

Nanny State Taxes:

Soaking the Poor in 2012

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Free people, free society

Executive summary

- Nanny State taxes raised \$13 billion in 2010-11.
- This is greater than the combined revenue forecast of \$11 billion to be collected from the government's Clean Energy Future Package (carbon tax) and the Minerals Resource Rent Tax (mining tax) in their first year of operation.
- In 2012, Nanny State taxes on consumer products include:
 - Excises upon alcohol and tobacco products
 - The GST on processed foods (see Box 1)
- Nanny State taxes disproportionately affect those on lower incomes. The poorest twenty per cent of households (by income) pay three times as much in Nanny State taxes as those in the top twenty per cent.
- Nanny State taxes have long been used by Australian governments not only as a general revenue source, but to reduce consumption of commodities perceived to be harmful on health, social or moral grounds.
- With the Gillard government hoping to deliver a surplus budget outcome in 2012-13, it is likely that the government will resort to increasing Nanny State tax rates in a quick grab for revenue.
- In line with the recommendations of the Henry Review and National Preventative Health Taskforce, the government has signalled additional Nanny State taxes in the pipeline for future implementation. Groups purporting to represent the interests of low-income earners have been silent about recent Nanny State tax increases and, in some cases, expressed support for these tax increases.
- Nanny State taxes encourage consumers to switch to other harmful products, and create illicit 'shadow markets' for the taxed products. The hypothetical imposition of a 'fat tax' levy on top of the existing GST would cost taxpayers between \$67 and \$268 million per annum, with low-income taxpayers again disproportionately affected.
- The imposition of Nanny State taxes also hurts small businesses that rely on the sale of consumer products such as alcohol, processed foods and tobacco to raise earnings.

About the authors

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I hope my two sons never smoke. I also hope they never ride motorcycles, skydive, bungee jump, or become Democrats. But more than anything else, I hope they do not grow up thinking that choices such as these should be made by anyone but themselves.

- William F. Shughart II, 'Preface', in *Taxing Choice: The Predatory Politics of Fiscal Discrimination*, p. xiv-xv.

Introduction

Increasingly, governments seek to tax and regulate the individual choices of their citizens. These activities are designed to direct consumption behaviour away from activities which are seen to harm the person who makes that choice.

The 'Nanny State' is a phrase that successfully encapsulates the broader societal trend of increased government interference into the lives of individuals. While the incremental efforts of governments to consolidate the Nanny State in economic and social life are subtle, the overall trend is unambiguous. As David Harsanyi has written, the Nanny State is 'a place where government takes a hyper-interest in micromanaging the welfare of its citizens, shielding us from our own injurious and irrational behavior.'¹

Predominantly using health consequences and costs as a justification, Australian governments are incrementally encroaching into the lives of individuals to remove risk and the downstream consequences of choices. And through taxes, regulations and prohibitions, the key targets of these behavioural measures are consumer products such as salty, fatty and sugary foods and beverages; alcohol; and tobacco products.²

Though Australia is a leader in introducing government measures to redirect consumer behaviour, it is not unique. Similar trends are emerging around the world. Through the World Health Organisation, healthy lifestyles and tackling non-communicable diseases has become a priority issue for the United Nations.³ Following the introduction of the World Health Organisation's Framework Convention on Tobacco Control,⁴ proposals for a Framework Convention on Global Health that will seek to promote the use of policy instruments to direct consumer behaviour have also been proposed by health activists.⁵

The Rudd government's National Preventative Health Taskforce sought to translate the objectives of these international policy proposals into a national context. The Taskforce released a report in September 2009 advocating a raft of policies to direct the consumption patterns of individual Australians. Amongst these was a recommendation that government commission a review of taxation systems, and develop methods for using taxation to discourage the consumption of "harmful" consumer products.⁶

In addition to the National Preventative Health Agency's proposals there are a host of examples of how these measures have already been put into practice. In Australia advertisements are now being run to suggest that consuming alcohol can have equivalent cancerous effects as the consumption of tobacco.⁷ A coalition of anti-alcohol activists recently launched the Alcohol Advertising Review Board to target alcohol advertising and placements deemed inappropriate.⁸

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There are also many proposals on the table. Health activists are calling for sugar to be regulated by government like alcohol.⁹ Mandatory health warning labels that are equivalent to first generation anti-tobacco warning labels have been proposed for alcohol.¹⁰ And regulations have been proposed to restrict how sugary, salty and fatty food products are displayed on supermarket shelves.¹¹

Plain packaging – a relatively new policy instrument for consumer products – is also attracting widespread adoption through the forced removal of trademarks and branding from consumer products.

In 2009 the South Australian government legislated for the plain packaging of R18+ videos if they are not separated from other video stock accessible to children.¹² In 2010 the Commonwealth government announced its controversial, and now legislated plan, to plain package cigarettes and cigars and increase the size of health warning labels.

Off the back of Australian proposals the British government announced it is considering similar plain packaging measures on tobacco products,¹³ as well as the plain packaging of alcohol.¹⁴ British newspapers have allNanny Stateso proposed plain packaging of salty, fatty and sugary foods.¹⁵

But the most widespread currently used measure is the use of Nanny State taxes. Excise taxes on alcohol and tobacco products are well established in Australia, and the 10 per cent GST on alcohol, processed foods and tobacco is now a part of the tax policy firmament. These taxes appear to enjoy widespread support. The traditional role for taxation is to acquire revenue for financing public sector expenditures. Nanny State taxes differ in that they are primarily designed to change individual behaviour. They raise government revenue, and they discourage the consumption of the targeted product.

With the Commonwealth government under financial pressure to deliver a budget surplus, either spending needs to be reduced or taxation will increase, or a mix of both. With both the mining and carbon taxes now legislated it is unlikely that the Commonwealth will revisit increased taxes on the directly affected industries.

In the past, when the current government has chosen to increase tax revenues in a quick grab for revenue, or even a convenient political headline, behavioural, Nanny State taxes have been a clear target. In an effort to prevent the incidence of 'binge drinking,' the Commonwealth increased the excise tax on pre-mixed alcoholic drinks (known as 'alcopops') by 70 per cent in the lead up to the 2008 budget.¹⁶ The final report of the Henry Tax Review, released in late April 2010, recommended that the Commonwealth introduce a common volumetric tax on alcohol with the rate determined by calculations of the net marginal spillover cost of alcohol.¹⁷

Based partly on the subjective belief of former Prime Minister Kevin Rudd that 'cigarettes are not cool,' the federal government announced a 25 per cent surge in the tobacco excise rate in the lead up to the 2010 budget.¹⁸ This measure was expected to generate an additional \$5 billion in revenue over four years for a cash-strapped government looking to invest in public hospitals.¹⁹ As opposition leader, Malcolm Turnbull proposed to increase the excise on tobacco by 12.5 per cent in his 2009 budget reply.²⁰ Similarly, during the 2010 federal election campaign, the Australian Greens announced a 1.5 per cent levy on alcohol and junk food advertising, yielding up to \$4 billion in revenue, and a requirement to include health information on such advertising.²¹

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Foreign governments are following this path. In early 2012 the Danish government introduced a 'fat tax' to target the consumption of fatty food products.²² And there are proposals in the United States for a soda tax to target sugary carbonated beverages.²³

Recently the Scottish government introduced a floor price for alcohol, and a similar measure is now being considered in England.²⁴ In Australia, the federal Opposition flagged in-principle support for introducing minimum pricing for alcohol.²⁵ It should be recognised that while floor prices aren't necessarily achieved through extra taxation, as is the case in the United Kingdom, they have the same impact on the consumer.

The efficacy and socially unjust impact these taxes have is well documented. In 1996 the IPA's Dr Alan Moran wrote *Soaking the Poor: Discriminatory taxation of tobacco, alcohol and gambling*.²⁶ *Soaking the Poor* highlighted the disproportionate impact that Nanny State taxes designed to target behaviours have on lower socio-economic demographics. This report seeks to update and extend Dr Moran's 1996 analysis and assess the continual extension and impact of nanny state taxes.

As the information presented in this paper makes clear, the emerging policy positions of Australian political parties favouring Nanny State taxes is problematic on a number of grounds.

- Nanny State taxes infringe on the liberties of Australians to consume products of their choice.
- Nanny State taxes hurt the economic interests of the poorest in our community.
- Rising taxes on consumer products also invoke a host of unintended consequences that either exacerbate the problems the taxes purport to resolve, or create new ones in the process.

While it is commonly recognised that the consumption of certain products have potentially significant health consequences over time, it remains a fundamental tenet that in a free society individuals should retain the freedom to exercise their consumptive choices. Moves to engage in fiscal exploitation through additional Nanny State taxation should be eschewed as a policy stance.

