Tobacco tax increases can also benefit states

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The smoking epidemic in Mexico lingers on. While efforts to fight it have been stepped up, more action is needed to continue pushing for an increase in tobacco excise tax to reduce consumption more effectively.

Why raise tobacco excise tax?

Reasons to increase excise tax on tobacco in Mexico include:

a) Excise tax is the most cost-effective strategy to reduce smoking, and the most effective reforms are those that raise the specific component of excise tax (Chaloupka et al., 2021);
b) The share of tax in the retail price of a pack of cigarettes is currently below the 75% threshold recommended by the World Health Organization (WHO, 2021);
c) Most of the Mexican population supports an increase in these taxes (Salud Justa, 2022); and
d) Current tax revenues from cigarettes do not come close to paying for the treatment of smoking related diseases.

States could introduce their own excise tax on tobacco

States have fiscal authority to implement a subnational excise tax on cigarettes.

It is within this framework that we put forward two reform scenarios. The first introduces a subnational excise tax of 4.5%, while the second also includes an increase in the specific component of excise tax to 1.50 pesos per stick.

Table 1. Tobacco excise tax reform scenarios in Mexico

DESCRIPTION	REFORM 1	REFORM 2
Federal ad valorem IEPS	160%	160%
Federal specific IEPS (per stick)	$0.5108	$1.50
Subnational IEPS	4.5%	4.5%

Source: Authors' calculations

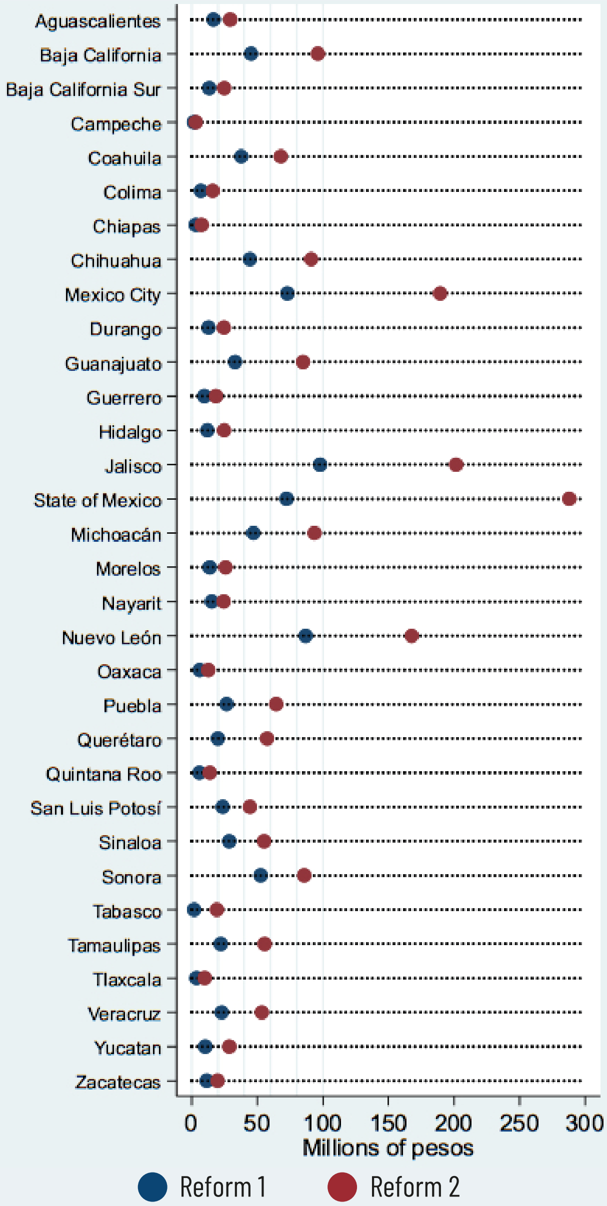
Reform 1 would result in just a 1.1% increase in price, while reform 2 would have a significant impact on prices. States with the highest levels of poverty (Chiapas, Hidalgo, Guerrero, Oaxaca, and Tlaxcala) would see the greatest falls in consumption, while wealthier states (Jalisco, State of Mexico, Mexico City, and Nuevo León) would see smaller but still significant decreases in smoking.

Chart 1 shows the impact that both reforms would have on revenue. Reform 1 would generate a total of 885 million pesos in revenue, enough to provide additional resources for local governments and ensure they share in responsibility for tobacco tax policy.

Poorer states would experience a greater reduction in tobacco use than non-poor states, with no adverse effects on poverty

Reform 2, on the other hand, offers the best outcome to increase tax revenue. The amount of federal revenue that can be distributed to states would jump from 3.65 billion to 4.76 billion pesos. Added to the 885 million pesos from local tax, this translates into a total of 287 million pesos in additional revenue in the State of Mexico, 201 million pesos in Jalisco, 189 million pesos in Mexico City, and 167 million pesos in Nuevo León, to mention just a few states. Importantly, neither of these reforms would have any significant undesirable effect on poverty.

Chart 1. Increase in tobacco revenue by state in Mexico (millions of pesos)



Source: Authors' calculations using MEXMOD v1.1
Note: Excludes 20.6% federal revenue for non-earmarked transfers (RFP)

A 4.5% local tax generates an additional 885 million pesos, and has the potential to raise the most revenue in states with larger economies

Conclusions

Increases in tobacco taxes not only serve to decrease tobacco use and improve health, they also constitute a source of revenue for the government. However, revenue distributed to the states is not earmarked for smoking-related health care.

The local tax would lead to decreases in consumption of over 40% in 4 states, over 30% in 20 states, and up to 30% in 8 states, while still providing an additional 885 million pesos in revenue for states (reform 1). However, combining this with a federal specific tax of 1.50 pesos per stick would provide an additional 1.112 billion pesos in revenue, on top of the 885 million pesos. At the same time, these tax reforms would have no adverse impact on poverty.

Ideally, Mexico should move forward with reforms that enable states to set a local tobacco tax that is specific (rather than *ad valorem*). This would provide the greatest benefits in terms of reducing smoking and increasing government revenue.

References

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