

PIGOUVIAN TAXES ON SEXUALLY ORIENTED BUSINESSES

INTRODUCTION

In 2007, Texas enacted a state tax requiring all sexually oriented businesses (SOBs) to pay a \$5 fee for each customer admission.¹ The statute claims that part of the revenues raised will fund a sexual assault program.² Likewise, in 2004, Utah implemented a 10% tax on all amounts paid to or charged by sexually oriented businesses.³ A large portion of Utah's SOB tax revenue is said to fund the "Sexually Explicit Business and Escort Service Fund," used to provide treatment and fund outpatient services for adults convicted of sexual offenses.⁴ Georgia taxes SOBs either 1% of yearly gross revenues or \$5,000, whichever is greater, and earmarks the revenues for the "Safe Harbor for Sexually Exploited Children's Fund".⁵

All of these taxes received heavy pushback. Some opponents claimed that the taxes unconstitutionally infringed upon free speech.⁶ Others have argued that such taxes don't actually reduce the harmful side effects because the tax is not strong enough to deter SOB operations.⁷ Worse, the taxes do not raise enough revenue to fund sexual assault programs adequately.⁸ Others argued that taxes should be primarily used to raise revenue, not as a regulatory tool.⁹

Economists Jonathan Masur and Eric Posner argue that, among other reasons, Pigouvian taxes are an overlooked regulatory tool because other laws and regulations "reflect some of the

¹ TEX. BUS. & COM. CODE § 102.052.

² TEX. BUS. & COM. CODE § 102.054.

³ UTAH CODE ANN. § 59-27-103.

⁴ UTAH CODE ANN. § 59-27-105.

⁵ O.C.G.A. § 15-21-209.

⁶ *See, e.g.,* Combs v. Tex. Entm't Ass'n, 347 S.W. 3d 277, (2011).

⁷ Frances Taylor Bishop, *Why the Patently Offensive Just Became More Expensive: The "Pole Tax" and the Texas Supreme Court's Expansion of the Secondary Effects Doctrine in Combs v Texas Entertainment Ass'n*, 61 CATH. U.L. REV. 1183, 1203 (2012).

⁸ Richard Whittaker, *The Cup Doth Not Floweth Over: Why the Sexually Oriented Business Surcharge Won't Pay for Real Sexual Abuse Programs, and Never Could*, THE AUSTIN CHRONICLE, Mar. 9, 2009, <https://www.austinchronicle.com/daily/news/2009-03-09/752960/>.

⁹*Id.*

economic thinking that motivates Pigouvian taxation.”¹⁰ In this paper, I argue a similar position. I argue that taxes on SOBs are often subjected to high levels of opposition because they are ineffectively designed and do not sufficiently reflect the “economic thinking” at the heart of Pigouvian taxes, causing them to more closely resemble a sin tax. Although a sin tax may incidentally accomplish some of the same purposes as a Pigouvian tax, in this case it cannot be as effective.

Many criticisms of taxes on SOBs could feasibly be resolved by redesigning them to better meet the goals of Pigouvian taxation. In this paper, I will argue for a Pigouvian tax on SOBs that involves taxing firms equal to the costs of the negative externalities they produce and recycling the revenues to further reduce negative externalities. Likewise, I will address common criticisms of similar schemes. Part I will give an overview of Pigouvian taxes, their purpose, and how they function. Part II will define SOBs and examine the negative externalities that they cause. Part III will address potential constitutional issues implicated by taxing SOBS. Part IV will explore general criticisms of Pigouvian taxes. In Part V I will explain how a properly designed Pigouvian tax on SOBs will fare using the normative criteria commonly used for evaluating tax schemes, specifically equity, efficiency, and administrative simplicity. Finally, in Part VI, I will offer suggestions for redesigning SOB taxes to be more effective and increase public acceptance.

I. OVERVIEW OF PIGOUVIAN TAXES

Pigouvian taxation functions as a regulatory tax designed to force the internalization of social harm on those who cause it.¹¹ Traditionally, Pigouvian taxes are defined as taxes on firms “equal to the harm that the firm imposes on third parties,” otherwise known as “negative

¹⁰ Jonathan S. Masur & Eric A. Posner, *Towards a Pigouvian State*, 164 U. PENN. L. REV. 93, 98 (2015).

¹¹ Reuvan S. Avi-Yonah & Yoseph M. Edrey, *Constitutional Review of Federal Tax Legislation*, 2023 U. ILLINOIS L. REV. 1, 4 (2023).

externalities.”¹² Forcing individuals to internalize negative externalities reduces the chance that consumption will exceed the socially optimal level, a type of market failure.¹³ Pigouvian taxes can minimize negative externalities in several ways. First, imposing taxes on certain items causes price increases that may deter consumers.¹⁴ Secondly, imposing taxes on firms causing negative externalities may incentivize the firm to undertake innovative measures to avoid producing negative externalities¹⁵. Finally, and least common, the taxes collected from firms that still choose to produce the negative externalities are used to combat the social harms that they cause.

Many criticisms aimed at Pigouvian taxes are better attributed to sin taxes. Sin taxes and Pigouvian taxes are conceptually similar. However, there are a few key differences. For one, where Pigouvian taxes disincentivize negative externalities, sin taxes penalize internalities, leading some to disfavor them as “paternalistic.” Unlike Pigouvian taxes, sin taxes are typically regulated based on subjective morals rather than concrete harm caused to others. Although Pigouvian taxes primarily focus on negative externalities, sometimes negative internalities may be implicated. For example, a Pigouvian tax on an SOB could limit sexual violence in the community while also altering individual patrons’ thoughts and attitudes toward women

Secondly, according to Victor Fleischer, Pigouvian taxes are distinct from sin taxes because they are designed to modify behavior, while sin taxes are primarily focused on raising revenue.¹⁶ As Fleischer notes, sin taxes’ “unwillingness to modify behavior” prevents them from becoming

¹² Masur & Posner, *supra* note 10, at 95.

¹³ Franklin Liu, *Sin Taxes: Have Governments Gone Too Far In Their Efforts to Monetize Morality?*, 59 B.C. L. REV. 763, 774 (2018).

¹⁴ Rachelle Holmes Perkins, *Saliency and Sin: Designing Taxes in the New Sin Era*, 2014 BYU L. REV. 143, 149 (2014).

¹⁵ Edenhoffer & Franks, et al., *Pigou in the 21st Century: a Tribute on the Occasion of the 100th Anniversary of the Publication of the Economics of Welfare*, 28 INT’L TAX PUB. FINANCE 1090, 1099 (explaining that innovation requires firm commitment to a Pigouvian instrument).