1. Nanny State taxes: bigger than the carbon price and mining tax combined

Nanny State taxes have long assumed a place in Australia's armoury of tax impositions.²⁷ Governor John Hunter imposed the first formal tax in Australia, an import duty on alcohol introduced in 1800.²⁸ Two years later license fees were imposed on liquor retailers by the NSW government to build an orphanage.²⁹ Colonial governments gradually extended their customs duty and excise tax base to also cover tobacco and what were considered at the time to be 'luxury' food items such as tea, sugar, flour, meal, rice, grains and pulses.³⁰

In 1901 the states surrendered their customs duties and excises to the newly-established Commonwealth government, enabling the Commonwealth to impose uniform taxes as a way to facilitate freedom of interstate trade. In the early years of Federation these Nanny State taxes represented the major source of revenue for the Commonwealth, however their overall importance in the total revenue mix has declined over time especially since the post-World War II period as direct taxes - especially income taxation - contributed an ever-increasing share of revenues.

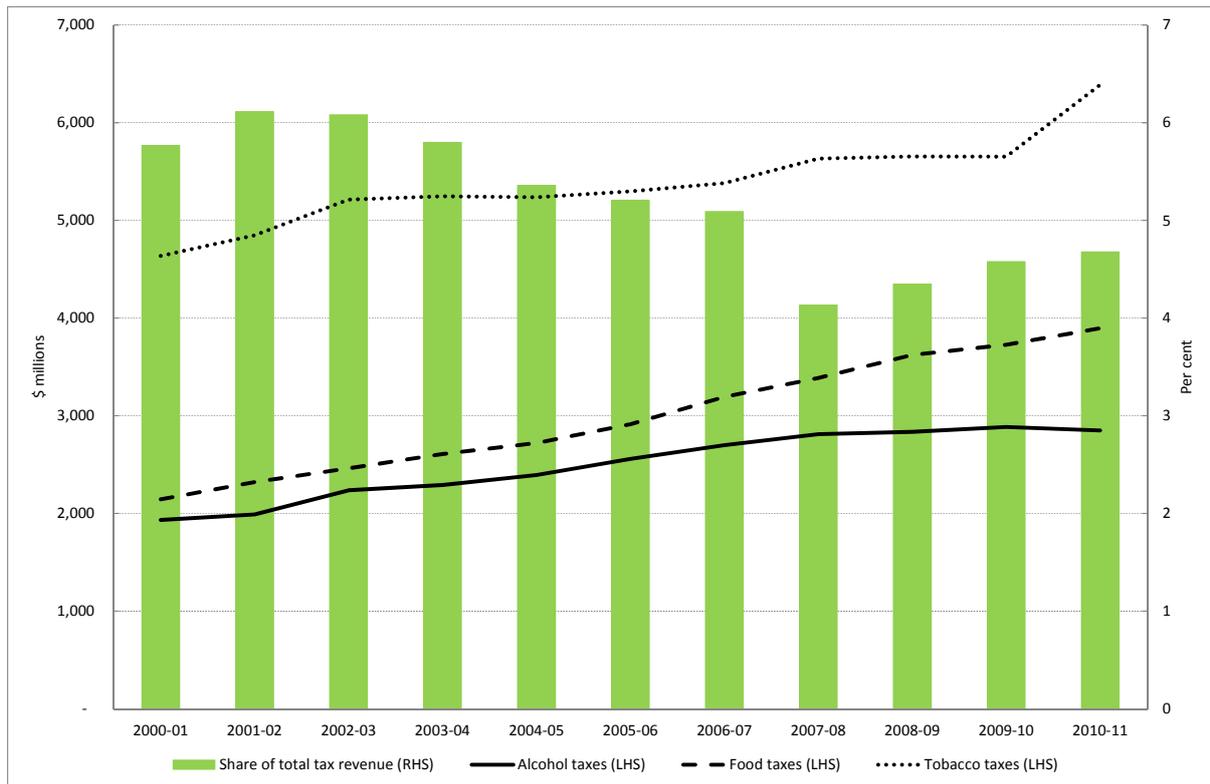
Faced with a severe budget shortfall at the time of the Great Depression, the Commonwealth government introduced a wholesale sales tax (WST). A host of basic foodstuffs were exempt from the WST with the exception of so-called 'luxury' items, including biscuits, chocolate, flavoured milk, muesli bars, orange juice, and soft drinks. Alcoholic beverages were also subject to the WST.

Concerned with the growing economic and legal arbitrariness of the WST system in the face of growing product variety and the development of the services sector, the WST was replaced by a 10 per cent goods and services tax (GST) in 2000 applicable to most goods and services produced and sold in Australia (including processed foods).³¹

It is possible to provide indicative estimates of the magnitude of revenues collected by the main Commonwealth Nanny State taxes - excises on alcohol and tobacco, and GST on processed foods (Figure 1).

In 2000-01 revenues from these sources totalled approximately \$8.7 billion, increasing to about \$13.1 billion by 2010-11 - an increase on an average annual basis of about 4.2 per cent. The share of Nanny State taxes to Commonwealth general government sector revenue fell from about 5.8 per cent in 2000-01 to about 4.1 per cent in 2007-08, however the relative importance of these taxes has since increased, reflecting a combination of changing economic conditions and public policies.

Figure 1: Revenues collected under commonwealth Nanny State taxes



Alcohol taxes include excises on alcoholic beverages. Tobacco taxes include excises on tobacco products. Food taxes estimated as GST imposed on processed food and non-alcoholic beverage expenditures. Processed food expenditure calculated on the basis of household final consumption expenditure on food presented in national accounts, with share of GST-taxable expenditure on processed foods derived from household expenditure survey data.

Source: Australian Bureau of Statistics, Household Expenditure Survey, Australia: Detailed Expenditure Items, 1998-99, cat. no. 6535.0; Australian Bureau of Statistics, Household Expenditure Survey, Australia: Detailed Expenditure Items, 2003-04, cat. no. 6535.0.55.001; Australian Taxation Office, GST Food Search: Detailed Food List, <https://expertsystems.ato.gov.au/scripts/net/SearchableFoodList/scSearchableFoodList.aspx?PID=68&ms=Businesses> (accessed 17 April 2012); Commonwealth of Australia, various years, Final Budget Outcome.

Contrasting the highly visible, and often acrimonious, debates concerning impending taxes on carbon dioxide emissions and mining rents against the (at best) muted reactions to Nanny State taxes is instructive: it reveals the prevailing order of priorities lent to taxation policy matters.

Many problems have been raised about the prospective implementation of a broad-based Commonwealth mining tax, including the impact of higher effective tax rates on an Australian mining sector increasingly subject to pressures associated with international competition.³² In a rare instance of explicit opposition to government policy by the business community, key mining sector participants had set aside up to \$22 million for advertising against the Rudd government’s Resources Super Profits Tax. This led to the subsequent Gillard government agreeing to a watered-down Minerals Resource Rent Tax (MRRT) applicable to coal, iron ore and some gases.

Meanwhile, the carbon tax scheme (to be set an initial rate of \$23 per tonne of carbon dioxide emitted by major industries) has established what can be best described as a ‘tax revolt’ of

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opposition from broad cross-sections of the community. Concerns over the impact of a carbon tax on the cost of living faced by individuals and families has had political ramifications, in the form of electoral defeats of the Labor Party in Victoria, New South Wales and Queensland, as well as continued weak polling for the Gillard federal government.

Revenue from the carbon tax is expected to raise about \$7.7 billion in 2012-13 (\$8.6 billion in 2013-14 and \$9.2 billion by 2014-15), with the Minerals Resource Rent Tax to raise about \$3.7 billion in 2012-13 (\$3.8 billion in 2013-14 and \$3.1 billion in 2014-15). However, the carbon and mining tax revenues in their first year (about \$11.4 billion in 2012-13) are expected to be *lower* than the total Nanny State tax revenues raised by the Commonwealth in 2010-11 (about \$13.1 billion). This is expected to remain the case at least in the short term.

Table 1: Nanny State taxes compared with the carbon price and mining tax

	Nanny State taxes	Clean Energy Future Package	Minerals Resource Rent Tax
Projected Commonwealth Revenue, 2012-14	\$13.1 billion	\$7.7 billion	\$3.7 billion

Source:IPA

Nanny State taxes in Australia: the state of play

Alcohol

The level of taxation on alcohol varies significantly on the basis of the varieties of alcoholic products available in Australia today.³³

