Experts call for a 20% sugar tax hike to boost health

From The Southern African

By Erene Roux

Experts are calling for a 20% hike in sugar tax due to the health sector's ongoing battle with the COVID-19 pandemic.

Experts recently suggested an increase on sugar tax from its current 10% to 20% in order to improve health outcomes and support increased revenue collection.

SUGAR TAX HIKE

According to the *SABC*, the proposal comes as Finance Minister Tito Mboweni is due to deliver the 2021 Budget Speech next week. Experts say a further increase in sugary beverages will not only result in a reduction in communicable diseases like diabetes, but it will also help support the country's growing tax collection shortfall.

Government currently projects a R300 billion shortfall in revenue in this year's budget. However, experts say a significant shortfall in the region of R250 billion is still on the cards. They add that the government has lost out on sin tax collections due to the ban on alcohol and cigarettes sale during the lockdown.

Director of Research at the University of Cape Town, Corne van Walbeek, says, "Of the alcohol, tobacco, and sugary beverages – those taxes in total comprise 3.5% of government revenue. The government is going to be collecting substantially less of what that they had anticipated".

The main reason for that is because of the ban on cigarette sales during 2020 for 20 weeks and the three different bans on the sale of alcohol during that same time period."

Director of the South African Medical Research Centre for Health Economics and Decision Science (SAMRC), Karen Hofman, says a 20% tax increase on sugary beverages will help reduce comorbidities, which have led to increased COVID-19-related deaths among the population. She also said that research has shown that sugar, particularly in liquid form, increases the risk of obesity, diabetes, hypertension, cardiovascular disease, many common cancers and dental decay.

Commenting on eating habits that cause illnesses, Hofman said people think they have "control over what [they] are eating and drinking", but they don't. "You have been told from an early age by your environment on what to buy, what to consume and what to eat."

She says the health incentive in this regard exceeds the financial incentive.

HOW TO BE EFFECTIVE IN RAISING REVENUE

The former head of National Treasury's Budget office, Micheal Sachs, says decisions regarding tax require the buy-in from the government, civil society, labour and business in order to be effective. Sachs says taxes that don't change public behaviour are more effective in raising revenue.

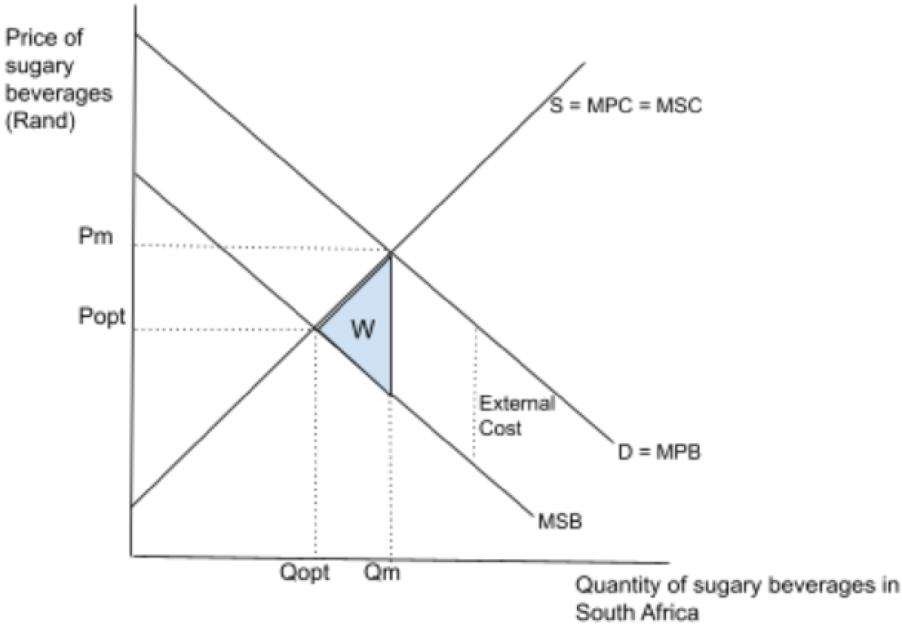
According to Mail and Guardian, head of Heala, Lawrence Mbalati, said the sugar tax had generated R5.4-billion for the government within its first two years and R3.2-billion after it was introduced in 2018.

"If the treasury doubled the health promotion levy now, it could net the government around R2-billion to help fund the fight against COVID-19 in the short term," he said, adding that these estimates are based on current sugar consumption levels and the revenue raised by the levy.

