



ISSN Print: 2394-7500
ISSN Online: 2394-5869
Impact Factor: 5.2
IJAR 2016; 2(12): 23-26
www.allresearchjournal.com
Received: 05-10-2016
Accepted: 06-11-2016

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Sin tax: Who is the real beneficiary? Society or Government? An investigation

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Abstract

Sin Taxes have earned significant tax revenue for governments in developed economies or emerging economies. Such revenue from taxes on – unhealthy consumables like tobacco, alcohol, and cigarettes– has increased substantially, especially in the past few decades. For several decades now, intellectuals and sociologists have questioned the morality of governments in imposing sin taxes. Economists have also doubted the effectiveness of such sin taxes, in deterring consumers from buying tobacco, alcohol or gambling. This research proposal focuses on identifying the reasons for the surge in levy of sin taxes by national and local governments. It also evaluates the ‘internality of taxes’ and interaction between redistributive as well as corrective motives. This research paper concludes with investigating if the motives were dampened or amplified. The use of optimization taxes is discussed, apart from considering elasticity-based considerations for the same. Consumer demand was ‘elastic’ with respect to price, while there was a co-variation between such elasticity, bias as well as income of consumer. The research findings indicated that more than sin taxes, the use of non-salient taxes, persuasive advertising as well as ‘glaring’ warning signals on labels were more effective deterrents over sin taxes or corrective taxes. Findings indicate that most of the governments have expanded the scope of utility of such excise tax revenue and are delivering appropriate health care services in majority of the countries, with a few exceptions.

Keywords: Sin tax, unhealthy consumables, optimization taxes

1. Introduction

Taxation policies are, in principle, implemented with a social objective. However, there are peculiarities such as ‘behavioural public finance’ which are applied to overcome consumer misoptimization. Consumerism has been on the rise now, regardless of the economic conditions of a nation. Significantly, the amount spent on non-essential consumables such as cigarettes, tobacco, alcohol, lotteries, casino, gambling and many other ‘culturally disfavored’ products and services have also increased. Countries across the world have expanded their ‘sin’-commodities-list and levy taxes on not only alcohol or tobacco but casino, lotteries and even marijuana and sugar, as obesity pressurizes government health care systems in many countries. As excessive consumption of such commodities place majority of the population under several kinds of health risk, governments fall back on imposing stringent ‘sin taxes’ to prevent such consumption. The ‘win’-side of these ‘internality taxes’ (taxes which are raised to overcome excessive consumption due to ‘misoptimization’ by consumers) is the direct increase in excise tax revenue for these governments. Contrary to this benefit, economic activity is impacted negatively. Sin taxes lead to drop in economic activities related to such commodities directly or indirectly. Economists also report such taxes on such commodities will not deter consumption, since they are inelastic expenses for consumers of such commodities. Therefore, the intrinsic exercise of imposing sin taxes by the government is to augment and enhance its own exchequer.

2. Review of Literature

Even as early as the 19th century, Scottish economist Adam Smith (1887) [6] wrote that commodities which are not necessary commodities for life but are objects of universal consumption, should be taxed – namely sugar, tobacco and rum. Historically, countries across the world have the United States has collected sin taxes in one form or the other. Other countries such as Sweden, Canada, and Philippines have sin tax for tobacco and

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alcohol. Back in 2013, Mexico had imposed Soda Tax, while Great Britain is pondering on sugar taxes given its exploding health care revenue.

Taxes are imposed on cigarettes and other commodities which are health-risks (Gruber, J. and Kőszegi, 2004) [3] by governments. This is necessarily viewed as corrective taxes and imposed so as to generate revenue or subsidies which are then used for other commodities such as greener or energy-efficient products, which see low consumption. Contrary to government intentions researchers have found that these taxes are regressive. This is because, most of these commodities, especially cigarettes are consumed by demography which is low-income earners. Contrastingly the consumers of green energy commodities are high net earners. Thus, governments are caught between motives of 'redistribution' and 'corrective' motives.

In Philippines, research by Jowett, M. and Hsiao (2007) [3] establishes the effectiveness of the 'sin tax' imposed in 2012. They found that there was significant drop in the number of smokers in the country. This was an important step forward since Philippines is statistically the 15th largest market for cigarettes in 2010, and has one of the strongest cartels for tobacco in Asia. The second benefit was seen in the increase in the government revenue, which was used to improve health care as well as the national health insurance program. The strategies adopted by the government are instructive example to countries exploring the possibilities of sin taxation to achieve health objectives. The campaign was successful and exceeded estimation by over 114% in the year of implementation. However, the projected levels of healthcare services were not possible to achieve, despite the influx of massive sin tax revenue. Thus, it was seen that the poor quality of health care, low literacy and weak infrastructure of health care lead to under achievement. The characteristic bridled-nature of organizational goals at the Philippine Department of Health meant that there was vertical stagnation of health programs, and failure to collaborate effectively with associated affiliates and third party organizations to expand the reach of health care services in regions and demography which did not have access or failed to utilize the programs already available. Facilities could not be improved at the same pace at which revenue was drawn, as allocation was based on legacy principles and had its own limitations. Besides, weak revenue too limited the program and the investment scope of several interested government and third party organizations. The expected impact due to additional revenue collected from Sin Tax, were not as expected. Further, there was difficulty in absorbing new revenues, thus mitigating the impact of sin tax.