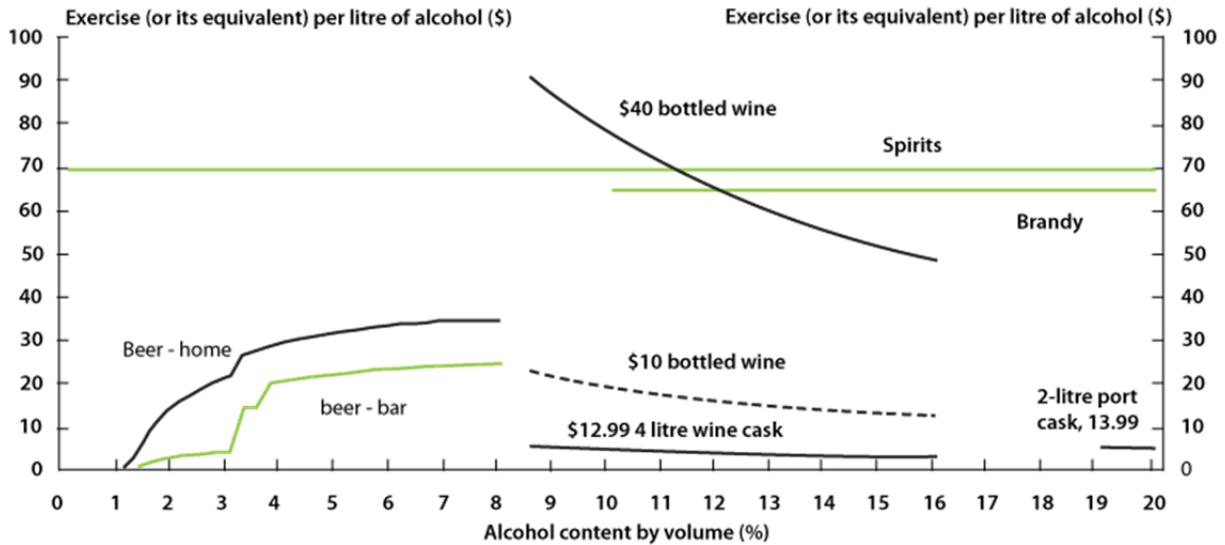
Beer, spirits and ready-to-mix ('alcopop') beverages below 10 per cent alcohol content are subject to excise or customs duty. Australian-produced alcohol products are subject to excise duty, collected by the Australian Taxation Office, while imported beer, spirits and alcopops are subject to customs duty collected by the Australian Customs Service.

Excise duties and customs duties (excluding a five per cent duty on imported products) are set on a 'volumetric' basis, thus they are levied on the actual amount of alcohol in the product. Excise duty and the volumetric component of the customs duty are set at the same level for each alcohol category, and are automatically increased twice a year to take account of movements in the consumer price index (CPI) in the previous six months.

All wine (such as cask and bottled wine, and other grape wine products such as marsala, vermouth, mead, sake and traditional cider) is subject to the Wine Equalisation Tax (WET). WET applies at the rate of 29 per cent of the last wholesale selling price (usually the last sale from the wholesaler to the retailer). The taxation of wine differs from that of beer, spirits and alcopops as it is a) levied on an *ad valorem* basis, rather than the alcohol content of the product, and b) there is no automatic six-monthly indexation of the WET. Imported spirits and alcopops (but not beer) is subject to an additional five per cent *ad valorem* customs duty.

Figure 2 shows the variation in tax for different alcohol products, at different levels of alcohol content.

Figure 2: Effective alcohol tax by beverage



WET is calculated using half-retail method.

Source: Australia's Future Tax System Review Panel, 2009, *Australia's future tax system: Report to the Treasurer*, Volume 2, Commonwealth of Australia, Canberra, p. 437.

Food

The main revenue-raising tax instrument imposed on most food and beverages (excluding alcohol) in Australia is the 10 per cent GST. Prior to its introduction in 2000 there had been many arguments mounted in favour of this value-added tax instrument, including its ability to impose a price penalty on unhealthy foods (Box 1).

In recent years a host of *ad hoc* levies on selective food products and additives, including sugar (three cents per kilogram), were introduced to help fund industry restructuring packages by the federal government. These levies have been subsequently abolished.

Box 1: The Australian GST as a fat tax

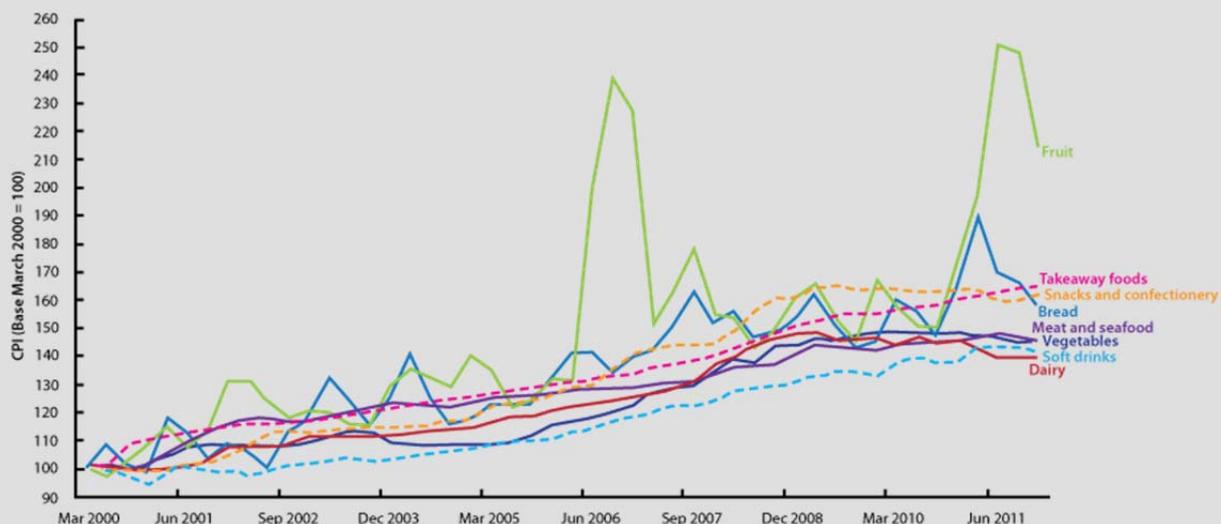
Most Australians may not be aware that one of the varied arguments in favour of the Goods and Services Tax (GST), introduced on 1 July 2000, was that it would represent a ‘fat tax’ on unhealthy foods. The GST is not levied on fresh food. According to former Australian Democrats leader and GST negotiating powerbroker, Meg Lees, the GST ‘serves public health interests in that the price of fresh, healthy food would actually fall but the price of some junk food would rise.’

How successful has the GST, which imposes a price penalty on processed foods, been in restraining the consumption of unhealthy foods? ABS trend data on turnover in the takeaway food retailing industry shows that sales have increased significantly since the GST implementation, from about \$575 million in July 2000 to about \$1.1 billion in February 2011. When including turnover from cafes and restaurants, this figure trended up from about \$1.3 billion to about \$2.8 billion over the same period.

The increase in sale is reflective of a general increase in the consumption of these foods; this is supported by data from the ABS Household Expenditure Survey. Average weekly household consumption expenditure on meals out and fast foods rose by about 88 per cent between 1998-99 and 2009-10.

Data from the consumer price index (CPI) provides insight regarding the changes in relative prices of foods. From March 2000, just prior to the GST, prices for some healthier foods (e.g., bread, fruit and vegetables) have generally increased at a faster rate than less healthy foods and beverages especially soft drinks and, to a lesser extent, snack foods and confectionery (Figure 3).

Figure 3: Consumer price indexes for selected food and beverage product sub-classes



A number of factors have been attributed to the increase in prices observed for products such as fruit and vegetables. These include the effects of prolonged drought conditions, adverse weather conditions (for example, Cyclones Larry and Yasi in 2006 and 2011 respectively destroyed much of Australia’s banana crop), increasing prices for farm inputs such as fertiliser, general movements in world food commodity prices, and seasonal variations.

Importantly, an ACCC inquiry into grocery prices in 2008 found that the grocery retailing market remains ‘workably competitive,’ with major players Coles and Woolworths/Safeway supplemented by rivals including Aldi and numerous small businesses. These market conditions have worked favourably to the benefit of

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consumers seeking healthy products such as fruit, vegetables and dairy, especially in recent months as major supermarkets actively engage in price reductions for these products.

These factors influencing food prices are largely outside the control of public policy variables, including a GST fat tax that already places a significant price premium on processed foods.

Source: Australian Bureau of Statistics (ABS), Consumer Price Index, Australia, cat. no. 6401.0; ABS, Household Expenditure Survey, Australia: Detailed Expenditure Items, cat. no. 6530.0 and 6535.0; ABS, Retail Trade, Australia, cat. no. 8501.0; Australian Competition and Consumer Commission (ACCC), 2008, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, Commonwealth of Australia, Canberra.

Tobacco

Australia imposes relatively high taxes on cigarettes and other tobacco-based products amongst advanced economies.³⁴

Cigarettes and cigars that contain 0.8 grams or less of tobacco are taxed on a 'per stick' basis, regardless of how much tobacco the stick contains. The excise rates are indexed twice a year in line with CPI. Other tobacco products, including cigars and cigarettes containing more than 0.8 grams of tobacco, rolling tobacco and smokeless tobacco, are subject to an excise at a per kilo rate equivalent to the per stick tax on 0.8 gram sticks.³⁵

Prior to the 2010-11 federal budget the former Rudd government imposed a 25 per cent increase in the tobacco excise rate, increasing the price of a pack of 30 cigarettes by \$2.16.³⁶ The excise on cigarettes rose from \$0.2622 to \$0.32775 per stick while the loose leaf tobacco excise rose from \$327.77 to \$409.71 per kilogram.

Proposals for new and increased Nanny State taxes

Nanny State taxes on alcohol, food and tobacco have been put on the political agenda as a result of the Rudd government-commissioned National Preventative Health Taskforce (NPHT) and the Henry Review into Australia's Future Taxation System.

