

<https://www.businesstoday.in/current/economy-politics/alcohol-makers-urge-delhi-govt-to-lower-70-liquor-cess-as-sales-dip/story/405908.html>

The article

Alcohol makers urge Delhi govt to lower 70% liquor cess as sales dip

The Confederation of Indian Alcoholic Beverages Companies (CIABC) has demanded that the Delhi government lower the 70% special corona fee that was put on sale of alcohol during the coronavirus lockdown. The organization claimed that the high tax rate is drastically affecting the sale of alcohol in the national capital. It wants the government to bring down the cess to a "realistic and sustainable" level.

The liquor manufacturers' association has told The Times of India that the sale of alcohol in the national capital dropped by 58% compared to what it was last year. Alcohol sales of neighbouring states like UP and Haryana seem to be bouncing back as there was only a 10-15% additional tax imposed on alcohol in these states.

According to the daily, in a letter to deputy CM Manish Sisodia, CIABC Director-General Vinod Giri claimed that national capital's alcohol business was slowly shifting to Haryana and Uttar Pradesh due to the difference in retail prices caused by taxes.

CIABC is an apex body of the alcoholic beverage industry and its members include major companies manufacturing and marketing their products in India and abroad.

Back in May, the Delhi government had imposed a 70% corona fee on the MRP on all types of liquor. By the end of May, the excise department had witnessed a total sale of liquor worth Rs 234 crore, which totalled up to Rs 150 crore in corona fees and almost the same amount as excise duty.

Giri told the daily that in early May he had advised the government that the corona fee on liquor would prove counterproductive in the longer run. "If imposed for long, it will lead to a fall in sales, and, hence, government revenue. The initial rush at liquor shops was misleading. The pent-up demand due to one and half months of lockdown was too high for 20% of the shops that had opened at that time," he added.

According to the daily, the sale of liquor is also down in Andhra Pradesh as they had also imposed a similarly high corona fee of 75%. "With lockdown restrictions easing up, interstate traffic will become easier, further aiding unlawful smuggling of liquor to Delhi," Giri said.

Giri argued that bringing down the cess to a realistic level would benefit all stakeholders including the government.

COMMENTARY

The article is about a 70% tax on the MRP of all alcoholic beverages called the cess, put by the Delhi government. CIABC wrote a proposal demanding that the tax be reduced to a more “realistic and sustainable level” complaining as the alcohol industry has been drastically impacted due to this.

Alcohol is a demerit good. Demerit goods are goods or services whose consumption could have a negative impact to the economy. Demerit goods have negative externalities. The government decided to open up individual standing alcohol shops after a month of quarantine. This caused a lot of crowding in front of alcohol shops and people broke the social distancing code. As this could have encouraged the spread of the coronavirus, to avoid crowding the government imposed a 70% tax on the MRP (maximum retail price) of all products in the alcohol sector to cover up the welfare loss.

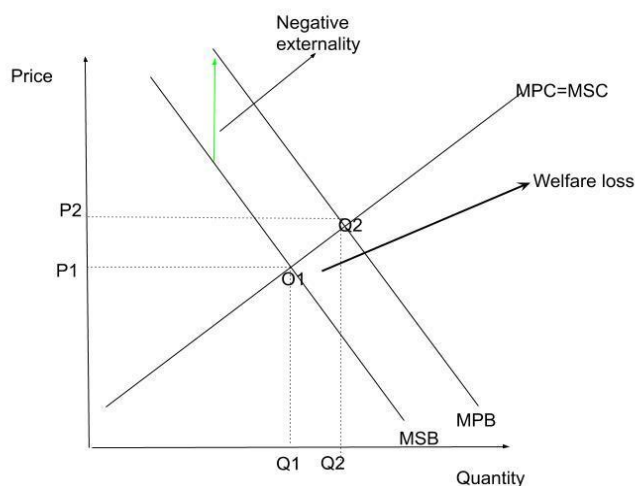


Figure 1 externalities diagram for the alcohol market beofre the cess tax

Social optimum is the point where $MSB = MPC/MSC$. The market shared a social optimum at Q_1 where $MSB = MPC$ at P_1 due to the negative externality there is a increase(negative) in the MPB which shifts the social optimum from O_1 to O_2 at $Q_2 = P_2$, creating a welfare loss in the economy.

