

# Revenue and tobacco-related expenditure

## Expanding health sector funding

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*Sufferers of diseases associated with smoking need increased funding to receive care in the public sector. Here's one way to achieve this.*

### 1 | Introduction

In Mexico, the cost of treating conditions associated with tobacco use exceeds health sector expenditure. An increase in tax would reduce tobacco consumption and generate more revenue. Earmarking revenue from the Excise Tax on Production and Services (IEPS) to fund the health system would help to narrow the gap between the cost of providing care to all those who need it as a result of tobacco use and actual spending.

A bill currently in the Congress<sup>2</sup> proposes an increase in the fixed component of IEPS on tobacco from 0.4944 to 1.4944 pesos per cigarette. This policy brief explores the effect of the proposed increase and the feasibility of earmarking revenue generated for the treatment of smoking-related diseases.

### 2 | Results, data, and evidence

#### 2.1 Increase in IEPS on tobacco

IEPS on tobacco includes two components: one fixed and one *ad valorem*. The *ad valorem* component is 160 percent of the manufacturer's price while the fixed component is currently set at 0.4944 pesos per cigarette<sup>3</sup>. The proposal currently in the Chamber of Deputies leaves the *ad valorem* component unchanged and increases the fixed portion to 1.4944 pesos per cigarette. Increasing this fixed component would increase revenue from IEPS on tobacco by 35.6

#### KEY MESSAGES

*An increase in tobacco tax means less cigarette consumption and more federal resources from revenue from IEPS on tobacco.*

*The cost of treating diseases caused by smoking is greater than actual expenditure on treatment of such diseases and greater than total tax revenue from tobacco.*

*Earmarking taxes is legally possible in Mexico. This would provide the public sector with additional funding to provide care for tobacco-related conditions for the most vulnerable members of the population.*

*An increase in tobacco taxes, since it is part of the "recaudación federal participable", increases the revenue distributed to the States*

percent, reduce sales of cigarettes by 18.1 percent, and raise the average price of 20 cigarettes from 58.1 to 82.9 pesos. The results are shown in Table 1. Additionally, since tobacco taxes are part of the "recaudación federal participable" an increase in the tobacco taxes revenue increases the revenue share of each state. Table 2 shows such increase when the specific component is increased from 0.49 to 1.49 pesos per cigarette<sup>4</sup>.

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<sup>2</sup> Medel Palma and Pérez Segura (2020).

<sup>3</sup> Cámara de Diputados del H. Congreso de la Unión [Chamber of Deputies of the Honorable Congress of the Union] (2020).

<sup>4</sup> Details of the calculations can be seen in García, Méndez, & Macías, 2020.

## 2.2 Healthcare costs vs. expenditure

The total medical cost of providing care for tobacco-related diseases in 2018 has been estimated at 79 billion pesos<sup>5</sup>. Considering that 60.3 percent<sup>6</sup> of the total population is not covered by social security institutions, and by weighting the total medical cost of each population, the cost of treating those without access to these health services comes to 48.223 billion pesos: nineteen times the 3.617 billion pesos spent by the Secretariat of Health and higher than total tobacco taxes revenue, which is 42.484 billions.

## 2.3 Revenue earmarking

Given the shortfall in funding for tobacco-related diseases in the health sector, earmarking revenue from IEPS on tobacco is one measure that could secure greater resources. It is constitutionally<sup>7</sup> possible to earmark most revenue generated from IEPS on tobacco, except for certain non-earmarked funds transferred by the federation to the states, known as *participaciones* (see Table 2)<sup>8</sup>.

The most viable way to earmark the remaining revenue is by amending the Excise Tax on Production and Services Law (LIEPS), in which it would be possible to specify more clearly which funds are to be earmarked and how they are

to be used. Specifically, Article 2, Section I, Subsection C) of the law would need amending.

