

SOAKING THE POOR

DISCRIMINATORY TAXATION OF TOBACCO, ALCOHOL AND GAMBLING

By ALAN MORAN

Taxes ranging from over 40 per cent to a mammoth 339 per cent on alcohol, tobacco and gambling have mercilessly exploited the consumer's fondness for these goods and services. The only other bundle of taxes that come within this range—those on petrol, at about 130 per cent—at least have the justification that they are a proxy means of collecting revenue for roads.

Soaking the Poor is an apt description of the effects of very high taxes on a narrow range of products that tend to represent a greater share of the consumption of the less well-off. The taxes lift fully 10 per cent of the income of the poorest members of society, a matter that receives remarkably little attention from those claiming to represent their interests.

Governments—particularly State Governments—have become heavily reliant on the revenues from these taxes. They account for a fifth of States' own revenue-raising and over a quarter in the case of Queensland and Tasmania. These shares have been showing a steady increase because of the narrow base the States have in their taxation opportunities.

The unfairness of these taxes and the distortions they bring about are testimony to the inefficient, *ad hoc* base of our tax structure. Radical reform is required to bring us closer to the tax neutrality which is the hallmark of an efficient and fair society.

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TAXATION REFORM PROJECT

SUMMARY AND CONCLUSIONS

Introduction

Those seeking to develop a fair and efficient taxation system for Australia face many dilemmas. The fundamental problems have been outlined in the first paper in this series, *Restoring the Balance: Tax Reform for the Australian Federation*. Among these problems is the very high proportion of taxes levied directly on income. These include taxes that effectively penalise saving, and taxes (like the Financial Institutions Duty) on transactions which discourage funds moving to areas where they have greatest value.

It has been generally agreed for some time now that reform of Australia's taxation system should include a re-balance which involves decreasing taxes on income and increasing taxes on consumption. In addition, fundamental changes are required to the present system of indirect taxation in Australia. The ideal indirect taxation system is one which has a single rate, simple tax on final consumption without exemptions; and Australia's hotchpotch of different rates and exclusions induces vast distortions, with the economic waste these bring, across the whole economy.

Issues in Indirect Taxation Rates

Within the indirect tax net, there is a polarisation of demands.

On the one hand, traditional notions of fairness have decreed that taxation of the 'necessities of life' should be avoided—a point of view which strongly emerged during the *Fightback!* debate a few years ago. On the other hand, taxing luxuries or non-necessities, by definition, means taxing things that consumers can do without and which they will consume less of once the tax is incorporated into the price. Less consumption means lower revenue. Fur coats and luxury motor vehicles cannot be taxed much more than at present, since this would lead consumers to evade the tax by ceasing to spend—the revenue raised may even be diminished, and the only point of the tax would be the satisfaction of soaking those of the rich who remained obdurate enough to buy at the new high price.

Although there are basic necessities of life, it is clear that all citizens in affluent societies have a relative abundance of these. The average Chinese citizen earns perhaps a fifth of the income of the poorest segment of Australian society (and even man-

ages to save 40 per cent of his or her income). Indeed, although food is undoubtedly a necessity, within western societies the more serious problem among the poorest sectors is obesity rather than malnutrition.

Similarly, the notions of luxury and necessity are a judgement in the eye of the beholder. And the judgement itself echoes with the sounds of the puritanical sentiment that people—and especially the less affluent—ought to spend money only on the goods and services that keep body and soul together. Increased affluence, however, means that yesterday's luxuries tend to migrate into the necessity camp. (So, for instance, the initially costly safety features that make expensive cars expensive eventually become part of the mass car market.)

Because people can choose not to consume those 'frivolous' expenditures that become too expensive, the most effective taxes are those levied on goods and services that are relatively unresponsive to changes in price. Although the traditional necessities—food, clothing and shelter—are already 'over-consumed' on a strict basis of need, if the tax net is cast sufficiently widely on these products there is likely to be little leakage to untaxed or less-taxed goods. Because of political opposition, however, it is unlikely that an Australian government could introduce a tax system that markedly raised revenue in these directions.

Compounding these difficulties, the area of demand that is growing most rapidly and which remains most lightly taxed is services. The failure of the GST to obtain electoral approval means that this, too, appears to be closed off from early action which might enable a re-balancing of the taxation burden between taxes on income and taxes on consumption. Yet many services epitomise the idea of non-essentiality; and the fact that goods and services are often substitutable (so that one can hire an accountant or buy an accounting software package, for instance) merely reinforces the anomalies. Moreover, a high share of expenditure on (untaxed) services is characteristic of the consumption patterns of the more affluent.

