

## Harm Reduction and Sin Taxes:

### Why Gary Becker is Wrong

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## I. Introduction

Much progress has been made in public opinion regarding drug prohibition. The policy has been an utter failure, very expensive, and increasingly disliked by people around the world. As a result several states have passed drug reform legislation that reduces penalties for the production, distribution, and consumption of previously prohibited substances such as narcotics and marijuana. Other states have placed more resources in drug treatment programs (demand reduction) instead of drug interdiction efforts (supply reduction). In North America, several states in the US and Canada have passed medical marijuana legislation to take advantage of the well-known medical benefits of marijuana.<sup>2</sup>

The advocates of drug policy reform generally promote the idea of “harm reduction.” This approach to reform rightly sees prohibition as a failed and highly destructive policy. Their “harm reduction” approach involves removing some elements of prohibition and replacing them with a variety of other policies, with the goal of reducing both the harm of drug prohibition and drug abuse. Their proposals typically include such measures as anti-drug education in the public schools; public service announcements warning against drug use; subsidies for drug treatment; drug maintenance and substitution programs (e.g. methadone); regulations on production, distribution, and consumption; restrictions on selling to minors; commercial zoning restrictions;

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<sup>1</sup> The author would like to thank Paul Wicks, Chris Peros-Tanaka and Jeffrey Tucker for helpful comments and suggestions

<sup>2</sup> Piper et al (2003).

advertising restrictions; and heavy excise or “sin” taxes.<sup>3</sup> Harm reduction proposals replace one set of government interventions with another and are sometimes referred to as *neoprohibition*.<sup>4</sup>

A prominent advocate of drug law reform is Gary Becker, a leading authority on the economics of addiction and proponent of the “legalization” of drugs. As a member of the prestigious Department of Economics at the University of Chicago he is certainly one of the most innovative economists of his generation and is now considered a leading representative of modern mainstream economics. Becker was awarded the John Bates Clark Medal by the American Economic Association in 1967 and the Nobel Prize in economics in 1992 by the Royal Swedish Academy of Sciences and the Swedish Central Bank for his research extending economic analysis to non-market behavior.<sup>5</sup>

Addiction is a major challenge to the Chicago School’s view of rationality. Building on his work with George Stigler, Becker’s rational theory of addiction attempts to model compulsive consumption behavior within the confines of rational economic man. Drugs are not rational in the sense that drug abuse is the correct thing to do; they are rational in that their behavior can be understood and explained. Here price determines consumption, present consumption determines future consumption, and high time preference leads some individuals to heavily discount the future and the resulting harm that comes with long-term drug abuse.<sup>6</sup>

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<sup>3</sup> See Fish (1998) for a representative survey of the literature.

<sup>4</sup> See Cass (2000) for a description of neoprohibitionism. Ford (1988) uses the label “new temperance” for the same phenomenon.

<sup>5</sup> <http://www.src.uchicago.edu/users/gsb1/>

<sup>6</sup> Stigler and Becker (1977), Iannaccone (1984, 1986), and Becker and Murphy (1988). Becker supervised Iannaccone’s dissertation, Stigler was a member of his dissertation committee.

This theory of addiction cleverly encompasses such phenomena as drug tolerance (addicts need more of the good over time), reinforcement (present consumption increases future consumption), bingeing and abuse, and going cold turkey (cessation). Becker's approach is far more scientifically satisfying than other views of addiction, and his theory of rational addiction has been applied to a variety of markets, from cigarettes to opera. This model of addiction has been criticized on a variety of fronts, but on a more positive note, Becker's analysis of addiction as rational behavior incorporates the role of individual time preference and taste and thus helped re-establish them in economic analysis. Mainstream economists prefer to work with the homogeneous and perfectly rational version of economic man, but with addiction we are faced with "lumpy" consumption where one individual consumes large amounts of a good while a person with similar economic and demographic characteristics consumes none at all. Even more realistically, "unstable steady-state consumption levels" must be considered (binge? cold turkey? binge), where individuals can drastically rearrange their consumption decisions. And then we are forced to realize that this pattern actually applies to a large percentage of individuals and goods, including such widely disparate items as drugs, ice cream, sex, religion and opera. Thus, rational addiction helps make mainstream economics more realistic.

In magazine articles Becker has long advocated drug legalization, but what is clear in both his popular articles and academic work is that he does not provide an argument for true legalization. Rather, he advocates replacing prohibition with decriminalization and high excise taxation. The excise tax simply takes the place of the other, more cumbersome government interventions designed to discourage consumption.

