

Synoptic Topics: Fiscal Policy and Labour Markets

The Sugar Tax

A new sugar tax on the soft drinks industry will be introduced in the UK, the Chancellor has announced as he unveiled the 2016 Budget. Pure fruit juices and milk-based drinks will be excluded and the smallest producers will have an exemption from the scheme. It will be imposed on companies according to the volume of the sugar-sweetened drinks they produce or import.

There will be two bands - one for total sugar content above 5g per 100 millilitres and a second, higher band for the most sugary drinks with more than 8g per 100 millilitres. Analysis by the Office for Budgetary Responsibility suggests they will be levied at 18p and 24p per litre. Examples of drinks which would currently fall under the higher rate of the sugar tax include full-strength Coca-Cola and Pepsi, Lucozade Energy and Irn-Bru. A typical can contains enough sugar - about nine teaspoons - to take someone over their recommended sugar intake in one hit.

The move has been hailed by campaigners as a significant step in the fight against child obesity. At the start of primary school one in 10 children in England is obese (very overweight) and by the end it is one in five. The issue has been described as one of the most serious public health challenges for the 21st Century by the World Health Organization, while NHS England's Simon Stevens has dubbed it "the new smoking".

Mr Osborne said the money raised - an estimated £520m a year - will be spent on increasing the funding for sport in primary schools. There has been pressure on ministers to increase spending in this area to build on the legacy of the 2012 Olympic Games and in light of the low numbers of children who take part in regular activity. Research has shown that half of seven-year-olds do not do enough exercise.

Adapted from the BBC Website

Q1

Define demerit good AND merit good.

Define fiscal policy.

Q2

Using an appropriate diagram, explain how the imposition of the sugar tax will affect the profits of a large supplier of sugary drinks.

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Q3

After the tax has been levied, a bottle of Coca-Cola may cost £3.00 for a 2-litre bottle. Calculate the proportion of the price that is tax revenue.

If the amount of sugar in Coca-Cola is reduced to conform to the lower rate of levy, what proportion of the £3.00 price is tax revenue?

Q4

Explain why small firms and milk-based products are exempt from paying the new sugar tax.

Q5

Assess the extent to which the sugar tax may affect dynamic efficiency within the suppliers of these drinks.

Q6

To what extent would fiscal policy measures such as the sugar tax affect the labour market?

Synoptic Topics Answer: Fiscal Policy and Labour Markets

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Q1

Define demerit good AND merit good.

A demerit good is one that is overconsumed because the consumer is unaware of the full extent of the cost of consumption. There are negative externalities in consumption.

A merit good is one that is underconsumed because the consumer is unaware of the full extent of the benefits of consumption. There are positive externalities in consumption.

