Why you really should pay a sugar tax

February 19 2016
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You might have missed it, but shares in Coca Cola Amatil jumped 5 per cent in value this week after it reported a 45 per cent surge in net profits after two years of weak sales. Domino's Pizza shares also surged, by an even more impressive 15 per cent to a record $62 after it unveiled a 49 per cent jump in first half profits.

Mmmmm, pizza and soft drink. Way to go with those New Year resolutions Australia.

This could be the year of the sugar tax, as several large nations consider levies on sweetened food and drinks to battle obesity and fatten government coffers.

Governments around the world are locked in a battle with food and beverage giants about how to reduce over-consumption of calorie-dense and nutrition-poor foods and drinks.

It has been four years since France introduced a €0.075 per litre tax on sugar sweetened drinks. Mexico – the world's fourth biggest sugary drink guzzlers – slapped a one peso per litre charge in 2014. Last year, Chile, Barbados and Dominica followed suit, as did the city of Berkeley in California.
Indeed, 34 states in the US now tax soft drinks sold in grocery stores, at an average of about 4 per cent.

In Britain, Jamie Oliver is urging the government to introduce a 20 per cent tax on sugary drinks to curb childhood obesity.

In Australia, almost half of kids aged between 2 and 16 consume a sugar sweetened beverage every day.

We know we've got a problem. A survey last year found 85 per cent of us would support a sugar tax if the revenue raised was spent on programs to prevent childhood obesity.

Social scientists have found taxes on unhealthy food are more effective in reducing consumption than subsidies for healthy food.

While sugar is not the only driver of increasing obesity and ill health, it certainly isn't helping.

Economics provides two solid rationales for governments to intervene with sugar taxes, so-called "sin taxes".

While what you eat and drink is a private decision, like a lot of decisions you make, it has impacts on others. Rising levels of obesity are driving a host of health problems, including heart disease and diabetes. That means premiums on health insurance are higher than they would otherwise be if people were slimmer. Taxes are also higher to fund bigger health budgets needed to look after sick people. Economists call these costs an "externality". And they usually advocate putting a price on the activity that creates the externality.

The second rationale comes from behavioural economics. People, as it turns out, have what economists' call "time-inconsistent preferences". I want to be slim but, in the short term, I also really want that gelato. If you tax me to correct my inconsistent preferences, ie, tax gelato, I will actually be happier in the long run than if you didn't.

Sugar taxes remain a relatively new phenomenon, meaning it's hard to get data on if they really work. But a study published last month in the British Medical Journal found consumption of sugary drinks has fallen 12 per cent in Mexico since their tax was introduced, and 17 per cent for low-income Mexicans.

And a paper released this month by four US social scientists, "Incentivising nutritious diets", confirms low-income people are particularly sensitive to the way price signals are framed.

The authors recruited more than 200 households at two grocery stores in upstate New York and following their spending for eight months. Participants were given two cards: one to swipe to identify themselves in store and one to swipe to receive discounts.

To keep shoppers coming back to the same store, all participants received a discount off their shopping bills. A quarter of households – a control group – just got a flat 10 per cent discount on all food purchased. Another quarter were given the 10 per cent discount, plus an extra 5 per cent on healthy food.

To test the effect of framing a 10 per cent price difference between healthy and unhealthy food as a tax on unhealthy food, a quarter of participants were told they’d get a 15 per cent discount on healthy food, but pay a tax of 10 per cent, ie only get a discount of 5 per cent, on non-nutritious food.
To test the alternative policy of a subsidy on healthy foods, the remaining quarter of participants were told they'd get a 5 per cent discount on all food, but a further 10 per cent off healthy food.

So, in all but the control group, participants faced a 10 per cent price difference between nutritious and non-nutritious foods.

Did this lead them to make healthier choices?

Well, no, not really. Spending on nutritious food rose by about $1.11 a week and spending on less nutritious food fell by $1.55 – not big enough to be statistically significant.

But the researchers did find a significant difference in the way low-income households responded to the price wedge depending on whether it was framed as a subsidy or a tax.

Far from helping, the subsidy on foods actually increased total spending on all food, including unhealthy food.

The lesson? Policy makers choosing between subsidies for healthy foods and taxes on unhealthy foods should choose the latter.

And if you want sugar taxes to work, they've got to be big.