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High alcohol taxes are self-defeating [1]

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Not too long ago I wrote about the HMRC's 'most wanted' tax evaders list [3]. As I pointed out, most of the criminals concerned were being given an opportunity to exploit high rates of duty and VAT on alcohol and cigarettes by smuggling. Similarly, this very revealing programme by BBC's File on 4 [4] traces some of the types of and scales of frauds carried out in the alcohol trade. Unfortunately, the programme focuses on the types of frauds conducted and ignores some rather more important issues.

Duty on alcohol was substantially increased by March 2008 by the then-Chancellor Alistair Darling who introduced a four year tax escalator due to last until 2014, under which the duty rate on all alcoholic drinks was set to increase by two per cent above the rate of inflation. High taxes on alcohol must be seen as a regressive tax (of about 1.6% of disposable income) on lower income groups as it constitutes a greater percentage of their disposable income than the better off [5]. HMRC reckon that £1.2 billion a year is being 'lost' to the Treasury due to these frauds, up from £400 million in 2001, which points to a significant and growing level of criminal activity. One of the interviewed police officers investigating these frauds, however, suggests that this may be a substantial under-estimate.

Aside from the loss of revenue to the UK Treasury, it would be interesting to know how much the enforcement activities demonstrated in the programme are also costing the police and HMRC, not to mention the costs which they impose on legitimate businesses. Surely this suggests that rates of taxation have exceeded their revenue maximising point (to say nothing of their growth maximising point, although this is clearly a contentious issue where alcohol is concerned) and it is quite possible that a cut in duty would be self-funding, not only from a tax but also an enforcement perspective. Quite simply, lower rates of duty mean lower profits for smugglers and therefore less smuggling.

Contrastingly, the conclusions of Richard Bacon MP given on the programme are - given that rates of duty are unlikely to be reduced - that enforcement should be stricter, which would surely only increase the costs to the taxpayer. Mr Bacon believes that reduction in duty is unlikely because of the UK's parlous fiscal circumstances, but one wonders if this is supportable in view of the Laffer curve effects outlined above. He also suggests that the high rates of duty exist because of the desire to discourage alcohol consumption. This is contrary to evidence that alcohol consumption in the UK is actually declining [6], except among certain groups who are probably extremely price inelastic anyway or who, one suspects, are actually buying the smuggled booze itself! It is also the case that differential rates of VAT on off-premises versus on-premises sales are helping to encourage people to drink at home rather than in pubs. Availability of

cheaper smuggled alcohol may also be a factor in this trend which has so seriously damaged the UK pub sector and is reckoned to have cost about 5,000 jobs here.

However, the programme also makes the point (which it does not go on to explore in depth) that the availability of illicit alcohol is actually pressurising legitimate retailers to drive down the price at which they sell. How much this is a factor in retailers' efforts to sell alcohol at below-cost prices and the resultant emergence of minimum unit pricing policies, which simply represent additional profits for retailers and smugglers, is hard to say. What is clear is that with alcohol, as with so many areas of public policy, government spends a great deal of money and resources attempting to correct the impact of problems is has created itself. It is also clear that rates of tax on alcohol, and much else besides, must come down - even the EU is arguing for that!

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