THE DISCRIMINATORY TAXES ON TOBACCO, ALCOHOL AND GAMBLING FALL PARTICULARLY HEAVILY ON POORER PEOPLE. ON AVERAGE, THOSE HAVING THE LOWEST FIFTH OF INCOME LEVELS PAY SOME \$15 PER WEEK IN TAXES ON THESE GOODS AND SERVICES

The Tax Rates on Alcohol, Tobacco and Gambling

Within this jumble of revenue needs and taxation constraints, alcohol, tobacco and gambling have a rare position. These goods and services are thought of as non-necessities, have reasonably few substitutes, a demand profile that changes relatively little in response to price changes, and are considered by many to have some undesirable features, features which allegedly require public intervention.

Alcohol, tobacco and gambling have the highest levels of tax of any goods and services. The cascading effect of State and Commonwealth taxes brings the total tax on wine, the most favourably treated of these goods and services, to 41 per cent of wholesale value. This is comparable to the burden on luxury cars, the most highly taxed other good. The tax rate on gambling exceeds that on luxury cars. Beer pays 91 per cent, while spirits and tobacco pay a massive 253 per cent and 339 per cent respectively.

The discriminatory taxes on tobacco, alcohol and gambling fall particularly heavily on poorer people. On average, those having the lowest fifth of income levels pay some \$15 per week in taxes on these goods and services, nearly half as much as those whose income is ten times as great. Put differently, those in the lowest income category are paying 10 per cent of their income in taxes on alcohol, tobacco and gambling, while those in the highest income category are paying only 2 per cent.

Not only are the taxes on these goods and services extortionate, but their design is skewed so that the impact is heaviest on the less affluent. This is most apparent in the case of alcohol, where beer—the preferred beverage of the less well-off—is taxed at over twice the rate of wine, the preferred beverage of the better-off.

The punitive tax rates on goods and services that are consumed so relatively heavily by those on the lowest incomes does not square with the fairness which purports to be one of the overriding goals of taxation. It is remarkable that so few voices among those challenging the equity of the present tax system are raised against the very taxes that impact most heavily on the poor.

Contribution of Alcohol, Tobacco and Gaming to Government Revenues

State Governments depend on this group of goods and services for nearly 20 per cent of their own revenue-raising. This reliance on a narrow expenditure base and the general imbalance of the State govern-

ments' expenditure requirements and their revenue-raising capacities is symptomatic of the fragility of Australia's present taxation arrangements.

TAXES, THE CONSUMER AND ECONOMIC DEVELOPMENT

All taxes distort production and consumption decisions. They create a wedge between what consumers are prepared to pay and what producers are prepared to offer. Normally, the higher the tax, the greater the distortion. A high tax either chokes off demand and shifts consumers to less preferred purchases, or it soaks up income that would otherwise be spent on other purchases. The result is that the consumers' wants are less satisfactorily met.

Governments require revenues for their expenditure requirements. The extent of their income take, however, at thirty per cent-plus of Gross National Product in most developed economies, is far in excess of the level where it does little damage to productivity and the growth of national output.

The least distortionary form of tax is one imposed on expenditure and at a single rate. Such a tax would not be a burden on income that is not actually spent, and so would avoid discouraging saving and its corollary, capital investment. Nor would it fall on financial transactions—impositions on these expenditures lead to actions designed to evade tax, resulting in a reluctance to shift funds to their most productive uses.

DISCRIMINATORY TAXATION

Discriminatory taxation is levied in response to three main factors:

- the effect on demand for the good or service following the influence of the tax on price;
- the political acceptability of taxing it; and
- the ease of collection.

The responsiveness of demand and supply is crucial if revenue is to be raised. Imposing a high tax on a narrowly-defined product will cause demand to shift to cheaper products. Conversely, placing a lower tax on a product with similar features to other taxed products will cause demand to migrate toward that lower-taxed product, thus reducing aggregate revenues as well as distorting demand itself.

Political acceptability covers several dimensions. In some circles, it means taxing more heavily those goods that are mainly produced overseas, under the misapprehension that it is the foreigner who pays. More legitimately, it means taxing luxuries on the basis, first, that such measures impact more heavily on those with higher incomes who can better afford to pay the taxes, and, second, that the luxuries are, by definition, not required by notions of essentiality. The problem is that there is no objective definition of luxuries, and yesterday's extravagances often become today's necessities.

