WORLD BANK GROUP

CONFRONTING ILLICIT TOBACCO TRADE:

A GLOBAL REVIEW OF COUNTRY EXPERIENCES

MEXICO: CONTROLLING ILLICIT CIGARETTE TRADE

TECHNICAL REPORT OF THE WORLD BANK GROUP
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MEXICO

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Controlling the Illicit Cigarette Trade

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Chapter Summary

In the last decade, Mexico has made important progress in tobacco control. Graphic warnings were included on cigarette packs, advertising was restricted, and 100-percent smoke-free environments were implemented in 11 of the country's 32 states. At the same time, tobacco taxation and tobacco tax administration were strengthened, with the homologation of ad valorem excise taxes for all non-handmade tobacco products, and a specific excise was added to reduce price differentials across tobacco products. Mexico's General Law for Tobacco Control, approved in 2008, incorporated two key measures designed to curb illicit tobacco trade: (1) the obligation for firms to obtain health licenses to produce or import tobacco products, and (2) the requirement that firms secure a specific permit for each import process involving tobacco products.

Mexico's customs controls have recently been enhanced. In particular, since late 2017, a fiscal mark for tobacco products is required. This mark consists of an alphanumeric code that is accompanied by a two-dimensional code that can be read with mobile devices. Officials can now immediately verify cigarettes' place and date of production and pull up

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detailed information about the producer or importer. The system is expected to improve tax compliance and could help identify potential diversion of national production into the illicit market.

Unfortunately, a lack of transparency has characterized Mexico's implementation of fiscal marks. This is exemplified by the absence of a public bidding process for the development of the technologies used to generate the codes. This casts doubt on the measure's integrity and ultimate effectiveness. In addition to clarifying this process and evaluating the effects on tax compliance of the information that is being generated with the codes, the Mexican tax authority will have to consider possible improvements in the physical characteristics of the fiscal marks (e.g., adding covert elements to make them more secure).

Although Mexico has relatively low levels of tobacco smuggling (below 3 percent, according to a recent national survey), regional cooperation must be strengthened to rein in illicit tobacco. Available evidence indicates that most of the current supply of illicit cigarettes in Mexico consists of products that are introduced into the country illegally, rather than domestically produced.

Finally, Mexico requires much more vigorous action on tobacco taxation. The lack of excise tax hikes during the last seven years has been accompanied by an increase in cigarette affordability and a reduction in the tax incidence, which was already below the level recommended by the World Health Organization.

1. Context

1.1 Tobacco Control in Mexico

In May 2004, Mexico became the first country in the Americas to ratify the World Health Organization Framework Convention on Tobacco Control (WHO FCTC). However, Mexico's General Law for Tobacco Control (LGCT), which includes most of the regulations designed to curb the country's tobacco epidemic, did not enter into force until August 2008. The LGCT and its regulations impose measures such as: smoke-free indoor environments with special smoking areas; restrictions on tobacco advertising;[2] a complete ban on tobacco-product sponsorships and promotional items; and requirements for product packaging and labeling. The LGCT also requires firms to obtain health licenses to manufacture or import tobacco products, along with a permit for each import process.

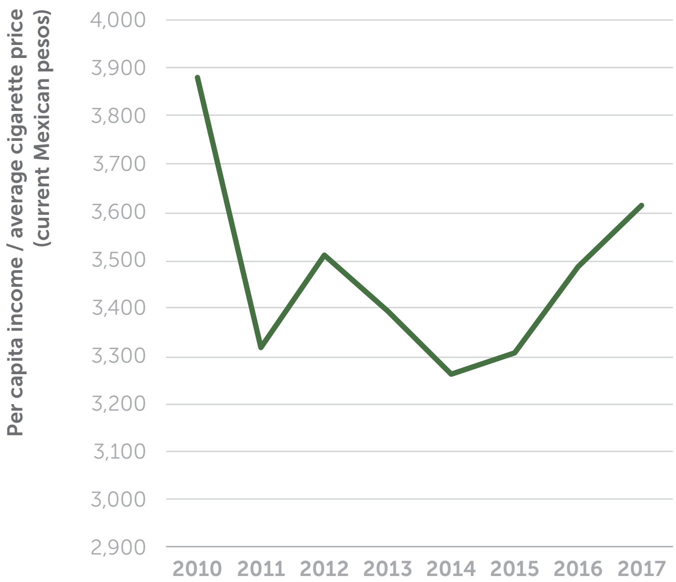
Mexico has made substantial strides in tobacco control at the local level. Although the LGCT does not fully protect non-smokers, 11 Mexican states have laws in place providing smoke-free environments. Such legislation currently protects 45 percent of the country's population.