3. Need of the Study

As governments across the world explore options to expand the list of commodities eligible for sin taxes – be it UK pondering Sugar Taxes, some of the state governments in the US considering Marijuana Taxes- it become important for an empirical study to identify the 'real' beneficiaries of such taxes. Economists and financial experts have established that optimization taxes can be leveraged to ensure that there is proper balance between corrective motives and redistribution of allocation motives.

4. Statement of the Problem

"Sin Tax": "Who Is The Real Beneficiary ? Society or Government? -An Investigation"-

5. Objectives

This paper researches the imposition of sin taxes in various countries. It shall evaluate the co-variation between consumer bias, demand and price elasticity, and incomes of consumers. Additionally, the paper also identifies the variation that occurs when sin tax rises, falls and the redistribution of motives. The research establishes that the dependence of optimal tax on the covariances is independent of internality taxes and is not applicable to externality taxes. The research also concludes that by studying optimization of taxes, techniques and tools can be optimized to ensure that ensure the fine balance between 'corrective' and 'redistributor' motives.

6. Hypothesis

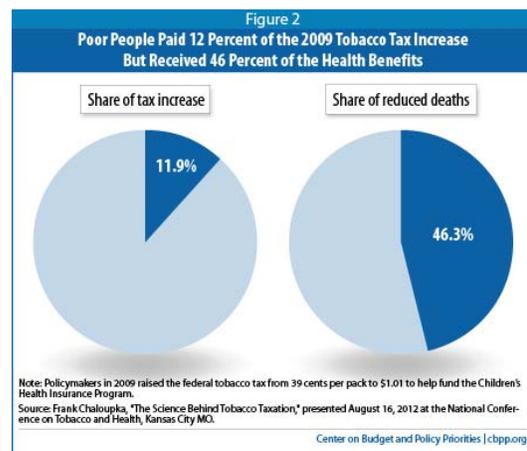
When consumers are not inclined towards regressive tax, then the sin tax redistributes – taking from the poor to the rich. The rich are effectively not paying more for their sin commodity. Consumers bias is the bases for optimizing commodity tax and very dependent on elasticity.

7. Research Methodology

In their research work, Benjamin B. Lockwood and Dmitry Taubinsky, in order to find out if misoptimization is at the low-income level or the high-income distribution level, a bias concentration was considered. The variation between income, bias as well as the co-variance between income as well as price elasticity of demand was studied based on Saez (2002a), Atkinson (1976) models. These models have already established that the goods that are preferred by low income consumers have to be sold at a 'discount' or be subsidized. While, those of high income group have to receive higher taxes, thus establishing that corrective motives have to be balanced with redistribution motives. Such a revenue appropriation will necessarily ensure optimization and thereby balanced taxation system, instead of the inverted 'sin taxation' system.

8. Results & Discussion

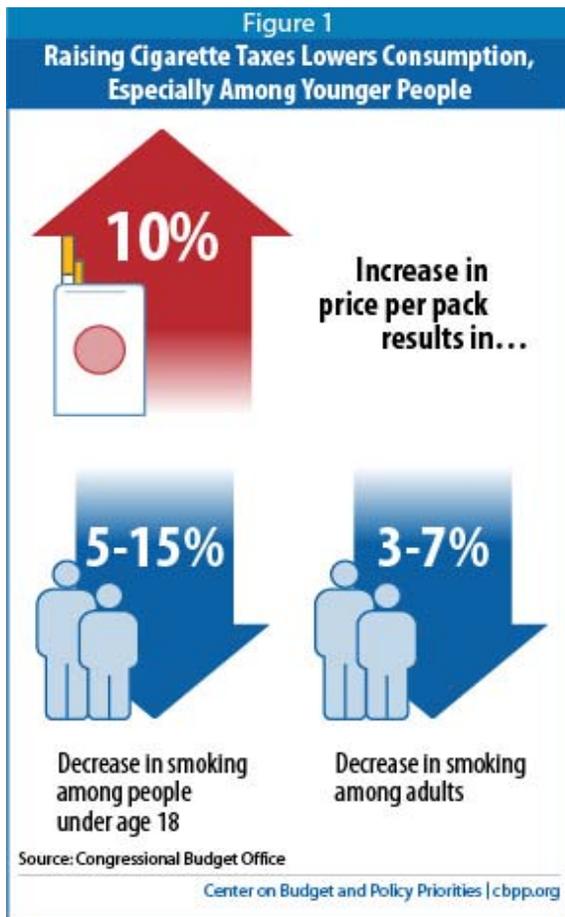
The research process in the literature reviewed, effectively shows that regressive taxes such as 'sin taxes' are a misinterpretation of 'corrective motives.' While the government's intentions are well-established that misoptimization of commodities such as cigarettes, tobacco or alcoholism lead to massive medical complications and place unbearable pressure on the health care services systems supported by the government. The need for the government to raise revenue through taxes, though appropriate is widely non-acceptable in the case of sin taxes.