The political acceptability of high taxes on certain alcoholic products and on tobacco has long been evident. In the case of distilled spirits, the level of taxation is so high that the government's share of the product's aggregate value considerably exceeds the owner's. For many governments, this has meant that they have, for most practical purposes, assumed ownership for themselves. Indeed, until recently, the

control of entry into storage areas was not vested with the wholesaler or manufacturer but with an excise official. This was abandoned only when it was seen to be unwieldy and costly.

The most heavily taxed items, like spirits, beer and

cigarettes, have the bulk of their taxation levied as a volume-based excise (which shields their real taxation rates from public scrutiny). In the past, because tax increases on these products brought an unfavourable electoral reaction, their increases tended to be uneven, in response to the electoral calendar. Tax increases—either to regain the real level of taxation in periods of inflation, or to increase that real rate—tended to take place when no election was expected.

Over the past dozen years, excise has been linked to the Consumer Price Index. This is designed to even out the tax increases, and to make them as smooth as increases in the Wholesale Sales Tax which take place automatically as the prices of taxed goods increase.

In addition to indexation, there have been further discretionary tax and franchise fee increases on some excised prod-

ucts. In the case of tobacco, increases have even been brought in at ostensibly unfavourable junctures of the electoral cycle—the perceived adverse effects of the product are apparently such that increases in its tax rate now incur little odium.

LEVELS OF TAX ON ALCOHOL, TOBACCO AND GAMING

Alcohol and tobacco carry several layers of tax. Beer and spirits have Commonwealth Wholesale Sales Tax at 22 per cent (for wine and other alcohol it is 26 per cent), and excise taxes (or their equivalents in customs duty). All alcohol products also face State franchise taxes. Tobacco does not pay Wholesale Sales Tax, but has very high excise duties.

Comparable tax rates are difficult to assemble in the case of gambling, because the product does not have an easily defined wholesale value, and expenditure levels bear little resemblance to the data derivable from the Household Expenditure Survey of the Australian Bureau of Statistics. Most expenditures on gambling are also, of course, returned to winners. The tax rates cited below are based on revenues collected and National Accounts data on net expenditure by households gaming activity.

These tax rates are converted into a share of expenditure, taking into account the retail mark-up. The tax share of expenditure is lower than the tax on output, even without a retail mark-up, because the rate is expressed as a percentage of the sum of the tax and the pre-tax price. (The figures for gaming already include the retail mark-up.) The tax rates are shown in Table 1.

THE AVERAGE SHARE OF TAX IN FINAL CONSUMPTION OF ALL GOODS AND SERVICES IS 10 PER CENT. EVEN WINE HAS A TAX RATE TWICE THAT LEVEL, WHILE THE TAX ON SPIRITS AND TOBACCO IS FIVE AND SIX TIMES THE AVERAGE

Table 1: Tax Rates on Alcohol, Tobacco and Gambling (%)

| | Wholesale sales tax equivalent | | | Tax share of expenditure |
|------------|--------------------------------|-------|-------|--------------------------|
| | C/W | State | Total | |
| Alcohol | | | | |
| beer | 70 | 21 | 91 | 35 |
| wine + | | | | |
| undefined* | 26 | 15 | 41 | 22 |
| spirits | 215 | 38 | 253 | 52 |
| Tobacco | 120 | 219 | 339 | 62 |
| Gambling | 0 | 42 | 42 | 30 |

Source: State and Commonwealth Taxation Statistics and revenue collections.

*Note: undefined alcohol refers largely to cider and alcoholic sodas.

**SOAKING THE POOR:
DISCRIMINATORY TAXATION OF TOBACCO, ALCOHOL AND GAMBLING**

The average share of tax in final consumption of all goods and services is 10 per cent. Even wine has a tax rate twice that level, while the tax on spirits and tobacco is five and six times the average. Taxes are higher on alcohol, tobacco and gambling products than on almost all other goods. Expressed in Wholesale Sales Tax equivalents, the tax on tobacco is in fact the highest level of tax that is levied, that on spirits the second highest, beer the third. The only other product that comes close to these tax rates is luxury motor vehicles at 46 per cent (a level which is in fact lower than the tax on gambling once the retail mark-up on cars is included).