[2] Advertisements for tobacco products may only be directed at persons of legal age and placed in magazines for adults, personal mail, or within adult-only facilities (Article 23 of the LGCT).

The first of these laws was Mexico City's 2009 Non-Smokers' Health Protection Law (*Ley de Protección a la Salud de los No Fumadores en el Distrito Federal*). The Mexico City measure was followed by similar laws in the states of Tabasco, Morelos, Veracruz, Zacatecas, Estado de México, Baja California, Baja California Sur, Oaxaca, Nuevo León, and Sinaloa.

Mexico's national tobacco excise tax, called the Special Tax on Production and Services (IEPS), increased steadily between 2000 and 2011. Originally, the IEPS was an ad valorem excise tax that varied across tobacco products, for example imposing lower rates on unfiltered cigarettes. However, a uniform tax was adopted in 2005 for all types of cigarettes. In 2007, the uniform tax was extended to virtually all tobacco products. (The uniform rate does not cover cigars and other tobacco products that are entirely handmade, but these account for less than 0.5 percent of tobacco sales in Mexico [Waters et al. 2010].) In 2010, the excise tax structure was also revised to include a specific component (Sáenz de Miera Juárez 2013). Effective from that year, a mixed tax that comprises the ad valorem excise and a specific excise denominated in pesos for each unit of product is in force (see Section 2.1.). At first, the specific component was set at 4 cents per cigarette but was increased to 35 cents in 2011. The reduction in price differentials across brands, aimed to limit consumers' options for switching to cheaper cigarettes, is one of the key advantages of this change, particularly given the sharp increase in the specific excise tax in 2011 (Sáenz de Miera Juárez et al. 2014).

Figure 1. Cigarette Affordability in Mexico, 2010-2017



Notes: Per capita Gross Domestic Product (GDP) is used to measure per capita income. Cigarette price affordability is calculated as the ratio between per capita GDP and the average price per cigarette pack of the most-sold brand.
Sources: International Tobacco Control Survey (average price per pack for 2010), INEGI (GDP and average price per pack for 2011-2017), CONAPO (population).

Taking account of increases in per capita income and inflation as well as cigarette prices (Blecher 2010), the affordability of cigarettes in Mexico increased by 8.5 percent from 2011 to 2017, as shown in Figure 1 (all prices are in current pesos). Cigarettes clearly became less affordable as a result of the most recent tax hike, implemented in 2011. However, per capita income has once again grown faster than cigarette prices in recent years.

While considerable efforts have been made over the past decade to improve Mexico's tobacco control strategy, significant gaps remain. Partial protection provided to non-smokers under the LGCT and the lack of adjustments to the special taxes over the past seven years perhaps best illustrate the stagnation in policies aimed at mitigating the harmful effects of tobacco on health and the economy. This, in turn, is reflected in the performance of key epidemiological indicators.

Although the average number of cigarettes consumed by daily smokers, who account for roughly half of current smokers, fell from 9.4 cigarettes per day in 2009 to 7.7 in 2015, no changes in smoking prevalence were observed (PAHO and INSP 2017). Both the Global Adult Tobacco Survey (GATS) and the National Addictions Survey (ENA, recently renamed National Survey on Drug, Alcohol, and Tobacco Consumption or ENCODAT) indicate that, between 2009 and 2016, there were no changes in overall smoking prevalence or in prevalence by gender or age group (Table 1). This was the case as regards smoking prevalence both among daily and occasional smokers (INPRF et al. 2017; PAHO and INSP 2017). Currently, smoking prevalence among women is about one-third the prevalence among men (approximately 8 percent vs. 25 percent, respectively).

Contrary to the experience in other countries (World Bank 2017), the rise in tobacco affordability from 2011-2017 did not increase prevalence, a tribute to the effectiveness of the other tobacco control steps the federal and local governments were taking. This speaks, however, to the reduction in prevalence that could have occurred, and the significant future death and disease that could have been prevented, if tobacco excise taxes had been raised significantly, at least enough to keep cigarette affordability from increasing.

