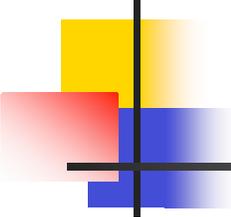


Excise Taxes: Design and Implementation

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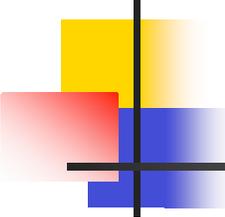


Role of Indirect Taxes:

All indirect taxes are intended to produce revenue; but some have other objectives also

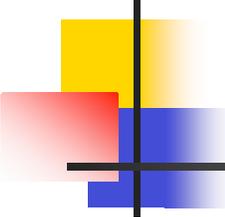
For example, import duties or tariffs may be imposed for protection as well as revenue

Similarly, in addition to revenue, excises may have the objective of internalizing external costs. Both aspects need to be considered



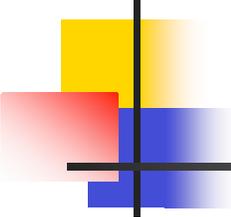
Excises for Revenue

- Excises may be very productive e.g. in ASEAN countries on average over 15% of taxes and 2% of GDP – almost as much as general consumption taxes.
- Moreover, when countries encounter fiscal problems, often the quickest and easiest way to close the gap is to increase excise rates.



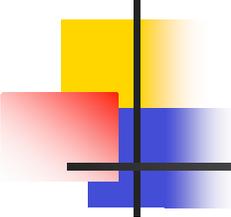
The Externality Argument

- The most important excises for revenue are usually those on petroleum products, alcoholic beverages, tobacco products, and motor vehicles.
- As it happens, these are also the products for which, because social costs exceed than private costs, there is a strong case for levying excises.
- Well-designed excises should thus not only produce revenue but also improve resource allocation and hence economic welfare.



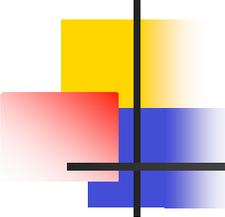
Some Issues in Designing An Excise System

- Scope of excise regime
- How high should the tax be?
- Specific or ad valorem rates?
- Rate differentiation
- Earmarking?
- Relation to other consumption taxes
- Administrative issues



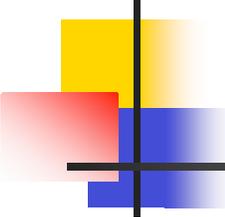
Scope of excise regime

- Limited to tobacco, alcohol, fuel, and perhaps vehicles?
- Inclusion of substitutes – e.g. denatured alcohol, soft drinks?
- Exclusion of ‘necessities’ – cooking fuel?
- Extension to minor items – ‘luxury’ goods?



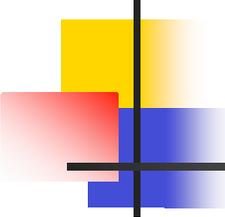
The Level of the Tax Rate

- The revenue-maximizing rate
- The optimal rate
- The feasible rate



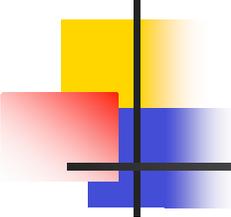
The Revenue-Maximizing Rate

- With data on relevant elasticities (responses to price changes) of supply and demand, RMR is easy to calculate in principle
- For example, a recent calculation for Kenya and Tanzania suggests that the existing tax rate for beer is much higher than the RMR in Kenya and much lower in Tanzania.
- But data are so poor that such calculations cannot be taken seriously in most cases



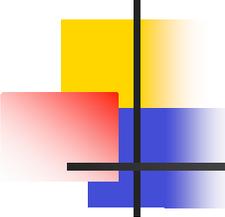
The Optimal Rate

- Economic analysis focuses on increasing people's well-being, not government revenue. The optimal rate (OR) not the RMR is what matters from this perspective.
- For example, studies in US and South Africa suggest doubling alcohol taxes to account for such externalities as increases in health costs, automobile accidents and violence. A recent study in India suggests that similar increases in tobacco taxes would not only maximize revenues but prevent millions of premature deaths.
- Again, however, underlying data is far from solid even in developed countries



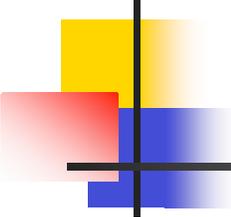
The Feasible Rate

- Other economic aspects
 - Effects of regulation
 - Links to other policy concerns – e.g. environment, energy
- Administrative aspects
 - Smuggling
 - Informal economy
- Other aspects – the political dimension
 - Jobs and other good things
 - Urban sprawl and other bad things



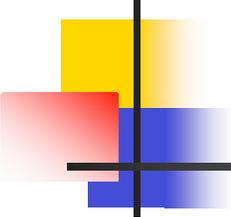
Specific vs. Ad Valorem Rates

- If a primary purpose is to discourage e.g. smoking and drinking, a strong case can be made for specific excises—the same tax burden per cigarette or per unit of alcohol
- Given oil price movements, specific excises may also be best for petroleum products
- Ideally, perhaps motor vehicles may call for a mixture of specific and ad valorem taxes
- Always critical to adjust specific rates for inflation – but few do so adequately



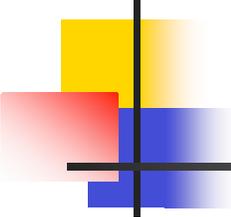
Questions on rate differentiation

- What should be the relative tax burden on beer (c.5 % alcohol), wine (12 % alcohol) and distilled spirits (40 % alcohol)?
 - Progressivity?
 - 'Cultural' style?
- Is there a case for protecting domestic producers (kretek cigarettes, small producers, low quality brands)?
- What should be the relative tax burden on diesel vs. gasoline vs. other fuels?
- Should the diesel excise be differentiated by end use?



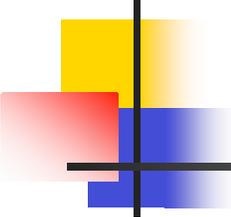
Earmarking

- Traditional case against earmarking is that it creates rigidities in budgeting and therefore leads to inefficient budgeting
- Nonetheless, especially in countries in which there is a lack of confidence in government and the budgetary process there may be a lot of earmarking, often of excises.
- Much earmarking is more 'symbolic' than real in the sense that it does not actually affect budgetary decisions at the margin: its function is more to advertise good intentions than to affect resource allocation.



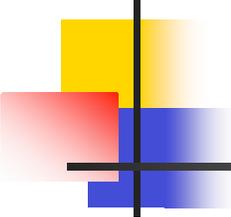
Earmarking Excises

- Case for real earmarking is strongest for motor fuel excises (as part of a system of road user charges as well as perhaps correcting for pollution and even congestion externalities). But seldom found in practice
- Case is much weaker for other excises e.g. on tobacco and alcohol. Such earmarking is often 'feel good' rather than 'do good'



Relation to other consumption taxes

- Should all excise products be subject to VAT?
- Should VAT be applied to price including excise? If so, should excise be lowered accordingly?
- Should imports and domestic products be subject to same excises?



A few issues in excise administration

- The border issue – international and domestic
- Stamps and seals?
- Taxpayer focus: checking consistency across taxes
- The sub-national dimension