

TOBACCO TAXES IN MEXICO:

**a means to raise revenue
and reduce poverty**

This Policy Brief was produced based on the background study for Mexico “Analysis of tobacco taxation and simulations in Mexico using LATINMOD”

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Introduction

In Mexico, smoking is a public health problem that claims 43,000 lives each year and causes numerous non-communicable diseases.

According to the National Survey on Drug, Alcohol, and Tobacco Consumption (ENCODAT), in 2017, 17.4 percent of the population aged 12 to 65 were smokers, and between 2011 and 2017, smoking increased particularly among 12 to 17-year-olds and women (Reynales et al., 2017).

The best way to fight the smoking epidemic is by increasing excise taxes, raising cigarette retail prices, and making them less affordable. This would reduce cigarette consumption but also would increase revenue.

Tobacco excise tax in Mexico and potential reforms

In Mexico, products which are harmful to health are subject to an excise tax. Examples include alcoholic beverages, unhealthy or “junk” food, and cigarettes.

The excise tax on cigarettes in Mexico includes two components: an ad valorem component of 160 percent of the production value, and a specific component that until 2020 was set at 0.35 pesos per cigarette (equivalent to 7 pesos per pack of 20 cigarettes). From 2011 to 2019, total tax (including VAT) accounted for 68 percent of the retail price of cigarettes.

Beginning in 2020, the specific excise tax increased from 0.35 to 0.4944 pesos per cigarette to adjust for inflation. This change has brought the total tax burden up to 70 percent of the retail price.

However, given the highly addictive nature of tobacco, the World Health Organization has suggested that the tax burden should represent at least 75 percent of the final retail price for excise tax reforms to be effective and achieve an impact in terms of reducing consumption (WHO, 2015). This would require a specific excise

tax of 1.35 pesos per cigarette, instead of the current tax of 0.4944.

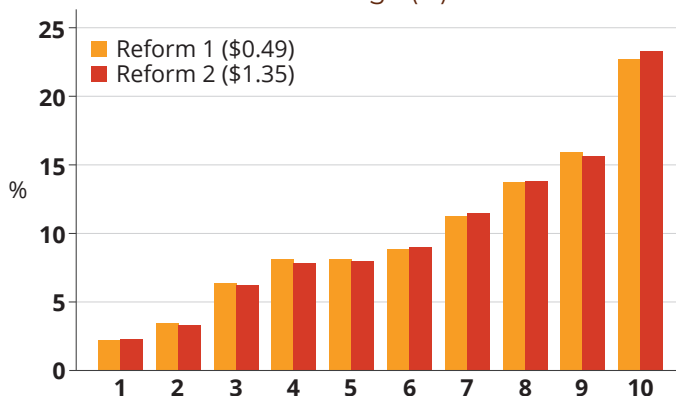
In Mexico, a large share of 12 to 65-year-olds support such a reform. According to ENCODAT, 71.3 percent of the population and 53.3 percent of smokers agree with a tax increase (Reynales et al., 2017).

A tobacco tax reform to affect the rich rather than the poor

In Mexico, higher-income households are the heaviest tobacco users: the richest decile smokes up to four times as much as the poorest (Huesca et al., 2019).

As cigarette consumption varies by income level, a reform of the specific component will fall mainly on higher-income households. Regardless of the amount levied by the specific component (\$0.4944 or \$1.35), higher income groups continue to pay over half of total tax revenue. Figure 1 shows that 52 percent of revenue from tobacco excise comes from deciles 8, 9, and 10 (those with the highest income), while deciles 1, 2, and 3 contribute just 11 percent.

Figure 1. Revenue by income decile, Mexico.
Percentage (%)



Source: Own work using LATINMOD.

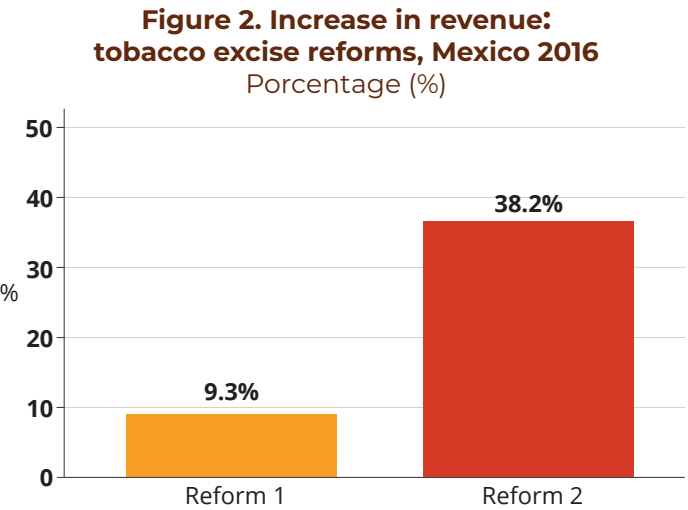
This means increasing tobacco taxes is a marginal progressive policy.