The final NPHT report *Australia: The healthiest country by 2020* made a series of claims and recommendations on how Australians must change their consumption choices and habits. It included a range of recommendations for new and increased taxes on specific consumer products (Table 2).

Table 2: National Preventative Health Taskforce taxation recommendations

'Risk' area	Recommendations
Obesity	<ul style="list-style-type: none"> • Conduct research into economic barriers, enablers, policies and tax incentives to inform a national active living framework and actions. • Commission a review of economic policies and taxation systems, and develop methods for using taxation, grants, pricing, incentives and/or subsidies to promote production, access to and consumption of healthier foods.
Alcohol	<ul style="list-style-type: none"> • Commission independent modelling under the auspices of Health, Treasury and an industry panel for a rationalised tax and excise regime for alcohol that discourages harmful consumption and promotes safer consumption. • Develop the public interest case for a minimum (floor) price on alcohol to discourage harmful consumption and promote safe consumption. • Direct a proportion of revenue from alcohol taxation towards initiatives that prevent alcohol-related societal harm.
Tobacco	<ul style="list-style-type: none"> • Ensure that the average price of a packet of 30 cigarettes is at least \$20 (in 2008 dollar terms) within three years, with equivalent increases in the price of roll-your-own and other tobacco products. • Further increase the price of cigarettes to keep pace with international best practice. • Continue to subsidise cost-effective treatments for smoking cessation.

Source: National Preventative Health Taskforce, 2009, *Australia: The healthiest country by 2020*, Commonwealth of Australia, Canberra, Australia.

The recommendations from this report were based on proposals almost identical to those raised for discussion by the Taskforce in its consultative document. In submissions the proposals generally received support from concerned stakeholders.

The emphasis of the proposals being considered by the Taskforce is to find product-specific taxation mechanisms to make products deemed undesirable less accessible. In the case of salty, fatty and sugary foods extra taxes are proposed to make them less financially attractive to healthier alternatives. For alcohol, additional taxes have been introduced to discourage the consumption of alcopops, and further taxes are proposed to establish minimum prices for alcoholic beverages. In the case of tobacco tax, increases are proposed to ensure there is a minimum price that would make consumption extremely unattractive.

The Commonwealth government's response to the final Taskforce report expressed a willingness to progress each of the key recommendations outlined.

The Henry Review final report also canvassed options for new and higher Nanny State taxes, particularly on alcohol and tobacco.

In terms of alcohol products, the Review advocated a common tax based on the alcohol volume of the product. Although the Review acknowledged the risks associated with moderate drinkers paying an unnecessarily high price for alcohol, it was argued that a volumetric tax would 'better address social harm through closer targeting of social costs.'³⁷ Such a measure would effectively set a floor price for alcoholic beverages.

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The final report of the Henry Review argued that '[t]he existing regime for tobacco taxation in Australia should be retained with the rates of tax substantially increased.'³⁸ In addition, the indexation arrangement for the excise should be tied to (faster growing) wages than the CPI. The Henry Review also recommended the abolition of duty-free tobacco for international travellers entering Australia.

Regular demands are also made by public health academics and other health sector stakeholders for new and additional taxes on consumer products, regardless of the tax rates and bases currently set by government or their effectiveness in stymieing consumption of these products.

2. Conceptual problems with Nanny State taxes

Governments routinely increase taxes in an attempt to create minimum cost levels for consumer products, such as alcohol, fast foods or tobacco, which decreases their value proposition or affordability to alternative products that the government would prefer individuals to consume. The following describes the major arguments developed in the economics literature that attempt to rationalise high tax levels on specific products.

Ramsey tax arguments

One justification for selective taxation is based on the work of early twentieth-century British economist Frank Ramsey. In a seminal 1927 article published in the *Economic Journal*, Ramsey posed the following problem: 'a given revenue is to be raised by proportionate taxes on some or all uses of income, the taxes on different uses being possibly at different rates; how should these rates be adjusted in order that the decrement of utility may be a minimum?'³⁹

Ramsey's answer to the problem he posited was that taxes should be levied on commodities in inverse proportion to their elasticities of demand (assuming the elasticity of supply is constant). In other words, commodities with relatively inelastic demands, such as tobacco and some forms of alcohol and food, in which changes in quantities demanded are relatively less responsive to changes in price, should be taxed more heavily.

Since consumers of such commodities are less likely to alter their purchasing decisions in response to price changes, it is argued that there will be less economic distortion caused by higher tax rates.

There are some limitations associated with the Ramsey theory of taxation. According to excise tax specialist Sijbren Cnossen there is no guarantee that the operation of Ramsey taxes would be welfare-enhancing. This is because an increase in tax upon a given commodity may affect the demand for other goods, for example beer against wine and spirits. These second-order effects have implications for the extent of revenue collections as well as the deadweight losses imposed by the tax system.⁴⁰

The application of the Ramsey tax rule may also violate equity norms in taxation. Individuals on equivalent incomes consume different amounts of goods like tobacco, alcohol or food. So to single those goods out for higher taxation is inconsistent with the principle of horizontal equity – that people with an equal ability to pay should pay equal tax liabilities.

Further, and as discussed below, it is well known that certain taxes are regressive in their effect, implying that individuals with the least ability to pay are paying relatively more in taxes (hence violating 'vertical equity'). Economist Arnold Harberger poignantly raised this problem when he stated, 'to tax salt more heavily than sugar, simply and solely because it has a lower elasticity of demand is at least as capricious (from the standpoint of equity) as taxing people according to the colour of their eyes.'⁴¹

Indeed, it has been suggested within the public finance literature that the case for Ramsey taxes is significantly weakened if governments can pursue their equity objectives through other means.⁴²

There is also a fundamental inconsistency between the revenue-raising and consumption-abating purposes of Ramsey and other specific commodity taxes. According to Shughart, '[t]he underlying

rationale for such taxes is that taxation will discourage the consumption of goods and services that the majority finds objectionable. But the Ramsey rule singles out products to be taxed precisely because taxation's impact on consumption is minimal. Hence, the regulatory and revenue-raising justifications for sin taxes work at cross-purposes.⁴³

Pigouvian tax arguments

Another argument advanced in support of taxes of Nanny State taxes relates to the use of taxation as a potential corrective for externality effects.

Using the taxation theory of British economist Arthur Cecil Pigou, it is argued that since market prices do not incorporate (for example) the effects of binge drinking or passive smoking on those who have not chosen to consume alcohol or tobacco, a tax impost is necessary to ensure that consumers pay a higher price reflecting the true "social cost" of their choices.

The idea that taxes should be imposed on products that generate externalities remains a highly controversial subject.

The most prominent objection against Pigouvian tax regimes relates to the 'knowledge problem' described by classical liberal economist and political philosopher Friedrich Hayek.⁴⁴ Specifically, the calculation of exact social costs generated by all market transactions would undoubtedly place prohibitive informational burdens on policymakers, thereby calling in question the practicality of Pigouvian tax design.

Even Pigou himself conceded in 1954 '[i]t must be confessed ... that we seldom know enough to decide in what fields and to what extent the state, on account of [the differential between private and public costs] could usefully interfere with individual freedom of choice.'⁴⁵

When the impacts of special interest lobbying by public health activists on the formation of public policies are considered, it appears even less likely that governments would establish optimal tax rates to internalise the social costs of private consumption activities.

'Nudge' tax arguments

In recent years, theories have emerged rooted in the idea that individuals cannot autonomously make informed and considered consumption choices. In this regard, it is the perceived task for governments to guide consumer choices, but without limiting them outright.

This 'libertarian paternalism,' or 'nudge' theory, argues in favour of tax measures that motivate individuals to consume less alcohol, eat healthier food and smoke less. According to O'Donoghue and Rabin, 'taxes change relative prices, they *change* choice sets relative to the no-tax case, but do not *reduce* choice sets.'⁴⁶

As discussed in the final report of the Henry Tax Review, specific consumer product taxes such as those on tobacco are deemed necessary because 'consumption poses self-control problems for most consumers ... [A consumer] may be able to see that their lifetime satisfaction would be increased by giving up smoking and decide to give up smoking at some time in the future, but when the time to give up arrives, they may find themselves unwilling to put their plan into action.'⁴⁷ In this context, it is considered that higher taxes would encourage those with weak willpower to reduce their tobacco consumption.

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Fat taxes have been increasingly adopted or considered in advanced economies on the purported basis of discouraging the consumption of energy-dense foods and offsetting the costs of obesity on the health care system. For example 33 American states tax the sale of soft drinks at an average rate of about five per cent,⁴⁸ while countries such as Iceland, Romania, Taiwan and the UK have considered (or are considering) various 'junk food' taxes.