His recommendations are essentially an economist's perspective on harm reduction approaches to drug policy reform, not true legalization or a return to free market policies. This article will demonstrate that Gary Becker, and the harm reduction approach in general, are wrong.<sup>7</sup>

We begin with a comparable example of the harm reduction model in a different market to show that it does not reduce harm. Next, evidence of Becker's specific proposal will demonstrate that it has already been shown to be a failed and politically unstable policy. Finally, the theoretical flaws of Becker's approach will explain why he is wrong. This investigation demonstrates the utility of the Austrian model of progressive interventionism and the value of the Austrian school's guidelines to policy espousal.

## II. Human Body Parts

Attempts to transplant human organs have led to advances in medical knowledge and technology that have stimulated the discovery of successful transplant operations. The first successful kidney transplant occurred in 1954 involving identical twins. Other procedures involving hearts, livers, lungs, pancreases, and other organs from recently deceased ("cadaveric"), as opposed to living donors, have been discovered along with a multitude of new procedures, instruments, and techniques. These advances have greatly improved transplant success rates, reduced human suffering, and decreased mortality.

One of the most important discoveries was immune suppressant drugs, which prevent the transplant recipient's immune system from attacking or "rejecting" the

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<sup>7</sup> See for example, Becker (2001), where he endorses legalization and sin taxes, along with virtually the entire gambit of neo-prohibitionist government interventions including minimum age laws (prohibition) and government-financed drug treatment and anti-drug education. Also see Becker (1987).

transplanted organ. The drug Cyclosporine was first approved for use in the US in 1983. This not only improved success rates; it permitted the transplantation of organs beyond the confines of traditional matching criteria, such as identical twins, siblings, and between parent and offspring.

The combination of immunosuppressant drugs and the use of cadaveric organs has greatly expanded the potential use of organ transplant operations, and these operations have experienced growing acceptance by patients, doctors, and insurance companies. The rates of successful operations are high and thereby permit most patients to eliminate their medical suffering and return to a normal life. Organ transplantation is one of the miracles of modern medicine practice and promises to both improve and extend life in the future.

There were nearly 25,000 successful transplant operations in the US in 2002. By far and away the biggest problem is a severe shortage of transplantable organs. There are currently almost 90,000 people registered to receive transplants. Of these official registrations, 80% have been on the waiting list for more than one year and 28% have been on the waiting list for more than three years. The pain and suffering of those waiting for a transplant, however, is just the beginning. Since 1988 nearly 50,000 people have died while on the waiting list and more than 10,000 have been removed from the list because they became too ill for a transplant operation.<sup>8</sup>

The reason for the intense shortage of transplantable organs is a price control. The government effectively keeps the price at zero by establishing a *prohibition* on the buying and selling of transplantable organs. The National Organ Transplant Act (NOTA) was passed in 1984 by the US Congress and signed into law by President Ronald Reagan. The

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<sup>8</sup> Based on OPTN data as of August 16, 2003 [<http://www.OPTN.org>].

law prohibits payments to individuals or the families of possible cadaveric donors to encourage donations. This prevents a market from forming, creates the shortage, and could even induce black market activity and all its related problems.

NOTA was intended to encourage the supply of organs, provide fairness in the distribution of organs, thwart exploitation of potential donors, and prevent unethical behavior connected with a commercial marketplace in human organs. As such, NOTA is a government intervention designed with the intent to both take the place of the market and to reduce the perceived harms of the marketplace. However, there was no evidence of problems in the areas of fairness, exploitation, and ethics prior to its enactment.

In place of the market, the US government instituted a variety of policies and organizations, including the Division of Organ Transplants in the Department of Health and Human Services. It also provides funding for various public-private partnerships such as the Organ Procurement and Transplantation Network, the Scientific Registry of Transplant Recipients, the United Network for Organ Sharing, and more than fifty organ procurement organizations around the US. These procurement organizations are essentially private, non-profit monopolists. The government thereby controls directly or indirectly almost every aspect of the production, distribution, and consumption of transplantable human organs.

This policy approach does not work and, in effect, has killed tens of thousands of people, left tens of thousands more suffering for years at a time, all the while limiting and distorting advances in transplantation procedures. This approach does not reduce harm; it creates harm that could easily be eliminated by the market. While the policy strives to achieve ethical superiority over markets and commercialism, and fairness in distribution,

in reality this scheme is subject to systemic problems of misallocated resources and favoritism (e.g., Mickey Mantle). It has undergone several legislative and structural changes, a clear indication that this policy approach is both ineffective and unstable.<sup>9</sup>

Kaserman and Barnett provide a comprehensive economic analysis of the current “market” for human organs and they find:

Organ transplantation holds the potential to restore the health of many otherwise terminally ill patients substantially. That potential, however, is currently being denied full realization by a chronic and severe shortage of cadaveric organs that are made available for this use. Importantly, that shortage is not due to an inadequate number of deaths that occur under circumstances that would allow transplantation of the deceased individual’s organs. Rather, it is directly attributable to a public policy that legally proscribes reliance on market forces to call forth the additional supply that is potentially available. That policy currently results in a collection rate of less than 30 percent of the available supply of cadaveric organs.<sup>10</sup>

They show that the government’s approach to organ procurement has not worked and despite several attempts to reform, it continues to fall far short of success. They found that the only realistic solution is to turn to economic incentives. Based on their evidence, they conclude:

Significantly, our findings indicate that payment of positive prices has the potential to eliminate completely the organ shortage at very modest levels of remuneration. Specifically, payments of such prices would not cause a substantial shift in the quantity intercept, and positive (but relatively modest) prices would call forth a substantial increase in the number of organs supplied. As a result, the equilibrium, market-clearing price per organ would be quite low—substantially less than \$1000.<sup>11</sup>

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<sup>9</sup> Becker (1997) has suggested that the federal government become the monopoly buyer and altruistic distributor of transplantable organs.

<sup>10</sup> Kaserman and Barnett (2002, p. 115).

<sup>11</sup> Kaserman and Barnett (2002, p. 115), emphasis added.



The institutions of government organ transplants are a comparable example of what most drug law reformers envision for drugs. In the view of these reformers, currently prohibited drugs will be “legalized,” but remain controlled, restricted and highly regulated. Likewise, most reformers advocate that drugs should be produced under controlled and regulated conditions, preferably by licensed and government-approved contractors. Distribution would also be monitored, if not conducted, by government. Limitations would also be established on when, where, and how these drugs could be consumed. Purchases and consumption would be limited to specialized licensed establishments, with limited hours of operations, and, of course, all agree that minors would not be allowed to purchase or consume drugs.

In addition, harm reduction advocates also tend to support a wide variety of demand-reduction policies. These would include such items as public education against the dangers of drug use, public service announcements, prohibitions against advertising, heavy taxation, drug treatment programs, drug treatment facilities, subsidies for drug treatment and rehabilitation, drug maintenance programs, drug substitution programs, as well as a wide variety of government-funded research. All efforts would be made to eliminate the profit motive and to limit commercialism in this new era. Harm reduction policy is neoprohibition.

Although it is far from a perfect analogy, the conditions surrounding the transplantation of human body parts have much in common with the “legalization” visions of drug law reformers. Both would permit the activity to take place, but control every aspect of the process. In both cases, either the government or some tightly controlled contractor would be in charge of each step. Virtually the entire gamut of

government interventions is exhausted in each. In many cases they employ the exact same type of interventions (e.g., public service announcements), while in others the connection is less direct (e.g., drug treatment centers and organ transplant centers). Only in normative terms is there a substantive difference. It is largely irrelevant that virtually all informed observers would like to see an increase in organ transplants but a decrease in certain types of drug consumption. What does matter is whether the means of government intervention achieve policy goals better than an unrestricted market process.

Kaserman and Barnett found many other subsidiary inefficiencies and distortions in this area of health care, but their primary finding that price control causes shortages is a good starting point because it is one that economists can understand and accept (market prices eliminate shortages). Becker (1997) accepts this basic reasoning between market incentives and human organ shortages. This is particularly helpful when we move to the case of non-price government interventions that are included in harm reduction proposals and it will also be helpful in diagnosing Becker's proposal to distort prices via the power to tax.

Upon reflection, common sense tells us that harm reduction approach is problematic, as illustrated with the case of human organ transplants. Government interventions do not work. Government bureaucracy is wasteful and costly. All these interventions create red tape, not consumer satisfaction. The economic and ethical goals are generally not achieved and new problems are created. The general public implicitly recognizes many of these problems, but in the cases of human organ transplants and narcotic drugs, they know of no alternatives. They have never seen a fully functioning market in these goods and have only been exposed to horror stories of abuse and

unethical behavior based on fabrication, exaggeration, and misconstruction of cause and effect. Without a known alternative, government bureaucracy wins by default. When it comes to markets, most people are from Missouri, the “show me” state.

Gary Becker shares the general public’s intuition when it comes to being skeptical of government intervention and bureaucracy. However, he is not from Missouri. He has the Chicago faith in economics—markets do work. The Chicago faith requires public pronouncements that all economic hypotheses have to be tested with real world data. However, in private, if your tests come back with the wrong message, then the tests are wrong and have to be reconfigured and redone until you get the right answer. In the profession’s lingo, the data must be tortured until it confesses.