¹⁶ Victor Fleischer, *Curb Your Enthusiasm for Pigovian Taxes*, 68 VAND. L. REV. 1673, 1704 (2015).

true Pigouvian taxes.¹⁷ While both taxes may inadvertently deter unwanted behaviors, Pigouvian taxes are intended to do so. I believe this is the “economic thinking” that motivates Pigouvian taxation. However, there may be cases where a Pigouvian tax fails its essential purpose. For example, if the costs imposed on the individuals causing negative externalities are too low to discourage their behavior, the negative externality will persist. Here, the amount of the tax is still equal to the costs of the negative externalities the firm creates, making it a definitionally accurate Pigouvian tax; however, it fails its essential purpose. This tax does not modify behavior, it simply raises money for the government, akin to Fleischer’s definition of a sin tax.

A Pigouvian tax that fails its essential purpose, modifying behavior, cannot be entirely effective. Therefore, I argue that in some cases, an effective Pigouvian tax requires the tax to match the costs of the negative externalities and the revenues raised by must be used to combat the externalities. Even in cases where the tax itself significantly deters consumption, revenue recycling would only increase the tax’s ability to reduce negative externalities. Thus, Pigouvian taxes should incorporate revenue recycling. Specifically, a Pigouvian tax on SOBs should be implemented and its’ revenues should be used to mitigate the negative externalities of SOBs to be optimally effective.

II. SEXUALLY ORIENTED BUSINESSES AND NEGATIVE EXTERNALITIES

For the purpose of this paper, “sexually oriented businesses” refers to firms that earn profit “selling, renting, or showing”¹⁸ sexually explicit or sexually suggestive “material, products, films, or live performances”.¹⁹ SOBs may be on-site, off-site, or entirely online. On-site SOBs

¹⁷ *Id.* at 1708.

¹⁸ *Renton v. Playtime Theatres*, 475 U.S. 41, 44.

¹⁹ Tracy N. Hipp et al., *Exploring the Relationship Between Strip Clubs and Rates of Sexual Violence and Violent Crime*, 49 J. CMTY. PSYCHOLOGY 1, 1 (2021).

involve sexual content that is available to view live, such as strip clubs, peep shows, or adult movie theaters.²⁰ At off-site SOBs, customers purchase “take home” sexual content on-site but typically take it to another location to view.²¹ Off-site SOBs include adult bookstores or video rentals.²² In the age of the internet, some SOBs, such as pornography websites, do not have a physical storefront and are instead operated entirely online. The most commonly cited example of a SOB is a strip club, which typically involves partially or fully nude performances.²³

As it relates to Pigouvian taxes, negative externalities are the functional equivalent of the “secondary effects” under the First Amendment analysis, discussed in section III. True Pigouvian taxes are designed to limit negative externalities and force the responsible firms to internalize their costs. SOBs have been shown to harm social welfare in a variety of ways, namely by increasing crime rates and rates of sexual violence, negatively influencing attitudes toward women, and reducing property values.

The most frequently cited negative externality associated with SOBs is increased crime rates in areas surrounding SOBs. The public may fear that the presence of SOBs in a community will impact the number of crimes in the area because the attendees are often “socially marginal, and perhaps criminal, individuals.”²⁴ One study hypothesizes that SOBs create a setting where “motivated offenders, suitable targets, and a lack of effective guardianship” come together, creating an increased likelihood of criminal activities occurring on or near the premises.²⁵

²⁰ Brigman Harman, *Is a Strip Club More Harmful Than a Dirty Bookstore? Navigating a Circuit Split in Municipal Regulation of Sexually Oriented Businesses*, 5 *BYU L. REV.* 1603, 1608–10 (2008).

²¹ *Id.*

²² *Id.*

²³ Hipp et al., *supra* note 19, at 1.

²⁴ Eric S. McCord et al., *Does the Presence of Sexually Oriented Businesses Relate to Increased Levels of Crime? An Examination Using Spatial Analyses*, 59 *CRIME AND DELINQUENCY* 1108, 1109 (2012).

²⁵ *Id.* at 1112.

One study found that the presence of crime was directly related to one's proximity to an SOB; the further one moves away from an SOB, the lower the rate of crime.²⁶ Interestingly, the surrounding area's character does not affect the finding that SOBs attract crime. Another study found that when an SOB opened in a rural area, crime rates increased by 60% and decreased by 60% when that SOB closed two years later, still indicating a strong link between SOBs and crime.²⁷ Another found that SOBs in neighborhoods and residential areas were also likely to attract crime.²⁸ However, the negative effects of SOBs may vary depending on the type of business.²⁹ More specifically, off-site SOBs, like bookstores or video rentals, are associated with lower crime rates than on-site SOBs, like cabarets and strip clubs.³⁰

Another study evaluated how different factors and features of SOBs affect crime in surrounding areas.³¹ Some of these factors included late hours of operation, low-priced drinks, levels of nudity, and use of private rooms.³² The results suggested that SOBs presenting any of the aforementioned risk factors were associated with higher levels of sexual violence and crime, while SOBs without these risk factors generated only higher levels of non-sexual crime.³³ More broadly, SOBs can influence the surrounding communities' attitudes towards women, For example, signs advertising SOBs may teach youth in the area that women are "tools for sexual gratification and fantasy fulfillment."³⁴ In turn, studies have linked these types of social norms and ideologies with increased sexual violence towards women.³⁵

²⁶ *Id.* at 1120.

²⁷ *Id.* at 1110.

²⁸ *Id.* at 1121.

²⁹ Christopher Seaman et al., *Are Adult Businesses Crime Hotspots? Comparing Adult Businesses to Other Locations in Three Cities*, 2014 J. CRIMINOLOGY 1, 4 (2014).

³⁰ *Id.* at 11.

³¹ Hipp et al., *supra* note 19, at 966.

³² *Id.*

³³ *Id.* at 973.

³⁴ *Id.*

³⁵ *Id.*

A more specific consequence of SOBs is high rates of violence towards employees. For example, in strip clubs, sexual violence towards female strippers and staff is common and usually caused by the business' patrons.³⁶ Likewise, many performers are subjected to sexual violence and harassment by club patrons.³⁷ Studies have shown that working in a sexualized environment within the service industry causes psychological problems in women.³⁸ SOBs also negatively affect the economies in surrounding areas. The presence of SOBs has been linked to depleting property values in both commercial and residential areas.³⁹ This often leads to rapid turnover of surrounding businesses.⁴⁰

Researchers emphasize the importance of understanding risk factors and their contributions to crime in working towards developing cost-effective methods for reducing violence.⁴¹ Likewise, they encourage regulators and law enforcement officials to educate themselves about the criminal impact SOBs have on surrounding communities and act accordingly.⁴² The same principles apply to Pigouvian tax planners. Fully understanding the negative externalities caused by SOBs is essential to drafting more effective Pigouvian taxes that successfully mitigate these harms.