An increase in tobacco tax may generate 55.6 billion pesos in revenue

For over a decade, revenue from tobacco tax has remained unchanged, accounting for 0.20 percent of GDP.

Figure 2 illustrates the revenue potential of tobacco tax reform and shows that while the current increase effective 2020 (Reform 1) leads to an increase of 9.3 percent, this figure jumps to almost 38 percent under a tax in-

crease to \$1.35 (Reform 2). Since the tax will raise the final retail price, cigarette consumption will decline. The results shown in Figure 2 have taken into account the drop in consumption due to the price increase.



Source: Own work using LATINMOD.

Assuming full pass through of the tax, this means that revenue from tobacco excise would amount to 0.22 GDP points under Reform 1 and up to 0.28 GDP points under Reform 2: double what the federal government allocates to the universal grant program “Becas para el Bienestar Benito Juárez para la Educación Media Superior” (“Benito Juárez Welfare Grants for High School Students”) (BBVA, 2019).

Table 1. Tobacco excise revenue in Mexico, (in millions of pesos).

EXCISE TAX	REVENUE	% GDP
No reform	40,236.20	0.20
Reform 1 (\$0.49)	43,994.11	0.22
Reform 2 (\$1.35)	55,621.29	0.28

Note: Values estimated using 2016 GDP. Source: Own work based on estimates by INEGI and LATINMOD.

More revenue, less poverty

An increase in revenue provides more resources for the Government to use in social cash transfer programs to reduce food poverty in Mexico.

The excise tax currently paid by smokers is not allocated to any specific purpose. This revenue could be allocated to fund pro-poor policies and at the same time give greater transparency in the use of public funds.

For example, a social program could be designed to provide 1,507 pesos in financial aid to households that fall un-

der the food poverty line. Such a program could benefit close to 2 million families living in poverty and would be funded from revenue generated from a specific tobacco tax increase to 1.35 pesos.

Table 2. Effect on food poverty: tobacco tax reform of 1.35 pesos per cigarette.

SCENARIO	HOUSEHOLDS		POVERTY
	QUANTITY	%	
No transfer	5,015,133	14.9	-40.1%
Transfer	3,005,440	8.9	

Note: Values estimated using 2016 GDP. Source: Own work based on LATINMOD and CONEVAL.

Official poverty figures for Mexico in 2016 showed that almost 15 percent of households were living in food poverty. A monthly cash transfer of 1,507 pesos would reduce this figure to 8.9 percent. In other words:

“

Revenue from tobacco tax would make it possible to reduce food poverty in Mexico by

40%

”

Other Latin American countries like Argentina, Colombia, Costa Rica, El Salvador, Guatemala, and Panama have set up specific accounts to manage tobacco excise revenue, with a particular focus on funding social or health programs and promoting sport and activities to prevent and treat tobacco-related diseases (PAHO, 2018).

Conclusions

Cigarette consumption is an ongoing problem in Mexico. The World Health Organization reports that an excise tax on tobacco is the most effective mechanism to reduce consumption, while also providing substantial government revenue. To this effect, the total tax levied (VAT and excise tax) should account for at least 75 percent of the final retail price of a pack of cigarettes.

The most recent tobacco excise reform increases the specific component from 0.35 to 0.4944 pesos per cigarette, raising tobacco tax revenue in terms of GDP by 9.3 percent. However, a greater increase in specific excise tax is needed to effectively reduce consumption.

One merit of an increase in specific excise tax to 1.35 pesos per cigarette is that higher-income smokers will bear the brunt of this tax and contribute over half of revenue, which is expected to increase by 38 percent.

These resources can be used to implement cash transfer programs and reduce food poverty in Mexico by up to 40 percent. For this to happen, the Government needs to promote a new tobacco tax reform and earmark this revenue for social programs to support the poor.

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