Testimony of Kevin S. Dietly[1]

Senate Standing Committee on Health
in Opposition to the Proposed Beverage Excise Tax

Good morning Senator Duane and members of the Committee. I am Kevin Dietly, a Principal at Northbridge Environmental and a consultant to the American Beverage Association on economic, environmental, and other strategic issues facing the industry. I have conducted research on public policy issues for clients in the food and beverage industry for more than 20 years as well as extensive economic and financial analysis for the US Environmental Protection Agency. Northbridge specializes in financial, economic, and information systems consulting to government and business, with offices in six cities across the US.

I have been involved in the analysis of beverage tax proposals throughout the US and have collaborated with a number of economists in assessing the impacts of existing and proposed taxes. Most recently I have assisted with evaluations of a proposed beverage tax in Maine, the so-called "fat tax" proposed by Governor Paterson in late 2008, and a potential federal beverage tax.

Following some background information on beverage taxes, I would like to focus my remarks in two general areas: first, a preliminary assessment of the economic impacts of the recently proposed tax in New York, drawing on available research conducted in New York and nationally. Second, I would like to address the "hidden tax" aspect of the proposal and the implications of that tax structure for consumers and the hoped-for health benefits of the tax.

Beverage Tax Background

Experience with selective beverage taxes (by that I mean taxes imposed on only certain categories of beverages) is very limited. Only two states have beverage excise taxes today in the US – Arkansas and West Virginia – and neither uses caloric content in determining the specific beverages upon which the tax is levied.

The Governor's budget figures indicate that the proposed tax would cost New York businesses $1 billion per year. To appreciate the magnitude of that tax on the industry, you must recognize that the total retail sales of all products subject to the tax in New York are between $4 and $5 billion per year. This tax proposes to add $1 billion to the cost of producing these products; the economic impact of such a large tax would clearly be profound.

To bring the numbers down to a manageable level, consider the impact of the tax on some commonly purchased products (Figure 1). The tax would represent at least a 47 percent increase in the price of a 12-pack of soda, using average prices in the NY market in 2008; the comparable figure for a two-liter bottle of soda is a 57 percent increase. These increases assume that the tax on each product is passed directly through to consumers with no additional markup – an unlikely scenario.

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Figure 1

Sample Impacts of the Proposed Beverage Tax

Sample Product	2008 Average Base Price – NY Market	Tax at 1¢ Per Oz	Price After Tax (No Markup or Sales Tax or Deposit)	Percentage Increase (No Markup or Sales Tax or Deposit)
12-pack soda	$3.05	$1.44	$4.49	47%
2-liter soda	$1.19	$0.68	$1.87	57%

Source: Prices for NY market area averaged across seven brands surveyed; price data from Beverage Digest Fact Book 2009, Appendix F

For these same products, if we factor in the sales tax and the container deposit, the new price for the 12-pack would be $5.45 and the new price for the 2-liter would be $2.07. State-mandated fees and taxes would represent 79% and 74% of those products' prices.

Economic Impacts of the Excise Tax

Introducing his assessment of a proposed national beverage tax, Dr. Robert Hahn of the Georgetown Center for Business and Public Policy commented that a beverage tax of this magnitude "would likely result in a significant short-term reduction in economic output in the industries currently involved in the production of beverages…"[2]

The mechanism through which these taxes affect the beverage and related industries is as follows:

- Imposition of the tax raises costs to produce and/or sell beverages
- Beverage producers pass these costs on to consumers, leading to higher consumer prices
- Consumers respond to higher prices by either switching to alternative products that provide similar utility to them at a lower price and/or by buying less of the taxed products (without substituting another product)
- The aggregate effect of changes in consumer behavior is likely to be a reduction in total sales of both taxed and non-taxed beverages
- Lower sales for beverage companies and retailers cause short-term disruptions in their businesses leading to:
    - Lost jobs, wages, and economic output in those industries directly affected
    - Lost jobs, wages, and economic output in industries and businesses that supply those companies (so-called indirect effects)
    - Lost tax revenue to governments from lower wages and corporate income

[2] "The Potential Economic Impact of a U.S. Excise Tax on Selected Beverages," Robert Hahn for the American Beverage Association, August 31, 2009, www.nofoodtaxes.com/economic-impact-of-a-proposed-beverage-tax/

- For products that are not taxed, sales may rise somewhat (if they are truly substitutes for the taxed products) or they may decline as well (if they are compliments rather than substitutes for the taxed products)

The economic analyses described below both take a net impact approach, incorporating both the sales losses and gains in various beverage sectors.

Study of 2008 Proposed "Fat Tax"

In last year's budget, Governor Paterson initially proposed an 18 percent sales tax on selected beverages. An economic analysis of that tax projected:

- 6,100 jobs lost in New York
- Disproportional sales and job losses in border areas – particularly devastating in the Southern Tier counties already reeling from the recession
- Market distortions around Native American reservations and the eventual displacement of retail businesses to neighboring states[3]

The Governor's newly proposed tax is substantially higher. Based on preliminary data, the proposed tax would add an average of 23 percent to the taxed product categories, even without factoring in any markup of the tax by retailers and restaurants. In addition, this proposed tax would affect more beverage sectors than were analyzed in the 2008 study. We can quickly conclude that the estimate of 6,100 jobs lost from the 2008 analysis is far too low.