III. FIRST AMENDMENT IMPLICATIONS

Historically, it has been difficult to regulate constitutional rights. However, “constitutionally protected activity is not all upside,” and legislative intervention may be necessary at times to

³⁶ Kelly Holsopple, “*Strip Clubs According to Strippers: Exposing Workplace Sexual Violence*”

³⁷ *Id.*

³⁸ Hipp et al., *supra* note 19, at 2.

³⁹ McCord et al., *supra* note 24, at 1111.

⁴⁰ *Id.*

⁴¹ Hipp et al., *supra* note 19, at 976 (“The field of violence prevention has also highlighted in recent years the importance of identifying shared risk and protective factors for multiple forms of violence, to develop effective cross-cutting prevention strategies that achieve greater reductions in overall violence rates with cost-effective approaches”).

⁴² McCord et al., *supra* note 25, at 1120.

prevent widespread social harm.⁴³ Pigouvian taxes are often an effective tool for reducing negative externalities while protecting constitutional rights because they are optimally designed to find the perfect balance between mitigating social harm and protecting constitutional rights.⁴⁴

Regulating SOBs may implicate the people’s constitutional right to free speech. The First Amendment bars the state from enacting regulations “prohibiting the freedom of speech, or of the press.”⁴⁵ Imposing taxes on SOBs may raise First Amendment issues because the businesses typically involve speech or expressive conduct.⁴⁶ If a regulation impermissibly restricts speech, the court will subject it to judicial review. Regulations frequently fail judicial review for one of two reasons.⁴⁷ First, the regulation lacks a genuine purpose.⁴⁸ Second, and arguably more pertinent, regulations frequently fail judicial review because they are not effectively tailored to the government’s purpose for enacting the regulation.⁴⁹

Judicial review requires courts to evaluate whether a speech regulation is adequately tailored to the government’s purported purpose. Tailoring requirements are essential to “ensur[ing] that laws do not sacrifice lots of protected benefit in exchange for small reductions in social costs.”⁵⁰ Different standards of review require different standards of tailoring, with strict scrutiny being the most difficult to pass. Under strict scrutiny, regulations must be *narrowly* tailored to promote an important government interest. Thus, even a well-tailored law may fail if “another regulation would achieve the same reduction in social cost while imposing a smaller constitutional

⁴³ Peter N. Salib, *The Pigouvian Constitution*, 88 U. CHICAGO L. REV. 1082, 1155 (2021).

⁴⁴ *Id.*

⁴⁵ U.S. Const. amend. I.

⁴⁶ Alexander Volokh, *Taxing Nudity: Discriminatory Taxes, Secondary Effects, And Tiers of Scrutiny*, 2023 J. FREE SPEECH L. 627, 635 (2023).

⁴⁷ *See, e.g., Id.* at 633 (“I conclude that a number of plausible governmental interests are either outright impermissible or are likely to fail narrow tailoring”).

⁴⁸ Salib, *supra* note 43.

⁴⁹ *Id.*

⁵⁰ *Id.* at 1115.

burden.”⁵¹ Strict scrutiny is almost always applied to content-based regulations on speech. The court would likely consider taxing SOBs as a content-based restriction because the taxes only apply to businesses that involve certain types of expression, such as nude dancing or pornographic films.⁵² Thus, it is likely that taxes the court would examine regulations on SOBs under the harshest standard of review, strict scrutiny.

Nevertheless, Pigouvian taxes have a high chance of surviving strict scrutiny. As Peter Salib argues, the inherent characteristics of Pigouvian taxes make them the most effective tool for regulating the negative consequences of constitutionally protected speech, even under strict scrutiny.⁵³ Specifically, Pigouvian taxes require regulations to be precisely tailored to eliminating the negative externalities; the amount of the tax is exactly equal to the amount of harm caused.⁵⁴ Thus, any limits on free speech will be exactly tailored to the court’s interest in minimizing the negative externalities of SOBs. Because Pigouvian taxes are exactly tailored to the government’s interest, they are the most effective method for regulating SOBs.

In fact, Pigouvian taxes likely surpass the tailoring requirements imposed on SOB regulations because the court typically evaluates these restrictions under the more relaxed standard of intermediate scrutiny. The Supreme Court introduced the secondary effects doctrine in response to cities regulating SOBs through zoning ordinances. The secondary effects doctrine allows content-based regulations to be evaluated under intermediate scrutiny, rather than strict scrutiny, if the government has a substantial interest in reducing the adverse secondary effects caused by the speech.⁵⁵ Frequently cited secondary effects of SOBs include “higher rates of

⁵¹ *Id.* at 1116.

⁵² Volokh, *supra* note 46, at 644 (“Erotic-expression taxes are thus content-based, because they impose a tax on a set of establishments defined by the substance of the expression they present”).

⁵³ Salib, *supra* note 43, at 1085.

⁵⁴ *Id.*

⁵⁵ Volokh, *supra* note 46, at 629.

prostitution, robbery, assaults, and thefts in surrounding communities.”⁵⁶ Intermediate scrutiny only requires the regulation to be *substantially* tailored to the government’s interest. Thus, because Pigouvian taxes are exactly tailored, it is almost certain that they will pass the more lenient standard of intermediate scrutiny. Intermediate scrutiny does not require perfection in tailoring, allowing some room for error. Thus, even in cases where the costs of SOB’s social harms cannot be precisely measured, intermediate scrutiny may still allow the state to constitutionally regulate speech.

IV. CRITICISMS OF PIGOUVIAN TAXES

A. Revenue Amounts

Not only is tailoring a common issue when regulating constitutional rights, but it is also a common criticism of existing taxes on harmful behaviors. Opponents of such taxes frequently lament that the amount of the tax is not sufficiently tailored to the social costs the firm causes.⁵⁷ For a tax to be considered Pigouvian, as traditionally defined, it must be exactly tailored to the costs of the negative externalities the firm creates.⁵⁸ One article suggests, for example, that taxes based on political agendas, rather than precise assessments of social costs are not Pigouvian because they reflect political desires rather than the true marginal social costs.⁵⁹ Thus, the amount of the tax must reflect the actual social cost of externality-producing activity.

Taxes on the consumption of unpopular goods that are not exactly equal to the amount of the negative externalities they produce are not Pigouvian. When policy makers arbitrarily set the amount, the tax more closely resembles a sin tax, which is typically designed to raise revenue

⁵⁶ City of L.A. v. Alameda Books, 535 U.S. 425, 430.

⁵⁷ Masur & Posner, *supra* note 10, at 105.

⁵⁸ *Id.* at 98.

