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Santa Fe Should Not Fatten Budget with Soda Taxes

By Gerald Prante

Fiscal Fact No. 98

The City of Santa Fe, New Mexico, has a budget shortfall of $200,000 that it needs to fill. Every city, county and state faces this dilemma, and there are only two policy options: cut spending or raise taxes. To no one's surprise, the city council has chosen to raise taxes, but people should be surprised at the dreadful choice of tax the council has made. Instead of a tiny hike in a broad-based tax that most people in the city pay, it has chosen to violate every principle of sound fiscal policy by raising taxes on specific "unhealthy" products.

Of course, this idea isn't unique to Santa Fe. Many local jurisdictions believe they can get away with a misguided tax on fatty or sweet food by exaggerating the extent to which it will change people's behavior: making obese people fit, cutting the rate of tooth decay, and so forth.

Sound tax policy adheres to the principles of simplicity, stability, transparency, and neutrality. A specific tax on soda and other "unhealthy products" in order to fill a budget gap falls short on every one of these standards.

Simplicity
It may sound simple to tax unhealthy products, but if the city council sits down to define "unhealthy," it will find out the same thing that other cities and states have found when they've tried: it's a nightmare of complexity.

- Will the healthiness of a product be measured with some scientific, nutritional method? Is that calories, or sugar content, or fat content, or something else?
- If, as suggested, soda is one of the products chosen, should diet soda be taxed less? Or perhaps not at all?
- Will meats and dairy foods—nutritious but fattening—make the cut?
- Would a snack-food tax targeted at ranch-flavored Doritos grant an exemption to fat-free pretzels?

A cynic might say the city council's anti-obesity rhetoric is just cover for a money grab, but what if it isn't? A soda tax will certainly not significantly change the weight of city residents, so what will the council do then? Raise more taxes? Mandate exercise? Some jurisdictions are offering tax incentives for health club memberships, regardless of whether people actually go to the gym and exercise, and club owners seem to be the main beneficiaries.

The benefits to the public, if any, of targeting soda or other unhealthy products with taxation would likely be outweighed by the added complexity to the tax code.

Stability
Tax stability means tax revenue is easy to estimate and won't fluctuate unexpectedly. To estimate how much revenue a soda tax or snack tax or fat tax would bring in, the city council will undoubtedly try to secure sales records of these items and assume that after enactment of the tax, sales will continue as before.

This is naive, however, for two reasons. The first is simple border-shopping, where consumers make their purchases of taxed items outside of the city to avoid the tax.

In addition, the city is likely to face competition for these revenues from criminals. Such schemes include organized smuggling but often involve retailers with stores both in and outside of a high-tax jurisdiction. The sales these retailers make in high-tax jurisdictions can be reported as if they had been made in a low-tax jurisdiction, essentially allowing the retailer to pocket the tax differential. Even with intensive audits, which are costly for both governments and businesses, such rackets may be impossible to detect.

As a result, the city council may fail in three ways. On the health front, people will probably buy just as many fattening foods as they ever did, but they'll buy them elsewhere. On the local business front, the retail outlets within Santa Fe will lose sales for no good reason. Finally, on the revenue front, people will still shop in Santa Fe, and highly taxed sales will be reported, so new tax revenue will come in but probably not as quickly as expected.

Transparency
Tax transparency means that a person knows when he's paying a tax and how much it is. A general sales tax is good on the transparency scale because it applies to all goods and services an individual buys (or at least it should), and the dollar amount is printed right on the receipt, separate from the pre-tax price.

Once separate rates are established for different products, no customer can be expected to remember all the different rates. And this consumer confusion is also a business nightmare, for it's the retailers who have to keep track of all the categories of products and rates. Small retail stores and family-run restaurants are at a particular disadvantage. These local "Mom and Pop" stores don't have the same technologies and economies of scale that big retail chains do. Large operations may quickly re-program their bar codes to reflect the new tax laws, while small retailers' employees must look up what is taxed and what is not at the point of sale.

Neutrality and Fairness
Tax neutrality and fairness demand that people be taxed equally. Broad-based taxes adhere much more to this principle than a tax on a select group of items.

Now if soda or snacks were dangerously unhealthy, the government might ban them. But in a free society that prizes individual liberty, why should the government tell adults what to eat or drink among safe products? Is it fair to force healthy people with good diets to pay more for a dessert or snack because other people eat excessively or don't exercise?

Let government collect what revenue it needs on a general, nondiscriminatory basis, and let people buy what they want with all choices taxed equally. Singling out certain people for higher taxes on safe products is unfair.

As the table below shows, a general sales tax is more fairly distributed across the income spectrum than a tax on sweets or fatty food. The poorest 20 percent of households pay only about 6 percent of the general sales tax, but they buy a considerably larger percentage of the sweet and fatty foods--over 12 percent

Nationwide Consumption of Food by Category and Income Quintile, 2005

	Consumers Divided into Five Equal Groups by Household Income				
	Bottom 20 Percent	Second 20 Percent	Third 20 Percent	Fourth 20 Percent	Top 20 Percent
Share of Money Income Earned	3.30%	8.70%	14.52%	23.10%	50.33%
Share of General Sales Taxes Paid	6.19%	10.98%	16.07%	25.02%	41.75%
Share of Sugar and Sweets Consumed	12.27%	14.62%	18.15%	24.37%	30.42%
Share of Fats and Oils Consumed	13.65%	16.71%	18.59%	23.06%	27.76%
Share of Nonalcoholic Beverages Consumed	12.21%	15.71%	18.88%	24.49%	28.78%

Sources: *Consumer Expenditure Survey*, 2005, Bureau of Labor Statistics; Andrew Chamberlain and Gerald Prante, "Who Pays Taxes and Who Receives Government Spending? An Analysis of Federal, State and Local Tax and Spending Distributions, 1991-2004," *Tax Foundation Working Paper*, No. 1, p. 42, 2007 (2005 numbers updated).

Conclusion

Citizens of every state, county and city must insist that their representatives use their taxing power with good judgment and discretion. Arbitrarily imposing a complex, unstable, confusing, unfair tax on a select group of consumers is the worst way to fill a budget gap. We would recommend either cutting the least-valued government spending or raising a broad-based tax like the general sales tax or property tax.

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