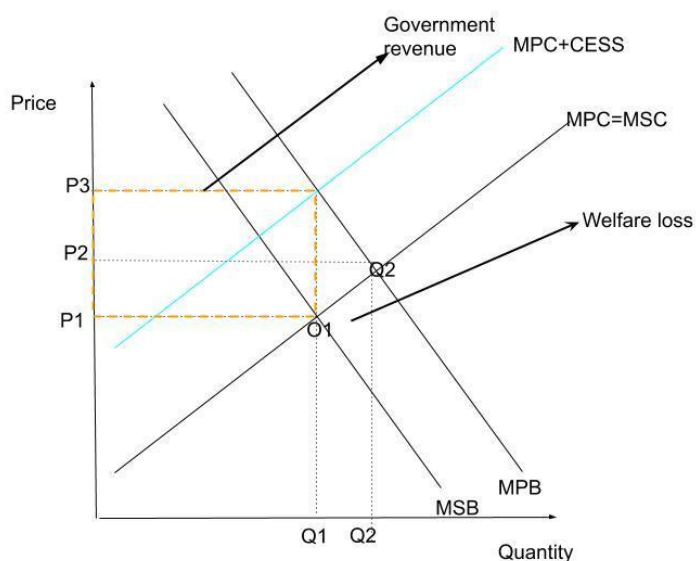


Figure 2 externalities diagram for the alcohol market with CESS

Because of the welfare loss, the government added a 70% CESS tax. Most of the welfare loss will be eliminated if the difference between the MPC and the MPC+ cess = negative externality (tax= negative externality). This increased their price which created a new social optimum(O_3) which brought the quantity back to the original state, whilst the price increased to P_3 . This would result in higher prices for consumers. As now they would be the ones paying the tax. The producer's revenues have decreased in the short run as the tax has only been applied for a short while until things with the virus settle down, resulting in fewer purchases due to high prices which have resulted in a 58% drop in sales. Whilst producers are only receiving Q_1/P_1 .

The demand for alcohol is inelastic. The elasticity of demand is the responsiveness of demand for the product by a % change in its price. When stated inelastic i.e. the demand is not much affected by a change in its price. The demand for alcohol is inelastic as it is an addictive product and does not have any substitutes. Hence, the consumers would buy it again and again due to the addiction caused to their bodies.

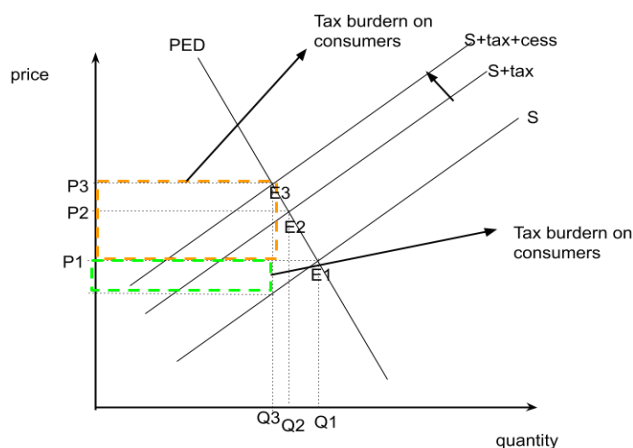


Figure 3 demand and supply diagram after the imposition of cess

Due to the addition of the cess tax the market formed a new equilibrium at E_3 , which made its quantity demanded decrease by 58% and setting a high price of P_3 in the market. whilst producers are only receiving the amount P_1 .

Alcohol is an addictive product; this tax would reduce the disposable income remained with consumers as now they would be spending a comparatively greater percentage of their income to buy alcohol. In addition, due to the covid-19 pandemic, many sectors have shut down and those people are not earning anything or are earning less. This thus decreases the living standards of the country. This tax will also encourage the unlawful smuggling of cheaper alcohol.

Alcohol's consumers tend to be from all income groups due to its addictiveness and lack of substitute. The tax imposed is an indirect tax (a regressive tax) i.e. the rich would be spending a lesser percentage of their income on alcohol than the poor, this would create income inequality. The drop in sales by 58%; has impacted the firms in the sector majorly driving them to cut costs. Firms started to not pay their workers or make their low skilled workers redundant which is creating structural unemployment in the economy.

The tax imposition generated large revenue for the government from the sector (300 crores +). Which could be used to help the development of a cure for the virus. Also, because now alcohol is expensive consumers would try to come out of the addiction

and would reduce consumption which is a long-term positive externality as these workers would be fit.

The government did not open all the alcohol shops in Delhi, 20% of individual standing shops were opened. As the tax was imposed to avoid crowding, I think the government should reduce the tax by a bit and open more individual standing shops so that the crowd could get distributed. This will be beneficial as it would reduce unemployment because now firms will not make their employees redundant and would generate some income for the retail sector. It would also generate income for those individual shop owners.