⁵⁹ Edenhofer et al., *supra* note 15, at 1093.

without accounting for the costs of any negative externalities.⁶⁰ For an SOB tax to be an effective and popular tool for reducing social harms, it must be Pigouvian, with the amount exactly tailored to the cost of the negative externalities. When taxes are not set at the correct level, it creates non-optimal levels of consumption.⁶¹

The Texas SOB fee is a particularly relevant example of improper revenue tailoring leading to stern criticism and public outcry. Texas officials admitted that before enacting the fee in 2008, there was no study conducted on SOBs to calibrate the amount of the fee precisely to the negative externalities.⁶² The \$5 per head fee was expected to raise \$87 million, with \$25 million being earmarked for a sexual assault program fund.⁶³ This equates to a mere \$1 per Texan, much less than other state's sexual assault funds which have raised roughly \$6 per person.⁶⁴ Not only were the initial estimates insufficient to reduce the negative externalities associated with SOBs, but the estimates severely underestimated the actual revenue that the tax would raise.⁶⁵ In the first year, the SOB fee raised a mere \$11.2 million, much less than the expected \$87 million.⁶⁶ By not adequately calibrating the amount of the tax to the amount of revenue needed to combat negative externalities, Texas' SOB tax could not eliminate related externalities. Thus, an effective Pigouvian tax on SOBs must precisely account for the costs of eradicating negative externalities.

Many critics of Pigouvian taxes attack the ability of policymakers to calculate the costs of the negative externalities precisely. However, as Peter Salib notes, there is almost always some

⁶⁰ Fleischer, *supra* note 16, at 1706.

⁶¹ Liu, *supra* note 13/

⁶² Whittaker, *supra* note 8.

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ *Id.*

⁶⁶ *Id.*

usable method for calculating the costs of negative externalities.⁶⁷ Negative externalities, by definition, are “quantifiable and objective.”⁶⁸ Nevertheless, there is no uniform method that can be used to measure the costs of every single externality because “different costs will invite different measurement frameworks.”⁶⁹ As previously discussed, SOBs create a wide variety of negative externalities, so policymakers may have to design multiple different methods for measuring the costs of each different externality. Although there may be some costs that are difficult or impossible to measure, most costs are likely quantifiable.⁷⁰ Even in challenging cases, policymakers can and should use their best efforts to calculate the costs of negative externalities and update them as better methods become available.⁷¹

Policymakers could potentially calculate the social costs of SOBs using several preexisting tools. For example, cost-benefit analyses have been used for centuries to determine the social costs of various regulations.⁷² Salib also points out that the state consistently puts a price tag on externalities when it calculates damages in tort cases.⁷³ In cases involving physical harms, the court attributes costs to certain injuries using sophisticated statistical estimates based on “people’s willingness to pay to avoid” that specific damage.⁷⁴ Under such schemes, the statistical value of a human life equates to roughly \$12 million.⁷⁵

Although morbid, policymakers could employ a similar structure to calculate the costs of crimes linked to SOBs based on the public’s willingness to pay to avoid becoming crime victims.

⁶⁷ Salib, *supra* note 43, at 1129–30.

⁶⁸ M. Paula Fitzgerald et al., *Will I Pay for Your Pleasure? Negative Externalities and Responses to Pigovian Taxes*, 1 J. ASS’N CONSUMER RSCH 355, 356 (2016).

⁶⁹ Salib, *supra* note 43, at 1129–31.

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² *Id.*

⁷³ *Id.*

⁷⁴ *Id.*

⁷⁵ *Id.*

However, not all social costs are easily determinable using the “willingness to pay” framework. For example, Salib explains that measuring the effect that fake news has on voting patterns is impractical because “voters’ willingness to pay might be hard to come by.”⁷⁶ Similarly, in the case of SOBs, attributing social costs to the heightened negative attitudes towards women might be hard to quantify. Likewise, it may be difficult to quantify the cost of increased psychological issues in female performers at SOBs. Moreover, the “willingness to pay” framework depends on the ability to link the end results to the activity that caused it. Again, Salib suggests using statistical analyses to observe connections between negative externalities and harmful behaviors.⁷⁷ He explains policymakers can establish causal links between externalities and the behaviors through traditional tort frameworks, which the court commonly uses to evaluate cause and effect.⁷⁸

Positive externalities also present obstacles to accurately calculating costs. Salib notes that in easy cases the harmful activities, such as gun ownership or spreading fake news, are extremely unlikely to create positive externalities.⁷⁹ Likewise, SOBs are unlikely to create any significant positive externalities that should be accounted for when setting the amount of the tax. However, if SOBs did create any positive externalities, policymakers could likely find some reasonable method for calculating the benefits.

There may not be any singular blanket method for precisely calculating the cost of every social harm that SOBs cause. However, I argue, in line with Salib, that it is highly likely that there is some usable method that can precisely determine each of these costs. If, against all odds, there are no methods that can adequately calculate the marginal social costs of SOBs,

⁷⁶ *Id.*

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ *Id.*

policymakers should use the method that comes the closest and update the method as access to information improves. Setting the amount of the tax at the exact cost of the social harms is an essential part of a Pigouvian tax, too important to overlook.

B. Earmarking & Revenue Recycling

Not only must the amount of the tax be narrowly tailored, but the use of the revenues should relate to the harm they cause. Professors William Baumol and Wallace Oates argue that in the case of depletable externalities, the government should pay revenues earned through Pigouvian taxes to those affected by the externalities.⁸⁰ In contrast, A. Myrick Freeman argues that compensation should not be paid to victims of either depletable or undepletable externalities.⁸¹ Both of these arguments are premised on the ability of the public to shift negative externalities to others, rather than absorbing them.⁸² Naturally, neither claim applies to taxing SOBs because the victims cannot shift the associated negative externalities. For example, it is highly unlikely that individuals are capable of shifting the costs of increased crime rates and decreased property values to others.

Moreover, as previously discussed, there are some cases where Pigouvian taxes without revenue recycling will fail their essential purpose by failing to effectuate any meaningful social changes. A tax on SOBs, without revenue recycling, is unlikely to significantly deter consumption because of the inelastic nature of SOBs.⁸³ Without revenue recycling, the negative externalities will persist, making the Pigouvian tax unsuccessful and potentially pointless. Thus, I argue that in the case of negative externalities on SOBs, it is both essential and practical to use

⁸⁰ Peter J. W. N. Bird, *The Transferability and Depletability of Externalities*, 14 J. ENV'T ECON. MGMT. 54, 54 (1985).

⁸¹ *Id.*

⁸² Daigee Shaw & Rong-Dean Shaw, *The Resistibility and Shiftability of Depletable Externalities*, 20 J. ENV'T ECON. MGMT. 224 at 226 (1991).

⁸³ See *infra* IV(A).

Pigouvian taxes to compensate those affected by the negative externalities, whether directly or indirectly.