INTERNATIONAL COMPARISONS

High tax rates on these goods are found in most countries throughout the world. The taxation levels often reflect long-standing historical factors, and vary in response to particular social and economic pressures and the lobbying power of producer and consumer interests. In this respect, wine has long been able to win favourable taxation treatment in countries with strong domestic industries. Low rates for wine are seen in France, Italy, Germany, the US and to some degree Australia. Beer taxes are low in France, Germany and the US. (They are also low in Switzerland where a constitutional amendment would be required to lift the tax rate.) In Japan, the traditional use of sochu and sake has left wine and spirits at lower tax rates than beer.

Table 2: Approximate Tax Burden On Alcoholic Beverages (1991)* (per cent)

| Country | Beer | Spirits | Wine |
|-------------------------------|------|---------|------|
| Australia | 31 | 48 | 21 |
| Canada | 53 | 82 | 69 |
| France | 17 | 42 | 17 |
| Germany | 19 | 64 | 12 |
| Italy | 26 | 36 | 8 |
| Japan | 44 | 23 | 22 |
| NZ | 30 | 39 | 32 |
| UK | 32 | 48 | 35 |
| US | 18 | 45 | 17 |
| All Developed Countries (avg) | 32 | 55 | 30 |

Source: Brewing Association of Canada.

*Note: The rates for Australia are equivalent to those shown in the final column of Table 1. There have been some minor tax changes since 1991.

Average tax levels also tend to be somewhat distorted by the very high rates in the Scandinavian countries. In those countries, however, duty-free and illegally distilled liquor is believed to form some thirty per cent of alcoholic consumption as a result of the punitive tax regimes—such alcoholic consumption is also believed to form a sizeable 18 per cent of the Canadian total. Table 2 contains some international comparisons.

The difference between the taxation rates of these similar products contains some noteworthy points. Among these is that, in 1991, Australia actually had the distinction of both the lowest ratio of wine-to-beer tax among OECD countries and the highest ratio of spirits-to-beer taxes. This suggests that the distortion between these similar goods is much too great. This sort of indication did not persuade the majority authors of the recent Wine Industry Inquiry markedly to re-balance the tax rates on the different product categories, because they were not convinced that there was sufficient evidence that the products formed the same basic market.

In the case of tobacco, high tax rates are also set in most other countries.

Table 3: Share Of Final Sales Price (including taxes) Of Tobacco Accounted For By Taxes (per cent)

| Country | Tax Effect |
|------------|------------|
| Australia* | 65 |
| Canada | 53–72 |
| France | 76 |
| Germany | 70 |
| Italy | 73 |
| Japan | 60 |
| NZ | 68 |
| UK | 78 |
| US | 19–43 |

Source: Tobacco Institute of Australia.

*Note: The Australian rate differs from Table 1 due to slightly different base price assumptions.

One feature of Australia's taxation base is the high proportion that is raised in direct income taxes. The corollary is a low proportion collected in indirect taxes. Hence, although Australia's taxes on tobacco and alcohol are not markedly different from those of other countries, relative to other indirect tax collections they are very high.

EFFECT OF THESE 'LUXURY' TAXES ON DIFFERENT GROUPS

The Different Patterns of Expenditure

In their incidence, the taxes strike at a relatively narrow class of consumption. In doing so, they are highly regressive, having a particularly severe impact on lower income earners.

The extent of this is not easy to track, since respondents to statistical surveys consistently understate their expenditures on these goods and services. The

Household Expenditure Survey of the Australian Bureau of Statistics accounts for only 65 per cent of the known consumption of alcohol, 61 per cent of tobacco and 25 per cent of gaming. The identification of only 25 per cent of gaming expenditure presents particular analytical problems.

While some of the alcohol shortfall could be attributed to corporate entertainment, this could not be the case for tobacco or gaming.

The following data take the 1993–94 Household Expenditure statistics for five strata of income levels. The shortfall of declared expenditure from known consumption is reallocated to the different income strata in proportion to their declared levels of expenditure.