The curious thing about the Chicago faith that certain big markets cannot work, or do not work well enough. Justice, law enforcement, and property rights enforcement cannot be left up to the market. Markets do not work in the case of money and cannot exist in the case of national defense. In fact, markets in general do not work well enough, so there must be anti-trust enforcement to ensure competition within and between markets. Their faith seems to weaken as you move beyond simple supply and demand in a single market. It appears that if a problem extends beyond a single market then is likely beyond the control of the market economy.

From this perspective, the “sin tax” approach of Gary Becker makes a great deal of sense. Individual markets in goods and services are to be preferred over government interventionism and bureaucracy because they are more efficient. For example, private drug treatment services are better and less costly compared to government programs. Privately produced marijuana and cocaine are better and cheaper than government-

produced products. However, the problems of drug abuse and addiction are too large and complex and therefore they are beyond the scope of the market. How could the market solve addiction? Might not profit seeking and efficiency increase addiction via advertising and reductions in price? Something needs to be done to correct for this—to reduce abuse and addiction and all their associated problems. While drug policy reformers seek governmental oversight; the economic theorist’s solution is to increase price to reduce consumption—forcing drug users up their demand curve. The solution is to tax the product with an excise or “sin” tax, similar to the markets for alcohol and tobacco.

This approach seemingly eliminates most of the bureaucracy and intervention while distorting economic incentives to reduce consumption. Is the approach a successful one? Does it reduce harm and, if so, is it a stable, sustainable policy? According to both theory and evidence, this approach is not successful, it does not reduce harm, and neither is it a stable or sustainable approach. One possible advantage is political in that the sin tax approach increases government revenues, but increasing government revenue is not an independent element of the social welfare function and has much to recommend against it. Normative issues aside, the only way to truly reform and achieve substantive harm reduction is through a laissez faire approach to drugs, just as with organ transplants.

### III. Do Sin Taxes Work?

Becker (1991) argues that legalization would reduce price and stimulate consumption by a significant amount, contrary to other hypotheses which argue addiction implies inelastic

demand and therefore a decrease in price would not overly stimulate consumption. The poor, the uneducated and the young would be particularly affected by the reduction in price, but government drug education efforts would have little effect on them. In contrast, the excise tax would have a significant deterrence on the poor and young. Therefore, according to Becker it might be possible to achieve the benefits of legalization without incurring the costs or “sins” of addiction.<sup>12</sup> Thies and Register (1993) provide evidence regarding marijuana that would seem to undermine Becker’s hypothesis regarding recent elasticity of demand for drugs.

Do excises taxes actually create socially desirable results? Here, we would have to cast grave doubt that any excise tax could ever achieve a reduction in sin or harm. First, excise taxes do not eliminate consumption of the targeted good. Second, like prohibition, excise taxes encourage the production and consumption of more potent and potentially more dangerous drugs. Third, the singling out of a good as “sinful” creates an attractive nuisance in the marketplace that appeals to male teens and young adults, who are often considered the most “at risk” of demographic groups.<sup>13</sup> Fourth, legitimate uses of the product are discouraged and some consumers pay an unnecessary and misplaced tax. Fifth, excise taxes provide incentives for consumers to switch to untaxed goods that are potentially less desirable and more harmful. Sixth, sin taxes encourage the development of black markets. Seventh, organized crime, corruption and violence are used to facilitate black market production and distribution. Eighth, there is no way to calculate the proper good to tax. Ninth, there is no way to calculate the proper tax rate. Tenth, the tax rate and the policy itself are politically unstable.

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<sup>12</sup> The term sins will be used to indicate all the social and individual problems associated with the consumption of alcohol and drugs.

<sup>13</sup> This result is certainly discernable from Becker’s own theory of rational addiction.

The sin tax approach is unstable, does not reduce harm, and does not lead to solutions of the problems involved. To the extent that sin taxes reduce the costs and unintended consequences of prohibition, they would do little or nothing to discourage consumption. If sin taxes are high enough to discourage problematic consumption, the problems of prohibition and black markets reestablish themselves. They are also a failure because they are unstable, lead to increasing government intervention, and often lapse back into prohibition.

