



Excise Taxes: A Tool of the Politically Powerful

by Amy K. Frantz

Excise taxes are often used to discourage or encourage certain behavior. Economic theory provides several justifications for the use of excise taxes, but rarely considers the political costs of these taxes. Randall Holcombe looks at the justifications for and the problems with excise taxes in “Excise Taxation and Interest Group Politics,” a chapter from *POLITICS, TAXATION, AND THE RULE OF LAW*, a new book from Public Interest Institute.

Public finance theory offers many justifications for relying on the excise tax as part of our overall tax structure. Excise taxes can be used as a source of revenue, to discourage certain acts (for example, increasing the cigarette tax to discourage smoking), or as a tool of industrial policy (encouraging or discouraging certain industries). However, the fundamental problem in relying on public finance theory to design the optimal excise tax system is that it doesn’t consider the political environment and the problems created by interest group politics.

One problem is that the justifications may conflict with one another. Political interest groups can argue for or against a particular excise tax, with groups on each side using equally valid, but conflicting, justifications for their position. Each political interest group will use the justification that suits them and their cause the best.

Another problem is that some of the information needed to determine the optimal excise tax may not be observable or objective. Governments have imposed excise taxes on goods such as cigarettes (“sin taxes”) and yachts (“luxury taxes”). But the decision on what items to tax and at what levels is not based on an objective economic measure. Fifty or sixty years ago, smoking was a generally-accepted activity, but it has now become socially unacceptable. Instead, the taxation of those goods is determined by the political clout of those on each side of the issue.

Excise taxes are also inherently redistributive. Excise taxes are imposed on a narrow base — a smaller pool of taxpayers — than a tax imposed on a broad base such as the income tax or sales tax. Narrow-based taxes set up a rivalry between the interests of those who pay the tax and those who do not.

The costs of taxation are not limited to the tax itself and the steps needed to comply with tax law. The tax system also imposes political costs, and “excise taxes have a greater potential to create political costs than more general and broadly based types of taxes.”¹ Political interest groups will lobby policymakers to gain tax changes favorable to members of the group. Citizens must also lobby to defend themselves from tax changes that may be unfavorable.

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Public Interest Institute at Iowa Wesleyan College

600 North Jackson Street

Mt. Pleasant, Iowa 52641-1328

Phone: 319-385-3462 Fax: 319-385-3799

E-Mail: public.interest.institute@limitedgovernment.org Website: www.limitedgovernment.org

Holcombe concludes that, because of the many problems associated with excise taxation, a substantial argument can be made against including excise taxes in the tax system. The best case that can be made for using the excise tax is only when the revenue from an excise tax is earmarked for a specific benefit to taxpayers, and there is clearly a link between the tax and the benefit.

Holcombe cites the example of the excise tax on motor fuels. If the revenue from this tax is used by the government to fund construction and maintenance of roads, the revenue is used specifically to benefit those who pay the tax. However, even this tax is susceptible to political interest groups that may want to use the tax revenue for other purposes, and will lobby to try to convince policymakers to use the revenue to benefit their cause.

Excise taxes are problematic and may impose greater political costs than other types of taxation. As a result, excise taxes should only be used in certain narrow cases, if at all. "In contrast to the goals of public finance theory, the use of excise taxes allows the politically powerful to tax the politically weak."²

ENDNOTES:

¹Randall G. Holcombe, "Excise Taxation and Interest Group Politics," in Donald P. Racheter and Richard E. Wagner (eds.), *Politics, Taxation, and the Rule of Law: The Power to Tax in Constitutional Perspective*, Kluwer Academic Publishers, Boston, 2002, p. 136.

²*Ibid.*, p. 134.

This Institute Brief is one in a series on the chapters of a recently published book, POLITICS, TAXATION, AND THE RULE OF LAW, edited by Dr. Don Racheter, President of Public Interest Institute, and Dr. Richard Wagner, Economics Professor at George Mason University and Chairman of the Institute's Academic Advisory Board. POLITICS, TAXATION, AND THE RULE OF LAW looks at the balance between providing government with the power to operate while preserving and protecting our rights of person and property.

The author of this chapter of POLITICS, TAXATION, AND THE RULE OF LAW is Randall G. Holcombe, Professor of Economics at Florida State University in Tallahassee.

This summary of Professor Holcombe's chapter was written by Amy K. Frantz, a Research Analyst with Public Interest Institute.

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