Ho Chi Minh City

Date: October 23, 2013

Respectfully to: Mr. Ngo Huu Loi
Director General of the Tax Policy Department
Ministry of Finance

Dear Sir:

Re: Coments on the Proposed Excise Tax on Carbonated Beverages

We are writing to you concerning a proposed excise tax on carbonated beverages. This tax, by design, would fall disproportionately on foreign-owned beverage producers. This is an issue that affects not only our members, but other foreign businesses in Vietnam as well.

BACKGROUND

The Vietnam Beer, Alcohol and Beverage Association (VBA) has recently proposed that the Vietnamese government impose a 10 percent special consumption tax on carbonated beverages. In a proposal sent to several departments of the National Assembly, including the Department of Law, the Economic Department, the Department for Social Affairs, and the Department for Finance, the VBA claimed that such a tax is "applied by many countries."[1] The VBA distributed materials to the media which claim that "carbonated beverages contain a level of acidity that is 100,000 times higher than normal water, which can lead to obesity," and that carbon dioxide (CO_2) interacts with stomach acid to "create pressure on the stomach and intestines" and is linked to stomach ulcers.[2]

POSITION

The proposed tax on carbonated beverages is based on dubious science and disingenuous motives. The claims that carbonation causes digestive problems, ulcers, or obesity have no support in medical science. In fact, medical research suggests that carbonated beverages can actually be useful in *preventing* digestive problems and obesity, and also authoritatively concludes that CO_2 does *not* cause stomach ulcers.

Media reports indicate that the VBA has ceded the carbonated beverage market to popular foreign branded beverages, and that it is proposing this tax to attempt to lower demand for carbonated, foreign branded beverages and increase demand for non-carbonated, local beverage brands such as juices and teas. The VBA has openly acknowledged that the brands that will be most affected by this tax are foreign branded beverages. If the Vietnamese government implements a tax designed to favor local branded beverages at the expense of foreign branded beverages, we believe such a tax would be a clear violation of Vietnam's WTO commitments and would send a message that Vietnam has raised illegal barriers to foreign direct investment.

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Below, we take an in-depth look at the carbonated beverage tax. First, we will demonstrate that the real objective of this tax is to put foreign branded beverages at a pricing disadvantage. Next, we will show that the claim that carbonated beverages contribute to health complications is false. We also argue that the claim that a carbonated beverage tax is "applied by many countries" is false. We will then discuss how a carbonated beverage tax fails the IMF guidelines for excise taxes, indicating that the tax is arbitrary and unjustified. Finally, we will show how such a tax would violate Vietnam's WTO commitments.

1. The purpose of the tax on carbonated beverages is to give its supporters an unfair advantage over their competitors

According to press reports, the Vietnamese beverage industry has warned repeatedly that Vietnamese soft drinks cannot successfully compete against these popular foreign branded beverages. For example, in August, the VBA stated that "[o]nly a few Vietnamese beverage companies" can compete with well-known foreign branded beverages.[3] The industry appears to have conceded the carbonated beverage market to the internationally-recognizable brands, as the VBA has argued that "[i]n the tough race with other major beverage groups in the world, Vietnamese brands can only exist when they develop products in 'different branches' to avoid direct competition" with global brands.[4] In an article discussing the VBA's excise tax proposal, *Việt Nam News* notes that local branded beverage companies "focus on non-carbonated drink products, leaving the carbonated drinks to the production of foreign giants."[5]
These press reports suggest that the real objective behind the tax is not health, but competitive advantage. The claim that CO_2 is linked to obesity and ulcers is simply not true, as science has established. While the purported public health benefits are unlikely to materialize, the non-carbonated beverage industry clearly stands to benefit from the excise tax, as it would lower demand for taxed carbonated sodas and increase demand for untaxed non-carbonated soft drinks.

2. There is no valid medical research showing any adverse health effects related to CO_2 consumption

The VBA's assertion that the "acidity" in carbonated beverages contributes to obesity, stomach problems, and ulcers has no support in medical literature. We evaluate each of these claims below.

a. Obesity

The VBA's claim that beverage carbonation, by itself, contributes to obesity has no basis in respected medical scholarship. In fact, research suggests that carbonation may actually be *beneficial* in combating obesity, as carbonated beverages are associated with greater feelings of satiety and significantly lower food intake.

A study published in the BRITISH JOURNAL OF NUTRITION demonstrated that increasing the level of carbonation in a beverage increases satiety and decreases later intake of calories.[6] Researchers found that, "[c]ompared with the beverage with low carbonation, consumption of the beverages with medium and high carbonation led to significantly higher satiety until lunch, when intakes of food and energy were significantly lower."[7] In other words, individuals who drink carbonated beverages before meals feel fuller and eat less, which could lead to lower levels of obesity. These results were replicated in a separate study by the University of Iowa, which also demonstrated that individuals feel satiated quicker and thus end up consuming a lesser amount when drinking carbonated beverages than when drinking noncarbonated beverages.[8]

b. Digestive issues

The VBA's stance that carbonated beverages are harmful because they interact with stomach acid to "create pressure on the stomach and intestines" is also an unsubstantiated claim. Research published in the *Journal of Food Science* found that carbonated beverages do not cause damage to the gastrointestinal tract.[9] Other recent studies even suggest that carbonated (or "sparkling") water is actually beneficial for digestive[10] and cardiovascular health.[11] Carbonated water has been used for centuries to treat digestive complaints, and a study published in the *European Journal of Gastroenterology and Hepatology* confirmed that sparkling water relieves indigestion and constipation symptoms.[12]

c. Stomach ulcers

The link between carbonated beverages and stomach ulcers is an outdated myth. It used to be thought that spicy, acidic foods caused peptic ulcers, and that colas and other acidic soft drinks contributed to the development of ulcers.[13] In recent years, however, Nobel Prize-winning research by Dr. Barry Marshall demonstrated that the bacterium *Helicobacter pylori* (*H. pylori*), not diet, is the cause of peptic ulcers.[14]