This failure of sin taxes can be illustrated with the history of sin taxes on alcohol in the US. Excise taxes on alcohol were established at the very beginning of the federal government when the federal excise tax on alcohol was increased. It led to a large open insurrection known as the Whiskey Rebellion. President Thomas Jefferson repealed the excise taxes only to have them reinstated during the War of 1812. Those excises were likewise repealed after the war and were not reenacted until the Civil War and the rise of the Republican Party to power. The Republican coalition included the prohibitionists, and their political dominance ensured that the heavy excise tax on alcohol would continue in force into the 20<sup>th</sup> century.<sup>14</sup> The establishment of the Income Tax quickly made alcohol taxes less important, and Boudreaux and Pritchard (1994) used a public choice model to analyze the passage of the 18<sup>th</sup> and 21<sup>st</sup> Amendments, which established and then repealed Alcohol Prohibition (1920-1933). Thornton (1996 and 1997) showed that prohibition was preceded by a long history of government interventions into alcohol markets, including heavy taxes, licensing, local option, and state prohibitions. He showed that these policies were ineffective and that as a result alcohol policy was unstable and

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<sup>14</sup> Of course there was an on-going battle throughout much of Appalachia between the moonshiners who were attempting to avoid the alcohol excise tax and the revenue agents of the federal government who were trying to enforce the tax. See Miller (1991).

tended to cycle. The repeal of alcohol prohibition led to the reestablishment of excise taxes on the federal and state level, while prohibitionists turned their attention to narcotics and marijuana. Have excise taxes on alcohol been helpful in reducing sin?

Research and advocacy related to alcohol and alcohol taxes have been biased against alcohol. This bias is based largely on three factors. First, there is professional bias, especially with health care and social science researchers. Economists appear less biased, but they exhibit a fixation regarding the price effect of taxation (reduction of consumption) that clouds their analysis. Second, there is a bias based on the “puritan instinct” in America. This instinct combines a compulsion to solve perceived problems and a belief that sins have objective causes, like in the cases of guns and sex toys. Here alcohol itself “causes” a variety of well-known sins and the solution is to remove, or at least greatly diminish, access to alcohol. Third, there appears to be strong rent-seeking bias in favor of excise taxation and other government interventions related to the inevitable research grants and consulting opportunities that go along with such interventions. However, none of these biases would be of much concern if the sin tax approach were valid.

Economists have studied a variety of issues related to alcohol and sin. Does alcohol consumption harm health, especially cirrhosis and heart disease? Does alcohol reduce human capital and family formation, increase absenteeism, or reduce productivity? Does alcohol increase automobile accidents, crime, violence or suicide? These questions have simple, straightforward answers, at least for those with the puritan instinct. Unfortunately, the empirical answers to these questions have been far from clear and in many cases have contradicted the preconceived puritan notions. In particular,

while it seems clear that excise taxes reduce average consumption, it remains unclear whether such taxes actually promote reductions of sin. It is clear that such excises rank very low in terms of equity considerations.

The most important consideration for alcohol policy, or aspirin policy for that matter, is not how much is consumed, but how it is consumed. Alcohol can be beneficial, benign or dangerous depending on how it is consumed. Binge drinking is the type of drinking that leads to intoxication, accidents, economic and social problems, and health consequences. Moderate drinking need not lead to any of these problems. For example, French, et al. (2001) found that chronic drug use was negatively associated with employment, but found no impact from light or casual use on employment or labor participation. Indeed, moderate drinking has long been known to improve health and to contribute to a successful and happy life. From the historical perspective, alcohol was an important reason for the civilization of humanity, a critical food, and the cornerstone of medicine. The most common result of alcohol consumption is a benefit to the individual and society in terms of health and economic impact.<sup>15</sup> Heavy excise taxes limit our ability to exploit these benefits.

The type of consumption that is of concern is bingeing and the resulting intoxication, accidents, and health consequences. Is the governmental approach of excise-sin taxes and other interventions the correct policy to address binge drinking and associated sins? One area where empirical studies have found some consistency is that excise taxes on alcohol have long been associated with reduced traffic accidents.<sup>16</sup> This is a somewhat curious consensus given that variations in alcohol taxes have a limited

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<sup>15</sup> Ford (1988).

<sup>16</sup> See for example Grossman et al. (1993) and Chaloupka et al. (1993).



effect on price and consumption, and more so given that heavy drinkers tend to be the least responsive to changes in price. Even more suspicious, forecasts by Chaloupka, Saffer, and Grossman (1993) of reduced highway fatalities due to higher excise taxes failed to materialize.

Mast, Benson and Rasmussen (1999) found that the relationship between excise taxes and highway fatalities could not be replicated using more recent data with standard models. Using a more comprehensive approach, they were able reestablish the relationship by using an alternative dependent variable (drive-involvement rate). However, they found the relationship to be sensitive to model specification and that in a fully specified model (such as including religious affiliation) the correlation becomes much smaller and insignificant. They conclude:

The point is that the relationship between beer taxes and alcohol-involved traffic fatalities is very sensitive to specification...because beer taxes clearly are correlated with other variables that can reasonably be hypothesized to influence beer consumption. When this is the case, a scaled down model that includes taxes but not the other variables implies that the coefficient on the tax variable cannot be interpreted as a pure tax impact, as it may be picking up the causal effects of left-out variables. Therefore, if a leaner specification is appropriate, the question becomes which variables should be omitted, and any procedure that excludes some variables simply because they are correlated with taxes is clearly ad hoc. In fact, the arguments made above suggest that there are reasons to expect that taxes may not be a particularly important determinant of fatalities and therefore that the tax variable should be the one that is dropped. Furthermore, taxes appear to be the only policy variable in the recursive model that is highly sensitive to specification, suggesting that in some models it has drawn explanatory power from left-out variables.<sup>17</sup>

Their results show that the relationship established in the economics literature between excise taxes and sin is far less robust than previously thought and is probably a wholly fallacious one. As a result, common sense about the effectiveness of sin taxes wins out

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<sup>17</sup> Mast, Benson and Rasmussen (1999, p. 246).

over more than a decade of statistical research by mainstream economists. More encouraging in their findings is that there are other causes and cures of sin that need to be further examined.

Excise taxes do not work to reduce sin precisely because the tax does not target the actions in question (e.g., drunken driving, highway accidents, violence, and crime). A tax on gasoline or restaurant meals at night might have a similar, extremely low level of deterrence. In order to reduce sin, it must be more directly targeted. A tax high enough to deter sin via reductions in alcohol purchases would simply reestablish the black markets and inferior substitutions that take place under prohibition.

Some advocates of neoprohibition model alcohol taxes as an insurance premium. Taxes are collected on all users and then the government spends the money on those who are harmed (e.g., hospitals, disability payments, and social services). In this view, taxes should be used to deter sin, but more importantly they should at least cover the “social cost” of alcohol use. Actually, most estimates of the “social cost” of alcohol have been found to exaggerate the true cost drinkers impose on the government, and provide further evidence that states set tax rates to maximize government revenue, not solve social problems. But even if they did, excise taxes are not real insurance premiums; they are “social insurance” premiums. Real insurance does deter bad driving, drunken driving, and accidents because insurance rates are increased for those with a bad driving record, and those with a history of alcohol-related incidents might lose their insurance and driving privileges altogether. Insurance companies also give positive incentives for good behavior. The excise does neither. In fact, the financing of the social safety net only provides a subsidy for bad behavior. This social safety net is a true moral hazard and

therefore a primary source of sin. Fix or eliminate the net and you reduce a true cause of sin, and probably a significant one.

With the case of alcohol and drunken driving, another obvious area to examine is the highways. Management of the roads is clearly at issue here although it is seldom even mentioned in the literature. Private ownership of roads would require sufficient control of access and usage to prevent the type of wide-scale slaughter that the government permits on today's highways. Road owners would be subject to negligence law, tort laws, and wrongful death lawsuits. Clearly owners would have to do everything on their part to prevent accidents of all types, and drivers incapable of paying for their own accidents would have to be filtered out. Surely this would subject all drivers to insurance requirements and greatly reduce the number of drunks, teens, and the elderly from the roads. Privatization of the roads seems like a remote possibility, but it should be considered in the negative when casting about for variables to model statistically. Evidence from Benson, Mast, and Rasmussen (1999) and many other sources suggest great potential for entrepreneurial control of the roads.<sup>18</sup> However, government efforts thus far have only imperfectly mimicked the market and are often carried out in limited and haphazard fashion.

Finally, some of the specific variables Mast, Benson and Rasmussen (1999) introduced also hint at a very important source of sin reduction. Religion is one factor that has an important connection with alcohol consumption and reckless driving, and this implies that issues such as family upbringing, culture, and social influence do indeed play an important role in sin and sin control. The anecdotal evidence certainly seems to suggest that societies that treat alcohol as a regular food and normal social device, rather

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<sup>18</sup> See for example Block (1979, 1980, and 1983), Gunderson (1989), and Klein (1990).

than a sin, have much fewer problems despite higher levels of consumption because children are taught that moderate alcohol consumption is normal while binge drinking and drunkenness are not. With this grounding, individuals can generate large economic benefits and widespread health benefits from moderate alcohol consumption, rather than social costs.

Societies that attempt to stigmatize and marginalize alcohol via prohibitionist policies tend to have greater problems with drugs and alcohol.<sup>19</sup> Children are not taught how alcohol should be consumed and the social marginalization of consumption only encourages binge drinking, drunkenness, and problem drinking. Drug addicts tend to hide their problems rather than seeking help because of the legal sanctions they face and prohibition restricts the types of therapies that treatment facilities can offer. In this light, sin taxes and other prohibitionist policies in effect create an attractive nuisance for teens, the poor, and the disaffected. Complete parental responsibility (and liability) for children, rather than the schools and government, could provide some remedy for a problem that most everyone agrees is the seed of most alcohol and drug-related problems.

A second category of variables examined by Benson, Mast and Rasmussen (1999) is related to various forms of government intervention. Some government interventions such as “dry county” or local prohibition try to reduce sin by reducing consumption. Such measures can indeed reduce consumption of targeted products, but often increase the number of accidents and highway fatalities. In the case of alcohol and drug prohibition, consumption does decrease, but the drugs that are consumed are much more potent and dangerous to consume because of prohibition.<sup>20</sup> Other types of government interventions

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<sup>19</sup> See for example Morgan (1974) and Rorabaugh (1979).

<sup>20</sup> Thornton (1991 & 1998a).

that attempt to mimic private management of roads, such the size of the police force and open-container laws, seem to actually reduce alcohol-related problems on the road. In addition to mimicking the private sector in roads, a private model of law would emphasize restitution, where criminals directly paid victims and their families the full value of their loss. This would surely be more effective than the present model of punishment and rehabilitation.<sup>21</sup>

This section has shown that the sin tax approach does not work, does not reduce harm, and has much to recommend against it. A number of policies have been added to sin taxes, such as regulations, in attempts to bolster its effectiveness, without success. The empirical literature on the economics of excise taxes was found to be hopelessly inconclusive, and where it has been conclusive it is both wrong and misleading. What does result, however, is a substantive list of issues that hold great promise in the reduction of harm associated with the consumption of alcohol.

#### IV. Why Becker got it wrong.

The adoption of sin taxes—or in Becker’s case, the advocacy of sin taxes—is evidence of ignorance of the market’s discovery process—*the undiscovered discovery process*. It is the market, along with social organizations and other voluntary and legal institutions, that can solve the sins associated with alcohol. Economists recognize this discovery process in certain well-established cases, such as computers and stock prices, but tend to be ignorant of the general nature of the discovery process and how it works.

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<sup>21</sup> See Benson (1999) for a full description of the superiority of restitution over punishment and rehabilitation.

Therefore, when faced with new conditions, unusual cases, or problems that span outside the confines of a single market, they cannot fathom how the market will work to solve the problem. Thus, the case for government intervention is built on ignorance. As noted above, the Chicago School of economics has a schizophrenic view of markets and competition, and much of their problem is a failure to understand the market's discovery process.<sup>22</sup>

Once the sin tax has been put in place, a bureaucracy is established and revenue is collected. However, there is no process in a sin tax regime that corresponds with addressing the sins associated with alcohol consumption. There is no mechanism, like profit and loss, that permits government bureaucrats to solve social problems or to adapt their operations to solve problems in a dynamic world. There is no “optimal level” of sin tax, because sin taxes are not part of the solution. As shown in the previous section, they are actually part of the problem, but the practical issue is that government intervention and bureaucracy cannot simulate the discovery process of the market—*the unsimulated discovery process*. As conditions fail to improve, or even worsen, the perceived need for a policy response increases. At that point the tax could be repealed and a true free market established, but more likely, there will be louder and politically stronger calls to increase the sin tax, regulate production, distribution, and consumption, establish minimum drinking age laws, and other such interventions.

As the result of taxation, firms and other market institutions will also experience increased government intervention. They become tax collectors for government and must seek out government licenses and permits to participate in the market. Even in mild cases,

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<sup>22</sup> See the “Symposium: Chicago versus the Free Market” in the special issue of the *Journal of Libertarian Studies*, Vol. 16 No. 4 (Fall 2002).

such interventions establish new costs of operation, regulations, reporting requirements, and auditing. This creates a barrier to entry and limits the extent of the competition. This also distorts competition and the discovery process from what it would have been in a free market. Firms now have certain things that they are required to do and other things that they are prohibited from doing, and thus the range of their options has been limited, as has their ability to discover new solutions—*the stifled discovery process*. With the government failing to solve the problem, and the market with “one hand tied behind its back,” the perception of the need for policy response and more government intervention grows even stronger.

As more government intervention is introduced into the market, the margin between market participation and non-participation is crossed by some participants. Some consumers will drop out and take up new habits, but we should hardly expect the alcoholic or drug addict to be the first one to drop out. Producers will also drop out, either to seek different employment or to participate in the same industry via the underground economy, or black market. Without all the taxes and regulations, business in the underground economy comes with a greater accounting profit margin. As the black market develops, the perception of lost revenue will undoubtedly call for a policy response to prevent black market sales and to police the market: more government intervention.

