tax is a flat tax, the poor will pay a higher proportion of their income. Second, the poor, as a class, also pay a higher absolute dollar amount because they consume a greater number of cigarettes. However, others, who prefer a life cycle approach, have argued that the regressivity of a tax is not accurately determined by examining a single time period.<sup>34</sup>

Differences in life-cycle and annual measures of tax may be particularly pronounced with a consumption tax. One reason that this may occur is because of time preference. For example, it is reasonable to assume that the young and the elderly consume more than their current income. If this were true, annual incidence studies would show a disproportionate burden on these groups, but would appear smooth over a lifetime measurement. Even when this is accounted for, Lyons and Schwab found that life-

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34 William N. Evans, Jeanne S. Ringel & Diana Stech, *Tobacco Taxes and Public Policy to Discourage Smoking*, (MIT Press, Working Paper, 1999).

cycle estimates of regressivity appear almost identical to “snapshot” measures of regressivity. This study concluded that those in the poorest quintile devote 40% more of their lifetime income to alcohol consumption than do those in the richest quintile.<sup>35</sup>

### IX. INCENTIVES TO RENT-SEEKING

A final failure of sumptuary taxation includes increased incentives to rent-seeking behavior. Many advocates of the sin tax argue that the revenues could be used to fund public health initiatives that combat advertising for “sinful” products and even traditional “junk” foods.<sup>36</sup> The possibility of ostensibly private organizations such as the American Cancer Society receiving revenue from sin taxes increases the incentive for groups like this to lobby for increases of these taxes.<sup>37</sup>

This type of behavior by private individuals, companies, or groups is known as rent-seeking. Rent-seeking occurs whenever a revenue stream is obtained outside the normal profit-loss mechanism of the market economy. One of the results of rent-seeking behavior is decreased productivity as groups divert energy and resources into obtaining a government-imposed regulation that will benefit them. The opportunity cost is failing to direct resources into lines of production which consumers judge to be

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35 Andrew B. Lyon & Robert M. Schwab, *Consumption Taxes in a Life-Cycle Framework: Are Sin Taxes Regressive?*, 77 THE REVIEW OF ECONOMICS AND STATISTICS 389 (1995).

36 Jeff Strnad, *Conceptualizing the “Fat Tax”: The Role of Food Taxes in Developed Economies*, (Working Paper No. 286, 2005).

37 Thomas J. DiLorenzo, *Taxing Choice to Fund Politically Correct Propaganda*, in TAXING CHOICE: THE PREDATORY POLITICS OF FISCAL DISCRIMINATION 117 (1997).

more valuable through demonstrated preference. Selective excise taxes place more of a burden on some groups as opposed to others (by contrast, a general tax would impose the same burden on all groups). One result of this differential burden is to incentivize those who stand to lose to expend resources in the political process to prevent the taxes from being enacted. Conversely, those who stand to benefit have an incentive to see that the taxes are enacted. These political costs impose welfare losses on society that would not necessarily exist in the face of a potential broad-based tax.<sup>38</sup>

Thus, Holcombe argues that the arguments for sin taxes, which are often couched in public-interest terms such as the need to internalize externalities, are usually advanced by special-interest groups. Ultimately, all interventions are justified on the idea that they will further the public interest. In reality, interventions always benefit one group at the expense of another in a zero-sum game.<sup>39</sup> One such historical example of rent-seeking appeared in the nineteenth century when the dairy industry lobbied for taxes on margarine to protect the “wholesomeness” of food that people consumed. The campaign of the dairy industry was advanced under the pretense that the consumer must be protected from the fraud inherent in a product that masqueraded as butter. For a time, butter producers were able to secure an artificial profit by the taxes and other regulations imposed on margarine producers.<sup>40</sup>

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38 Randall G. Holcombe, *Selective Excise Taxation From an Interest-Group Perspective*, in *TAXING CHOICE: THE PREDATORY POLITICS OF FISCAL DISCRIMINATION* 81 (1997).

39 *Id.* at 81-82.

40 Adam Gifford, Jr., *Whiskey, Margarine, and Newspapers: A Tale of Three*

In fact, the margarine case is significant in a study of public policy because the margarine tax raised a Constitutional question. The excise tax on margarine was imposed, not with the purpose of raising government revenue (legitimate under the Constitution), but with the specific intent of regulation. As such, its imposition would increase the police powers of the federal government. In the words of Justice Marshall, "the power to tax is the power to destroy," and taxation for revenue purposes does not constitute destruction because it would be nonsensical for the government to destroy its source of revenue. After intensive lobbying from butter manufacturers, Congress imposed an excise tax of two cents per pound. The tax pushed one-third of the margarine makers out of business.<sup>41</sup>

#### X. CONCLUSION

If Prohibition did not significantly curtail the consumption of alcohol in the 1920s, are we to expect that a mere excise tax can eradicate drunkenness or second-hand smoke?<sup>42</sup> Sin taxes are often imposed out of the best motives—namely the welfare of individuals within the taxed jurisdiction. One role of economic analysis is to examine the difference between the stated goals of a policy and the actual results. This involves examining not only what is seen, but also what is unseen. In the case of sin tax analysis, we have concluded that the imposition of the tax has many undesirable sec-

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*Taxes*, in *TAXING CHOICE: THE PREDATORY POLITICS OF FISCAL DISCRIMINATION* 57 (1997).

41 *Id.* at 69-71.

42 *See* DiLorenzo, *supra* note 37, at 135.

ondary and “unseen” affects. Laborers, entrepreneurs, and capitalists experience a drop in their respective incomes, even those not closely related to the “sinful” good. Furthermore, consumers find a myriad of ways to compensate for the tax, sometimes through even more perverse consumptive behaviors. Black markets and illegal activity increase incentives to crime. The tax creates yet another avenue for individuals to seek income outside the profit-loss safeguard of productive market activity. In short, the burden of government is expanded with the imposition of any tax. The type of tax is immaterial—it allows the state to gain command of additional resources, thus depriving members of society from using the same. Worse, government expenditures are devoid of net income and net worth calculations that determine profitability on the free market.<sup>43</sup> The shift of resources from private control to control by the state is what constitutes the greatest burden of taxation—and one that ultimately affects every member of society.<sup>44</sup>

As with any tax scheme, the most important issue of economic analysis is often obscured. The fundamental issue to determine regarding any tax is the gross amount of resources that have been transferred from private individuals (and thus economic calculation) and into the hands of the public sector, thus obscuring economic calculation. Though there are many political pressures to increase the sin tax rate, either because concerns over health are on the rise or because it is a relatively “popular” tax when the gov-

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43 See MISES, *supra* note 6, at 200-18, for a discussion of how economic calculation ensures that entrepreneurs do not squander scarce resources.

Most importantly, he notes on page 215 that “Economic calculation cannot comprehend things which are not bought and sold against money.”

44 ROTHBARD, *supra* note 5.

ernment is strapped for revenue, the foregoing analysis shows that the sin tax imposes heavy costs on society. Given these concerns, the tax should never be levied from the naïve viewpoint, often adopted by shortsighted politicians, that social outcomes can be manipulated through coercive force. Instead, consumptive decisions are best left to individuals, not only for their own good, but also for the maximum welfare of all members of society.