A MASTER'S POLICY REPORT

A "Nickel a Drink" Tax Increase How Will California's Alcohol Industry Be Affected?

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Executive Summary

California Governor Arnold Schwarzenegger proposed a nickel a drink excise tax on beer, wine, and distilled spirits for the 2009-10 budget as a way to decrease California's budget deficit. Given the projected changes in consumption, this tax could increase tax revenue by up to $737.5 million, which will help reduce the state's budget shortfall in addition to providing valuable support to programs that deal specifically with alcohol-related problems. However, due to resistance from the alcohol industry, the excise tax was absent from the Senate approved budget. Opponents claim that a tax increase would be detrimental to the alcohol industry, consumers, and California's economy. This study will evaluate the claims made by the alcohol industry and then examine the costs and benefits by conducting a cost-benefit analysis.

Industry Claims

- Alcohol taxes are a form of regressive taxation.
- A five-cent tax is a tremendous tax hike, at 640% increase for wine, 265% increase for beer, and a 129% increase for spirits.
- Alcohol taxes will cause a 20% drop in sales, resulting in 38,200 jobs lost and millions of dollars in lost tax revenue for the state.

Evaluation of Industry Claims

Alcohol Taxes Are Not Regressive

The alcohol industry claims that low income consumers experience a greater tax burden as a result of alcohol taxes. In reality, the heaviest tax burden falls on the heaviest drinkers, who come from all income levels. The top 20% of drinkers consume 85% of all alcoholic beverages (CSPI, 2004). Therefore a five-cent tax increase would place the greatest burden on heavy drinkers, who appropriately assume a greater share of the cost of social problems caused by their drinking.

Alcohol Taxes Have Not Kept Up With Inflation

Because excise taxes are based on volume and not value, rates have no automatic inflation protection. Therefore, the infrequency and modesty of recent alcohol tax increases has caused their real (inflation adjusted) value to decline substantially (Chaloupka, 2002; Grossman et al., 1993; CSPI, 2004; Rosen et al., 2008). Using the Inflation Calculator found on the Bureau of Labor Statistics website it was determined that the current beer and wine tax rate of $0.20/gallon is now worth about $0.13/gallon, in 2007 dollars. Similarly, the current spirits tax rate of $3.30/gallon is now only worth $2.17/gallon, in 2007 dollars. Since 1991, California's alcohol taxes have lost 35% in value. And if you go back to 1967, the most recent tax increase prior to 1991, alcohol taxes have lost 85% of their original value. In reality, a five-cent tax increase is reclaiming value that has been lost due to inflation.

Tax Increase Will Have a Marginal Effect on Sales

The industry has claimed that a tax increase on alcohol will cause a 20% decrease in sales (Sink the Drink Tax, 2009). This study utilizes price elasticity of demand to predict how consumers will react to a change in price. The price elasticities are -0.46 for beer, -0.69 for wine, and -0.80 for spirits, meaning that a 1% increase in the price of alcohol will reduce beer sales by .46%, wine sales by .69%, and spirits sales by .80%.

Therefore given the price elasticity of demand, sales will decrease by approximately 1.65% for beer, 2.20% for wine, and 2.35% for spirits. By volume that would equate to reduction of approximately 11.4 million gallons sold of beer, 2.8 million gallons sold of wine, and 1.2 million gallons sold of spirits. In terms of sales, that would be a loss of approximately $176 million for beer, $116 million for wine, and $182 million for spirits.

This is a small loss compared to the growth in sales that the industry has seen over the past decade. Sales of beer, wine, and spirits have been on the rise since the 1994 (Brewer's Almanac, 2008). Therefore it has been noted that higher alcohol taxes will have little effect on the profitability of the industry as a whole (Cook, 2007).

Loss in Sales Will Have a Small Impact on Jobs

The industry claims that 38,200 jobs will be lost as a result of a tax increase on alcohol (Sink the Drink Tax, 2009). However this study has estimated that approximately 1,176 jobs will be lost, which equates to a 0.3% reduction in overall alcohol industry employment in California. The estimated 1,176 job losses will cost up to $26.3 million in lost wages and $1.2 million in lost state income tax revenue. There are two possible reasons for the differential between this study's and the alcohol industry's findings. The first is that the alcohol industry may assume that the demand for alcohol is more elastic, and therefore an increase in price will have a more significant impact of sales. The second possible cause of this differential is that the alcohol industry assumes a very broad ripple effect when calculating job loss estimations. This study, however, only includes jobs that are directly related to production, distribution, and sales of alcohol in California.

Taxing Alcohol to Reflect Social Costs of Alcohol Use

While there is data to support that moderate alcohol consumption can improve health, it is largely known that excessive alcohol use can lead to heart disease, liver disease, cancer, and birth defects (Weimer et al., 2005). In some cases, publicly subsidized health insurance programs pay for these alcohol-related health costs. In addition, alcohol contributes to traffic accidents and fatalities, crime, and productivity losses. These social costs are not fully absorbed by the price of alcohol and therefore are passed onto society. Supporters believe that a five-cent per drink tax increase could be a useful tool in compensating for these negative externalities.

Cost-Benefit Analysis

Due to the relative inelasticity of demand for alcohol, especially among heavy drinkers who are the source of a majority of the alcohol-related social costs, consumption levels are not expected to decrease substantially. Nevertheless, any reduction in alcohol consumption could lead to a reduction in alcohol-related social costs. Therefore a 2.07% decrease in overall alcohol consumption could lead to a possible reduction of $1

billion in social costs. In addition to the reduction in social costs, this study included the following to conduct its cost-benefit analysis: increase in tax revenue, social surplus loss, payment of the tax by distributors, loss in wages, and loss in income tax revenue. In doing so, it was determined that a five-cent per drink tax increase could result in a net social benefit of $236.4 million.