3. Other nations do *not* tax beverages based on CO_2 content

The VBA's statement that their proposed tax on carbonated beverages is "applied by many countries" is misleading. While it is true that non-alcoholic beverages are subject to excise taxation in a few nations, these taxes are *not* based on CO_2 content. It is worth noting that excise taxes on beverages, as a general matter, are highly controversial, and numerous jurisdictions that have experimented with such taxes have later repealed them. For example, countries including Argentina, Denmark, the Dominican Republic, Egypt, Ghana, Indonesia, Pakistan, the Philippines, South Africa and Zambia (among others), along with several U.S. states, either have reduced or eliminated taxes on carbonated beverages or have rejected the idea of imposing such taxes.

4. The proposed excise tax on carbonated beverages is a discriminatory tax under IMF guidelines

Imposing an excise tax to benefit local branded beverages over foreign branded beverages is an improper use of the government's taxation power, as it would be a "discriminatory" tax. "According to the seminal IMF Tax Policy Handbook, [the] best practice is to limit discriminatory taxes (typically implemented via excise taxes) to products that cause negative externalities or are luxury goods, or where such taxes result in a more progressive tax base and/or deliver efficient revenue generation."[15] As the Oxford International Tax & Investment Center notes, "[t]hese are not characteristics that broadly apply to the food and non-alcoholic beverages category,"[16] and particularly not to carbonated beverages.

Carbonated beverages carry no known "negative externalities"—particularly not the health externalities alleged by the VBA. As discussed earlier in this piece, there are no health complications arising from the consumption of carbonated beverages. There are no externalities linked to CO_2 that would justify an excise tax.

Nor are carbonated beverages a luxury good. Carbonated beverages are widely consumed by individuals at every income level, and are in the same price-range as non-carbonated beverages.
Furthermore, a tax on carbonated beverages would be a regressive tax. "[T]he poorest consumers spend a greater proportion of their income on food and non-alcoholic beverages than wealthier households,"[17] so a tax on carbonated beverages would place a greater burden on low-income consumers than wealthy consumers. Also, excise tax is an indirect tax policy; i.e., consumers themselves, not sellers, have to pay such tax.

Finally, a tax on carbonated beverages would not deliver efficient revenue generation. "If the goal of [a selective food and non-alcoholic beverages tax (SFBT)] is to produce tax revenue," states the Oxford ITIC, "an SFBT should generally be applied to products that are price inelastic," meaning that a price increase will not proportionately lower demand.[18] However, "[i]n developing countries, consumption of some items, *such as carbonated soft drinks,* is extremely price elastic. In these cases, imposing a tax may lead to significantly lower demand for that particular product and may therefore not generate additional tax revenue for governments."[19]

The proposed tax on carbonated beverages fails all four of the IMF's criteria for an excise tax. The criteria demonstrate that the carbonated beverage tax is highly arbitrary and a poor tax policy. As the IMF concludes in its Tax Policy Handbook:

> "Specific taxes, for example, on…nonalcoholic drinks, and carbonated drinks, should be relegated to the realm of curiosities. If any consideration is given to taxing other products…, it is recommended that the advantages (revenue) be weighed against the disadvantages, such as discrimination, substitution, and administrative costs."[20]

5. The VBA's tax on carbonated beverages, which targets foreign branded products, would violate Vietnam's WTO commitments and undermine Vietnam's attractiveness to foreign investors

The non-carbonated beverage industry's tax proposal, if implemented, would be a violation of Vietnam's WTO obligation to provide "national treatment" to foreign-invested businesses. As the WTO notes, "this principle of "national treatment" (giving others the same treatment as one's own nationals) is found in all the three main WTO agreements"[21] (GATT, GATS, and TRIPS). It is a fundamental principle of the WTO.[22] The Working Paper on Vietnam's ascension to the WTO noted that Vietnam made assurances to the WTO that its laws "conformed fully to the national treatment principle with respect to excise taxes."[23] There are many cases in which the WTO has found that similar discriminatory excise taxes on beverages violate the national treatment principle.

A finding that the carbonated beverage tax is discriminatory against foreign branded products would be highly damaging to Vietnam's reputation with foreign investors. In recent years, Vietnam has had success in attracting foreign investment. Foreign investors expect the tax system to be fair, equitable, and predictable, and Vietnam has made large strides in fixing tax rates, which no longer discriminate between Vietnamese- and non-Vietnamese-owned enterprises. However, a tax that, in effect, discriminates against products manufactured by foreign invested firms would signal a reversal of its laudable past efforts. Moreover, it would send a message that Vietnam does not welcome foreign investment and competition from foreign-invested companies. At a time when foreign investors can consider multiple options where to invest and when other markets in the region also present attractive opportunities, Vietnam should not adopt a tax that targets foreign-invested products.

RECOMMENDATION

An excise tax will not improve the physical health of Vietnamese citizens, and it will violate Vietnam's international commitments. The proposal is an attempt by non-carbonated beverage industry to use national tax policy to advance their own interests at the expense of their competitors. We recommend that the Ministry of Trade and Industry and the Ministry of Finance reject the proposal to tax carbonated beverages.

Respectfully yours,

Mark Gillin, Chairman

Attachment: References

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