FoodDrinkEurope Summary of the study on “food taxes and their impact on competitiveness in the agri-food sector”
At the request of the EU’s High Level Forum for a Better Functioning Food Supply Chain, a study has been undertaken by the ECSIP consortium on “Food taxes and their impact on competitiveness in the agri-food sector”.

The research questions of this study were:

1. How do food taxes impact the consumption of foods with a high percentage in fat, salt and sugar? What qualitative and quantitative results support a public health or fiscal objective?
2. How do food taxes impact competitiveness of the agri-food sector on the Member State level (in terms of costs, profitability and investments)?
3. How do food taxes impact employment and trade flows within the Member States as well as the EU Internal market?

The study concludes the following:

1. **Impact on consumption of the taxed goods**

   • In line with economic logic and therefore not very surprisingly, “an increase in the price of a good, resulting from a tax, reduces consumption of the taxed good”. However, the study identifies two important caveats:

   I. **Product substitution**

   o “Results also suggest that reduced consumption of the taxed good is generally coupled with increased consumption of substitute goods.” Indeed, it has been observed that “consumers may move to cheaper versions of the taxed product (brand substitution), to non-taxed products or to less heavily taxed products (product substitution).” Concrete evidence for this was found in the case studies examined in the study: “In all cases examined, it is found that there is some movement towards cheaper brands (manufacturers) or lower prices stores (retailers) of the taxed products”.

   o Importantly, the authors conclude that “product substitution has important implications for the total health effects of food taxes because a food tax aimed at reducing consumption of one product or ingredient, may in fact increase consumption of other products”. Therefore, looking at the impact of such taxes on consumption behaviour, it is important to consider “whether product substitution results in consumers increasing or decreasing their intake of the targeted nutrient (commonly sugar, salt or fat), that is, whether the aim of the tax in reducing consumption of a specific nutrient is actually achieved or if consumers simply find non-taxed products with the same or similar [or even higher] sugar, salt or fat content.”

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1 *While health effects of the food taxes were not the primary focus of the study, they have been considered as well.*
The study recognizes that more research is needed on consumer and consumption behaviour as “empirical studies are limited by the available data which is often at a broader category level, preventing observations of product substitution within a given product category (e.g. moving to cheaper versions of the same product)” and “modelling studies are limited by the robustness of the demand elasticities that they use to predict consumer purchase behaviour towards the taxed product and product substitutes.”

II. Consumer prices

Furthermore, findings show that “there is no clear and uniform transmission of taxes to consumer prices due to strategic pricing behaviour by manufacturers and retailers.” Firms may be able to neutralise the effect of tax policy interventions on consumer prices by undershifting the tax (“firms absorb the tax by reducing margins and therefore profitability lowers”).

The study also indicates that “food taxes are generally regressive in terms of income. There are suggestions that food taxes could benefit the low-income population segments the most in term of health outcomes, however findings on this are not conclusive.”

In the case studies, it is shown that the tax may not match the desired health objectives. For instance, in the case of the Hungarian tax, “with respect to salt, for instance, the tax covers a scope of products, which accounts for a few per cent (6%) of the salt intake only. Clearly, should the consumption of these products be totally discontinued, the desired reduction of the salt input by a rate of 60-70% could not be achieved either.”

Overall, the authors conclude that “health effects are uncertain, primarily due to uncertainties and disparate views on product substitution, as well as due to the linear methods used in simulation studies”.

Therefore, it is acknowledged that “there are as yet no robust conclusions on the impact of food taxes on public health” and “the effectiveness of food taxes in curbing obesity is therefore uncertain”. “To what extent changes in consumption resulting from a food tax actually lead to public health improvements is still widely debated and evidence from academic literature is inconclusive and sometimes contradictory”.

Impact on competitiveness and profitability

- The study concludes that “food taxes may impact industry competitiveness in terms of administrative burden, and profitability. Relative competitive positions, at both the retail and manufacturing level, may also be affected by changes in consumer preferences brought about as a result of taxes.”

- The authors explain: “We observe food taxes leading to an increase in administrative burdens, notably if the tax is levied on ingredients (specific tax) or the tax base is highly differentiated and complicated. Food taxes may negatively impact profitability, although changes in net profitability are
dependent on a wide range of factors, including the impact of food taxes on substitute products and factors that are not influenced by food taxes.”

- A loss of competitiveness is also visible at company level: “in some cases (Finland and Hungary), manufacturers of the taxed products have lost competitiveness to those manufacturers of the non-taxed goods due to the scope of the tax not covering all of the products within a category.”

- With particular regard to Small and Medium-sized Enterprises (SMEs), which comprise 99.1% of the European food and drink industry, it notes that “it may be more difficult for SMEs to mitigate the impact of food taxes on profitability by means of product reformulation or increased profitability on substitute products due to their smaller product line.”

The study has found evidence of a negative impact of food taxes on competitiveness of food and drink producers in terms of administrative burden and profitability. It is asserted that “the profit margin for the taxed product is negatively affected which, together with the decline in demand for the taxed product, negatively impacts firm profitability”.

2. Impact on employment, trade flows and the EU Internal Market

- From the literature review undertaken in the study, “it is apparent that very limited empirical evidence, nor modelling / simulation evidence of high is methodologically quality, exists on the impact of food taxes on investment, employment or trade flows. More empirical research is needed in these specific areas.” It is recognized that “as investments often concern long-term plans, the short-term data available does not allow to test for multi-year effects.”

- However, the study acknowledges that “production often occurs in the Member States using local employment. Moreover, there are large numbers of local SMEs that manufacturers work with, mostly active in bottling, packaging, advertising and retail. Therefore food taxes can have a direct effect on local employment, as well as a trickle down effect on employment through the value chain.”

- The study also suggests that “no firm conclusions can be drawn on the basis of data analysis of international trade flows due to the limited number of cases.”

The study notes that “on the impact of food taxes on the internal market, employment may be negatively impacted”. Whereas there are signs in the market that there indeed is a negative impact of food taxes on employment, trade flows and the EU Internal Market, it is recognized that more long-term data and empirical research are needed.