Taxes that incorporate revenue recycling tend to be more popular with the public. Environmental tax expert Steffan Kallbekken argues that tailoring the distribution of Pigouvian revenues is perhaps the most essential aspect of garnering public support from taxpayers.⁸⁴ The public worries that their tax money is being wasted or spent on programs that they disapprove of but are more willing to support taxes if the revenue is specifically related to the good being taxed.⁸⁵ For example, a New York poll found that only 52% of residents would support a soda tax, but if the revenues funded anti-obesity programs, support jumped to 72%.⁸⁶ The way policymakers frame a tax is a crucial aspect of gathering support.⁸⁷

Earmarking funds has become an essential consideration for public support because legislators often use sin taxes as a vehicle to push secret agendas.⁸⁸ Sin taxes are easy to pass because they claim to target unpopular activities to raise funds for a noble cause, making it unlikely that anyone will oppose the tax.⁸⁹ However, sometimes after a sin tax is passed, the revenue is used for a purpose that the tax did not initially advertise.⁹⁰ This deception has created a greater need for honest and transparent earmarking and revenue recycling in Pigouvian taxation.

Fears about misappropriated funds are not entirely unsubstantiated. Take, for example, Texas' SOB attendee fee; not all of the revenue goes towards addressing negative externalities

⁸⁴ Steffan Kallbekken et al., *Do You Not Like Pigou, or Do You Not Understand Him? Tax Aversion and Revenue Recycling in The Lab*, 63 J. ENV'T ECON. MGMT. 53, 54 (2011).

⁸⁵ *Id.* at 54; Liu, *supra* note 13, at 788.

⁸⁶ Liu, *supra* note 13, at 781.

⁸⁷ Kallbekken, *supra* note 84, at 54.

⁸⁸ Liu, *supra* note 13, at 781.

⁸⁹ *Id.*

⁹⁰ *Id.* at 765.

caused by SOBs.⁹¹ The Texas comptroller states that the first \$25 million funds a sexual assault prevention program, and any excess helps provide health benefits to low-income individuals.⁹² Others claim that only \$12 million of the projected \$40 million raised will fund sexual violence programs.⁹³ Previously, Texas proposed a tax on SOBs with the revenues set aside to fund schools, but it was eventually dismissed as inappropriate because the government's use of funds was so far removed from the source of the revenue.⁹⁴ In these instances, the revenues are not directly and exactly related to combatting the negative externalities of SOBs.

Although revenue recycling is an important aspect of Pigouvian taxes, they also reduce externalities by disincentivizing consumption or participation in harmful activities. However, the public is often unaware that Pigouvian taxes reduce social harm in multiple ways.⁹⁵ Essentially, failure to earmark funds for the purpose of reducing externalities may result in lost public support, because the public is unaware that the tax deters consumption. Again, taxes that do not deter consumption and do not use the revenue to mitigate negative externalities more closely resemble the purposes of a sin tax than a true Pigouvian tax. Thus, if the SOB fee in Texas does not deter consumption, it is not an effective Pigouvian tax because the government uses only some of the revenue to target negative externalities. If the SOB tax directed the entirety of the funds towards mitigating the social harms of SOBs, it would more closely align with the goals of Pigouvian taxation, and concerns about earmarking would be inapplicable.

C. Negative Externalities & Paternalism

⁹¹ TEX. BUS. & COM. CODE § 102.054.

⁹² TEXAS COMPTROLLER, *Sexually Oriented Business Fee Frequently Asked Questions*, <https://comptroller.texas.gov/taxes/sobf/faq.php>, (last visited Apr. 5, 2024).

⁹³ Rachel E. Morse, *Resisting the Path of Least Resistance: Why the Texas "Pole Tax" and the New Class of Modern Sin Taxes are Bad Policy*, 29 B.C. Third World L.J. 189, 202.

⁹⁴ *Id.*

⁹⁵ *Id.*

The public's perceptions of negative externalities and whether they personally affect them significantly influence their willingness to support Pigouvian taxes.⁹⁶ One study suggests that perceptions of negative externalities offer the best prediction of public support of Pigouvian taxes.⁹⁷ Individuals may argue that the alleged negative externalities do not exist, or are not related to the good being taxed, making the tax unnecessary.⁹⁸ For example, opponents of a soda tax may argue that sugary drinks are not necessarily related to obesity, so taxing drinks to eliminate obesity is ineffective and useless.⁹⁹ Likewise, individuals who do not drink soda may not support a soda tax because they do not believe any negative externalities affect them. Conversely, when an individual believes a negative externality exists and is harming them, they are more receptive to Pigouvian taxes framed to eliminate said harms.¹⁰⁰

When it comes to SOBs, the negative externalities are many and varied; it would be difficult to argue that SOBs cause no harm to surrounding communities.¹⁰¹ As previously mentioned, studies have linked the presence of SOBs to crime, sexual violence, reduced property values, and increased business turnover.¹⁰² Moreover, few people would be willing to argue against funding programs that curtail sexual violence and crime in their community.

When the public disbelieves in the existence of a tax's purported negative externalities, they are more likely to argue that it is inherently paternalistic.¹⁰³ Merely labeling a tax as a tax leads the public to believe that the government morally disapproves of the activity and is acting

⁹⁶ Fitzgerald et al., *supra* note 68, at 355.

⁹⁷ *Id.* at 371.

⁹⁸ Liu, *supra* note 13, at 766.

⁹⁹ *Id.*

¹⁰⁰ Fitzgerald et al., *supra* note 68, at 356.

¹⁰¹ *See, supra* section II.

¹⁰² *Id.*

¹⁰³ Fitzgerald et al., *supra* note 68, at, 363

paternalistically.¹⁰⁴ Likewise, sin taxes may only target negative externalities rather than externalities, causing widespread belief that state intervention is overreaching. It is becoming increasingly common for goods to be categorized as “sinful” not because they cause social harm but because they are unpopular.¹⁰⁵

Taxes on negative externalities or merely unpopular activities are not truly Pigouvian because Pigouvian taxes necessarily require the existence of negative externalities. Pigouvian taxation is premised on avoiding the market failures that occur when consumption produces suboptimal levels of negative externalities. Thus, a Pigouvian tax would be pointless if consumption did not produce any social harm. Pigouvian taxes are less paternalistic than sin taxes because they entail the existence of actual harmful negative externalities. Research reflects this concept, with one study finding that voters who believed in the existence of a negative externality were less likely to perceive the tax as a paternalistic act of the “nanny-state.”¹⁰⁶ Thus, criticisms of Pigouvian taxes being too paternalistic are better directed at general sin taxes, which typically regulate externalities.

D. Public Aversion to “Taxes”

The way a tax is framed is essential to garnering public support.¹⁰⁷ As Masur and Posner explain, taxes are often met with strong negative connotations in the United States.¹⁰⁸ Past attempts at Pigouvian taxation have failed solely because they were labeled as a “tax.”¹⁰⁹ Classifying something as a tax has been shown to change the public’s perception and their

¹⁰⁴ Bruce G. Carruthers, *The Semantics of Sin Tax: Politics, Morality, and Fiscal Imposition*, 84 *FORDHAM L. REV.* 2565, 2570 (2016).

