

Tobacco tax reforms decrease its consumption and do not hurt pocket's health

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Tobacco taxes are an effective measure to reduce tobacco consumption (WHO, 2013; Chaloupka et al., 2021). In 1981, the Special Tax on Production and Services (IEPS) was introduced on tobacco products. For decades, this excise tax was exclusively ad-valorem, levying a higher rate on filtered cigarettes than those without filters. Since Mexico ratified the Framework Convention on Tobacco Control (FCTC) in 2004 a piecemeal reforms on excise tobacco taxes have been approved.

Did the Excise Tax on Tobacco Really Increase?

In 2010 a specific excise component was introduced, and since then, IEPS excise for cigarettes is a mixed type tax. A gradual increase in the specific component per cigarette was introduced in the order of 0.04 pesos in 2010, 0.06 pesos in 2011, 0.08 pesos in 2012, until it reached 0.10 pesos per stick (DOF, 2009). However, the amount established by the reform was too low (just \$0.80 pesos per pack of 20 cigarettes in 2010).

That same year, a reform initiative was presented to increase the fixed specific tax to \$0.40 pesos per unit and adjust it annually for inflation; however, it was not approved. The following year (in 2011) a new provision came into force establishing a specific amount of \$0.35 pesos per cigarette (DOF, 2010), which implied an increase in the specific component by 775%.

With this previous reform the amounts of the excise tax represented up to 68.8% of the final sale price (\$7.00 per pack) (Reynales-Shigematsu *et al.*, 2019). Despite such significant progress the reform did not provide for the updating of the specific quota for inflation. This meant that the amount of the tax on the reduction of consumption weakened over time in real terms (Graph 1). The introduction of the specific component reduced relative price differentials, thus discouraging consumers from switching from expensive to cheap brands. However, it is crucial that the specific tax component be updated at least for inflation to prevent such products from becoming affordable again in the short term.

Consumption decline and tax revenues increase are robust

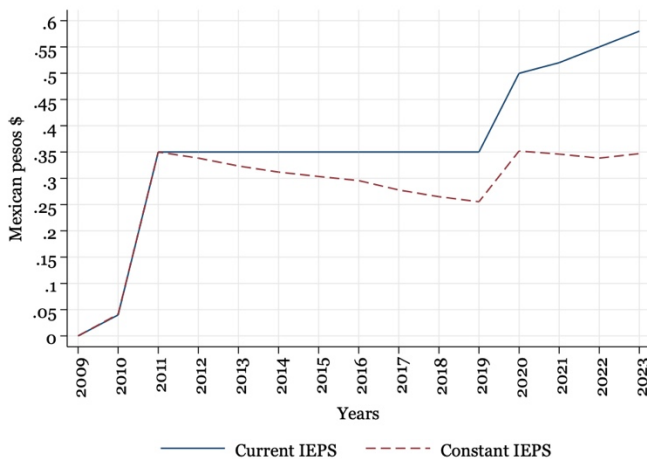
The World Bank reports that the tax policy implemented by Mexico between 2007 and 2011, joint with other tobacco control measures, was associated with a 30% reduction in consumption. In fact, prevalence of tobacco use went from 22.9% in 2008 to 19.1% in 2011 (World Bank Group, 2019). For its part, GATS (Global Adult Tobacco Survey, 2023) reports that the prevalence of daily smokers did not change significantly between 2009 and 2023 (it was 15.9% and 15.3% respectively), while the daily number of cigarettes

consumed decreased from 9.4 to 7.7 units, respectively (World Bank Group, 2019).

Although in Mexico there were subsequent reform proposals to increase the specific tax in 2013 and 2016, these did not prosper (Saldaña & Melgoza, 2020) and it was not until 2020 that the reform came into force that updated the tax for inflation from \$0.35 to \$0.4944 pesos per cigarette (\$9.98 per pack) (DOF, 2019) and permanently established the annual adjustment for inflation.

In 2011, a specific component was introduced to IEPS but it lost its value due to inflation, until 2019 when it was updated to remain the same as in 2011 in real terms

Graph 1. Specific excise tax per stick: Current Vs constant, 2011-2023 (2011=100)



Source: Authors' estimation using data from SHCP & INEGI, corresponding years.