Table 4: Weekly Expenditures By Income Group

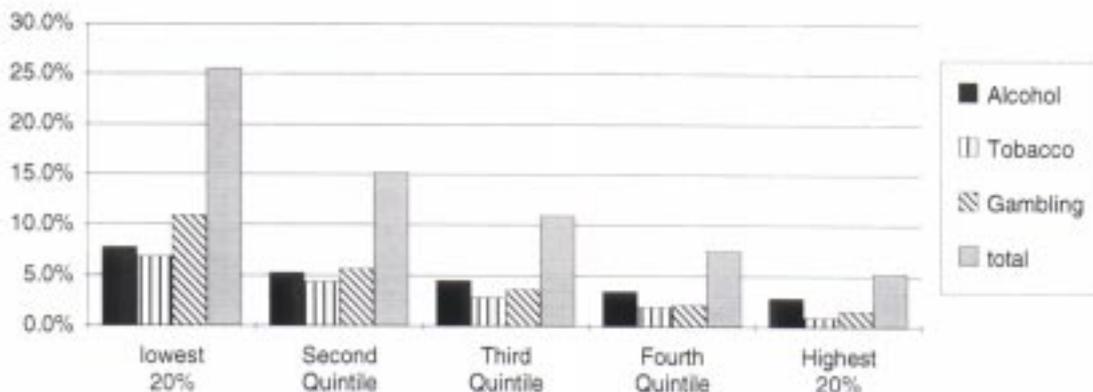
| | lowest 20% | Second quintile | Third quintile | Fourth quintile | Highest 20% | All households |
|----------------------------------|---------------|--------------------|-------------------|--------------------|----------------|-------------------|
| Pre-tax average household income | \$151.66 | \$353.91 | \$592.28 | \$909.22 | \$1,608.77 | \$723.26 |
| Expenditure on: | | | | | | |
| Alcohol (total) | \$11.72 | \$18.25 | \$26.41 | \$31.01 | \$45.65 | \$26.88 |
| beer | \$7.26 | \$10.29 | \$15.18 | \$17.65 | \$20.65 | \$14.29 |
| wine + undefined | \$2.55 | \$4.54 | \$6.52 | \$7.94 | \$16.34 | \$7.77 |
| spirits | \$1.91 | \$3.42 | \$4.71 | \$5.42 | \$8.66 | \$4.82 |
| Tobacco | \$10.46 | \$15.44 | \$16.87 | \$17.74 | \$14.85 | \$15.07 |
| Gambling | \$16.64 | \$20.08 | \$21.64 | \$19.88 | \$25.20 | \$20.68 |

There is a vast disparity in the share of household income that is spent on this narrow range of goods and services. The expenditures in aggregate amount to a little under 9 per cent of household income. For the poorest fifth of the community, however, they account for 26 per cent of income and are 15 per cent for the next poorest fifth. By contrast, they account for only 5 per cent of the income of the high-

est-earning fifth of households and 8 per cent of the next highest fifth.

These disparities are not markedly changed if gaming is excluded. The proportions of income accounted for by alcohol and tobacco taxes from the lowest fifth is 15 per cent, compared to 4 per cent from the highest fifth. Figure 1 below illustrates these data.

Figure 1: Expenditure Shares by Income Group



The Taxation Impact

The combination of very high tax rates on these goods and services and their high usage by lower-income categories places a disproportionately high burden on lower-income earners. Some 10 per cent of the income of the lowest fifth of income earners is

accounted for by tax paid on alcohol, tobacco and gambling. For all income categories, the average is 3–4 per cent, while for the highest earners, the average is 2 per cent of income and 2.7 per cent of after-tax income. Table 5 summarises these estimates.

Table 5: Taxation Paid By Different Income Categories (\$ per week)

| | lowest 20% | Second quintile | Third quintile | Fourth quintile | Highest 20% | All households |
|--------------------------|---------------|--------------------|-------------------|--------------------|----------------|-------------------|
| Average household income | \$151.66 | \$353.91 | \$592.28 | \$909.22 | \$1608.77 | \$723.26 |
| Disposable income | \$149.59 | \$335.90 | \$511.93 | \$737.88 | \$1195.90 | \$586.23 |
| Tax on: | | | | | | |
| Alcohol (total) | \$4.09 | \$6.38 | \$9.20 | \$10.75 | \$15.32 | \$9.21 |
| beer | \$2.54 | \$3.60 | \$5.31 | \$6.18 | \$7.23 | \$5.00 |
| wine + undefined | \$0.56 | \$1.00 | \$1.44 | \$1.75 | \$3.59 | \$1.71 |
| spirits | \$0.99 | \$1.78 | \$2.45 | \$2.82 | \$4.50 | \$2.50 |
| Tobacco | \$6.48 | \$9.57 | \$10.46 | \$11.00 | \$9.21 | \$9.34 |
| Gambling | \$4.99 | \$6.02 | \$6.49 | \$5.96 | \$7.56 | \$6.20 |
| Total | \$15.57 | \$21.98 | \$26.15 | \$27.70 | \$32.09 | \$24.76 |
| % of Income | 10.3% | 6.2% | 4.4% | 3.0% | 2.0% | 3.4% |
| % of Disposable Income | 10.4% | 6.5% | 5.1% | 3.8% | 2.7% | 4.2% |