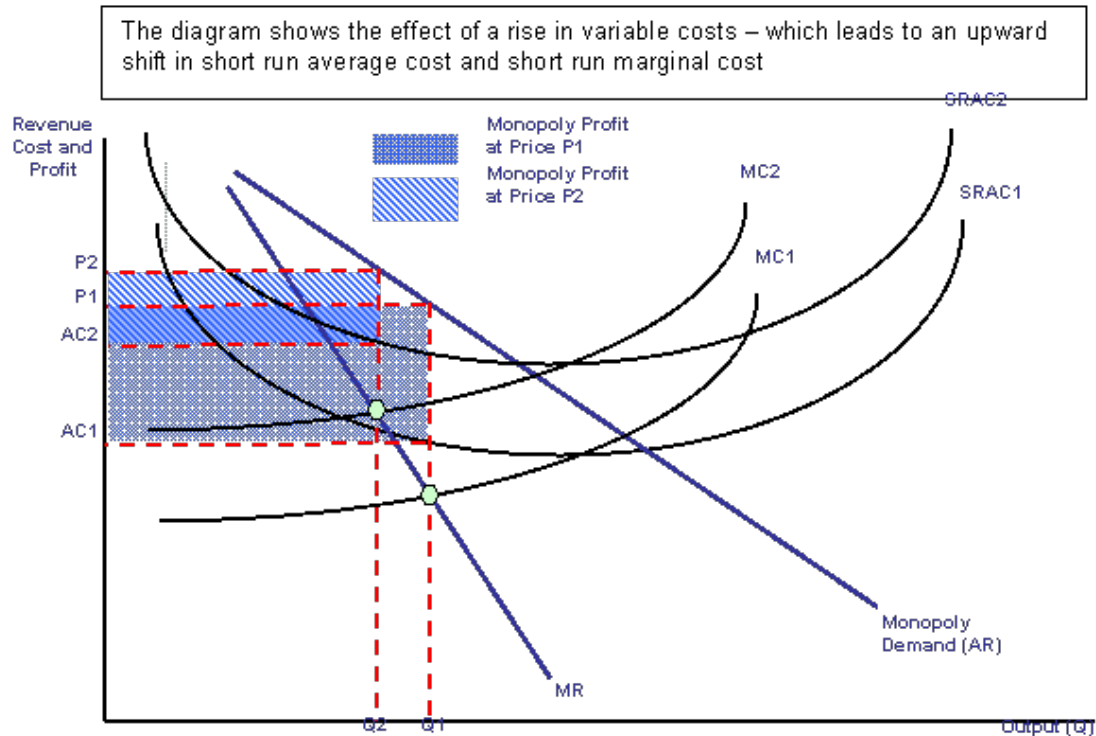
Define fiscal policy.

The manipulation of government spending and taxation in order to achieve macroeconomic objectives.

Synoptic Topics Answer: Fiscal Policy and Labour Markets

Q2

Using an appropriate diagram, explain how the imposition of the sugar tax will affect the profits of a large supplier of sugary drinks.



Q3

After the tax has been levied, a bottle of Coca-Cola may cost £3.00 for a 2-litre bottle. Calculate the proportion of the price that is tax revenue.

Tax is 24p/litre, so total tax is $24 \times 2 = 48p$.

$$\frac{48}{300} \times 100 = 16\%$$

300

If the amount of sugar in Coca-Cola is reduced to conform to the lower rate of levy, what proportion of the £3.00 price is tax revenue?

Tax at lower rate is 18p/litre, so total tax would be $18 \times 2 = 36p$

$$\frac{36}{300} \times 100 = 12\%$$

300

Q4

Explain why small firms and milk-based products are exempt from paying the new sugar tax.

- **Small firms are likely to be exempt as the tax would raise their costs of production and they would be unable to compete with the big firms that can exploit economies of scale. This would reduce the competition in the drinks industry, which would be detrimental for consumers.**
- **Milk-based products are likely to be exempt because they have some health benefits in the form of calcium, and thus have positive externalities.**

Q5

Assess the extent to which the sugar tax may affect dynamic efficiency within the suppliers of these drinks.

- **Dynamic efficiency is likely to be diminished as supernormal profits have been reduced, leaving less profit available for research and development of new styles of soft drinks or new flavours. Equally the opportunity for future reduction in costs of production resulting from better production processes resulting from investment is likely to be reduced.**
- **However the consumer may not notice too much difference as there isn't that much dynamic efficiency evident in this market. If costs of production are reduced, it is unlikely that those cost savings are passed on to consumers due to the oligopolistic nature of the market.**
- **Dynamic efficiency may be more evident in small, innovative firms introducing new drinks such as smoothies, yet these firms are exempt from the tax.**

Q6

To what extent would fiscal policy measures such as the sugar tax affect the labour market?

- **They will affect the labour market because:**
 - **If costs of production are raised, supernormal profits are squeezed and output falls (see diagram above). Therefore fewer employees might be needed and hence redundancies may occur.**
 - **If obesity levels fall, then people will be generally healthier and hopefully will take less time off work and thus increase productivity levels.**
- **They will NOT affect the labour market because:**
 - **The soft drinks industry is capital intensive, with relatively few staff required to run the big factories, so rising costs of production will not impact labour.**
 - **It is generally children that drink excessive quantities of sugary drinks, so a reduction in consumption by children will not have a huge impact on the current labour market, but will affect the next generation of labour.**