Nudge rationales for such fat taxes are becoming commonplace. In an editorial in the *American Journal of Public Health*, Australian public health academics argued, 'although education and access to information are fundamental rights and are important in a democracy, they have negligible impact ... increasing choice is little more than a ruse, more likely to increase consumer confusion than to promote healthy eating.'⁴⁹ Among their preferred solutions to quell the consumption of fatty, salty and sugary foods and beverages are plans to '... [increase] ... the price of unhealthy food (the so-called fat tax).'⁵⁰

Numerous limitations with nudge theories have been identified by economists. The Hayekian knowledge problem outlined above is particularly relevant to the critique of nudge policy design. Economists Mario Rizzo and Glen Whitman indicate that Nanny State tax policymakers need to take into account the following factors:

- Identification of the 'true' preferences of consuming economic agents, that are to be maximally satisfied
- Determination of the extent of each cognitive bias or decision-making problem
- Account for privately adopted self-debiasing measures, and ascertain how nudge policies would affect such measures
- Consider issues associated with interdependent biases
- Anticipation of unravelling or unlearning effects by agents; and
- Establish the extent of heterogeneity in the population with respect to all factors outlined above.⁵¹

According to Rizzo and Whitman, 'these factors taken together present a formidable barrier that robs the new paternalism of any presumption of welfare improvement.'⁵²

The key methodological insight of public choice theory – that behavioural assumptions attributed to consumers in private marketplaces can be equally applied to political actors when deliberating over collective choices – suggests that politicians and bureaucrats, like consumers, also possess problems of self-control and other cognitive biases in the enactment of policies that achieve their stated objectives with the least economic harms and infringements upon personal liberties.

In this environment the scope for policy error is greatly magnified; for example, taxes could be so poorly designed that the economic welfare of non-addicted consumers is diminished. When the possibility of successful rent-seeking influence by special interests is also taken into account (for example, producers of dairy drink products favouring taxes on soft drinks), policymakers may become even more prone to ill-judged decisions at great economic cost.⁵³

Whitman and Rizzo have developed a powerful critique against nudge theory on the basis of the much-observed incapability of policymakers to arrest the 'slippery slope' effect of ever-increasing

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government intervention.⁵⁴ In other words, 'soft' nudge policies introduced today eventually transform into a 'hard' push against revealed consumer preferences later.

Similarly, Nobel laureate in Economics James Buchanan warned of the dangers of 'meddlesome preferences' exercised in the political realm as the democratic process leads to a struggle amongst different groups within society to impose their preferred paternalistic policies on each other:

If I can resort to politics to impose my own preferences on the behavior of others, even if these preferences are not highly valued intrinsically, then it would seem that other persons, in working democratic process, can do the same to me. I may find that the political process is double edged. If it can be used to my advantage to impose my personal preferences over the behavior of other persons, it can be used to my disadvantage in imposing the preferences of others on my own behavior.⁵⁵

As explained by the nineteenth century liberal philosopher John Stuart Mill, the appropriate scope for collective action is necessarily much more constrained than nudge theorists are prepared to acknowledge:

the only purpose for which power can be rightfully exercised over any member of a civilised community, against his will, is to prevent harm to others. His own good, either physical or moral, is not a sufficient warrant. He cannot rightfully be compelled to do or forbear because it will be better for him to do so, because it will make him happier, because, in the opinions of others, to do so would be wise, or even right. These are good reasons for remonstrating with him, or reasoning with him, or persuading him, or entreating him, but not for compelling him, or visiting him with any evil ... The only part of the conduct of any one, for which he is amenable to society, is that which concerns others. In the part which merely concerns himself, his independence is, of right, absolute. Over himself, over his own body and mind, the individual is sovereign.⁵⁶

Mill's statement is consistent with a long line of classical liberal thinking spanning centuries, in which the individual is conceived as ultimately the sovereign over his or her life and that governments should not interfere with actions made by individuals that render no harm to third parties, even if these cause self-harm. As noted by Chris Berg:

democratic legitimacy rests on a positive belief that while not all citizens may be equally intelligent or informed, they are equally sovereign ...

The systematic chipping away by nanny state activists of these assumptions – that people should be assumed to be competent to make ... portentous choices themselves – presents more of a challenge to democratic legitimacy than the public health community may recognise.⁵⁷

The idea that governments should force or nudge individuals to make certain consumptive choices is tantamount to the tax policymaker stating to the consumer 'you may or may not know what's best for you, but regardless you choose not to practice what's best for you, so we'll make you do it.' Such paternalistic intervention in turn erodes the legitimacy of individual choice, as well as the exercise of responsibility and trial-and-error learning about individual preferences that accompanies such action.

3. Practical problems with Nanny State taxes

Apart from the inherent difficulties for policymakers to collate and process complex economic information to design appropriate tax structures, the ability of Nanny State taxes to achieve government objectives are highly doubtful for additional reasons as outlined below.

Nanny State taxes rarely achieve their goals

A standard result of the public finance literature is that a non-lump sum tax can influence economic choices by encouraging private sector economic agents to shift their consumption or production activities from heavily taxed to lower (or non-) taxed goods and services or activities.⁵⁸

In most circumstances, policymakers react to such behaviour by seeking to impose broad-based taxes preventing individuals from escaping the revenue collection net. However, in the case of Nanny State taxes governments often publicly state that they prefer to forgo revenue for the sake of encouraging individuals to shift their consumption away from the taxed 'sin' product (e.g., alcohol, unhealthy food, tobacco). As discussed above with reference to Ramsey taxation, the extent to which people shift from products subject to specific taxes depends critically upon the elasticity of demand for the taxed product in question.

As noted by Ryan Vinelli, certain products exist whereby people form a habit to consume them on a regular basis.⁵⁹ This implies that the demand elasticity of the taxed product for habitual consumers (say, older smokers or alcohol drinkers, or regular fast food eaters) could be significantly lower than for those with less experience in consuming the product.

That people with stronger consumption habits will be less responsive to an increase in Nanny State taxes means that the overall success of government policy, at least in the short term and with respect to incremental tax increases, may be considerably diminished.

For example, heavy alcohol drinkers are much less responsive to price increases than moderate drinkers. According to New Zealand economist Eric Crampton, most estimates suggest that heavy drinkers are half as responsive as moderate drinkers, implying a disproportionately heavy tax burden on moderate drinkers for a small decrease in heavy drinkers' consumption.⁶⁰

In the case of tobacco taxation, Evans and Farelly found that smokers in high-taxing US states are more likely to smoke cigarettes that are longer and higher in tar and nicotine content.⁶¹ Younger smokers, who tend to be more responsive to changes in taxes than older smokers, actually increased their total daily tar and nicotine intake after a tax increase.

The success of Nanny State taxes also depends on the availability of substitutes for the taxed good. Consider the case of the soft drink tax, popular in many American states. While it has been estimated that such taxes do lead to a moderate reduction in the amount of soft drinks consumed by young people, the reduction in soft drink consumption had been completely offset by the consumption of other high-calorie beverages.⁶²

In these and similar cases Nanny State taxes merely diminish consumer welfare, particularly for those on lower incomes. The reduction in disposable income resulting from the tax erodes the capacity of consumers to purchase other goods and services. The notion that Nanny State taxes can

be rendered ineffective by the availability of substitutes has even been acknowledged by public health scholars with an interest in major policy interventions to reduce obesity:

‘Why wouldn't a soda tax decrease obesity rates by shifting consumption toward healthier beverages? This is because price elasticity can refer to “own-elasticity” - changes in the patterns of consumption of a commodity in response to changes in its own price - or to “cross-elasticity” - changes in consumption of a commodity in response to changes in the price of another commodity. When it comes to sugar-sweetened beverages, there seems to be some evidence of the former, yet no evidence of the latter. Moreover, even if there were cross-elasticity between sodas and more healthful drinks, many beverages that are considered to be “healthy” and that therefore would not be taxed, such as ... smoothies, have as many calories (or more) as an equivalent amount of sugar-sweetened cola.’⁶³

Nanny State taxes change behaviour in unpredictable ways

There are recent anecdotal examples of Nanny State tax changes in Australia leading to counterintuitive consumption patterns that were the opposite of what was originally intended by policymakers.

For example, immediately prior to the April 2010 increase in the tobacco excise rate, supermarkets and other retail outlets reported significant increases in sales of cigarettes and other tobacco products, as smokers sought to beat the tax-induced price rise.⁶⁴ Meanwhile, the introduction of the alcopops tax by the Rudd government was associated with the consumption of heavier strength alcohol beverages (Box 2).

Box 2: The Australian alcopops tax experiment - A failed policy

In April 2008 the tax rate applying to ready-to-drink (RTD) pre-mixed alcoholic beverages was increased from \$39.36 to \$66.67 per litre of alcohol. This measure implied that RTDs are taxed at the same volumetric rate as bottled spirits. The government initially estimated that the measure would deliver an additional \$3.1 billion in revenue over the forward estimates.