Civilization has always witnessed overconsumption of certain ‘non-significant’ commodities. These have been taxed and prices increased exponentially, so as to deter their consumption, and also augment state coffers. However, the framework and models used in this research study help to establish that the inequality in incomes is a significant factor to consider when framing tax laws. This is because the earnestness towards redistributive motives is quickly overridden by corrective motives. The analysis in the literature review (Lockwood, B. and Taubinsky, D., 2015) [4] showed that optimization of taxes is possible subject to the size or magnitude of bias the consumer has for the product. However, it is also clear that redistributive and corrective motives are not necessarily opposed to each other.

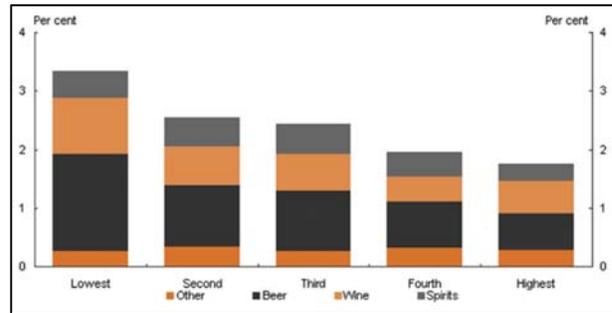
9. Findings

Lockwood, B. and Taubinsky (2015) [4] research established that both redistributive and corrective motives reinforce each other. Further, it was found that they are covariant with the income of a person and subject to the elasticity towards sin tax. Another factor to consider is the consumer’s bias in the context of the average consumer. This covariation therefore, changes the magnitude of the optimal corrective tax to be applied.



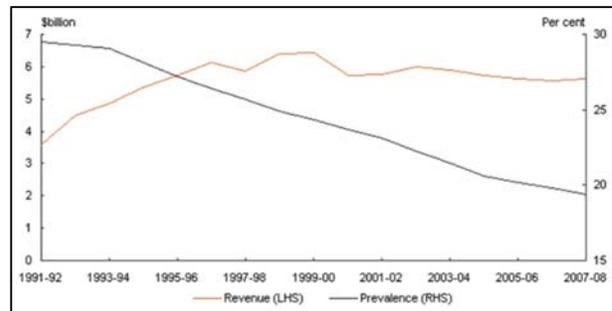
10. Recommendations

Sin taxes, although an effective tool, in the context of excise commodities, should be used sparingly and effectively. The optimization of taxes should allow for faster and effective scope for balancing corrective and redistributive motives.



Source: ABS (2006a).

Appendix 1: Spending on alcohol as a percentage of gross household income By gross income quintile (2003-04)



Source: ABS (2008h); AIHW (2008); Australian Government (2008a).

Appendix 2: Smoking prevalence and tobacco excise revenue 1991-92 to 2007-08 (2007-08 dollars)

11. Conclusions

The research work, based largely on literature review, of researchers in the field of behavioural economic finance, provides great insight into tax policy and its use in achieving social objectives. However, it is necessary to also understand that overexploitation of regressive taxes would be detrimental and have different repercussions. Thus, by using empirical studies and research work, tax policies have to be aligned such that social objectives are achieved. Thus, the research work clearly establishes that sin taxes, are a means of increasing the revenues of the government, and do not necessarily deter the consumer from the overconsumption of such commodities. Therefore, it is recommended that governments optimize taxes in such a manner that redistribution of corrective motives. Hence, the research clearly establishes that the direct beneficiary of Sin Tax is the government and not the consumer.

12. Limitations

The limited access to consumer data, with specific references to cigarette, tobacco, or alcohol was a challenge for field-based research and analysis.

13. Scope for Further Research

The need to identify patterns of consumption of commodities such as cigarette, tobacco, or alcohol.

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