In response to enforcement efforts, black marketers will have to find ways to avoid detection. This will mean that firms in the underground economy will have to run their businesses in a completely different manner than the market economy. They will have to discover new ways to conduct production, wholesaling, and retailing—a *wholly*

*superfluous discovery process*. This is what causes products such as illegal drugs and alcohol to be so potent and dangerous to consume. This is where organized crime and street gangs come from and this is what causes the violence, crime, and corruption associated with drug prohibition, but it also happens in markets with high excise taxes and government intervention.<sup>23</sup> Naturally, all of these negative results create the perception that policy needs to be reformed. Most often, this only results in greater levels of government intervention. The result is a *process of progressive interventionism* where interventionism increases, government grows in size and power, and social problems worsen.

This process of progressive or increasing intervention has been recognized most famously by Hayek (1944), but it was established earlier by Mises (1929) and more recently confirmed by McKie (1970). In the case of drugs and alcohol, the model has been accepted and documented by Anderson (1997), Thornton (1997), and Weise (1998). Excise taxes have been particularly unstable and subject to political manipulation. Any proposal to enact sin taxes should therefore recognize not only their general ineffectiveness, but also the general tendency for such taxes to lead to additional government interventions and for this process to eventually result in de facto or official prohibition, as was the case with alcohol, narcotics, and marijuana. Tobacco is currently in that same process. The sin tax approach is an unstable policy because people adapt to the sin tax and policy makers react by making adjustments in tax rates, collection methods, enforcement techniques, and bureaucratic mechanisms. Policy failure generates a demand for policy innovation and this generally leads to an expansion of policy in the

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<sup>23</sup> See Thornton (1991 and 1998a).



direction of bigger, more intrusive government. For a full discussion of the public choice aspects of prohibition, see Thornton (2003).

## V. Conclusion

Sin taxes are not an effective means of reducing the harms associated with drug use and drug abuse. If sin taxes are set very low, the policy approaches true legalization, but such taxes would have no beneficial effect on drug abuse and potentially some negative effects. If sin taxes are very high, they would reduce legal consumption, but would have little beneficial effect in reducing the harms of drug abuse. Punitive taxes would, however, lead to underground economic activity, smuggling, black markets and many of the problems of prohibition, such as crime, corruption, and violence. As describe above, any excise tax between the two extremes can generate a process of progressive interventionism that is likely to degenerate into de facto or official prohibition and all its related problems.

The sin tax approach is therefore not a viable alternative to prohibition. It might be a policy worth voting for, but in terms of policy espousal based on economic science it is highly flawed and must be rejected. The Austrian theory of progressive interventionism, as developed by Mises, Hayek, and others provides a more holistic perspective on policy analysis because it clearly shows these interventions do not work and are unstable.

The Austrian approach to policy espousal provides a stronger ground for policy development. Here, the ideal policy is championed while transitional issues and political

acceptability are considered only secondary or eschewed altogether. If the policy of prohibition does not achieve its goals and imposes high costs, then it should be replaced. The default position is generally the free market. Does the market achieve the goals of prohibition? It certainly does not in terms of eliminating consumption, but it does provide various mechanisms that directly target the harms of drug abuse, such as employment rules and incentives, insurance, negligence and liability law, and the basic rules of business law, which, for example, disallow valid contracts with minors. When more specific problems with alcohol and drugs are addressed, such as drunk driving and burdens on social services, the reasons for these specific problems need to be investigated and analyzed. For example, the problem of drunken driving is one of many problems on the highways that are related to government management of the roads. Drunkenness and drug abuse also increase burdens on the social safety net, but they are among many types of behaviors that increase the burden on taxpayers, because government programs generate a huge moral hazard that has gone uncorrected. I have argued elsewhere that “perfect legalization” requires not only true legalization in the market in question, but similar reforms in related markets and institutions, such as the “social safety net.”<sup>24</sup> Problems such as addiction and highway accidents are not confined within a single market; they traverse many markets and institutions and the full impacts of both prohibition and legalization are difficult to foresee.<sup>25</sup> As noted above, this larger perspective seems to be a flaw of the Chicago school approach.

Only when things get so bad, as they did in the 1920s and as they have now gotten in the war on drugs, is there a public outcry for a different tack in policy. If the sin

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<sup>24</sup> Thornton (1998b).

<sup>25</sup> See Beil and Thornton (1998 and 2000).

tax regime is chosen, then the cycle will only repeat itself. Alternatively, true legalization could be chosen. This would establish real reform that would relieve us of both the destruction of prohibition and the harms or sins that result from drug abuse by freeing up the market process to address the genuine problems of drug abuse. This will require the discovery of the market's discovery process, a result more difficult to attain when economists share the general public's ignorance and make policy recommendations based on that ignorance. This approach should not be considered utopian, Pollyannaish, or politically naïve because it fully recognizes all the difficulties involved. More importantly, it recognizes a particular role for the economist in policy espousal, and in particular how economists can best help their societies to employ their resources to achieve their ends.

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