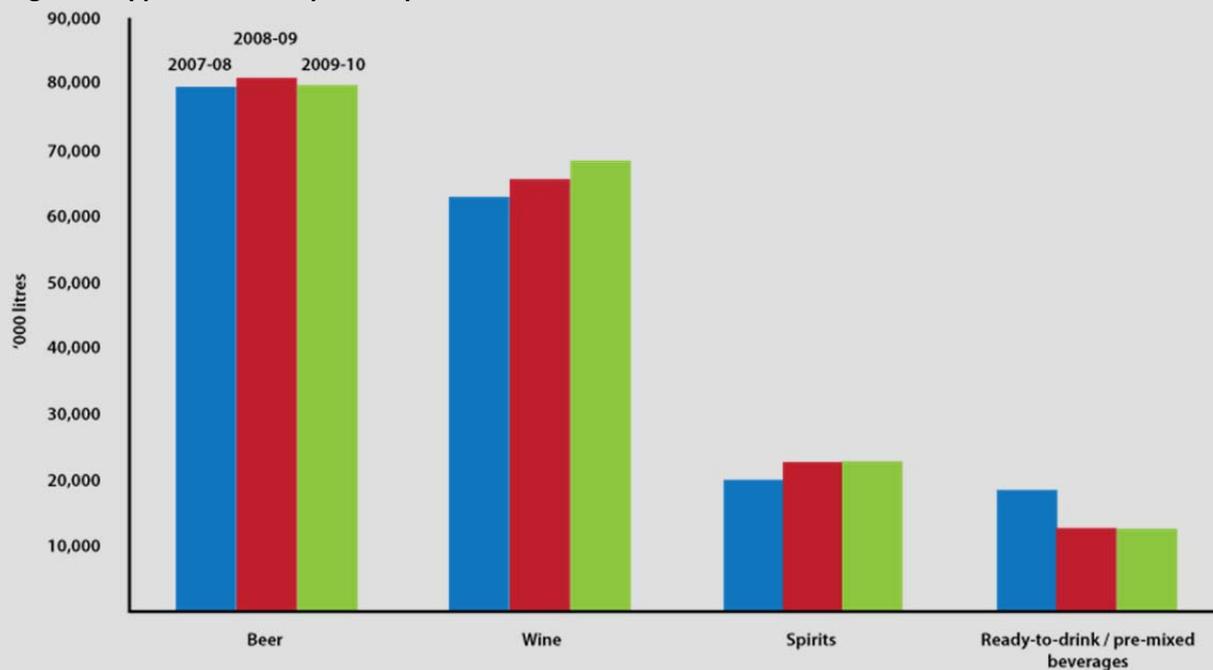
The policy was predicated on the basis of tackling what was labelled by the Rudd government as a binge drinking ‘epidemic’ within the Australian community, particularly affecting young people.

The Bill to give effect to the tax was initially defeated in the Senate in March 2009, but passed in August 2009 in its second attempt at legislative passage.

Data from the Australian Bureau of Statistics shows that consumption of RTD beverages declined by 32 per cent since 2007-08. On the other hand, there is evidence of a switch to other alcoholic drinks including spirits (14 per cent increase in consumption), wine (nine per cent) and beer (0.3 per cent) (Figure 4).

There is evidence that the consumption of cider, taxed at the lower WET rate along with wine, has also increased significantly. Cider consumption grew by 18 per cent in the year after the imposition of the alcopops tax alone.

Figure 4: Apparent consumption of pure alcohol



Polling by Galaxy Research had shown that the targeted demographic for the tax hike – young people – considered the policy to be ineffective in dealing with binge drinking. According to the poll, only 20 per cent of surveyed people aged 18 to 24 believed that the alcopops tax was ‘very effective’ or ‘somewhat effective’ in this regard.

Source: Adam Creighton, 2012, 'Cider tipplers may face 'alcopop' tax slug', The Australian, 16 April; Australian Bureau of Statistics, Apparent Consumption of Alcohol, Australia, 2009-10, cat. no. 4307.0.55.001; Commonwealth of Australia, 2008, Ready-to-drink alcohol beverages inquiry, Senate Community Affairs Committee; Galaxy Research, 2009, 'Alcopops Tax Survey', Prepared for Distilled Spirits Industry Council of Australia, May.

Nanny State taxes encourage black market activities

Another consequence of Nanny State taxation is the emergence of lucrative 'black' markets consisting of the production, distribution and sale of cheaper, yet illegal, products that are not subject to tax.

Particular concerns have been raised internationally about the presence of high taxes on tobacco products in encouraging the development of sophisticated smuggling operations, including with links to organised crime. The Australian Crime Commission says that organised crime has been linked to the illicit tobacco market.⁶⁵

In the United Kingdom it has been estimated that the share of illicit cigarettes was 20 per cent, two-thirds of which can be accounted for by smuggling.⁶⁶ A recent UK study found that high taxes contributed to illicit market activities in cigarettes, hand rolling tobacco, beer and spirits, leading to approximately £22 billion of foregone government revenue between 2005-06 and 2009-10.⁶⁷

Similar problems have been observed in the United States. It has been estimated that New York City fails to collect taxes on 50 per cent of cigarettes smoked, as smugglers sell bootlegged cigarette packages and cartons on street corners. Meanwhile, in California, 300 million untaxed cigarette packs a year are smoked due to Internet and cross-border sales, as well as smuggling.⁶⁸

A recent study in Canada suggests that the black market in tobacco constitutes about 27 per cent of that country's tobacco market, and that a 10 per cent increase in the price of tobacco products reduces lawful cigarette sales by between 3-10 per cent.⁶⁹

There is evidence that Australia has not been left untouched by tobacco smuggling activities as Nanny State taxes on these products continue to increase. In general there are three types of illegal tobacco available in Australia:

- Unbranded tobacco (otherwise known as 'chop chop') which is generally sold in clear plastic bags as loose-leaf tobacco
- Counterfeit cigarettes that are manufactured overseas illegally and smuggled into Australia
- Contraband cigarettes, which are legitimately branded products, but with the excise duty having been evaded.⁷⁰

It is difficult to quantify the full extent of the Australian black market in tobacco. It is estimated that the size of the illicit tobacco market represented as a proportion of the legal tobacco market was 15.9 per cent in 2010.⁷¹ Over the past three years to 2010, customs authorities have seized 715 tonnes of tobacco and 217 million cigarettes in sea cargo.⁷²

Research suggests that the total illegal tobacco market in Australia has grown to up to 2.3 million kilograms of tobacco consumed (or 12 per cent of cigarettes sold), representing a tax revenue loss to the Commonwealth (excluding GST) of \$624 million.⁷³

Nanny State taxes are convenient revenue-raisers for spendthrift governments

Governments around the world openly consider that consumers of specific commodities, such as alcohol, food and tobacco, are ripe for the taxing. According to Cnossen:

[i]n practice, most excises have probably been enacted for revenue purposes, the main consideration being that they could be administered more easily than other taxes. Excise duties on tobacco ... [and] alcohol ... are good potential sources of revenues, because the products are easy to identify, the volume of sales is high, and that fact that there are few producers ... simplifies collection. Also, there are few substitutes that consumers would find equally satisfactory, so that consumption, and by extension revenue, remain high despite excise-induced price rises.⁷⁴

However, the extent to which Nanny State taxes represent easy revenue raisers for governments depends on a range of factors. In practice, revenue responses to tax rate changes will depend on the tax system already in place, the timing of changes, the presence of an underground economy and other issues.⁷⁵ These issues are reflected in the well-known 'Laffer curve' effect observed in taxation policy.

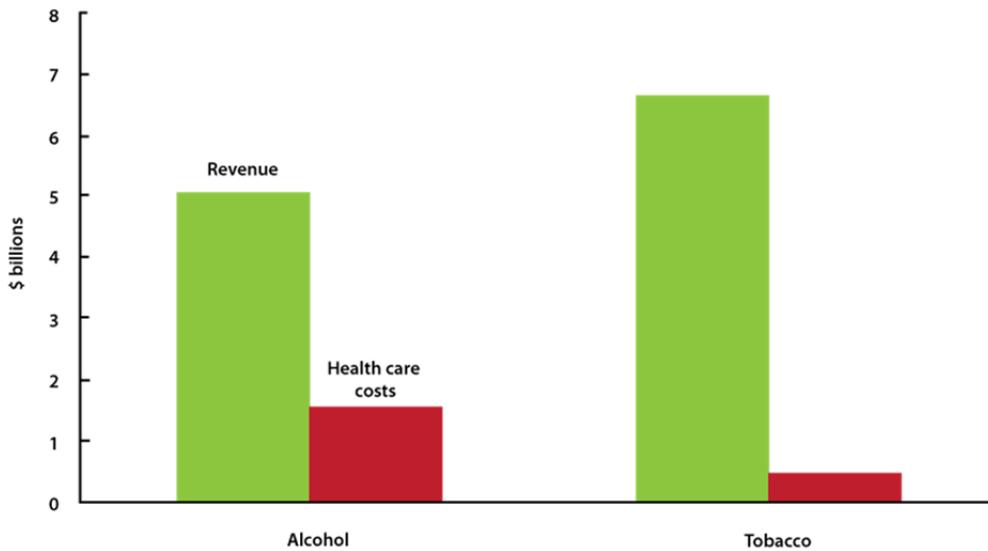
There is some evidence in the United States to suggest that tobacco tax rates, for instance, are situated at the wrong side of the Laffer curve, with an increase in existing tax rates leading to a reduction of revenues. New Jersey raised its cigarette tax in 2007 by 17.5 cents, collecting \$US22 million less than it did the previous year.⁷⁶ More generally, less than a third of cigarette tax increases in the US over the past decade actually met state revenue projections.⁷⁷

The rate of Australian tobacco excise could be approaching, or be slightly over, the highest point of the Laffer curve. The amount of revenue collected in 2010-11 was about \$6.4 billion, or \$333 million less than what was expected to be collected at the time of the 2011-12 Budget.⁷⁸ Revenue from the tobacco tax is nonetheless expected to increase in each year of the forward estimates, even in spite of government estimates that the recent excise increase will reduce the number of smokers by 2-3 per cent (or 87,000 people).⁷⁹

Public health advocates are increasingly arguing for higher Nanny State taxes to fund the health care system costs to governments generated by the private consumption of certain products. However, given the revenue implications of marginal changes to Nanny State tax rates, it is clear that the Commonwealth government is already acquiring revenue well in excess of even the most generous (albeit contestable) estimates of net health care costs as a result of the consumption of alcohol and tobacco (Figure 5).⁸⁰

In effect, the government is engaging in outright fiscal discrimination against consumers of these products, and eroding individual consumer surpluses in the process, in order to fund activities *other* than health treatments.⁸¹

Figure 5: Alcohol and tobacco revenues and health care costs



Revenue includes excises, customs duties and wine equalisation tax. Health care costs are gross costs from alcohol and tobacco consumption for medical, hospitals, pharmaceutical and ambulance services, less imputed savings from premature deaths.

Source: David J. Collins and Helen M. Lapsley, 2008, 'The costs of tobacco, alcohol and illicit drug abuse to Australian society in 2004/05', Commonwealth of Australia, Canberra.

Arguments for higher Nanny State taxes to fund health care system costs are questionable on non-fiscal grounds. As discussed by Michael Keane, '[f]orcing a citizen to undertake an action against their will for the "greater good" of healthcare-cost reduction is a wholly unethical position. No person can be ethically compelled to participate in a health program against their will.'⁸²

Consistent with this, there is the clear prospect of a 'slippery slope' of ever-increasing interventions, based on increasingly spurious connections between individual lifestyle choices and health system costs. This would violate personal liberties and abrogate the exercise of adult personal responsibilities.⁸³ At the very least, these arguments tend to blur the distinctions between what can and cannot be conceived as genuine externality effects (Box 3).

Box 3: How the concept of 'fiscal externalities' informs misguided public policies against the interests of consumers and taxpayers

A common policy stance favoured by governments to deal with the health effects of cigarette smoking upon the public budget is to invoke a Pigouvian tax so that the consumer internalises the fiscal costs of their smoking by paying more. According to the former federal Health minister Nicola Roxon, 'we get a pretty good return for our money if we can save ... the health system a fair amount of money' by enforcing the cessation of tobacco consumption.

In an important paper published in the *Public Finance Review*, Edgar K Browning stated, 'it has become increasingly common to see the term externality applied to a type of fiscal interdependence that is produced by the existence of government tax or expenditure policies.' However 'the general point is that we cannot logically infer inefficiency from the mere presence of a fiscal externality; we must know more. Specifically, we must know the justification for the pre-existing policy through which the fiscal externality makes itself felt,' including altruistic concerns to assist patients through a subsidised health care system.

Even so, it is not necessarily to rely upon a consideration of policy motives to appreciate that 'if the fiscal externality in the cigarette market is associated with excessive cigarette smoking and there is a welfare cost, it is simply a reflection of the welfare cost produced by the medical care subsidy. There is no "new" inefficiency produced by the fiscal externality.'

While Browning shows that, under certain restrictive conditions, the imposition of a cigarette excise tax is equivalent to the elimination of medical care subsidies, he counsels that knowledge problems in the determination of the appropriate tax rate, the administrative and compliance costs involved, and the problems associated with establishing slippery slope taxes on other perceived 'bads' implies that 'removal of the policy that creates the fiscal externalities is likely to be more efficient than attempting to correct the inefficiency through the addition of further policies designed to offset the inefficiency of the pre-existing policy.'

The ultimate conclusion drawn by Browning that 'fiscal externalities do not necessarily imply any inefficiency, and when there is inefficiency, it is the result of the policy that creates the fiscal externality' might well be an inconvenient one for policymakers who wish to expand the reach of Nanny State taxes, but is the obvious consequence of recognising that such pecuniary effects do not strictly in themselves represent a cause for public policy concern.

Source: Edgar K Browning, 1999, 'The Myth of Fiscal Externalities', *Public Finance Review* 27: 3-18; Julie Novak, 2011, 'The technological-pecuniary distinction in externality theory: A primer for dummies', Free Market Liberal blog, <http://freemarketliberal.blogspot.com.au/2011/09/technological-pecuniary-distinction-in.html> (accessed 11 April 2012).

Nanny State taxes disproportionately affect the poor

Nanny State taxes also typically fare poorly on equity grounds, undercutting the case often put forward by political 'progressives' (with self-avowed concerns for the poor) in support of higher taxation.

The Australian Bureau of Statistics provided information on the amount of taxes paid by different income categories in 2003-04. Although official data sources tend to consistently understate the expenditure on goods such as alcohol and tobacco, it provides a reasonable indication of the regressivity of a host of Nanny State taxes.

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The lowest fifth of income earners pay over six percent of their total income as tax on alcohol, foods and tobacco. For all income categories the average tax paid out of income is about three per cent, and as low as two per cent for the highest earners in the Australian income distribution (Table 2).

Table 2: Taxation paid according to equivalised final income quintiles, \$ per week

	Lowest 20 per cent	Second quintile	Third quintile	Fourth quintile	Highest 20 per cent	All households
Gross income	410.12	700.57	1,043.15	1,440.06	2,374.39	1,127.37
Disposable income	382.58	624.34	885.32	1,166.49	1,765.10	915.80
Taxes on:						
Alcohol	7.59	7.65	10.86	12.36	17.44	10.86
Foods	10.55	12.93	16.20	18.77	23.01	15.78
Tobacco	7.87	8.20	7.66	7.72	6.21	7.56
Percentage of gross income	6.3%	4.1%	3.3%	2.7%	2.0%	3.0%
Percentage of disposable income	6.8%	4.6%	3.9%	3.3%	2.6%	3.7%

Gross income equals private income plus cash government benefits. Disposable income is gross income less taxes on income. Taxes on foods include non-alcoholic beverages, meals out and fast food. Taxes include GST component.

Source: ABS, Government Benefits, Taxes and Household Income, 2003-04, cat. no. 6537.0.

Proportionately greater Nanny State tax revenues are compulsorily acquired from other types of households from lower socio-economic backgrounds:

- Households whose primary source of income was government pensions and allowances paid 4.8 per cent of their disposable income in Nanny State taxes, compared to 3.5 per cent for wage and salary earners
- Households renting through state and territory housing authorities paid 5.1 per cent of their disposable income in Nanny State taxes, compared to 3.5 per cent for home-owning households with mortgages
- Lone person households and one-parent family households with children paid 4.1 per cent and 3.6 per cent of their disposable incomes in Nanny State taxes respectively; coupled-family households with children paid 3.4 per cent of their disposable incomes in Nanny State taxes
- People aged between 15 and 24 on average paid 4.8 per cent of their disposable income in Nanny State taxes, compared to 3.7 per cent for people aged 35-44 years and 2.9 per cent for people aged 75 and over
- Householders in regional areas paid four per cent of their disposable income in Nanny State taxes, compared to 3.6 per cent for people living in capital cities.⁸⁴

Notably, people dependent on government welfare payments for their income pay relatively greater shares of those monies back to government in the form of alcohol, food and tobacco taxes - a trend symptomatic of the extensive churn of the modern Australian welfare state.⁸⁵

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It is possible to obtain rough estimates of the financial impact of recent Nanny State tax policy developments on consumers. As a result of the April 2010 tobacco excise increase, the average price of a pack of 30 cigarettes has risen by \$2.16. It is also known that the average number of cigarettes smoked per week is higher for individual smokers in lower socioeconomic status areas - people in the lowest SES areas smoked an average of 117 cigarettes per week, compared to 74 cigarettes per week by people in the highest status SES areas.⁸⁶

