Sugar-Sweetened Beverage Taxes and Sound Tax Policy

Scott Drenkard
Economist, Tax Foundation

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Members of the Committee:

My name is Scott Drenkard, and I’m an economist at the Tax Foundation. For those unfamiliar with the Tax Foundation, we are a non-partisan, non-profit organization that has monitored fiscal policy at all levels of government since 1937. We have produced the Facts & Figures handbook since 1941, we calculate Tax Freedom Day each year, and have a wealth of data, rankings, and other information at our website, www.TaxFoundation.org.

I’m pleased to have the opportunity to speak today with regard to H. 234, a bill to impose an excise tax on sugar-sweetened beverages at a rate of $1.28 per gallon. In 2011, I authored a large study on sugar and snack taxes. In 2012, I authored a smaller piece on how two California cities might be affected if they chose to implement an equivalent tax to the one this committee is considering. I’ve included both of those pieces in my written materials.

In November 2012, Richmond and El Monte, California put a penny-per-ounce soda excise tax to voters. Both measures were resoundingly defeated. This was in a state that traditionally does not have qualms with voting to increase taxes on themselves. In Richmond, 67 percent of voters voted against a soda tax, and in El Monte, 77 percent of voters said no.

One of the chief concerns of onlookers, reporters, and activists leading up to that vote was the regressive nature of the tax. Excise taxes are generally regressive, because low-income taxpayers tend to spend more of their income on consumption compared to high-income taxpayers. But in the case of soda taxes, low-income taxpayers don’t just pay more as a percentage of their income, they actually pay more in raw numbers. A 2006 study found that a 10 percent excise tax on fatty foods would harm high-income individuals to the tune of $24.29, whereas low-income families had a burden almost double: $47.38. Bear in mind that this is just the effect of a tax of 10 percent. If you turn the penny-per-ounce tax this committee is discussing into percentage terms, you get a tax of at least 24 percent and, depending on the
product, as high as 132 percent. In short, the regressive effects under the current proposal will be magnified compared to what the economic literature suggests.

Perhaps more importantly, the influence of soda taxes on obesity outcomes is questionable. We know from the law of demand that raising the price of a product will make people consume less of that product, but people don’t behave in a vacuum. A 2010 study found that soda taxes do reduce soda consumption, but that children and adolescents tend to perfectly substitute in calories from other sources. **This resulted in no net change in caloric consumption.** A 2007 study found that an increase of 1 percentage point in the state soft drink tax rate would lead to a decrease in BMI of just 0.003 points. For perspective, the CDC defines a “healthy” BMI for a six foot tall adult male as between the large range of 18.5 and 24.9.

There is also evidence that taxes on soda lead people to drink more beer. A 2012 study by economists at Cornell University showed that for households prone to buying alcohol, there was a 172.4 ounce increase in beer consumption per month when a 10 percent tax was applied to soda. This equates to a heightened intake of 1,930 calories in the same time frame. This raises concerns about potentially switching one public health problem for another. As an interesting side note, Vermont currently taxes beer at a rate of 27 cents per gallon. **The proposed rate on soda would be almost five times as high as the current tax on beer.**

I think the overarching lesson to learn from this is that people respond to tax changes, but not necessarily in the way policymakers would want them to.

Theoretically, the only reason for imposing a special excise tax on a product is if that product creates what economists call a negative externality. The classic example of an externality problem is a paper factory that expels fumes into the air while producing paper. Economists see this as a problem because while the company enjoys the benefits of profits from their sale of paper, they shift some of the costs of paper production onto the rest of society in the form of increased pollution. Their incentive is always to expel more pollution into the air than what economists would call the socially optimal level.

Economists and policymakers sometimes support governmental intervention to correct for externality problems, but in the case of soda, the logic is flimsy. According to proponents of taxes on soda, obese people create a negative externality because they get sick more often. Some estimate that health problems associated with being obese or overweight account for 9.1 percent of all health care costs in the United States. This amounts to $147 billion, with one half of that amount being paid for by Medicare and Medicaid.

Therefore, proponents claim, taxpayers and insurance holders pay for the actions of obese people in the form of higher entitlement spending for Medicare and Medicaid recipients or in the form of higher premiums for anyone who happens to share a private insurance risk pool.
with obese people. This allegedly means that levying a tax directly on the obese people would force them to consider the full societal costs of their diet choices.

However, taxes on soda do not reasonably address the obesity problem under these criteria. Obesity may create an externality, but soda is merely one input (the literature suggests just 7 percent of all calories) to a dietary lifestyle.

Ultimately, I think a lot of this debate centers around moral questions. **Reducing obesity is an important goal, but policy actions have costs.** My largest concern is that placing a tax on soda is a blanket policy that would affect all Vermonters. There are many people that enjoy sodas regularly and make adjustments in their diet elsewhere to maintain a healthy lifestyle. These people will be affected by an excise tax as well, and I think that is why the tax code is far too blunt an instrument to address something as comprehensive and subtle as nutrition choices.

Thank you for your consideration, I look forward to your questions.

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The Tax Foundation’s Center for State Fiscal Policy produces timely, high-quality, and user-friendly research and analysis for policymakers and the public, shaping the state policy debate toward economically principled tax policies.