¹⁰⁵ Liu, *supra* note 13, at 789.

¹⁰⁶ Fitzgerald et al., *supra* note 68, at, 363.

¹⁰⁷ Kallbekken et al., *supra* note 84, at 54.

¹⁰⁸ Masur & Posner, *supra* note 10, at 141.

¹⁰⁹ *Id.* at 141–42.

willingness to support its enactment.¹¹⁰ One study found that voters prefer indirect taxation over direct taxation, despite their end results being identical.¹¹¹ Put simply, “[t]he word ‘tax’ is toxic.”¹¹² Perhaps understanding the negative connotations associated with the word “tax,” Texas framed their regulation on SOBs as a fee.¹¹³ However, one study found that voter perceptions of the word “fee” and “tax” were almost identical.¹¹⁴ In an experiment, 41% of voters supported a proposition labeled as a tax and 48% supported it labeled as a fee, suggesting no major differences in public perception of the words.¹¹⁵ More specifically, using a “fee” label rather than a “tax” label does not increase support for Pigouvian regulations that earmark revenues for a specific purpose.¹¹⁶

If both “fees” and “taxes” carry heavy negative connotations by the public, how can Pigouvian taxes on SOBs be reframed to garner more public support? One author offers several suggestions for improving public perceptions of taxes, such as eliciting feedback on taxes, explaining their benefits, and appealing to social norms to increase public compliance and support.¹¹⁷ Perhaps implementing these ideas would help the public overlook their aversion to taxes.

IV. CRITERIA FOR EVALUATING TAXES

Economists typically employ three criteria when evaluating potential taxes: efficiency, equity, and administrative simplicity. This section will explain how a true Pigouvian tax on

¹¹⁰ Kallbekken et al., *supra* note 84, at 54.

¹¹¹ *Id.*

¹¹² Masur & Posner, *supra* note 10, at 141.

¹¹³ TEX. BUS. & COM. CODE § 102.052.

¹¹⁴ Kallbekken et al., *supra* note 84, at 60.

¹¹⁵ *Id.*

¹¹⁶ *Id.* at 63.

¹¹⁷ Abigail B. Sussman & Shannon M. White, *Negative Responses to Taxes: Causes and Mitigation*, 5 POL’Y INSIGHTS BEHAV. BRAIN SCIENCES 224 (2018).

SOBs would fare under these criteria. Likewise, it will address several common criticisms or issues related to these evaluative criteria.

A. Efficiency

The efficiency of Pigouvian taxes depends on a variety of factors, including the likelihood of market distortion and the elasticity of the tax base.¹¹⁸ When services are inelastic, their demand is only minimally affected by an increased price.¹¹⁹ Thus, taxes on inelastic goods or services are more likely to survive.

The nature of SOBs makes them unlikely to respond to changes in the market caused by a Pigouvian tax. SOBs, especially strip clubs, are fairly inelastic, with demand for the goods and services remaining unusually steady.¹²⁰ In fact, a tax on SOBs is unlikely to distort the market because the goods and services they provide are addicting. Research has found that continuous exposure to sexual imagery causes compulsive or obsessive behaviors that mirror addiction.¹²¹ Thus, increases in price are unlikely to deter customers from frequenting SOBs significantly.

Critics of SOB taxes worry that imposing taxes on attendees will create market distortion, resulting in the closure of small businesses.¹²² However, previous studies have linked the presence of SOBs to rapid business turnover in surrounding areas, so disincentivizing SOBs may ultimately protect more small businesses than it harms.¹²³ Moreover, if the goal of Pigouvian

¹¹⁸ Rachele Holmes Perkins, *Salience and Sin: Designing Taxes in the New Sin Era*, 2014 BYU L. REV. 143 (2014).

¹¹⁹ *Id.* at 173.

¹²⁰ Sam Baier, *Freakynomics: An Economic Analysis of Gentlemen's Club*

¹²¹ Geoffrey R. Stone, *Sexual Expression and Free Speech: How Our Values Have (D)evolved*, AMERICAN BAR ASSOCIATION, https://www.americanbar.org/groups/crsj/publications/human_rights_magazine_home/the-ongoing-challenge-to-define-free-speech/sexual-expression-and-free-speech/ (last visited Apr. 4, 2024).

¹²² Morse, *supra* note 93, at 210.

¹²³ McCord et al., *supra* note 24, 1111.

taxation is to minimize the negative externalities caused by SOBs, causing them to close would be an efficient outcome, practically speaking.

Although SOB's inelasticity and addictiveness make them unlikely to be subjected to widespread business closures, a Pigouvian tax would still be a valuable tool in minimizing their negative externalities. First, rather than causing businesses to close, a properly designed SOB tax may encourage safer practices within existing businesses. If patrons are only taxed at businesses presenting certain risk factors, SOBs will be incentivized to eliminate those risk factors to keep prices low and remain competitive. Second, keeping SOBs open will allow the tax to raise more money, which in turn will be used to address the negative externalities. Thus, it is inconsequential whether the tax would cause business closures; either way, a properly designed Pigouvian tax will reduce SOB's negative externalities, creating an efficient outcome.

B. Equity

Unlike efficiency, it is more difficult to gauge whether a Pigouvian tax is equitable.¹²⁴ Regardless, political support for taxes often depends on perceptions of equity.¹²⁵ Equity typically refers to "the manner in which the burden of tax is to be apportioned."¹²⁶ Perceptions of equity depend on the frame of reference used to view the imposition of taxes.¹²⁷ In the past, researchers have used two frames of reference to evaluate the fairness of Pigouvian taxes: how tax revenues are distributed and the final effects of the distribution.¹²⁸ Ultimately, research has shown that when it comes to Pigouvian taxes, the public cares more about equality in *how* the revenue is distributed

¹²⁴ Stephen Kroll et al., *Pigouvian Tax Aversion and Inequity Aversion in The Lab*, 30 ECON BULL 1, 1 (2010) ("[F]airness is a more elusive concept").

¹²⁵ Christopher R. Knittel & Ryan Sandler, *The Welfare Impact of Second-Best Uniform Pigouvian Taxation: Evidence from Transportation*, 10 AM. ECON. J. ECON. POL'Y 211 (2018)

¹²⁶ Joseph T. Sneed, *The Criteria of Federal Income Tax Policy*, 17 STAN. L. REV. 567, 574 (1965).

¹²⁷ *Id.* at 575.

¹²⁸ Kroll et al., *supra* note 124, at 1.

than the final effects of the distribution.¹²⁹ Thus, a revenue scheme that focuses on reducing externalities will likely be considered fairer than a revenue scheme that creates an equal outcome for all.¹³⁰ Again, carefully earmarking funds can bolster equity in Pigouvian taxation.

Pigouvian taxes are often criticized as being regressive because they tax goods that lower-income individuals disproportionately consume.¹³¹ For example, Pigouvian taxes on unhealthy foods disproportionately affect lower-income individuals because unhealthy food is often cheaper than fresh food and produce, and lower-income people spend a higher portion of their income on food.¹³² Likewise, taxes on cigarettes, alcohol, and soda may unfairly burden less affluent individuals because they “tend to smoke and drink more” and are more likely to drink non-diet soda.¹³³ Additionally, Pigouvian taxes are frequently framed as regressive because the poor spend a greater portion of their money on consumption than the rich.¹³⁴

These concerns are particularly heightened when the government restricts access to constitutionally protected activities, such as free speech. However, as Peter Salib notes, Pigouvian taxes on constitutionally protected activities should not be discredited based on these equity considerations because any type of regulation will create similar results.¹³⁵ Although the constitution guarantees the rights of the poor to engage in constitutionally protected activity, it “does not guarantee the right to partake of protected benefits cheaply.”¹³⁶ Pigouvian taxes are

¹²⁹ *Id.* at 6.

¹³⁰ Kallbekken, *supra* note 84.

¹³¹ Perkins, *supra* note 14.

¹³² Morse, *supra* note 93, at 206–09.

¹³³ *Id.* at 209; Liu, *supra* note 13, at 779.

¹³⁴ Liu, *supra* note 13, at 779.

¹³⁵ Salib, *supra* note 43, at 1148 (explaining that regulations on all constitutionally protected activity, such as regulating free speech, raise the cost of the activity).

¹³⁶ *Id.* (“The Constitution does not guarantee the right to partake of protected benefits cheaply, and it certainly does not require society to subsidize those benefits, including by absorbing associated costs.”)

better equipped to handle these distributional shortcomings because exactly tailoring the tax keeps the cost of the activity as small as possible, whereas other forms of regulation may overcharge.¹³⁷ This ensures that the costs of participating in the activity are kept as low as possible, subsequently “pricing out” fewer people.¹³⁸

Furthermore, many of these inequities are likely not applicable to patrons of adult businesses. For one, attending an SOB is not a true necessity, unlike food or fuel, which all people must purchase regardless of the costs or increased taxes.¹³⁹ Moreover, taxes on SOBs would not disproportionately target the poor. In general, strip club attendees tend to be white men of varying ages who typically have “a decent amount of discretionary income.”¹⁴⁰ A typical SOB’s customer base is not constrained to one socioeconomic status; “the wealthy visit just as often as the poor.”¹⁴¹ For example, one study categorized strip club attendees by six distinct personality types, one being the infamous “sugar daddy,” indicating that well-off individuals are frequent customers of SOBs.¹⁴² Because the goods and services sold at SOBs are not disproportionately consumed by the poor, a Pigouvian tax on SOBs would not inequitably harm the less affluent.

Under some Pigouvian taxes, the equitable use of the tax revenue may be more important than the equitable taxation of the activity itself as it relates to regressivity.¹⁴³ In the case of taxing SOBs, the use of the revenues raised tends to benefit lower-income communities. Higher-income

¹³⁷ *Id.*

¹³⁸ *Id.*

¹³⁹ Liu, *supra* note 13, at 779; Knittel & Sandler, *supra* note 125, at 236.

¹⁴⁰ Baier, *supra* note 120.

¹⁴¹ *Id.*

¹⁴² David John Erickson & Richard Tewksbury, *The “Gentlemen” in the Club: a Typology of Strip Club Patrons*, 21 *DEVIANT BEHAV. INTERDISC J.* 271, 287 (1999).

¹⁴³ Knittel, *supra* note 125, at 236 (explaining that in some cases, particularly in the context of taxing emissions and pollution, “the uses of tax revenue may be more important than the tax itself to determine the regressivity of a carbon tax.”)

communities typically have more social and political power at their disposal to keep SOBs out of their neighborhoods.¹⁴⁴ As a result, SOBs are more densely concentrated in “vulnerable lower income, minority and immigrant communities.”¹⁴⁵ Thus, the negative externalities disproportionately affect lower-income communities. Because Pigouvian taxes are designed to limit negative externalities, it is likely that lower-income communities would ultimately receive more benefits from the tax than the rich.

Whether the public believes a Pigouvian tax is fair depends on their perceptions of the negative externalities and their sensitivities to them.¹⁴⁶ Essentially, if someone doesn’t believe that a negative externality harms them or they believe the externalities are small, they are less likely to think a Pigouvian tax is fair. Conversely, individuals who perceive negative externalities as high typically believe that Pigouvian taxation is fair.¹⁴⁷ Regardless of variations in feelings of fairness based on perceptions of externalities, Pigouvian taxes are objectively fair because they are designed to maximize aggregate social welfare.¹⁴⁸ They are, by nature, focused on fairness because they attribute costs to those who cause it. The use of Pigouvian taxes ensures that everyone benefits socially. At the same time, only those responsible for the negative externalities suffer financially.¹⁴⁹ It is, for example, unfair for individuals who do not participate in SOBs to internalize the costs of those who do not.

¹⁴⁴ John J. Chin et al., *Where and Why Do Illicit Businesses Cluster? Comparing Sexually Oriented Massage Parlors in Los Angeles County and New York City*, 43 J. PLANNING EDUC. RSCH. 1, 1 (2019).

¹⁴⁵ *Id.*

¹⁴⁶ Fitzgerald et al., *supra* note 68, at 356.

¹⁴⁷ *Id.*

¹⁴⁸ Edenhofer et al., *supra* note 15, at 371 (“Rather, Pigovian taxes are desirable primarily because they are fair, addressing costs to those who create them”).

¹⁴⁹ Ahmet Niyazi Ozker, *Efficiency of Pigou Tax in the Distribution of Resources and Possible Deflections in Pigouvian Tax Targets*, in *Economics and Administration Sciences Modern Analysis and Research*, at 31.

C. Administrative Ease

If policymakers cannot reliably determine the social cost of an activity, it may be challenging to construct and administer a Pigouvian tax.¹⁵⁰ But, in general, Pigouvian taxes are simple to administer when the marginal social cost is equal to the average social cost.¹⁵¹ In these cases, a uniform excise tax would likely be sufficient to eliminate negative externalities.¹⁵² Administration gets trickier when some firms produce more significant or severe negative externalities than others.¹⁵³ Likewise, Pigouvian taxes are more effective when policymakers can predict which firms will do the most harm before the harm begins.¹⁵⁴

Pigouvian tax planners can take one of two approaches to account for variations in social harm. First, tax planners may operate under the assumption that all firms produce the same harm.¹⁵⁵ However, this assumption is flawed. Pigouvian taxes are designed to impose the exact cost of a negative externality on the firm that produced. If there are any variations between firms, a uniform tax can never yield optimal results.¹⁵⁶ In the case of SOBs, it is particularly unlikely that every firm contributes equally to the representative social harms.

