HEALTH TAXES POLICIES IN LATIN AMERICA AND THE CARIBBEAN: ARE WE MAKING PROGRESS?

Excise Taxes and Obesity in the Pandemic Context

May 12, 2022
Patrick Petit
Senior Economist
Fiscal Affairs Department

The views expressed are those of the author and do not necessarily represent the views of the IMF, its Executive Board, or IMF management.
Plan

- The burden of obesity
- The cost of the pandemic and tax policy
- The cause of obesity and excise taxes
- The level, composition and revenue potential of SSB taxes
- Conclusions
The economic burden of obesity is large and growing

- Direct responsibility for 2.8 million deaths annually
- Economic burden of about 1 percent of GDP in the USA
- Can tax play a role in fighting the obesity epidemic?

Share of Deaths Linked to Obesity in the World 1/ 2/

1/ Communicable diseases include “Communicable, maternal, perinatal and nutritional conditions”.
2/ Main conditions only - this list is not exhaustive. Many of these conditions have additional risk factors, some of which could be more important than obesity.
THE IMPACT OF THE COVID-19 PANDEMIC

- A significant economic impact
  - Economic contraction of 3.4 percent of GDP in 2020
  - Additional burden of 16 trillion USD in direct health spending and other indirect costs
  - Significant fall in tax revenue

- Many additional compounding factors, of which:
  - Stronger impact on lower income groups in a world of already growing inequality
  - Demographic challenges and impact on public finances (revenue and expenditures)
TAX POLICY FOR A STRONG RECOVERY*

- More progressive taxation of income
  - Individualized PIT to decrease the effective tax rate on the second earning
  - Appropriate exemption threshold, rates schedule, and top rate
  - Worker credit for low income, along with simple and limited deductions to improve compliance

- A strong and tight corporate income tax
  - Avoid tax competition through rates and incentives, but also avoid high rates on mobile capital
  - Strong international tax cooperation to avoid profit shifting

- Make full use of property taxes to improve equity
- Simple one-rate VAT with few exemptions and appropriate threshold
- Modernize excises: health and environment

HEALTH TAXES

- Health taxes: no deadweight loss and a WIN-WIN situation
  - Improve efficiency by pricing the negative externalities of harmful behavior
  - Adjust the underestimated personal costs of consuming harmful items (time-inconsistent choices or “internalities”)
  - Significant revenue potential in many countries
  - Tobacco, alcohol…and SSBs?
RISK FACTORS OF OBESITY: CAN THEY BE TAXED?

- Which food items cause obesity?
  - Long-term caloric imbalances: 100-200 kcal/day (one soft drink) = gain of 1lbs / month
  - **Sources of extra calories**: Soft drinks, chips / potatoes, unprocessed red meat, processed meat
  - BUT sugar-sweetened beverages (SSBs) represent up to HALF of extra calories (mainly US evidence)

- A complex link from tax to obesity
  - Taxes ➔ Higher prices ➔ Lower consumption ➔ Lower caloric intake ➔ Obesity impact
    - (Passthrough?) ➔ (High price-elasticity?) ➔ (Substitution?)

- Strong health impact ➔ Strong reaction to price (HIGH Price-elasticity)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Soft drinks</td>
<td>-0.79</td>
<td>-0.74 Low-income</td>
<td>-0.74</td>
<td>-1.21</td>
<td>-1.37</td>
</tr>
<tr>
<td>Sweets/sugars</td>
<td>-0.34</td>
<td>-0.68 Middle-income</td>
<td>-0.68</td>
<td>-0.6 to -1.2</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>High-income</td>
<td>-0.56</td>
<td>1/</td>
<td>1/</td>
</tr>
</tbody>
</table>

- Taxes have empirically led to a significant decrease in SSBs consumption …
THE IMPACT OF SSB EXCISES ON OBESITY AND THE LEVEL OF TAXATION

- No empirical link from taxes to obesity outcome…WHY?
  1. Too early to conclude ("...long-term caloric imbalances")
  2. Substitution effects towards other high caloric foods
     - E.g., Harding and Lovenheim (2017): 20 percent tax on SSBs ➔ purchases down by 10.35 percent, but related caloric intake by only 4.84 percent
     - Important constraints on high ("tobacco-style") excise rates

- Need more evidence / Substitution effects are not well understood

Current proposals suggest use of low taxes in the range of 1 US cent per ounce (equivalent to 15-20 percent of price)
OTHER CONSIDERATIONS ON THE LEVEL OF TAXES

- Excises have a limited and well-defined role in modern tax systems

- Externalities: impact on third party of own-consumption
  - Mainly through the health care system, but dependent on the institutional setup (e.g., out-of-pocket = no externalities)
  - The definition of the externality is not clear (≠ burden of disease, externalities vs risk pooling)
  - Evidence gathering, and point to a tax of 10-20 percent of price on soft drinks (US evidence)

- Internalities: underweighting long-term costs of short-term consumption
  - Technically difficult to assess and therefore limited number of estimations
  - Estimates so far point to corrective taxes higher than for externalities (more research needed)

- Equity issues
  - Lower income households buy more SSBs…but have more long-term gain from reduced consumption
  - Equity is generally related to government spending (redistribution) and to personal income tax
THE COMPOSITION OF TAXES: SPECIFIC VS AD VALOREM

- **Specific excise tax:** $ / quantity vs **Ad valorem** excise tax: % of value (price)

- Health objectives generally motivate the use of specific excises
  - Harm is related to quantity: specific excises
  - Define the base: Sugar content / Ounces of liquid (regardless of sugar content)
  - But inflation can erode the tax ➔ adjust regularly

- The use of sugar content thresholds
  - For example:
    - Tax applies to products with more than X grams of sugar per ounce
    - Higher tax for different brackets of sugar content
  - Better align the tax on the health impact of sugar / Can nudge product reformulation
  - Might be more demanding on administrative capacity: labelling / imports and other considerations
THE REVENUE POTENTIAL OF SSB TAXES

- Convenient / stable revenue raising requires **LOW** Price-elasticity: Not the case
- ...But some countries raise significant revenue (…but less than tobacco)

<table>
<thead>
<tr>
<th>Country</th>
<th>Share of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rwanda</td>
<td>0.16 %</td>
</tr>
<tr>
<td>Cambodia</td>
<td>0.16 %</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Country</th>
<th>Share of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Latvia</td>
<td>0.06 %</td>
</tr>
<tr>
<td>Mexico</td>
<td>0.10 %</td>
</tr>
</tbody>
</table>

- Ad valorem on SSBs have been used for a long time for revenue purposes in low-income countries
  - Convenience: formal sector is easier to tax
  - Price is easy to observe (limited valuation / transfer pricing issues)
  - Same producers are sometimes already paying ad valorem taxes on other products (e.g., beer)
  - SSBs represent a higher share of government revenue in low-income countries
  - Government spending have a higher marginal value than in high-income countries
CONCLUSIONS

- Very high health and economic burden of obesity
- High revenue needs in the pandemic
- Strong conjunctural and structural rationale for health taxes
- Impact of SSB taxes on obesity still uncertain, but they could be part of a larger policy package
- Revenue potential is small but real
- Taxes should be specific…but can also be ad valorem
- Along with other tax policy measures, these taxes should help increase budget allocations for health financing
THANK YOU
References


SEE ALSO:


THIS PRESENTATION IS BASED ON THE FOLLOWING TEXT: