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*Excise Taxation in Australia*

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# Excise Taxation in Australia

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## Why levy excise duties?

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Atkinson and Stiglitz (1976): if the income tax schedule is chosen optimally, then social welfare cannot be improved by differential commodity taxation...

but income tax not perfect, so revenue-raising efficiency, externality correction and progressivity enhancement through differential commodity taxation are issues that should be explored

## Revenue-raising efficiency

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Ramsey rule assumes zero cross-elasticities of demand and ignores income effects:  
...implications can be dangerously misleading

Crawford-Keen-Smith: weak separability between market consumption of goods and time in paid work should be firmly rejected...

## Revenue-raising efficiency (cont.)

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The key demand characteristic relevant to revenue efficiency is the degree of complementarity / substitutability of commodities with market labour supply

...but effects are small and differentiated tax difficult to implement

## Externality correction

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Pigou: charge consumers and producers for external costs not reflected in price inducing them to reduce their activities to the socially optimal level

Internalisation of external costs approximately feasible for cigarettes and energy  
...but difficult trade-off between reduction in welfare of moderate consumers of alcohol and higher tax on abusive drinkers

→ taxes should be non-linear in the level of consumption

## Internality correction

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Gruber and Koszegi: internalities occur when people discount the short-term costs and benefits of their actions to a greater extent than the long-term effects

This asks for a commitment device, such as an excise

## **Benefit charge**

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Road user charge should equal social cost of operating the roadwork

Charge should consist of charges for consumption of road infrastructure, environmental costs, congestion costs and accident costs

# Progressivity enhancement

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Taxes on luxury goods indicated if income tax not optimal

...but case for such taxes is weak if capacity for administering income tax and social benefit system is adequate

## Instruments of excise taxation

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- Specific vs. *ad valorem* duties: external cost independent of price at which “bads” are sold → indicates specific rates
- Taxes and regulations: regulations required if externality tax cannot be adequately differentiated → direct regulation of consumption generating the larger marginal cost
- Taxes, permits and C&C-regulations
  - taxes fix marginal cost but have uncertain impact on quantity of emissions
  - permits guarantee quantitative reduction but at uncertain cost

## Taxes on smoking

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Australian tobacco cigarette excise is designed better than tobacco taxes in the EU: the (indexed) rate is specific and other tobacco products are taxed equivalently

Possibly, the duty level approximates external costs, while passive smoking can be prevented through bans on smoking in public places

Concern should be with smoking in the family

# Drinking duties and regulations

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Alcohol tax reform should probably be a spearhead for Australia's future tax system

Current duty structure is highly complicated; adjustments on the basis of alcohol content seem indicated

## **Costs of Alcohol Abuse**

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- Heavy drinking leads to violent behaviour, causes accidents and has harmful effects on health
- Costs are shown in Cost-of-Illness studies, e.g. by Collins and Lapsley
- Problem is that COI studies draw an insufficiently clear distinction between private and external costs
- Maynard, Godfrey and Hardmann: “When policymakers are given such studies, they should be aware that they come with a government health warning: naive use of such data can damage a Nation’s health!”

## **Conclusion on drinking duties and regulations**

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External costs of alcohol abuse appear to exceed excise duty collections per adult and per litre of pure alcohol by a wide margin

Optimal balance between reduction in social welfare of moderate drinkers and internalisation of external costs caused by abusive drinkers can be improved through better combination of tax and regulatory policies

## **Taxes on gambling**

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Two recent developments are the rise of internet gambling and the demand for resort casino's

High taxes will not affect problem gamblers but may hamper development of resort casino's