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# Alcohol taxes and labor market outcomes

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## Abstract

We present reduced form estimates of the effect of alcohol taxes on employment, weekly work hours, and wages. The reduced form estimates are meaningful in two ways: first, they provide estimates of the effect of an important public policy tool—alcohol taxes—and second, they can be used to evaluate hypotheses about the structural effects of alcohol use on labor market outcomes. Estimates indicate that there is a weak and indeterminate relationship between alcohol taxes and labor market outcomes. This implies that alcohol use does not adversely affect labor market outcomes and is inconsistent with findings from previous studies. © 2002 Elsevier Science B.V. All rights reserved.

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## 1. Introduction

Alcohol consumption has the potential to reduce a person's physical and psychological well being, and may cause a variety of individual and social problems. The deleterious effects of alcohol consumption have engendered a public interest in measuring the extent of alcohol-related problems, particularly in light of the government's influence over the distribution and use of alcohol products. The public concern with alcohol consumption also stems from the negative external effects of alcohol consumption—such as drunk driving fatalities—which extend beyond the individual consumer of alcohol to other members of society.

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In the case of drunk driving, the causal influence of alcohol is indisputable, and public policies aimed at reducing alcohol consumption can be partially justified on this basis (Kenkel, 1993). For other social problems, the causal effect of alcohol consumption is not as clear. For example, the effect of alcohol consumption on employment and income has received considerable attention from researchers, which is not surprising given the critical role that the labor market plays in determining economic prosperity. Several studies have attempted to measure the effect of alcohol use on employment and income.<sup>1</sup> Most have found that problem or heavy drinking is associated with less employment and lower earnings, although this finding is not uniform.<sup>2</sup> The more significant issue of whether or not this relationship is causal remains unknown. In this case, causality is difficult to establish because alcohol use may be correlated with unmeasured personal factors such as motivation that influence labor market outcomes (i.e. statistical endogeneity), and because some labor market outcomes, such as wage income, influence alcohol consumption (i.e. structural endogeneity).

Researchers studying the relationship between alcohol use and labor market outcomes have responded to these empirical problems in a variety of ways. Some simply ignore the problems, and as a result, provide only descriptive evidence about the relationship between alcohol use and labor market outcomes.<sup>3</sup> Other researchers have addressed the statistical problems caused by the endogeneity of alcohol consumption by using instrumental variables (Kenkel and Ribar, 1994; Mullahy and Sindelar, 1996; Heien, 1996; Hamilton and Hamilton, 1997). The efficacy of the instrumental variables (IV) procedure depends critically on the quality of the instruments, which can be evaluated in several ways. Of first order importance is the validity of the exclusion restrictions. In this case, alcohol taxes or prices are considered to be ideal instruments for alcohol use and the validity of these instruments is generally accepted.<sup>4</sup> Indeed, all of the researchers using IV have included either prices or taxes among the variables used as instruments. However, the use of alcohol taxes or prices as instruments places other demands on the data that have not been explicitly noted in these studies. Specifically, because the demand for alcohol—particularly among heavy drinkers who are expected to have the most problems—is relatively inelastic, a large number of observations are necessary to obtain credible IV estimates. Variation in alcohol prices or taxes may cause only slight differences in alcohol consumption that will result in small differences in labor market outcomes. In order to detect reliably such small differences many observations are required.

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<sup>1</sup> Mullahy (1993) provides a summary of research as of 1993. More recent studies include Kenkel and Ribar (1994), French and Zarkin (1995), Mullahy and Sindelar (1996), Heien (1996), Hamilton and Hamilton (1997), Zarkin and French (1998) and Kenkel and Wang (1999).

<sup>2</sup> Mullahy and Sindelar (1993, 1996), Kenkel and Ribar (1994), French and Zarkin (1995) and Hamilton and Hamilton (1997) find a negative effect of heavy alcohol use on earnings, whereas Zarkin and French (1998) find a positive effect.

<sup>3</sup> See for example, French and Zarkin (1995), Zarkin and French (1998).

<sup>4</sup> Another criterion used to evaluate the adequacy of instruments is the partial correlation between the instruments and the endogenous variable. In this case, there is a relatively large literature demonstrating that alcohol prices and alcohol taxes are significantly related to alcohol consumption, although perhaps less so for heavy drinkers. See for example, Kubik and Moran (2001), Manning et al. (1995), Manning and Mullahy (1998), Leung and Phelps (1993) and Grossman et al. (1998).

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