2009 National Analysis

In his assessment of a potential federal tax, Robert Hahn examined a scenario in which a wide range of beverages would be assessed a $1.07 tax per gallon. We have adjusted the results of that analysis to match the proposed $1.28 per gallon and used industry employment, wage, and output data to adjust the results to New York alone. While this is only a preliminary analysis (a more rigorous assessment of the New York proposal is underway), it does provide an indication of the magnitude of the impacts this new tax could produce:

- More than 20,000 jobs lost in New York in the beverage, retail, and supplier industries
- More than $1 billion in lost wages
- More than $4 billion in lost economic output for the state

Summary of Economic Analyses

The proposed tax would dramatically affect New York's beverage industry, its retail customers, and its suppliers: over 20,000 jobs could be lost. A key issue for this assessment is the consumer response to higher prices. This behavioral link between price and consumption also lies at the heart of the proponents' advocacy for the tax approach – that taxing certain foods or beverages will improve health by driving people away from those products. I will address this issue next.

[3] "The Negative Economic & Employment Implications of New York's Proposed Beverage Excise Tax," Capitol Hill Research Center, February 2, 2009.

The Problem of a Hidden Tax

To achieve any of the claimed health benefits, the tax must reduce consumption of the affected products ***and*** of the substitute products that consumers purchase must be "healthier." The Governor and tax advocates claim that consumption of the taxed products will fall and a healthier population will emerge. An economic assessment of those claims raises serious doubts about their validity.

Impact of a Hidden Tax on Consumption

I contend that using an excise tax to raise money for the budget is unlikely to produce the intended consumer behavior. Because of that, the health and nutritional benefits claimed for the tax are little more than window dressing for a substantial new tax on businesses and consumers.

Let me expand on this thesis by comparing the Governor's "fat tax" from last year with the proposal before us today. Last year's proposal would have levied an 18 percent sales tax on selected beverages at the point of sale – that is at the checkout stand – and the tax would have been posted clearly and separately on the receipt. This method of assessing a tax would directly communicate its existence to consumers and allow consumers to know what products were carrying the tax and how much it was costing them every time they shop.

In contrast, the $1.28 per gallon tax is an excise tax. The tax would be levied against beverage manufacturers, distributors, and wholesalers that import packaged beverages, beverage concentrates, or powders into the state at the point of importation or production. Each month the manufacturer or distributor would file a tax return and send a check off to the state.

The effect of the excise tax on producers and distributors is precisely the same as any other large production cost increase – for example a spike in the price of energy or raw materials. That increased cost of business must be addressed in order for the company to remain viable. The company can choose to raise prices and/or cut other costs.

Companies are likely to take a portfolio approach to covering these costs, raising prices on a range of products including non-beverage products sold by the companies. The more diversified the company is, the greater their ability to spread these costs among other products and sectors.[4] At the end of the day, consumers may end up paying for the excise tax on sweetened beverages through higher prices for products ranging from salsa to soda and bottled water to Borax.

So, while the use of a hidden excise tax may be a politically expedient course (since it hides the tax from obvious detection by consumers), it largely obliterates price signals to consumers about what the Government has deemed to be "good" and "bad" beverages.

What Do Consumers Buy Instead?

Another article of faith for tax advocates is that lower consumption of taxed beverages leads to consumption of "better" alternatives. This is a simplistic assumption and one that is not borne

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[4] Note that for a small New York beverage distributor or independent bottler, a tax of this magnitude is a death sentence. Excise taxes are extremely discriminatory against small operators because of their limited ability to spread costs to other products. The tax would make them less competitive and cost them market share.

out by evidence. It would be convenient for proponents of the tax to argue that a highly taxed case of soda will motivate a consumer to buy a case of diet soda instead. Unfortunately, the economic literature does not support that as a likely outcome.

A 2009 study found that the beverages most likely to increase in consumption if regular soda prices rose were high fat milk and 100 percent juices; diet soda and bottled water consumption did not increase in response to higher regular soda prices.[5] What the literature does not explore is substitution outside of the beverage category for consumers. The actual substitute for a highly taxed soda might be a cookie or a candy bar – selections that might avoid the tax, but would have more calories and fat.

I encourage you to evaluate critically assumptions about the true caloric and health benefits attributed to this proposed tax.[6]

Summary

In the end, then, the problem of understanding and modeling consumer behavior becomes the crux of the analysis for both health advocates and economists on this issue. By hiding the tax from public view, the Governor and tax supporters may avoid some of the unpleasant publicity their fat tax attracted last year, but they may have also undermined the health-based rationale used to justify a billion dollars in new taxes.

What we are left with is a large new tax that will cost jobs, disproportionately hurt small businesses, and take money out of consumers' pockets for everyday grocery items.

Thank you very much for your time and I would be glad to answer any questions about my remarks.

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[5] "Demand Interrelationships of At-Home Nonalcoholic Beverage Consumption in the United States, Dharmasena, S. and Capps, O., 2009 cited in Hahn.

[6] See, for example, http://mercatus.org/publication/taxing-sin