1.2 Institutions Tasked with Designing and Monitoring the National Tobacco Control Strategy

The *Comisión Nacional contra las Adicciones* (National Commission Against Addictions, CONADIC) is responsible for devising and spearheading the national policy on the prevention and treatment of addictions. As a decentralized administrative body of the Ministry of Health, this Commission enjoys technical, operational, and administrative autonomy. Its mandate includes: (a) proposing programs for the prevention, treatment, and control of addictions to the Secretary of Health, and spearheading and coordinating their implementation once approved; (b) proposing crosscutting programs and strategies for actions to other agencies of the Federal Public Administration; (c) serving as a liaison with the bodies that may be established by states to deal with addiction prevention and control; and (d) proposing to the relevant bodies preliminary draft reforms of legal provisions on the production, marketing, and consumption of alcoholic beverages, tobacco, and other psychoactive substances. Established at the same time as the LGCT, the *Oficina Nacional para el Control del*

Table 1. Smoking Prevalence in Mexico Based on Selected Demographic Characteristics, 2009-2016

	GATS (15 YEARS OLD AND ABOVE)				ENA/ENCODAT (12-65 YEARS)			
	2009		2015		2011		2016	
	%	CI (95%)	%	CI (95%)	%	CI (95%)	%	CI (95%)
Total								
Current smokers	16	(14.8, 17.1)	16.4	(15.4, 17.3)	17.0	(16.1, 18.0)	17.6	(16.9, 18.3)
Daily smokers	7.6	(6.8, 8.3)	7.6	(6.9, 8.3)	7.0	(6.4, 7.6)	6.4	(6.0, 6.9)
Occasional smokers	8.4	(7.6, 9.2)	8.8	(8.1, 9.5)	10.0	(9.3, 10.7)	11.1	(10.6, 11.7)
Gender								
Men	25	(23.2, 26.6)	25.2	(23.6, 26.9)	25.2	(23.5, 26.9)	27.1	(26.0, 28.2)
Women	7.8	(6.7, 9.1)	8.2	(7.3, 9.3)	9.3	(8.4, 10.2)	8.7	(8.1, 9.3)
Age*								
15-24 years	17	(14.8, 19.0)	17.4	(15.5, 19.5)	22.0	(19.2, 24.7)	23.0	(21.6, 25.1)
25-44 years	17.0	(15.6, 18.4)	18.7	(17.2, 20.4)	20.0	(18.2, 21.0)	21.0	(19.6, 21.8)
45-64 years	16	(13.8, 17.7)	14.6	(12.8, 16.5)	17.0	(14.6, 18.5)	17.0	(15.9, 18.3)
65 years and above	8.0	(6.4, 9.9)	8.2	(6.5, 10.2)				

Notes: GATS = Global Adult Tobacco Survey, ENA = National Addictions Survey, ENCODAT = National Survey on Drug, Alcohol, and Tobacco Consumption. The ENA was recently renamed ENCODAT, but maintains the same goal and objectives. The definition of a current smoker is the same for both the GATS and the ENA and refers to persons who have smoked in the past 30 days. *Age groups for ENA/ENCODAT differ slightly from those for the GATS. Specifically, in the case of ENA/ENCODAT, the first age group ranges from 18 to 24 years, while the last age group ranges from 45 to 65 years.
Source: PAHO/INSP (2017), INPRF et al. (2017).

Tabaco (National Tobacco Control Office, ONCT) is currently located within CONADIC and is focused on FCTC implementation in Mexico.

Established in 2001, the *Comisión Federal para la Protección contra Riesgos Sanitarios* (Federal Commission for Protection Against Health Risks, COFEPRIS), another decentralized body of the Ministry of Health, is responsible for monitoring compliance with the LGCT and enforcing administrative sanctions for violations.

The *Subsecretaría de Ingresos* (Office of the Undersecretary for Revenue) in the Ministry of Finance and Public Credit (SHCP)—through the *Unidad de Política de Ingresos* (Revenue Policy Unit) and the *Unidad de Legislación Tributaria* (Tax Legislation Unit)—is tasked with designing tobacco taxes, while the *Sistema de Administración Tributaria* (Tax Administration Service, SAT), a branch of the SHCP, has responsibility for their administration. Broadly speaking, the SAT is responsible for applying tax and customs legislation, ensuring that taxpayers comply with tax and customs provisions, and generating the information needed to devise and evaluate tax policy.