Graph 1 shows how the enactment of the specific tax IEPS in 2011 resulted in \$0.35 pesos. This tax was maintained from 2011 to 2019 and therefore the fiscal policy was not updated in real terms. It can also be seen how between 2020 and 2023 the adjustment for inflation of the specific tax barely compensates for the level it had for 9 years without having changed in real terms,

which invites us to repropose a tax reform that adequately increases its rate.

Increasing the magnitude of the tobacco tax beyond inflation would reduce tobacco consumption, raise more tax revenues, and mitigate the associated health harms without impacting poverty

The two tobacco tax reforms that took place in 2011 and the most recent one in 2019 had differentiated impacts with respect to basic indicators such as tobacco spending and consumption, public revenues, and the conditions of poverty of smokers. If tobacco tax policy is not continued to be strengthened it will be stagnant over time as just updating rates with inflation has not been enough. In 2019 the reform of the excise tax to adjust it only for inflation which had remained unchanged since 2011, has had benefits but not like those achieved in the previous reform of 2011.

The 2011 reform reduced tobacco consumption by -32.7%; while the effect of the 2019 reform was only by -1.9%

The poorest 20% of households with smokers had seen consumption fall by 21%, while the richest 20% reduced it by only 4.5%. Revenue collected was greater in the highest income quintiles. In the first quintile, tax collection decreased by 51% as registered in microdata surveys, but in the second quintile onwards it increased by 14%, 88%, 24% and 87% respectively in the 2011 reform, while the highest quintile registered revenue to increase by 16.7% with the 2019 reform.

Did tobacco tax reforms have an impact on poverty?

A statistical exercise was conducted to isolate the effect of a tax reform on poverty. Notwithstanding this, in 2011 it had a poverty-reducing effect of -4.4% in households with smokers; meanwhile in 2020, the effect was -2.6%. In other words, the tobacco reforms did not have an impoverishing effect on these households. Therefore, the country's poverty levels in 2020 are attributed mainly to the pandemic and not due to the increase in the price of cigarettes.

The levels of poverty observed in the country are not attributable to tobacco tax reforms

These findings guide the need to promote reforms for a significant increase in tobacco taxes at present, and not only adjusting for inflation, given that this indexation, although necessary, does not allow for the continuance of positive effects on revenue collection and falls in consumption, and both indicators would remain unchanged over time.

Table 1. Effect of Tobacco Tax Reforms in México

Reform	Prevalence*	Expenditure	Consumption	Revenues	Poverty
2011	↓ - 6.8%	↓ -5.5%	↓ -32.7%	↑ 9.1%	↓ -
	↓	↑	↓	↑	↓ 4.4%
2019	-4.9%	6.5%	-1.9%	6.5%	-
					2.6%

Notes: Decline: ↓ Moderate decline: ↓ Increase: ↑ Moderate increase: ↑
 *Calculated as the percentage of households with positive tobacco expenditure.
 Source: Own elaboration, CIAD.

CONCLUSIONS

Both tax reforms in 2011 and 2019 were effective in reducing tobacco consumption and produced readjustments in consumer spending but did not result in an increase in poverty conditions.

The 2011 reform was more effective as it observed more significant changes in the indicators than the 2019 reform. The 2011 tobacco tax reform was important as it resulted with significant adjustment for the first time to the specific excise component.

With the use of timely information from surveys on household income and expenditure in the years before and after

the fiscal measures, it is found that tax reforms were effective and that those did not harm the well-being of the tobacco-consuming population.

In contrast, such reforms allowed for an improvement on revenues and, at the same time, reduced cigarette consumption as well as declined the variation in tobacco expenditure in the budget of Mexican families. These reforms helped to perceive the need to promote increases in specific taxes on tobacco at a higher level, since indexing it just by inflation will stall progress in tobacco control in the country. More information is provided in the full research report available at the Economics for Health website <https://economicsforhealth.org/> as well

as on CIAD's website on tobacco taxes at <https://www.ciad.mx/impuestosytabaco/>.

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