OTHER ISSUES ON THE COMPOSITION OF THESE 'LUXURY' TAXES

The regressive incidence of these taxes is amplified by different rates in the case of both tobacco and alcohol. For tobacco, the excise tax is levied by weight. Accordingly, it falls relatively more heavily on the cheaper tobacco types which are consumed more heavily by poorer people.

The high tax rate on tobacco also tends to have a heavy impact on younger people, as a much larger proportion of people in the age groups over 40 have either never smoked or have ceased smoking. Tobacco usage presents a risk to longevity, but this is not a risk that any smoker can be unaware of. It is argued that governments have a duty to deter this activity, and penal taxation rates can certainly have this effect. But smokers, like other members of the community, are best placed to determine for themselves how or whether they trade off relative preferences for the product and its adverse health effects. (This is not to say that non-smokers who dislike the environmental impact of smoking should not be able

to demand its non-use where it has some impact upon them.)

It is often claimed that the high tobacco tax compensates for the increased health costs its usage entails. The tax collections, however, vastly overcompensate for any such costs.¹ Indeed, to the degree that smokers die younger than non-smokers, a cold social cost–benefit approach would indicate that its consumption reduces the costs of maintaining 'un-productive' older citizens!

¹ The best and most comprehensive assessment of the costs and benefits of smoking in Australia is by ACIL Economics in *Smoking: Costs and Benefits for Australia*, March 1994, which concludes that:

'The principal market imperfections relevant to smoking are tobacco taxation (imposed at a much higher rate than for other products) (\$2.5 billion), tariff imposts (which allow higher tobacco product prices to prevail within Australia) (\$0.1 billion), partly offset by more intensive use by smokers of subsidised health care (\$0.4 billion). This nets out to an annual transfer of \$2.2 billion away from smokers, mainly to consolidated revenue.

Thus, contrary to popular belief, the level of taxation on tobacco products easily exceeds claimed health care costs by smokers on the community.'

The continued high usage of tobacco in the face of escalated taxation levels is evidence that it is highly preferred by those using it. Its persistent usage is indicative that it is addictive. The evidence for this is somewhat challenged by the vast number of people

(perhaps the majority of the population over 45) who are former smokers. In any event, if it is indeed addictive, it is somewhat anomalous that the victim's habit should be punished.

In the case of alcohol, health concerns are also sometimes offered as a rationalisation for high taxes.

These claims are spurious: very few people consume sufficient quantities of alcohol to harm their health, and taxing it to deter such small proportions of the population would be akin to taxing food because some people over-eat. For other moderate consumers, alcohol actually has a beneficial health effect by reducing the incidence of heart disease—this effect is common to all types of alcohol.

As previously alluded to, the tax rates on beer, wine (including cider) and spirits are vastly different. These differences largely reflect historical and industry pressures. The wine lobby has successfully resisted taxation rates comparable to those of the other two categories. Yet beer, with an equivalent wholesale tax rate of over 90 per cent, is overwhelmingly the alcoholic drink of preference for those with lower incomes, while wine, with a rate of 41 per cent, is mainly consumed by the more affluent.

Even in the case of spirits, traditionally the preferred alcoholic drink of higher-income earners, the lower-income earners actually spend a higher proportion of their income on these products than higher income categories. Nor is there a plausible case for placing higher taxes on spirits because of their higher potency. Spirits drinkers are aware of the strength of the alcoholic content. In any event, almost all spirits are consumed in a mixed form and at strength less than that of wine.

The effect of the very high rates of tax on spirits is likely to come under severe pressure as a result of technological change in the industry. Alcoholic drink manufacturers are increasingly able to imitate the tastes of those products that face very high tax levels with lower-taxed substitutes. Thus, in Australia there is now a range of synthetic alcoholic products often

based on wine and cider (for instance, Two Dogs, Subzero, Father O'Leary's) that pay only a fraction of the tax rate of the products with which they compete. These products are enjoying an explosive growth in sales at the expense of the more traditional products.

