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# Schroders TalkingPoint

## Should investors worry about an 'obesity tax'?

**Charles Somers, Consumer Sector Specialist, Global Equities**

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**Charles Somers**

Consumer Sector Specialist, Global Equities

**Obesity is one of the most pressing health problems of the twenty first century and a growing financial burden on governments. Some countries have already introduced taxes and other measures to address the problem, and other countries threaten to follow suit. Fast food chains and food and drink manufacturers with fattening products appear to offer good growth prospects for investors. But should the food and drink industry be worried, and how should investors respond?**

The rising obesity problem is well documented: obesity rates have doubled over 30 years, with 1.4 billion people overweight. By 2030, 50-60% of the population in many countries are on target to be classified as obese.

The cost of this trend is stark. Globally, obesity is the fifth-highest risk for death and the annual cost of obesity-related illness in the US alone is around $190 billion – almost 8% of the country's total annual medical spending.

In the 1950s the world woke up to the harmful effects of smoking and, through taxation, education and other measures, this marked the beginning of the structural decline of cigarette consumption in the developed world. Some governments are already taking action against obesity, so could something similar be about to hit the food and drink industry?

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**How likely are fat taxes?**

Until recent years, governments have been fairly reluctant to use regulation and fiscal levers to encourage healthy eating. The process is costly and many believe it is not the role of the government to interfere in such matters.

More recently, governments are increasingly concerned about the cost of obesity-related health problems and it is now seen by a growing number of voters as a legitimate area for government involvement.

Denmark has received the most attention as the first country to tax saturated fats. Since October 2011, foods containing at least 2.3% saturated fat have incurred an additional tax. The Danish Agriculture and Food Council estimated the average Danish family would spend an extra 1000 kroner (£105.76) a year as a result (if eating habits remained unchanged). Figure 1 summarises the 'fat taxes' in place at the moment.

**Figure 1: Overview of food and drink taxes and initiatives**

| Country | Status | Overview |
|---|---|---|
| **Denmark** | **In place** | Introduced a tax on foods more than 2.3% saturated fats (meat, cheese, butter, edible oils, margarine, spreads, snacks, etc) in 2011. Consumers pay 16 kroner (€2.15) per kg of saturated fat on domestic and imported food, which is equivalent to up to 30% more for a pack of butter, 8% more for a bag of chips, and 7% more for a litre of olive oil. Tax revenues are expected to be over €200mn/y, and saturated fat consumption is expected to decrease by 4%. Denmark had also increased its excise taxes on chocolate, ice cream, sugary drinks and confectionary by 25% in 2010. Danes pay an additional 16 Danish kroner per kg saturated fat. |
| **Finland** | **In place** | Introduced a tax on confectionary products, while biscuits, buns and pastries remained exempt. The tax, originally intended to be set at almost €1/kg of product, was subsequently dropped to €0.75/kg. The existing excise tax on soft drinks was raised form 4.5 cents to 7.5 cents per litre. |
| **France** | **In place** | Tax on soft drinks came into force in January 2012. The tax affects both drinks with added sugars and drinks with artificial sweeteners. It is set at €7.16/hectolitre (ie €0.072€/litre or approximately €0.024 for a 33cl can) for both categories. It is payable by manufacturers established in France and importers. The tax is expected to generate revenues in the region of €280mn/y). |
| **Hungary** | **In place** | Introduced a tax on selected manufactured foods with high sugar, salt or caffeine content. Carbonated sugary drinks are among the products targeted by the new measures. Hungarians have to pay a 10 forint (€0.037) tax on foods with high fat, sugar and salt content, as well as increased tariffs on soda and alcohol. The expected annual proceeds of €70mn will go toward state health care costs, including those associated with addressing the country's 18.8% obesity rate (vs. EU average of 15.5%). |
| **Poland** | **Under Consideration** | The Polish Government is weighing up the benefits of a FAT tax or VAT tax increase on unhealthy foods in Poland. Currently the VAT tax rate is 8% on food. The proposal is to raise the tax rate to 23% in order to discourage people from eating unhealthy food. Poland withdrew its subsidy on animal fat in the '90s and permitted imports of vegetable oil, which led to a major dip in cardiovascular mortality rates. |
| **Romania** | **Under Consideration** | Romania also considered a "fat tax" early last year, expanding beyond sodas and candies and trans fats to tackle junk food more broadly. Romanian Health Minister Attila Cseke said the tax would "be a percentage of the sale of fast-food products" and that the revenue would be used "to increase the budgets of health programs and fund investments into the system's infrastructure." The idea was axed after the government considered its potential impact on consumers, particularly given rising food prices. |
| **UK** | **Under Consideration** | David Cameron, the Prime Minister, said in October 2011 that the government would consider introducing a "fat tax" to tackle Britain's growing obesity levels. |
| **USA** | **In place (state & city level)** | Various states and cities have sales taxes on soft drinks, snack foods and sweets. However, none of these taxes is designed explicitly as a 'fat tax'. |

Source: Government websites, BofA Merrill Lynch Global Research, June 2012

Although there has been lots of media and industry chatter about further fat taxes, there is very little concrete action in the pipeline elsewhere. The UK prime minister, David Cameron, was quoted in 2011 as saying he would "consider" a fat tax in Britain but there has been no action since.  There is even less momentum in the US. Although 'soda taxes' are levied at a low level in 30+ states, the industry has been successful in lobbying to keep the emphasis on self-regulation rather than taxes or other formal restrictions.