Lastly, if the application of the LGCT, the tax laws, or the customs law reveals the possible commission of smuggling or counterfeiting offenses, the Office of the Attorney General (PGR) is charged with instituting criminal proceedings (upon filing of a criminal complaint by the aggrieved party)[3] and, where appropriate, applying the relevant punitive measures. To address criminal complaints pertaining to counterfeiting, the Mexican Institute of Industrial Property (*Instituto Mexicano de la Propiedad Industrial*, IMPI) is charged with preparing the technical statement needed to bring criminal justice action.

1.3 Political Situation

Mexico has recently been engaged in a large-scale electoral process in which over 3,400 local and federal offices were contested. On July 1, 2018, Andres Manuel Lopez Obrador, often described as an anti-establishment figure, was elected President for the 2018-2024 term. At the same time, a completely new Federal Congress was ushered in (including 500 federal house members, 300 elected by direct vote and 200 by proportional representation, along with 128 senators). State-level elections were held in 30 of the country's 32 states, including Mexico City. Governorships and other offices were contested in nine states, while other jurisdictions elected mayors and/or local lawmakers. After a 100-year ban on the reelection of lawmakers, senators can now be reelected for up to two consecutive terms while members in the lower house can serve up to four consecutive terms, paving the way for newly elected lawmakers to potentially remain in office until 2030. While these developments will make it possible for organized civil society and citizens in general to demand that their representatives ensure continuity and progression in tobacco control policies, it is also expected that the industry will scale up its efforts to influence decision making (see Section 1.4).

The sharp rise in violence and high levels of corruption—the primary concerns of the Mexican people[4]—have naturally dominated the political agenda. In 2016, the *Instituto Nacional de Estadística y Geografía* (National Institute of Statistics and Geography, INEGI) recorded 23,953 homicides, or 20 homicides per 100,000 inhabitants, more than double the figures recorded ten years earlier (8,867 homicides or eight homicides per 100,000 inhabitants in 2007). These increases were observed in 30 of the 32 states. The homicide rate quintupled between 2007 and 2016 in states such as Baja California Sur and Guanajuato, and increased tenfold in such states as Colima (INEGI 2017).[5] Corruption has

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[3] In order to institute legal proceedings in cases involving smuggling offenses, the SHCP, in accordance with the country's Tax Code, must file a criminal complaint, notify the tax authorities of the harm caused, and draft its statement.

[4] The 2017 National Survey on the Impact and Quality of Governance (ENCIG) conducted by INEGI indicates that insecurity and crime, followed by corruption, are the most pressing concerns of the Mexican people. It further notes that, between 2015 and 2017, the percentage of people expressing these concerns rose from 66.4 percent to 73.7 percent with respect to insecurity and from 50.9 percent to 56.7 percent in the case of corruption (INEGI 2018).

[5] The number of journalists murdered is another indicator of violence in the country. Reporters Without Borders (RSF) ranks Mexico as the world's deadliest country at peace for journalists. In 2017, 11 journalists were murdered in Mexico, making the country second only to Syria in this ranking (Reporters Without Borders 2017).

also worsened in the country. Mexico ranked 123 out of 176 countries on Transparency International's Corruption Perceptions Index in 2016 and 135 out of 180 countries in 2017, making it the most corrupt nation in the OECD (Organization for Economic Cooperation and Development) (Transparency International 2018).

In this context, although the main presidential candidates presented a number of general health proposals, the legislative-branch candidates paid scant attention to this issue. It is therefore difficult to predict if the new configuration of the Federal Congress will facilitate the approval of the necessary reforms to the LGCT and the LIEPS (Law on the Special Tax on Production and Services) and the possible ratification of the Protocol for the Elimination of the Illicit Trade in Tobacco Products.

1.4 The Tobacco Industry

Mexico's tobacco industry is dominated by two companies—Philip Morris Mexico and British American Tobacco Mexico—both of which are subsidiaries of transnational corporations that control a large share of the global cigarette market. The 2015 GATS reported that the Philip Morris Marlboro cigarette brand was the most popular among just over half of Mexican smokers (52.7 percent), followed by Pall Mall and Montana from British American Tobacco (17.8 percent) (PAHO and INSP 2017).