Commentary 3 – Tax on sugary beverages in South Africa

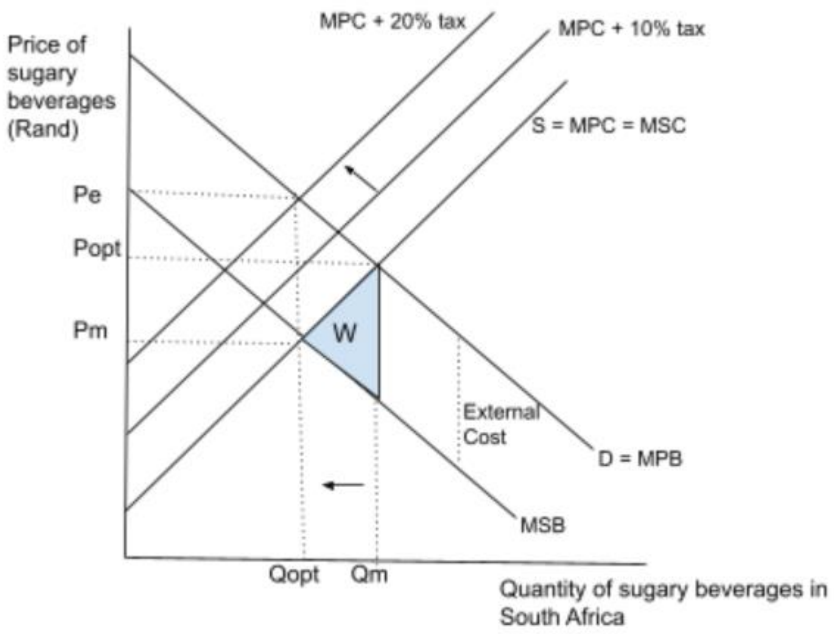
In South Africa, experts are calling to increase tax on sugary beverages from 10% to 20% to increase government revenue and ameliorate the health of citizens. Sugary beverages are considered a demerit good, defined as undesirable for consumption but over-provided by the market which results in negative externalities of consumption. Externalities associated involve health “risks" including “obesity”, “diabetes”, and “cardiovascular diseases" which are found to have a link with “increased COVID-19 related deaths". The increase of sugar tax aims to mitigate these externalities as well as raise government revenue to “fund the fight” against the pandemic.

Diagram 1 - Incurrence of negative externality from consumption of sugary beverages in South Africa



As shown in Diagram 1, negative externalities associated with consuming sugary beverages have caused the MSC curve (extra benefit of consuming an extra unit of good to society) to lie below the MPC curve (extra benefit of consuming an extra unit of good to the individual). The vertical distance between MSB and MPB represents the external costs of consumption. In the free market, allocative efficiency occurs at Qopt, Popt where MSB=MSC. However, the society currently operates at MPB=MPC, where for all units greater than Qopt, MSC is greater than MSB. This suggests an overallocation of resources towards the production of sugary beverages, thereby creating a welfare loss ‘w’ and market failure.

Diagram 2 - Effect of indirect tax on consumption of sugary beverages in South Africa



Shown in diagram 2, the current 10% tax on beverages does not fully internalise the welfare loss, therefore the tax hike to 20% aims to reduce the consumption of sugary beverages by shifting MPC further left to a higher price. Due to higher price, affordability decreases, and consumers internalise the external costs through reduced quantity consumed and higher priced paid for sugary beverages at Pe. The lower price received by producers at Pm also internalises external costs. This is displayed in the reduction of welfare loss ‘w’, and at the resulting new equilibrium Qopt, Pe, allocative efficiency is achieved as MSC = MSB.

With increased 20% tax, in the short run consumers are likely to spend on cheaper alternatives such as healthier food options. In the long-run, this may have positive health benefits as sugar-related “comorbidities” which has “led to increased COVID-19-related deaths” is reduced. Decreasing such ailments increases the productivity of workers and the “efficiency” of output, leading to greater GDP and higher living standards.

However, even the 20% tax on sugary beverages may not sufficiently change the consumption patterns of consumers. Sugary beverages are considered as highly addictive with low PED, indicating price inelastic demand. As people “are told from an early age...what to...consume and eat”, beverages may thereby be seen as a necessity to consumers. This indicates that percentage change in quantity demanded is less proportional to the percentage change in market price, and thus changes in quantity demanded require larger changes in values of tax. Hence, the 10% addition tax may still be insufficient in influencing consumption, and externalities may persist even after taxation.

Nevertheless, increased tax should increase government revenue to support the country’s “growing tax collection shortfall”. Prolonged lockdown from the pandemic resulted in significant loss of “tax collections”. As sugar beverages have a low PED, tax on beverages may be more “effective in raising revenue”. “Increased revenue collection” from taxation of sugary beverages may be used to subsidise healthier alternatives, or help to fund the “fight against COVID-19”, both leading to better standards of living.

Despite this, consumers are made worse off relative to producers with the large consumer burden (incidence of tax paid) due to low PED of sugary beverages. In addition, low-income earners may also be disproportionately worse off as the regressive nature of the indirect tax will take up a larger part of their income, resulting in income inequality. However, since the price of goods take up a larger proportion of lower-income earners’ income, this suggests that they may be more likely to change their consumption patterns, and hence reap greater benefits from the price change.

Reduced demand may also lead to unemployment. As tax hikes the price of beverages and reduces demand, higher prices may force firms to lower their cost of production by laying off workers, resulting in higher unemployment. Moreover, producers and consumers may circumvent the tax by forming underground markets to enable purchase of beverages at lower prices. Overall, these loopholes may defeat the purpose of the tax as negative consumption externalities continue to result from overconsumption.

Although the tax may disincentivize sugary beverages consumption and raise government revenue, the risk may outweigh the gain as consumers and producers are rendered with lower disposable income and potential unemployment.