Gambling expenditure may have increased markedly over recent years, though data on this are difficult to assemble as, prior to the legalisation of casinos and the introduction of gaming machines, there may have been a high incidence of illegal and unreported expenditure.

The tax on gaming is subject to a considerable number of distortions, not the least of which is local monopolies on casinos, which represent a regulatory tax on gamblers, a tax which State governments are seeking to collect in the form of specific franchise charges on the right to establish the monopoly.

In addition, some States have severe limitations on the installation of gaming machines. In Victoria, for instance, there is a limit of 27,500 such machines. The location of these machines is controlled, and there is an insistence that 50 per cent of them be placed in licensed clubs rather than pubs. Demand for their installation in clubs is fully satisfied, hence those pub owners fortunate enough to have the scarce supply are able to enjoy high profits whether for the machines themselves or from the products consumed while patrons use them.

Furthermore, there is a discriminatory tax regime between pubs and clubs, with the Government taking 33.3 per cent of the daily take in the former and 25 per cent in the latter. This is in addition to the income tax-exempt status that clubs enjoy, a distortion that a recent Industry Commission report on tourism has drawn to the attention of the Commissioner of Taxation.

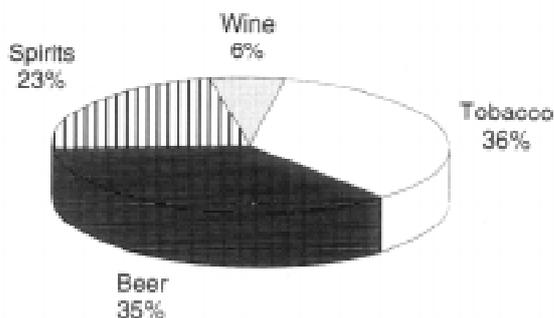
IT IS NOT ACCEPTABLE FOR GOVERNMENTS TO MAINTAIN THAT THEY SHOULD IMPOSE HIGH TAX RATES ON THESE GOODS AND SERVICES TO DISCOURAGE CONSUMPTION. SUCH A CLAIM WOULD BE HYPOCRITICAL IN VIEW OF GOVERNMENTS' OWN DEPENDENCY ON THESE REVENUES

THE SIGNIFICANCE OF 'LUXURY' TAXES TO GOVERNMENT REVENUE

The Commonwealth

Commonwealth revenue from tobacco and alcohol in 1994–95 is estimated at some \$4.2 billion. This comprises \$1,128 million in sales tax on alcohol and \$3,082 million in excise plus import duty on beer, spirits and tobacco. The share of the different products is shown in Figure 2 below.

Figure 2: Share of different products in total 'luxury' tax revenues

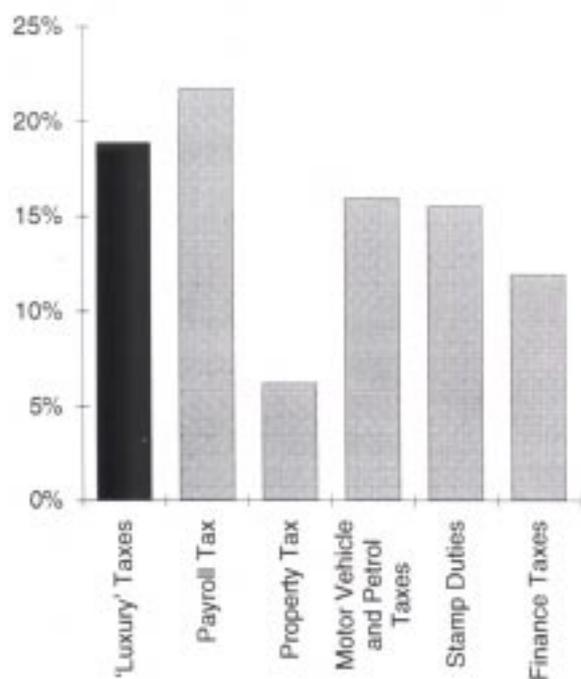


These goods account for over 15 per cent of Commonwealth indirect tax revenues and 4 per cent of total tax revenues. Over recent years, their growth has been relatively low—sluggish growth in consumption (and some shift out of higher-taxed and into lower-taxed alcoholic products) has been offset by continued tax increases on tobacco products.

The States

The 'luxury' taxes have grown to comprise one fifth of State revenues over recent years. They now account for only slightly less than Payroll Taxes, traditionally the mainstay of State finances, and are more important than property taxes (6 per cent), motor vehicle and petrol taxes (16 per cent), stamp duties (16 per cent) and the financial duties on bank and insurance transactions (12 per cent).

