

Do Taxes Produce Better Wine?¹

Martin Ljung²

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Abstract

Theory predicts that unit taxes increase the quality in a market since unit taxes reduce the relative price of high quality goods. Ad valorem taxes, on the other hand, have no effect on relative prices and should not affect product quality. The hypothesis is tested empirically in the US wine market. I find that the market share of high quality wine is significantly increased by unit taxes and that there is no significant effect of advalorem taxes, in accordance with the hypothesis and a previous empirical study. However, this test is indirect and does not identify the theoretical prediction. The paper develops and performs direct tests of the hypothesis. The direct tests find no evidence of quality shifting.

JEL codes: D12, H31

Keywords: Quality Choice; Unit Tax; Tax Distortion.