As is the case in many other countries, the tobacco industry has used various methods to obstruct progress on tobacco control in Mexico (Madrazo and Guerrero 2012). Industry representatives have focused much of their effort on tax policy. The claim that higher tobacco taxes will increase the illicit tobacco trade is the industry's most frequently used argument against tax hikes.

One of the most common strategies employed by the industry is lobbying, conducted directly by representatives of the large corporations or indirectly through lobbying firms. Another approach is the mobilization of business organizations or small distributors (Fundación InterAmericana del Corazón Argentina, et al. 2012). Along with other authorities and stakeholders, the tobacco industry also currently participates in the *Mesa de Combate a la Ilegalidad*, a task force convened by the SAT to coordinate actions against smuggling and counterfeiting of various products, including tobacco products (see Section 2.6).

2. Combating the Illicit Tobacco Trade in Mexico: Legal and Institutional Framework

2.1 Excise Taxes on Tobacco Products

In Mexico, the LIEPS contains all the provisions relating to excise taxes (IEPS). In addition to tobacco products, excise taxes are also imposed on a wide range of goods and services, including: alcoholic beverages, energy drinks, flavored drinks, pesticides, fuels, high-calorie, non-staple foods, betting and sweepstakes games, and mobile and internet services provided through public telecommunications networks.

To put the role of excise taxes in context as a source of financial resources for the country, Table 2 shows the origin of the federal government's budget revenue. Currently, three-quarters of this revenue is generated by taxes. Specifically, close to 10 percent of all federal revenue comes from the IEPS. While revenue from the IEPS on gasoline and diesel far surpasses revenue from other applications of this tax, tobacco products contribute close to 11 percent of the revenue from the IEPS and approximately 1 percent of total revenue.

The IEPS currently has two components: an ad valorem component, calculated based on the price to the retailer, and a specific component, consisting of a fee in Mexican pesos per unit of product (number of cigarettes or grams) (Table 3). The exact composition of the excise on tobacco products has varied over time (Figure 2).

The manufacturers or importers of tobacco products are responsible for paying the IEPS to the Tax Administration Service (SAT). The deadline for payment is the seventeenth day of the month following the sale of the products. In addition, during the first month of the year,

Table 2. Federal Government Revenue, Mexico, 2017

ITEM	MILLIONS OF PESOS	% OF TOTAL	% OF TAX REVENUE	% OF THE IEPS
Total	**3,837,584.6**	**100.0%**		
Oil	**437,346.8**	**11.4%**		
Non-oil	**3,400,237.9**	**88.6%**		
Tax Revenue	2,854,799.3	74.4%	100%	
Income tax	1,573,688.3	41.0%	55.1%	
Flat Rate Business Tax (IETU)	-1,744.4	0.0%	-0.1%	
Tax on Cash Deposits (IDE)	-739.1	0.0%	0.0%	
Value Added Tax (VAT)	816,039.1	21.3%	28.6%	
Special Tax on Production and Services (IEPS)	367,834.4	9.6%	12.9%	100%
IEPS on gasoline and diesel	216,498.7	5.6%	7.6%	58.9%
IEPS on manufactured tobacco	**39,123.6**	**1.0%**	**1.4%**	**10.6%**
IEPS on alcoholic drinks	14,958.2	0.4%	0.5%	4.1%
IEPS on beer and carbonated drinks	35,007.7	0.9%	1.2%	9.5%
IEPS on betting and sweepstakes games	2,741.4	0.1%	0.1%	0.7%
IEPS on public telecommunications networks	5,752.1	0.1%	0.2%	1.6%

Table 2. Federal Government Revenue, Mexico, 2017, Cont.

ITEM			MILLIONS OF PESOS	% OF TOTAL	% OF TAX REVENUE	% OF THE IEPS
		IEPS on energy drinks	7.9	0.0%	0.0%	0.0%
		IEPS on flavored drinks	23,162.9	0.6%	0.8%	6.3%
		IEPS on high-calorie, non-staple foods	18,339.4	0.5%	0.6%	5.0%
		IEPS on pesticides	705.2	0.0%	0.0%	0.2%
		IEPS on carbon	11,537.2	0.3%	0.4%	3.1%
		IEPS on water, soda, and concentrates	0.0	0.0%	0.0%	0.0%
		IEPS on other goods and services	0.0	0.0%	0.0%	0.0%
	Imports		52,330.1	1.4%	1.8%	
	Exports		0.4	0.0%	0.0%	
	Motor vehicle tax		0.0	0.0%	0.0%	
	New automobiles		10,536.3	0.3%	0.4%	
	Tax on exploration and extraction of hydrocarbons		4,329.6	0.1%	0.2%	
	Hydrocarbons Income Tax		0.0	0.0%	0.0%	
	Other		376.9	0.0%	0.0%	
	Other related government charges		32,147.7	0.8%	1.1%	
Non-tax revenue			545,438.6	14.2%		
	Betterment levy		50.8	0.0%		
	Non-oil duties		61,283.2	1.6%		
	Earnings		7,830.5	0.2%		
	Government charges		476,274.1	12.4%		

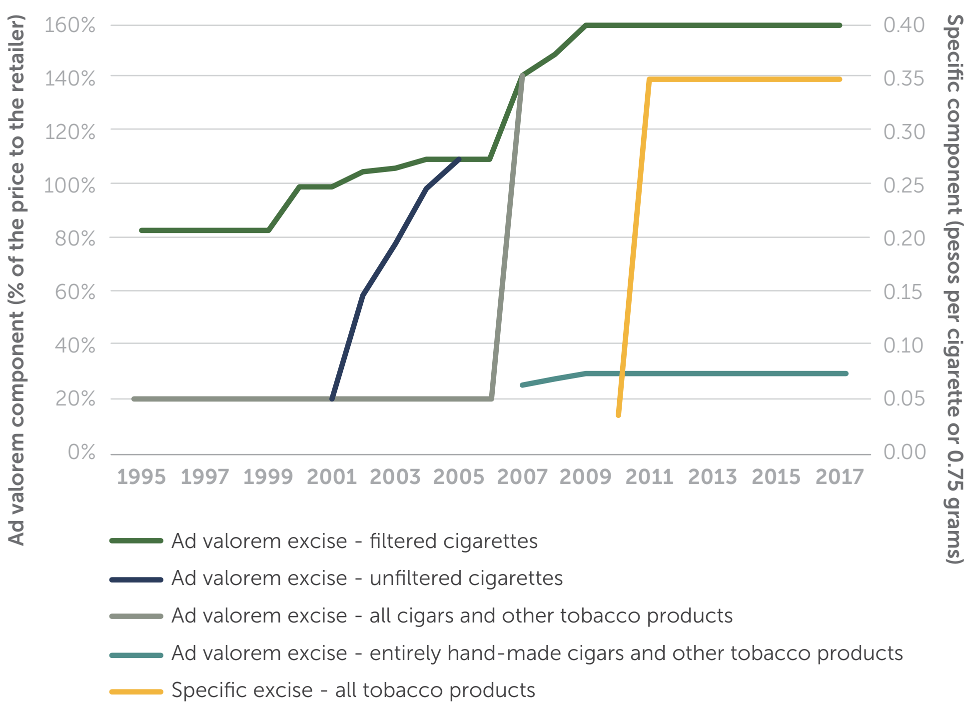
Notes: Oil revenue includes transfers from the Mexican Oil Stabilization and Development Fund and income tax on contractors and assignation holders for exploitation of hydrocarbons.
Source: Ministry of Finance and Public Credit (SHCP).

Table 3. Special Tax on Tobacco Products in Mexico, 2018

PRODUCT	AD VALOREM (% OF THE PRICE TO THE RETAILER)	SPECIFIC
Cigarettes	160%	$0.35 per cigarette
Cigars and other manufactured tobacco products	160%	$0.35 per 0.75 grams
Cigars and other entirely hand-made manufactured tobacco products	30.4%	Exempt

Notes: The weight of the cigars and other tobacco products other than cigarettes must take into account the weight of other substances mixed with the tobacco, except for the filter, paper, or any other tobacco-free substance in which they are wrapped.
Source: Special Tax Law on Production and Services (LIEPS).

Figure 2. Components of the Excise Tobacco Tax, Mexico 1995-2018



Notes: The specific component of the excise tax implemented in 2010 applied to all tobacco products, but in 2014 entirely handmade cigars and other tobacco products were exempted from this duty.
Sources: Law on the Special Tax on Production and Services (LIEPS).

manufacturers and importers must present to the tax authority a list of prices for all their products classified by brand and presentation. This list must include the price to the whole-saler, the price to the retailer, and the suggested price to the end consumer. If the prices are modified before January of the following year, the manufacturer or importer must present the list of updated prices within five days after the changes are implemented.

In the third month of each year, manufacturers and importers of tobacco products must also present to the SAT data on the products sold the previous year. Similarly, at the start of each quarter (January, April, July, and October), they must present data on their 50 main clients and service providers during the previous quarter. Lastly, they are required to provide monthly data on the price and volume of the tobacco products sold, classified by brand.

2.2 Other Taxes Applicable to Tobacco Products

In addition to the IEPS, tobacco products are subject to payment of the Value-Added Tax (VAT) of 16 percent of the sale price to the consumer (Law on Value-Added Tax). This price includes the price to the retailer (taxable base of the ad valorem component of the IEPS), the IEPS (ad valorem and specific), and the retailer's revenue and expenses. The retailer is responsible for expressly passing on the VAT to buyers of the products and then paying it to the SAT.

Tobacco products that are imported from a number of countries are also subject to an additional ad valorem tax. The applicable rate for imported cigarettes is 67 percent of the price to the importer, while the rate for cigars and cigarillos is 45 percent (Law on General Import and Export Taxes). The price to the importer includes the cost of the products, pack-aging expenditures, transportation costs, and insurance. However, as a result of the trade agreements in effect, imports of tobacco products from some countries, such as the United States and Canada, are exempt from payment of these import duties. It is worth highlight-ing that the majority of the cigarettes consumed in Mexico are manufactured domestically, and those that are imported come largely from countries for which duties are not levied. In the case of imported tobacco products, the price to the retailer used to calculate the IEPS includes the price to the importer, the import duty, and the importer mark-up.

Import taxes, when applicable, are paid by importers at the time of initiating the process. This is also recorded in a customs declaration that importers must present to the customs brokers. The customs declaration also contains detailed information on the products that are being imported, such as weight and volume. Travelers over the age of 18 can bring into the country a maximum of ten packs of cigarettes, 25 cigars, or 200 grams of loose tobacco tax free.

In the event that the customs authorities detect lack of compliance with the tax provisions during the import process, they must impose the administrative sanctions provided for in the Customs Law. These sanctions are determined based on the percentage of resulting tax evasion or in accordance with intervals specified in the law. It is important to mention that administrative sanctions are independent of sanctions arising from criminal proceedings, which may be imposed by a judicial authority. In the case of products that are in transit, the Customs Law establishes in detail the periods, documents, and means of transport that can be used.

2.3 Fiscal Markings on Tobacco Products

Unlike with alcoholic beverages, Mexican law does not require that tobacco products include tax stamps or tags. The fiscal mark that had been provided for in the LIEPS since late 2009 was a security code to be printed on packs of cigarettes manufactured or imported for sale in Mexico. This was scheduled to enter into effect in July 2010, which would have given the SAT time to establish rules governing the characteristics and mechanisms for printing the codes. However, these rules were not published and, therefore, the codes were not implemented.

Subsequently, with the reform of the LIEPS approved in December 2013—which was part of a much broader tax reform process—the possibility of reviving the security code system presented itself. Details were then added about the codes, and another period was established for the publication of more specific rules and the implementation of appropriate mechanisms. However, successive Miscellaneous Tax Resolutions (RMF) postponed the system's entry into force. Ultimately, the final version of the rules was presented in the RMF for 2016, while the resolution for 2017 determined that the requirement should be met from July of that year. Accordingly, since late 2017, cigarettes packs sold in Mexico bear an alphanumeric code accompanied by a two-dimensional, machine-readable code.

On one hand, these codes could lay the foundation for a system to monitor and track tobacco products, which would help improve tax compliance and identify potential diversion of national production to the black market. However, the lack of transparency in the implementation process casts doubt on its effectiveness. In principle, recent RMF indicate that only the SAT can generate the security codes, but both the SAT itself or pre-authorized companies can act as providers of the codes for manufacturers and importers.[6] If the former is true, cigarette manufacturers and importers must:

- Print the code as part of the process of producing the cigarette packs or prior to importing them,
- Record and store the data contained in the security code,
- Supply the SAT with the data on entries online and in real time, and
- Implement all the technical and security features established by the SAT.
- Specifically, the code must be random and encrypted; include a graphic representation readable with mobile devices; and contain the following information visible to the user to authenticate the products:

[6] It is important to mention that the reform of the LIEPS approved in 2013 established that the code was to be handled through authorized third parties, but subsequent RMF opened the possibility that the SAT could act directly as provider of the codes.

a. Random security folio;

b. Place and line of production;

c. Manufacturing machine;

d. Date, time, and place of production;

e. Brand and commercial characteristics;

f. Number of cigarettes in the pack;

g. Country of origin and number of import permit, if applicable;

h. Federal Taxpayer Registry (RFC) and name of the producer or importer; and

i. Banner of the Ministry of Health "Smoking kills slowly."

j. No other physical high-security features are required (e.g., covert elements).

