

Reading Passage

Taxes are also imposed by many subnational entities. Taxes consist of direct tax or indirect tax, and may be paid in money or as its labor equivalent (often but not always unpaid labor). A tax may be defined as a "pecuniary burden laid upon individuals or property owners to support the government a payment exacted by legislative authority." A tax "is not a voluntary payment or donation, but an enforced contribution, exacted pursuant to legislative authority" and is "any contribution imposed by government whether under the name of toll, tribute, impost, duty, custom, excise, subsidy, aid, supply, or other name."

The legal definition and the economic definition of taxes differ in that economists do not consider many transfers to governments to be taxes. For example, some transfers to the public sector are comparable to prices. Examples include tuition at public universities and fees for utilities provided by local governments. Governments also obtain resources by creating money (e.g., printing bills and minting coins), through voluntary gifts (e.g., contributions to public universities and museums), by imposing penalties (e.g., traffic fines), by borrowing, and by confiscating wealth. From the view of economists, a tax is a non-penal, yet compulsory transfer of resources from the private to the public sector levied on a basis of predetermined criteria and without reference to specific benefit received.

In modern taxation systems, taxes are levied in money; but, in-kind and corvée taxation are characteristic of traditional or pre-capitalist states and their functional equivalents. The method of taxation and the government expenditure of taxes raised is often highly debated in politics and economics. Tax collection is performed by a government agency such as Canada Revenue Agency, the Internal Revenue Service (IRS) in the United States, or Her Majesty's Revenue and Customs (HMRC) in the UK. When taxes are not fully paid, civil penalties (such as fines or forfeiture) or criminal penalties (such as incarceration) may be imposed on the non-paying entity or individual.

Lecture

Unintended consequences. Nothing illustrates the principle better than cigarette taxes. They've been in the news a lot lately as state governments try to close their deficits — at least in part — by hiking the tax paid on each carton or pack of cigarettes.

In 2002, 20 states implemented higher excise taxes on purchases of cigarettes. There have been more than 80 cigarette tax hikes since 1989 in the United States. The immediate consequence of hiking taxes, it is hoped, is more revenue. There are often ancillary impacts, however, that are not anticipated, and that have negative effects — smuggling, theft, in Europe there have been murders over cigarette smuggling and financing terrorism.

Regardless of the "unintended consequences" category that a policy fits into we now know that large cigarette tax increases in a number of states have led to at least three ancillary problems that must be reckoned with. They include: Interstate smuggling, theft, and "channeling." Channeling simply describes changes in the way people obtain the product they seek. "Rolling your own," is a good example. In Michigan, sales of kits to help people make their own unfiltered cigarettes have leapt.

The most pertinent of these three is smuggling. Smuggling has traditionally been associated with moving goods across international borders to avoid paying duties or tariffs on the product. Indeed, the earliest recorded cases involve smuggling wool from England in the 1300s. Smuggling, however, does not have to go across international borders. We banned alcohol and had smuggling across state and county lines, and even today alcohol is smuggled across borders to avoid excise taxes.

The Tax Foundation has, to their great credit, been tracing the effects of cigarette excise taxes on the increased use of contraband — or illicit — tobacco in the United States since 1960. They estimate that, in 1962, when the average cigarette tax was just 26 cents a pack (1997 constant dollars), 5.6 percent of all cigarettes were "procured through some type of cross-border activity."

By 1997, when the average cigarette tax was 35 cents per pack 7.8 percent of all cigarettes were obtained through cross-border activity. Today the average tax stands at 60 cents per pack. What impact would an average 71 percent increase in the cost of cigarettes have on smuggling? The Tax Foundation has not yet calculated the exact change in cross-border activity resulting from the latest hike in excise taxes. Executive Director Scott Hodge of the Tax Foundation believes it will be dramatic. Edward Hudgins, a regulation expert and adjunct scholar with the Cato Institute, estimated in 2000 that profits made illegally from smuggling cigarettes ranged from \$10 billion to \$17 billion.

Why should state legislators be concerned about this unintended consequence? By increasing the price for cigarettes via taxation legislators announce to the world that there are profits to be made in the illicit delivery of cigarettes. Price acts as a signal to producers to make more or less of any product. In this case a price hike tells smugglers that there are profits to be made running cigarettes between two areas — one, a low-tax area; the other, a high-tax area. Consider as an example North Carolina.

In the summer of 2000, FBI agents raided a house in Charlotte, N.C., in an action dubbed "Operation Smokescreen." Inside they found cash, weapons (including shotguns, rifles and an AK-47), documents written in Arabic — and cigarettes. Lots of cigarettes.

It appears that the raid was on a house that was used as a base for smuggling smokes. The smuggling operation exploited the tax differential between North Carolina, which has low cigarette taxes at 5 cents a pack, and Michigan, with high taxes at 75 cents (it is now \$1.25) a pack. Incredibly, the profits gained from this smuggling operation was used to buy terrorist equipment.

The next big unintended consequence you will be reading more about in the coming years is the **counterfeiting of cigarettes themselves**. The Chinese are now exporting cigarettes designed with the look and feel of Marlboros and Marlboro lights. At Long Beach harbor last year, customs officials report a 10-fold increase in the number of counterfeit cigarettes uncovered over 2001. Remember, this is just one port, and one brand we're talking about. Not even Phillip Morris employees can tell these apart from looking at them. And the counterfeit tobacco is often laced with things that shouldn't be there, such as sawdust.

There are serious policy implications of going to the tobacco well for revenue, and I have only been able to mention a few of them here.

The reason that well-intentioned officials keep trying such policies is because they may either not understand the adverse consequences, don't care about them, or have a view of the role of government that is not consistent with the limited one envisioned by America's Founding Fathers and ALEC.

Reading Notes	Lecture Notes
<p>Taxes consist of direct tax or indirect tax</p> <p>A tax may be defined as a duty given to individuals or property owners to support the government</p> <p>Payment is usually enforced by the legislature</p> <p>Not a voluntary payment or donation</p> <p>Economists do not consider many transfers to governments to be taxes: for example tuition.</p>	<p>Unintended consequences of cigarette taxes.</p> <p>The immediate intended consequence of hiking taxes, it is hoped, is more revenue. However, that are unanticipated negative effects —smuggling, theft, in Europe there have been murders over cigarette smuggling and financing terrorism.</p> <p>Interstate smuggling, theft, and "channeling." Channeling simply describes changes in the way people obtain the product they seek. "Rolling your own," is a good example. In Michigan, sales of kits to help people make their own unfiltered cigarettes have leapt.</p> <p>Today the average tax stands at 60 cents per pack.</p>

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Tax collection is performed by a government agency such as Canada Revenue Agency, the Internal Revenue Service (IRS) in the United States, or Her Majesty's Revenue and Customs (HMRC) in the UK.

When taxes are not fully paid, civil penalties (such as fines or forfeiture) or criminal penalties (such as incarceration) may be imposed on the non-paying entity or individual.

As a result, in 2000, profits made illegally from smuggling cigarettes ranged from \$10 billion to \$17 billion a year.

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