



Tax and Spend for Better Health

March 2009

Often Overlooked, Fiscal Policies Are Powerful Tools

Governments in developed and developing countries use fiscal policies—taxing and spending policies—to improve their nations' health. These policies include taxing alcohol and tobacco, subsidizing certain foods and medicines, and giving tax breaks to businesses or individuals to pay for health care. Experiences from developing countries show that fiscal policies work well when public institutions are credible and strong, when consumers and producers respond to changes in prices, and when the policies are well designed so that the neediest people benefit. Because fiscal policies do not work well everywhere and for every health objective, governments supplement these policies by providing health care directly and by supporting information campaigns to promote healthy behaviors.

Why Use Fiscal Policies for Health?

Fiscal policies use the government's power to tax and spend to alter the price and quantity of health-related goods and services, and to change people's health-related behaviors. The policies may have several rationales:

- To discourage (through taxes) unhealthy behaviors such as tobacco and alcohol consumption;
- To promote better health by investing in sanitation and hygiene, making preventive health care available, and educating the public about healthy lifestyles;
- To ensure that health care is affordable, exempt from taxes, or guaranteed as a legal right;
- To support initiatives in education, agriculture, housing, and energy that affect health indirectly; and
- To support research and development on health care products and services.

Fiscal policies have a range of designs, but most entail *taxes* and tax exemptions, or *subsidies* for consumers and producers—where the government pays part of the price to make a good or service cheaper.

Taxes That Influence Health-Related Behaviors

Sales taxes—including excise taxes and value-added taxes—and tax exemptions are the most common fiscal policy tools to influence consumers' health-related purchases and behaviors. Common examples include:

- **“Sin taxes” on tobacco and alcohol.** Taxes on cigarettes and other tobacco products are indispensable tools in the worldwide effort to curb tobacco use. There is clear evidence that taxes reduce smoking, and the health benefits go well beyond eliminating the harmful effects of smoking, for example, when consumer spending is diverted to healthier alternatives such as food. Taxes on alcohol are widespread and are used primarily to raise revenue. Additionally, harmful alcohol use is controlled through restrictions on the hours and places it can be sold; laws against purchases by minors and against drinking and driving; and limits to alcohol content and the types of alcohol that can be sold. Unfortunately, smuggling and tax evasion are common in developing countries (see Box 1 on page 2).
- **Food taxes.** Taxing unhealthy foods has gained prominence since member countries of the World Health Organization approved the Global Strategy on Diet, Physical Activity, and Health in 2004. The strategy points to increasing rates of obesity and overweight in developing countries and recommends that countries use fiscal policies and other measures to reduce the consumption of unhealthy (i.e., fatty and high caloric) foods. Governments can use these taxes successfully only if the tax rates are high enough to change consumption in a way that improves health. In many developing countries where overnutrition and undernutrition coexist, food taxes can have harmful effects on the poor if other healthy and affordable food alternatives are not available.

- **Tax exemptions** on healthy and staple foods, medicines, and other health care goods. Governments can set policies so that certain health-related expenses are tax deductible or tax exempt for employers or individuals. Exemptions should apply to a limited number of goods that are easily differentiated from non-exempt goods. As with other tax policies, if most spending occurs outside of the formal economy, tax systems may be too weak to make the tax deductions or exemptions effective.

Government Subsidies for Goods and Services

On the spending side, governments subsidize certain goods and services to make them more affordable to those who would not otherwise pay market prices for them. The following items are commonly subsidized:

- **Staple foods.** Ample evidence shows that subsidizing food improves nutrition. The challenge is targeting the subsidies so that the government can afford the cost and the neediest groups receive them. Subsidies may be limited to certain essential foods, specific geographic areas, specific populations, or a combination of all three.
- **Condoms.** Subsidies on condoms increase their use, usually in combination with information campaigns promoting safer sex and condom use. In recent years, social marketing programs, which use commercial marketing techniques to promote condom use and distribute subsidized supplies, have surged as part of the fight against HIV/AIDS.
- **Water purification.** The Safe Water System initiative, promoted by the U.S. Centers for Disease Control and Prevention and the Pan American Health Organization, improves the quality of drinking water for households by providing subsidized storage containers, disinfectant, and education on proper handling. Many countries have implemented the initiative, but the costs are still higher than the cost of boiling water.
- **Soap.** Reducing the incidence of diarrhea and other hygiene-related diseases requires hand-washing, with or without soap. Some research shows that programs that subsidize soap and educate households about the benefits of hand-washing are self-financing because of the resulting decline in disease.
- **Insecticide-treated bed nets.** Key in the fight against malaria, insecticide-treated bed nets are distributed free of charge in some countries and at discounted prices in others through social marketing programs.

BOX 1 : USING TAXES FOR HEALTH PROMOTION: OBSTACLES AND CHALLENGES

Taxes as a tool for health policy face significant obstacles to implementation and pose challenges for governments to ensure they are effective.

- Targeting can be difficult. For example, all consumers would be subject to a tax on “junk” food, even though in some countries it would only present a health threat to a small percentage of people.
- Governments must be sure to tax close substitutes to the item identified as harmful. For example, if cigarettes are taxed but not chewing tobacco, consumption could shift quickly to the latter.
- Governments sometimes favor locally produced goods over imports (because of local lobby groups), even when the import is healthier. Taxing the less-harmful good will encourage greater consumption of the more-harmful good.
- In countries with weak tax and law enforcement, smuggling and illegal markets commonly emerge in response to taxes and tax increases. Moreover, because smuggled products cannot be monitored for quality and safety, the contraband goods (such as tobacco and alcohol) may pose even greater harm to health.
- Tax authorities need a well-functioning system for imposing, collecting, and monitoring taxes and, to ensure compliance, the public should perceive the system as fair and credible.
- Taxes should be cost-effective: the net cost of imposing the tax should compare favorably with other policies, such as regulation or direct government spending, in achieving a particular health goal.

Households may not use bed nets because of the price (of the net and the insecticide), lack of knowledge, and/or cultural preferences. Successful programs address all of these barriers.

- **Clean cooking fuels.** Fuel subsidy programs have promoted the use of liquid petroleum gas, natural gas, and kerosene to lower rates of respiratory illnesses that result from burning biomass such as dung, soft coal, and wood. Targeting is essential, as many of these subsidies have benefited mainly middle- and higher-income families in urban neighborhoods.
- **Medicines and medical supplies.** Governments may subsidize the price of antiretroviral and other drugs, vaccines, and reproductive health care for certain populations to improve maternal and child health and lower the incidence of tuberculosis and malaria. The health benefits of these interventions often far outweigh the cost of the subsidies.
- **General health care.** In some developing countries, governments provide health care directly, while in others subsidized health insurance is made available to families below a certain income level. Both models require identifying families who cannot afford health care and the types of services that merit public subsidies. A successful example of subsidized health care is in the Mexican poverty-reduction program, Oportunidades (see Box 2).

Subsidies for producers encourage the production of goods and services in situations where the supply in the private market falls short of meeting social needs. Examples include medical supplies, vaccines, food additives, and medical research. The incentives to businesses may come in the form of direct subsidies—for example, for fortifying foods or conducting medical research—tax exemptions, or import preferences.

BOX 2: MEXICO'S OPORTUNIDADES PROGRAM: A POLICY SUCCESS STORY

The Mexican program originally known as Progresa and now called Oportunidades is a useful example of how cash payments to families can affect health, and how fiscal policies (through subsidies) can promote healthy behavior. The government launched the program in 1997, and by 2004 it was providing subsidized education, health, and nutrition to the majority of those living below the poverty line. The federal budget pays for the program, which gives cash transfers (equivalent to 20 percent to 30 percent of families' incomes), on the condition that families send their children to school and use certain health and nutrition services. The program also provides basic health care at subsidized prices.

Oportunidades is successful both in terms of targeting the poorest households and in achieving measurable gains in health, health care use, nutritional status and growth, and school attendance and achievement. Evaluations of the program's impact have found reduced illness among children, lower anemia, greater growth, and higher scores on tests of cognitive and motor skills—all of which help children escape the vicious cycle of poverty.¹ The program's success is attributed to many factors, including an integrated package of services; financial incentives linked to school attendance, visits to health clinics, and participation in other health education initiatives; and, critically, a rigorous evaluation process.

Reference

Gertler, P. 2004. "Do Conditional Cash Transfers Improve Child Health? Evidence from Progresa's Control Randomized Experiment." *American Economic Review* 94 (2): 336-41; and Fernald, F.C.H., P.J Gertler, and L.M. Neufeld. 2008. "Role of Cash in Conditional Cash Transfer Programmes for Child Health, Growth, and Development: An Analysis of Mexico's Oportunidades." *Lancet* 371: 828-37.

Conclusions

Fiscal policies are powerful—but often overlooked—tools for health promotion. They sometimes do not work, for example, when tax enforcement is weak; and they can have unintended effects, for example, when the wealthy benefit more than the poor. Moreover, once a subsidy or tax exemption is given, there is typically pressure to expand the program even in the face of severe budget limitations. Consumers and businesses everywhere tend to resist paying for something once it is offered for free. Thus, fiscal policies must be carefully designed so that they target those most in need of government assistance, and they must be administered effectively and efficiently.

Fiscal policies for health offer a unique opportunity for health and finance ministries to interact. All too often,

these ministries operate in different spheres, with separate and even conflicting objectives. Finance, planning, and health officials should actively study and debate health investments, both to ensure their cost-effectiveness and to understand the economic benefits that accrue from promoting better health.

For More Information

Nugent, R., and F. Knaul. 2006. “Fiscal Policies for Health Promotion and Disease Prevention.” *In Disease Control Priorities in Developing Countries*, 2nd ed., ed. D.T. Jamison, J.G. Breman, A. R. Measham, G. Alleyne, M. Claeson, D.B. Evans, P. Jha, A. Mills, and P. Musgrove, 211-23. New York: Oxford University Press.