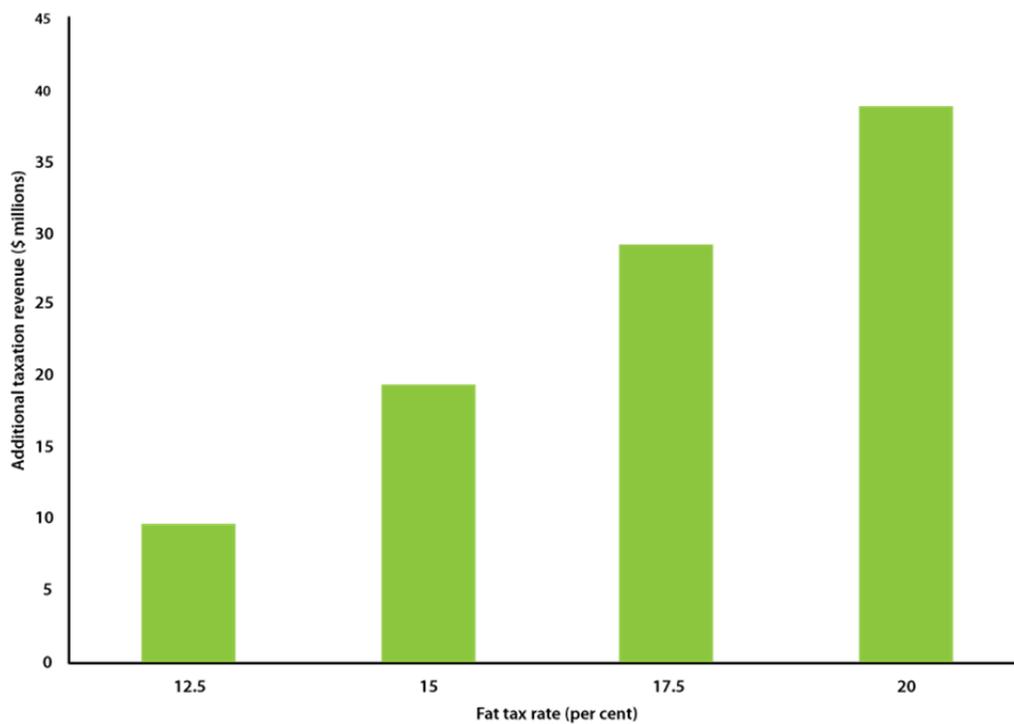
In other words, low SES smokers consumed an average of 3.9 packs of 30 cigarettes per week while high SES smokers consumed 2.5 packs. Applying the \$2.16 impost and converting to an annual basis reveals that low SES smokers were made worse off, on average, by the government's tobacco tax increase to the tune of about \$438 per annum. Smokers in the highest status SES areas were made worse off by about \$277 each year.

It is also possible to use the ABS published figures presented above to roughly model the effects of fat taxes, as advocated by the Australian Greens, public health academics and other groups, on households by income ranges. Assume that an additional impost is added to the 10 per cent GST for takeaway meals and fast foods only, punishing those time-poor consumers who prefer the convenience of food products prepared by the restaurant and catering industries. Under the scenarios presented here, the effective GST rate for these products ranges from 12.5 per cent to 20 per cent.

Applying these imposts and converting to an annual basis shows that the government would compulsorily acquire an additional \$67 million from households each year as a result of a 12.5 per cent fat tax.⁸⁷ Households on the bottom 20 per cent of incomes would be collectively worse off to the tune of almost \$10 million per annum (Figure 6).

The amount of revenue obtained by the government progressively increases as the fat tax rate is increased. For example, a fat tax levied at an *ad valorem* rate of 20 per cent would raise an additional \$268 million per annum in total with low-income households paying an extra \$39 million.

Figure 6: Additional government revenue from low-income households due to fat tax



Fat tax imposed as an additional rate of GST on meals out and fast food.

Source: ABS, Government Benefits, Taxes and Household Income, 2003-04, cat. no. 6537.0; IPA calculations.

It is conspicuous that representative organisations purporting to represent the interests of the (presumably, politically voiceless) poor have not publicly opposed the existing level of burden imposed by Nanny State taxes, nor have they counselled the Commonwealth government to not increase Nanny State taxes into the future.

For example, the December 2008 Australian Council of Social Service (ACOSS) submission to the National Preventative Health Taskforce failed to mention the implications of specific taxes, such as alcohol and tobacco excises or the GST, upon the financial wellbeing of low socioeconomic status (SES) communities. The only reference to taxation related to a suggestion that the Taskforce engage in cross-cutting policy agendas, such as the Henry Tax Review, as a means to influence the vaguely-defined 'social determinants of health.'⁸⁸

A similar stance on the question of the financial impact of Nanny State taxes upon those on lower incomes was adopted by representatives of indigenous and multicultural communities and aged Australians, with one group even providing in-principle support for a minimum floor price on alcoholic beverages.⁸⁹

Similarly, submissions by organisations representing low SES groups to the Henry Tax Review revealed a glaring lack of acknowledgement of the adverse effect of Nanny State taxes upon the constituencies they purport to represent.

ACOSS' submission to the Review effectively endorsed the prevailing system of Nanny State taxes in that it stated that a purpose of the taxation system is to discourage 'undesirable activity (such as excessive consumption of alcohol and tobacco).'⁹⁰ A subsequent media release listing ten priority

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areas from the Tax Review failed to nominate the alleviation of Nanny State tax burdens as an item on the ACOSS tax policy 'wish-list.'⁹¹

It is in this environment of tacit or even explicit support for Nanny State taxes and the broad agenda of the public health lobby, including by groups established to defend the interests of people in difficult financial circumstances, that the Gillard government has explored policy options to increase Nanny State taxes with seemingly minimal political opposition.

Nanny State taxes hurt small businesses

There is some anecdotal evidence that the Rudd government's alcopops tax on may have affected turnover in clubs, hotels and pubs as consumers switch from ready-to-drink alcoholic beverages to bottled spirits, including those to be mixed with other beverages at home.

The 2010 Australian tobacco tax increase appeared to have unintended consequences for sales by grocery retail outlets. According to the Executive Director of the Australian Retailers Association, '[f]or low- and middle-income earners, a 25 per cent tax rise is eating into their budget for other items: chocolates, magazines, skin care, aftershave for men. There's a slowdown in all those products.'⁹² The Council of Small Business of Australia also noted that the take increase would reduce purchases of non-tobacco items in small retail stores.⁹³

As noted above, the extent to which Nanny State taxation facilitates the growth of underground markets in illicit products also leads to lost sources of income for retailers selling legal goods and services.

4. 'You're next!...': The slippery slope of Nanny State taxes

One of the more insidious problems associated with Nanny State taxes is that they create a political precedent for increasing government interventions that serve to stifle freedom of consumptive choices.

Individuals either look to escape the financial penalty of higher Nanny State taxation by shifting to substitutes also deemed harmful, or ignore the tax-induced penalty and largely retain their consumption of the targeted products. The *ex-post* observations of revealed preferences by consumers fuels additional demands for even more government intervention, which if implemented inches an economy toward a comprehensive control of private activities by the non-market sector.

Examples of such trends may be readily observed in Australia and other Western countries. In an effort to 'make smoking history,' public health advocates successfully urged governments to impose smoking bans in public places on top of existing Nanny State taxes, and also suggest plain packaging of cigarettes that expunges the intellectual property rights of producers.

To fight the latest scourge of binge drinking, governments impose taxes layered with licensing restrictions on the sale of alcohol, and layered once again by restrictions on club and pub opening hours (such as the failed 2am Melbourne nightclub lockout trial of 2008).

The increasing influence of 'healthism,' as extolled by public health academics and public servants, also leads to suggested additional government encroachments in areas previously considered out of bounds by the general community. In his 1996 research paper criticising the Nanny State, Alan Moran highlighted the 'spurious' assumptions underpinning the idea that taxes can be used to discourage consumption behaviour. According to Dr Moran '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.'⁹⁴

Dissatisfied with existing Nanny State tax regimes, public health activists also advocate a 'window of political opportunity' for fattening up governments through prescriptive interventions to nudge consumption choices. These include the subsidised provision of healthy 'foods of choice,' promoting inefficient agriculture through the encouragement of small-scale farms, and the wholesale alteration of physical environments to deter private motor vehicle usage.⁹⁵

Conclusion

Nanny State taxes are now a permanent feature on the Australian public finance landscape. As with most government interventions, the rationales for taxes have varied and become more creative over time.

For example, the advent of World War I witnessed the climax of the alcohol temperance movement in Australia, whose members appealed for government Nanny State taxes and other interventions to prevent people from consuming morally suspect, and even sinful, beverages.⁹⁶

Modern public health activists now argue that Nanny State taxes are necessary to make us healthy. For some of these advocates, age-old religious concerns have taken on a new twist with, for example, fat taxes needed to discourage mass agricultural production hopefully placating 'Gaia' in the process.⁹⁷ In recent times, as evidenced in an article published in the *Nature* journal, public health lobbies are seeking to confuse the general public into accepting their preferred policy positions by labelling naturally occurring substances such as sugar as 'toxic.'⁹⁸

Of course, a discussion of the desire of governments to raise revenues for their various ventures has also remained quietly in the background of theorising about Nanny State taxes. While the revenue motive remains an important rationale underpinning the desire of government to maintain Nanny State taxes, the emergence of moralistic-cum-healthist arguments have provided political inspiration to further increase Nanny State tax rates irrespective of their economic or financial consequences.

Implicit within the framework supportive of Nanny State taxation is a vision of society that is indifferent, if not overtly hostile, to the concept of freedom of individual choice coupled with the exercise of self-responsibility. The current 'nudge' exhortations of behavioural economics in particular represent little more than a cynical intellectual exercise in the paternalism of yesteryear, albeit dressed in new descriptive garb.

As this paper has shown, Nanny State taxes are a recipe for fiscal discrimination against consumers of alcohol, food and tobacco, yet they often fail to meet their underlying policy objective - quelling consumption of these products. This suggests the need for governments to forgo such fiscal impositions and allowing the seeds of individual choice to germinate.

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