## 3| Public policy implications

Expenditure on providing care for tobacco-related diseases to those not covered by social security institutions is insufficient. An increase in the specific component of IEPS on tobacco from 0.4944 to 1.4944 pesos per cigarette would increase revenue from IEPS by 57.944 billion pesos, 32.7 percent more than expected revenue in 2020<sup>9</sup>.

For these funds to be channeled into the health system in order to reduce the gap between actual expenditure and the cost of providing care to all those who need it and are not covered by the social security institutions, amendments need to be made to the Excise Tax on Production and Services Law (LIEPS). Such amendments would make it possible to earmark revenue from IEPS on tobacco (after deducting the share transferred to states in the form of *participaciones*) to fund the health system. The current discussion in the Congress entails a reform of the LIEPS, paving the way to further discussion on the possibility of earmarking income.

TABLE 1. Comparative table

Revenue in billions of pesos

Variable	Status quo	Specific IEPS of 1.4944
Revenue from VAT	11.062	13.02
Revenue from IEPS	43.679	57.944
Total revenue	54.741	70.964
IEPS as % of price	54.5%	61.4%
Total tax burden as % of price	68.3%	75.2%

Created by CIEP with information from Euromonitor, SHCP, and INEGI

<sup>5</sup> Calculations by CIEP using estimates by IECS (2017) and the Institute for Health Metrics and Evaluation (2017).

<sup>6</sup> This includes the population registered with the Seguro Popular (now INSABI) and those not covered by any health program or institution.

<sup>7</sup> Article 73 of the Political Constitution of the United Mexican States.

<sup>8</sup> In 2018, approximately 28 percent of IEPS revenue from tobacco was distributed to states as *participaciones*.

<sup>9</sup> Cámara de Diputados [Chamber of Deputies] (2019).

TABLE 2. Change in revenue by State

*Amounts in millions of pesos*

Variable	<i>Statu Quo</i>	Specific IEPS 1.4944	Change	% of total
Aguascalientes	141.9	192.4	50.5	1.1%
Baja California	381.3	517.1	135.8	3.1%
Baja California Sur	92.1	124.9	32.8	0.7%
Campeche	80.2	108.7	28.6	0.6%
Coahuila	305.6	414.5	108.9	2.4%
Colima	97.7	132.4	34.8	0.8%
Chiapas	385.9	523.3	137.4	3.1%
Chihuahua	398.1	539.9	141.8	3.2%
Ciudad de México	1,389.9	1,884.9	495.0	11.1%
Durango	165.7	224.7	59.0	1.3%
Guanajuato	543.3	736.8	193.5	4.4%
Guerrero	249.1	337.8	88.7	2.0%
Hidalgo	224.4	304.4	79.9	1.8%
Jalisco	905.7	1,228.2	322.5	7.3%
México	1,840.5	2,496.0	655.5	14.7%
Michoacán	406.2	550.9	144.7	3.3%
Morelos	158.9	215.5	56.6	1.3%
Nayarit	113.8	154.4	40.5	0.9%
Nuevo León	670.3	909.0	238.7	5.4%
Oaxaca	288.2	390.8	102.6	2.3%
Puebla	494.6	670.7	176.1	4.0%
Querétaro	268.1	363.6	95.5	2.1%
Quintana Roo	152.7	207.1	54.4	1.2%
San Luis Potosí	253.2	343.4	90.2	2.0%
Sinaloa	295.5	400.8	105.3	2.4%
Sonora	359.1	487.0	127.9	2.9%
Tabasco	304.4	412.7	108.4	2.4%
Tamaulipas	385.0	522.1	137.1	3.1%
Tlaxcala	114.4	155.2	40.7	0.9%
Veracruz	670.5	909.3	238.8	5.4%
Yucatán	208.0	282.1	74.1	1.7%
Zacatecas	146.1	198.1	52.0	1.2%
<b>Total</b>	<b>12,490.2</b>	<b>16,938.4</b>	<b>4,448.2</b>	<b>100.0%</b>

Created by CIEP with information from SHCP, INEGI y the *Ley de Coordinación Fiscal*.

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