A second solution to this issue is to “carve up the population” to specifically target the firms responsible for the majority of the negative externalities.¹⁵⁷ This is commonly referred to as “the optimal Pigouvian tax.”¹⁵⁸ One author suggests, for example, implementing a Pigouvian tax on

¹⁵⁰ Masur & Posner, *supra* note 10, at 138.

¹⁵¹ Fleischer, *supra* note 16, at 1679.

¹⁵² *Id.* at 1691.

¹⁵³ *Id.* at 1680.

¹⁵⁴ *Id.* at 1691.

¹⁵⁵ *Id.*

¹⁵⁶ *Id.*

¹⁵⁷ *Id.* at 1680.

¹⁵⁸ Knittel & Sandler, *supra* note 125, at 212.

guns by sorting owners “into a number of risk tranches” and assigning costs equal to the risks.¹⁵⁹ Although divvying up costs based on risk is optimal, it not always administratively easy to enforce. Administration becomes increasingly complex when a Pigouvian tax institutes rules or exceptions based on “whom, where, and under what conditions the tax applies.”¹⁶⁰ However, these administrative difficulties decrease when the risk categories are “easy to observe and define.”¹⁶¹

As previously noted, SOBs that exhibit certain risk factors, such as late hours of operation, low-priced drinks, full nudity, and use of private rooms, are more significant contributors to high rates of sexual violence in surrounding communities.¹⁶² Existing taxes on SOBs are already designed to target the businesses that are the most responsible for causing the negative externalities. Both Texas and Utah’s SOB taxes are limited to SOBs that serve alcohol. Adult businesses that serve alcohol are more closely tied to crime, particularly sexual violence. Liquor licensing makes it administratively simple to track down SOBs that serve alcohol. Thus, even if there is a significant difference between marginal and social costs, weeding out the firms with the highest contributions to negative externalities should be administratively simple.

Unlike a Pigouvian tax on alcohol consumption, for example, a tax on SOBs is more straightforward to administer when there are variations across firms. In the case of alcohol, there is vast variation in marginal social costs and a nearly uncountable number of consumers.¹⁶³ The majority of consumers may drink responsibly, while a handful are alcohol abusers. It would be administratively unfeasible to account for these differences and charge innumerable individuals

¹⁵⁹ Salib, *supra* note 43, at 1142.

¹⁶⁰ *Id.* at 1691.

¹⁶¹ Fleischer, *supra* note 16, at 1680.

¹⁶² Hipp et al., *supra* note 19, at 973–74.

¹⁶³ *Id.* at 1707.

the precise amount to account for their individual contributions to negative externalities.¹⁶⁴ In contrast, a finite number of SOBs would be subjected to a Pigouvian tax. For example, the Texas SOB fee was estimated to apply to only 169 businesses, making it much simpler to administer.¹⁶⁵ Even if it was not possible to implement an optimal Pigouvian tax that charges firms proportionally to the level of externalities they produce, one study found that a uniform tax on all is still a second-best option.¹⁶⁶

On the other hand, taxing SOBs may be more administratively complex than taxing alcohol consumption because SOBs cause a wider variety of negative externalities. As previously discussed, SOBs are inextricably linked to several different negative externalities. Although it may take more administrative effort on the front end to account for multiple negative externalities, continued enforcement will remain relatively simple because there are few firms that will be subjected to the tax.

VI. THE DESIGN

This section offers suggestions about how to design a Pigouvian tax on SOBs that will be effective and publicly supported. Although the existing taxes on SOBs provide a decent framework, they can be updated to reduce negative externalities and increase voter support more effectively.

First, policymakers must reframe taxes on SOBs to prevent widespread voter pushback. As previously noted, how a tax is framed is essential to acquiring public support and compliance. For

¹⁶⁴ *Id.*

¹⁶⁵ Bill Mears, *Texas Court Allows ‘Sin Tax’ for Strip Club Patrons*, CNN, Aug. 26, 2011, <http://www.cnn.com/2011/US/08/26/texas.sin.tax/index.html>.

¹⁶⁶ Knittel & Sandler, *supra* note 125, at 212.

one, an SOB tax could draw attention to the negative externalities associated with SOBs, increasing the likelihood that the public will support its implementation. One author encourages policymakers to undertake “actions or campaigns that reliably enhance perceptions of negative externalities” because they can be a powerful tool for shaping public opinion.¹⁶⁷ Likewise, keeping the public informed of a tax’s purpose can increase support.¹⁶⁸

Additionally, as discussed, current taxes on SOBs need to be updated to reflect the true costs of the negative externalities they create. Not only will this increase public support, but it will ensure that the tax more adequately deters patronage at SOBs, reducing negative externalities. Moreover, revenue recycling is likely a necessary component for an effective tax on SOBs because of their inelasticity. Even if the tax adequately deters consumption, implementing a revenue recycling scheme would only create additional benefits by further reducing the negative effects of SOBs.

Specifically, the revenues earned from a Pigouvian tax on SOBs must be prominently earmarked for combatting externalities. These funds could go towards various programs designed to eliminate the negative effects of SOBs. The public will likely be more responsive to a tax on SOBs if they are clearly informed of the tax’s proposed revenue use. For example, the revenues could be earmarked to fund sexual assault victim programs, like the SOB regulations in Texas and Utah. Another author suggests “[p]roviding a visible law enforcement presence in the immediate vicinity of [SOBs] is an obvious means for counteracting the effects of such businesses.”¹⁶⁹ This

¹⁶⁷ Fitzgerald, *supra* note 68, at 372.

¹⁶⁸ Sussman & White, *supra* note 117.

¹⁶⁹ McCord, *supra* note 24, at, 1121.

would deter motivated offenders from congregating around SOBs, reducing one of the most prominent negative externalities.¹⁷⁰

CONCLUSION

Pigouvian taxes are an effective and frequently underutilized tool for addressing market failures. Previous taxes on SOBs were well-intentioned but were ultimately ineffectively designed. Although they were sufficiently tailored to withstand strict and intermediate scrutiny, they were not tailored enough to be optimally effective, nor to garner public support. To achieve these two goals, Pigouvian taxes must first be truly Pigouvian. That is, the amount of the tax must be precisely set at the marginal social costs created by SOBs. Likewise, an effective Pigouvian tax on SOBs will require proper revenue recycling. A tax on SOBs that is precisely calculated and recycles revenue will be efficient, equitable, and administratively simple. In light of the clear social harms caused by SOBs, it is imperative that policymakers consider redesigning and implementing more effective Pigouvian taxes.

¹⁷⁰ *Id.*