THE AUSTRALIAN

Sugar coating hard truths about obesity tax

Illustration: Eric Lobbecke

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Recommending new taxes should not be done lightly. But while it is full of strong claims, last week's Grattan Institute report proposing a tax on sugar-sweetened soft drinks ignores relevant evidence and is marred by serious errors of analysis.

That is not to the deny that there is a baby gasping for air in the report's sugary bath water. Its proposals may not stack up, but the report does highlight the dangers of removing from our health system a sensible degree of personal responsibility for the consequences of one's decisions.

The point is simple: subsidise unhealthy behaviour by making its costs fall almost entirely on the community, rather than on those who engage in it, and you will get more unhealthy behaviour than you should.

The answer, however, lies in healthcare reform, introducing deductibles and co-payments that ensure individuals bear some of their choices' costs, rather than in the revenue grabs disguised as corrective taxes that the report, and Greens leader Richard di Natale, who launched it, advocate.

The report centres on three propositions: that sugar-sweetened beverages (SSBs) are a major contributor to an obesity "epidemic"; that that epidemic imposes enormous costs on the public; and that steeply taxing the natural sugar content of SSBs would contribute to bringing it under control.

Unfortunately, each step in its reasoning has myriad flaws. To begin with, while obesity's incidence has increased, per capita consumption of SSBs has fallen, with the proportion of young children consuming SSBs halving from 1995 to

2011-12.

And the natural sugar content of soft drinks has declined even more, as producers replace natural with artificial sweeteners. It is therefore unlikely that SSBs caused the rise in obesity.

Even less convincing are the report's estimates of economic costs. Obesity, it claims, imposes "third party costs" — that is, costs shifted onto parties other than the obese themselves — of $5.3 billion a year, over half of which arise from the loss of tax revenue due to the lower earnings of people who are obese.

To the extent to which those revenue losses are genuine third party costs, the report errs in their calculation.

In effect, as the Productivity Commission has noted, the cost to the community of reducing tax revenues by a dollar is not one dollar: it is, at most, that dollar's opportunity cost, which can be estimated as the economic damage caused by raising another dollar to replace it, with the rest of the fiscal loss being a transfer from one part of the community to another. On the report's assumptions, that net cost amounts to 25 cents.

However, the report not only counts the 25 cents, but adds to it the original dollar — so that 25 cents in community costs becomes $1.25, with the double counting generating gasp-wrenching estimates.

Finally, having rather arbitrarily allocated some of the harm to SSBs, the report claims that a tax of 40 cents per 100 grams of sugar on SSBs would be an efficient, welfare-increasing, response. But while demanding a high burden of proof from less intrusive interventions, here too it fails to establish its claim.

For example, SSBs are consumed by more than 80 per cent of the population, with the vast majority of SSB consumers being neither obese nor likely to become so. Yet the tax will distort their choices too, causing a community loss that must be set against any gain from altering the behaviour of the significantly at-risk population. Instead, the report ignores this issue entirely, along with other complexities proper tax analysis involves.

Compounding those errors is the report's needless stridency. It is absurd, for example, to claim experience shows these taxes "work" when only three of the twenty-two studies the report cites refer to actual taxes on SSBs — and even these have ambiguous results — while the others merely model hypothetical taxes.

Equally, it is troubling that while the main body of the report claims consumers could "easily" avoid the tax by switching to close substitutes, the revenue estimates in the appendix assume the opposite.

And why argue at length that consumers are poorly informed, myopic and irrational, only to then model their response to the tax exactly as if they were fully rational agents?

But despite those concerns, the report does serve a purpose: it neatly illustrates what Jonathan Pincus has called the logic of an overreaching welfare state. Having made each person's decisions a matter of momentous financial consequence for others, it then has an excuse to control those decisions. Put in economic terms, having invited moral hazard, the state cannot resist heavy-handedly intruding to alter the consequences.

In reality, any health insurance will involve some moral hazard. And recent work in health economics, by MIT's Amy Finkelstein and her colleagues, shows it is more pervasive than economists generally believed. Not all its costs can or should be eliminated; but modest co-payments, better aligned across Medicare's different components, would help.

Yet the Greens, who champion Grattan's tax, vociferously oppose co-payments, as does Labor. That can't be because they would be inefficient. On the contrary, unlike Grattan's tax, they would encourage efficient responses: if your preferred method of avoiding obesity is to consume sugary drinks and run marathons, while mine is a life of tap water and kale salad, we would each have incentives to choose according to our preferences, undistorted by taxes on specific way of staying healthy. Nor would co-payments be inequitable, given properly designed safety nets.

Rather, the problem is that such an approach would encourage individual freedom: and treat adults as — yes, adults. Labor and Greens would rather tell us what to do, raising taxes to squander along the way. And with its generous taxpayer funding, Grattan is there to help them.