

## **Discuss economic arguments for and against imposing substantially higher taxes on sale of alcohol**

Governments interfere in markets and their working with the primary purpose of provision of welfare to people and preventing market failure.

There are many methods of intervention such as

- taxes and subsidies
- buffer stocks
- applying maximum and minimum prices
- provision of public goods and services
- provision of education and training
- legislation and market reforms

Applying taxes has two purposes: to generate revenue for the government and to discourage consumption and output of certain goods, usually demerit goods.

Demerit goods are those goods that are usually over consumed by in a market system, and have social costs exceeding social benefit due to high negative externalities. They contrast merit goods which are desirable for the welfare of society, as positive externalities exceed negative externalities.

Taxes out on goods such as alcohol are considered indirect taxes. Depending upon the price elasticity of a good, and its demand and market price, government places either

- specific taxes that are of a specific number, e.g. 10 dirhams on every bottle of beer
- *ad valorem* taxes that add a percentage of the market price onto taxes e.g. 5% of price of beer

A government must analyze the effects of taxing, or increasing taxation on a good, whether or not the taxation satisfies the goals.

The Social costs of alcohol involve the cost of production, cost of purchase and negative externalities such as alcohol poisoning and drunken driving deaths and violence.

The social benefits are the profit made by producers, the utility gained by consumers and externalities such as prevention of heart diseases.

The imposing of substantially higher taxes on the sale of alcohol may be good in two ways:

Firstly, alcohol is regarded as a habit forming good. Hence it may be assumed that either it disobeys the law of demand (quantity demanded of a good is inversely proportional to change in price, all other factors remaining constant), or it is price inelastic (a percentage change in price causes a smaller percentage change in quantity demanded). Although

imposition of taxes will increase the market price of alcohol, the change in demand would be substantially lower. Therefore the government would gain revenue, which it may use for provision of welfare.

Secondly, alcohol is a demerit good. It has private benefits as an industry, and it provides utility and satisfaction to consumers. Its positive externalities include reducing coronary diseases, and providing amusement to others in social events. However, its negative externalities include addiction, drunken driving accidents and fights which result in property damage, and provide a burden to society. Its positive externality of preventing coronary diseases arises only from minimal consumption, and can be substituted by medication and other foodstuff. Also the opportunity cost of consuming alcohol is great, as consumers pay money to buy alcohol, which they could have saved, invested or used to buy some merit good. Also the production of wines takes many years, which can be used in production of other goods. Therefore not only will taxation of alcohol provide revenue, but also prevent the consumption of a demerit good and hence reduce its negative externalities.

However, within this statement lies a paradox that serves as an argument against the consumption of alcohol. If the consumption of alcohol reduces, then how will revenue gained from taxation rise?

Also, raising taxes will result in reduction of revenue of firms, and hence, reduction in profits. Profit maximising firms will therefore reduce their costs by either reducing wages, or removing labour generating unemployment, and poor level of income and savings. Also, alcohol is used in the production of various medicine and drugs; hence they too will rise in prices due to rise in prices of alcohol. All this will result in reduction of welfare, which is opposite of the aim of the government.

Imposing taxes will also reduce the real income of people; hence buyers and consumers for alcohol will be able to buy less. Profit maximising firms will cut supplies further increasing prices of alcohol. This will lead to inflation. Also, black markets may arise too, which will serve as a hindrance on the government.

Thus the government must decide whether it aims at reducing the consumption of alcohol, or for raising revenue. If the aim is reducing consumption, there other methods such as regulation of supply and production, as well as restrictions on consumption may be more appropriate. However, there are already many restrictions on alcohol consumption such as legal age being 18, and permits or licences required to consume alcohol in some countries. Further restricting consumption may be looked upon as a loss of freedom of consumption.

I feel that instead of raising taxes on alcohol sale, it is necessary to impose laws restricting alcohol consumption, in order to wipe out its negative externalities. Ensuring that age limits and driving rules are satisfied will substantially lower negative externalities. Therefore legislative steps are necessary.