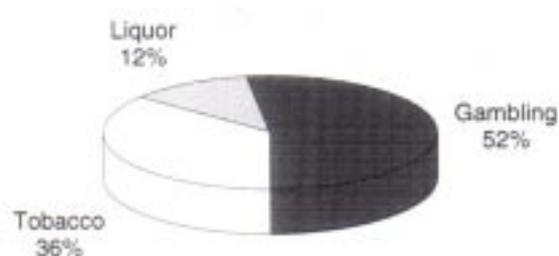
Figure 3: State revenue base



The 'luxury' taxes are responsible for over one-quarter of government revenues in Queensland and Tasmania. Figure 3 above illustrates their importance across the States in general.

These taxes have grown from a share of 15 per cent in 1989–90, largely due to an increase in tobacco taxation levels. Gambling taxes account for over half the revenues raised on the three product categories. The relative shares are shown in Figure 4 below.

Figure 4: Share of different products in total 'luxury' tax revenues



CONCLUDING COMMENTS

A range of very high taxes is levied on tobacco, alcohol and gaming, expenditures that are associated with extravagance or harmful activity. People tend to understate their consumption of these goods and services, possibly out of a sense of guilt about their indulgence in these expenditures.

Expenditure on tobacco, alcohol and gaming is equivalent to some 8 per cent of income in the average household, but 24 per cent for those on lower incomes. The high taxes on these goods and services have a very heavy impact on lower-income earners, accounting for 10 per cent of the incomes of the lowest quintile compared with only 2 per cent of the incomes of the highest income quintile.

The taxes on these products are highly regressive and a harsh impost on poorer people's leisure and social consumption.

There is a long tradition of citizens taking action against excessive levels of taxation—the Boston Tea Party being perhaps the most celebrated instance. One form of this action is being seen in other countries in the evasion of alcohol taxes; and in Australia there is a clear shift of supply and demand into the more lightly-taxed wine, cider and synthetic alcohol products.

The tax regime in Australia is over-dependent on revenues from alcohol and tobacco. One factor in this is the successive High Court decisions that have legitimised taxes that are effectively nothing more than State-based sales taxes as 'franchise' taxes. There is increasing urgency to redress the imbalance between the States' abilities to raise revenue and their expenditure requirements. Allowing the States some scope for more equitably and efficiently levying tax on goods and services would be a good start. Re-viewing the disallowance of State taxation on goods would allow greater scope for widening their taxation net.

At the Commonwealth level, one major necessary step is to bring greater balance to the tax rates for similar products, in particular wine, spirits and beer.² Technological changes are already disturbing the fragile equilibrium that has allowed such disparate rates to persist for so long. Even so, there has

² While a volumetric tax on all alcoholic beverages would redress the distortion between different alcohols, it would still leave the problem of inequity in the tax rates between alcohol and other goods and the effects of this on different income groups.

been a steady erosion of beer's market share, to the benefit of wine. Without early action, we will see economically wasteful decisions as suppliers reformulate their products purely to benefit from differential rates.

It is not acceptable for governments to maintain that they should impose high tax rates on these goods and services so as to discourage consumption. Such a claim would be morally ambiguous in view of governments' own dependence on these revenues. More importantly, however, it is not the role of governments to encourage or discourage different sorts of expenditures by their citizens. Rather, it is a fundamental role of government to preserve people's freedom to choose for themselves which goods and services they consume. The benefits which people obtain from consuming tobacco, alcohol or gaming clearly outweigh the value of the money they spend on them. In the absence of any adverse 'spillovers' affecting others from the consumption of these goods and services—and almost all the benefits and costs of consumption are borne by those buying them—the appropriate outcome is that they be taxed no higher than other goods and services.

ABOUT THE AUTHOR

Since July 1996, Dr Alan Moran has headed up the IPA's Deregulation Unit. For the previous two years he was Deputy Secretary, Energy in the Victorian Department of Agriculture, Energy and Minerals. Prior to then he was Director of Research at the Tasman Institute. Dr. Moran also spent 12 years with the Commonwealth Government where his positions included senior roles in the Industry Commission and Director of the Business Regulation Review Unit (now the Office of Regulation Review). As the author of four books and a great many articles on economics and regulatory matters, he has played a major role in promoting reduced levels of government intervention within the economy.

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