Many countries appear to be waiting to see the results of Denmark's 'experiment'. However, in Denmark public and political support for the tax – initially very strong – is dwindling rapidly. In the last few weeks there have been reports the fat tax may even be scrapped along with a 'sugar tax' due to be implemented in January 2013. It is early days but most political parties have said they are willing to negotiate repealing the taxes. This would surely be a blow to the chances of further obesity legislation in other countries.

Fats, sugar and salts are an essential part of our diet in moderation...Ideally, we would tax *overconsumption* of fat, but clearly that is not possible."

### How much would a tax influence consumer habits?

Parallels made with the impact of tobacco taxes on consumption of cigarettes, while inevitable, do not carry a great deal of weight due to key differences. While cigarettes can be cut out completely, food clearly cannot. Furthermore, while tobacco is bad for you, fats, sugar and salts are an essential part of our diet *in moderation*. This makes it hard to determine what should actually be taxed and by how much. Ideally, we would tax *overconsumption* of fat, but clearly that is not possible.

The impact of food price rises on consumer behaviour is fairly under-researched, especially on cross price elasticities of various foods. The one message that does seem clear, though, is that food taxes have to be really high to change

behaviour. A 2007 study from the Forum for Health Economics and Policy (*Fat Taxes: Big Money for Small Change*, Hayley Chouinard, David Davis, Jeffrey LaFrance, Jeffrey Perloff, 2007), for example, modelled the impact of a 10% fat tax on dairy products and found less than a 1% reduction in average fat consumption.

Soft sugary drinks are often targeted as a key cause of obesity. A paper published this May in the British Medical Journal (*Taxing unhealthy food and drinks to improve health*, Oliver Mytton, Dushy Clarke, Mike Rayner, May 2012) suggested that such drinks would need to be taxed by at least 20% in order for consumer behaviour to change enough to impact obesity levels.

Studies in controlled environments with very high price increases have shown the most effect on consumption. For example, US research (*Point-of-purchase price and education intervention to reduce consumption of sugary soft drinks*, Block JP, Chandra A, McManus KD, Willett WC, 2010) showed that a 35% tax on sugary drinks sold in a canteen led to a 26% drop in sales. In another study (French et al., 1997), the prices of low-fat goods in vending machines were reduced by 50% for three weeks. During the three weeks, total sales were unchanged but the percentage of total sales that were low fat products rose from 26% to 46%. How this would translate into a supermarket environment is a different matter, however.

Looking at real life cases, there is no evidence that taxes on soft sugary drinks in US states have changed consumer habits, although the tax rates (between 1-8%) are very low. It is still too early to meaningfully gauge the impact of the Denmark fat tax, but a November poll suggested only 7% of the population had changed habits.

**How much would a fat tax hurt companies?**
The evidence that moderate fat taxes do little to change consumer behaviour is of course encouraging for the food and drink industry. Nevertheless, growing calls from medical bodies and other stakeholders are unnerving for the industry which is lobbying strongly against overly harsh changes.

The Danish food industry has claimed the price burden would result in a loss of business revenue, production and over 2000 job losses. Some businesses have said the sugar tax, should it be implemented, will mean they will struggle to turn a profit.

In its annual report Coca-Cola put obesity, related negative publicity and possibility of new legislation at the top of its list of 30 risks to profitability."

How much of this is scaremongering by lobbyists is hard to say. Many large cap companies can take comfort in diversification. Nestle, for example, derives a sizeable proportion of sales from water, coffee, pet food and infant nutrition. Kepler Capital Markets estimates that around 30% of Nestle's portfolio would be affected by a fat tax. Similarly, Unilever, which produces a number of margarines, ice creams and spreads, has over half of its portfolio in home and personal care and probably has just 25% exposure.

The food and drink industry does not appear complacent, however. In its most recent annual report Coca-Cola put obesity, related negative publicity and the possibility of new legislation at the top of its list of 30 risks to profitability.

The industry is (inevitably) calling for self-regulation instead of government measures. Many companies are taking pre-emptive steps by reformulating unhealthy products. Mars, for example, has reduced saturated fat in its Mars bars and Snickers by 15%, claiming independent taste tests have ensured they taste the same. This is not without cost – the change took five years and cost the company millions of dollars in R&D. Other companies aim to increase profits in the mean time by acquiring high-growth and high-margin healthier brands or launching their own healthy lines.

**Non-tax measures**
Government measures to combat obesity need not be related to tax. There have been numerous attempts to pass laws on marketing to children on the basis that they are vulnerable. Some have succeeded but often they fail on freedom of expression grounds. The bulk of action has been through industry-wide self regulation or voluntary moves by individual companies. For example, major companies in the EU have signed up to a minimum standards pledge not to advertise food and drink products to children under 12 years old. In June, Walt Disney Co became the first major media company to ban adverts for junk food on its TV channels, radio stations and websites, to take effect from 2015.

The results across the industry have been fairly limited, however. Stakeholders and obesity specialists argue that there is evidence that curbs on advertising can lead to a drop in body mass index but the effects of self regulation were half those produced by formal regulation.

Another non-tax measure would be clearer labelling but, again, the efficacy of this approach has been disputed.

## Conclusion

Obesity and related regulation is an issue that could gather momentum further down the line. But, as many in the industry point out, changing the eating habits of developed world consumers is a complex issue about far more than just costs.

More research needs to be done on the impact of taxes on consumption and company profits. In the mean time, the obesity crisis and related regulation is clearly a trend that the food and drink industry must watch closely. However, while we do not advise complacency, the pipeline for governmental measures is vague and evidence that consumers will change their habits is mixed at best. For now at least, the food and drink industry seems in the clear.

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