If authorized printing-service providers are employed, these providers have to carry out the printing, recording, storage, and submission of data derived from the code. However, to date, no certification process for authorized providers has been made public.[7] On the other hand, it is not clear who developed the technology to generate the codes and how the SAT acquired it (no public bidding process was implemented), how much it cost, and whether it was paid with public resources. In other words, it is impossible to rule out conflicts of interest in the implementation process and to assess the extent to which the code is under exclusive control of the SAT.

2.4 Health Markings on Tobacco Products

In accordance with the LGCT, packaging for tobacco products must contain the following:

» A pictogram or image covering 30 percent of the front of the package; rotating pictograms should be printed directly on the packages,

» A health message covering 100 percent of the back and one of the sides of the package; rotating health messages should also be printed and should include a telephone number at which to obtain information on prevention, cessation, and treatment of illnesses or adverse effects caused by tobacco consumption, and

» The caption "For sale exclusively in Mexico."

Warnings and textual information should be in Spanish on all packaging and external labeling of all tobacco products.

Although the LGCT entered into force in 2008 and its regulations in 2009, it was after the publication of the initial agreements of the Ministry of Health in September 2010 that the packaging started being printed as described above. These agreements set forth in detail

[7] According to recent RMF, the list of authorized providers (including name, fiscal address, website and RFC) would have to be published on the SAT's website, just as is done with other service providers.

the features and content of the health warnings and images. Originally, the images could be freely downloaded in high resolution from the Ministry of Health's website, but now they are only provided directly to authorized manufacturers and importers to prevent forgery of the images. So far, there have been nine rounds of warnings implemented, the last of which will be in force up to May 2020.

2.5 Health Import Licenses and Permits

Although smuggling is not expressly defined in the LGCT, the law provides for at least two measures that aim to prevent it. First, the LGCT establishes that all manufacturers or importers of tobacco products must have a health license from the COFEPRIS. This license is valid for three years, although it can be renewed as long as the administrative and technical requirements set forth in the RLGCT continue to be fulfilled. The administrative requirements include the payment of fees in the manner authorized by the SHCP and proof of legal personality, while the technical requirements refer to issues of hygiene, order, and other health-related aspects. Second, importers must request health permits from the COFEPRIS for each import process. The main objective of this permit is to verify that the merchandise entering the country corresponds to what the importer is claiming to import. These permits are only granted to holders of health licenses that comply with the applicable requirements and are valid for 90 days, which can be extended for another 90 days if the health authority's requirements continue to be fulfilled.[8] Importers of tobacco products must present the health permits at the time of customs clearance along with the customs declaration confirming payment of the applicable taxes (see Section 2.2).

Based on the foregoing, it follows that tobacco products brought in without health permits issued by the COFEPRIS are considered to be illegally imported and, consequently, are subject to the applicable security measures (e.g., seizure and destruction) and penalties. Penalties can range from 4,000 to 10,000 times the general minimum wage, according to the provisions of the LGCT.

As a result of its supervision activities, at least since 2014, the COFEPRIS has issued health alerts in which it includes the cigarette brands that do not fulfill the regulations regarding packaging and/or the import health permits. Generally speaking, these are "non-traditional" brands, meaning they are different from those of the corporations that dominate the cigarette market in Mexico (see Section 1.4) and, therefore, are not listed in the index of brands that the SAT periodically publishes, based on the information submitted to it by cigarette manufacturers and importers.

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[8] The requirements for requesting an import permit, according to the RLGCT, are: (1) Certificate issued by competent authority of the country of origin indicating that the tobacco product was manufactured in the country of origin, its physicochemical composition, the place of origin, with validity by batch or by certificate of free sale that mentions that this product is consumed without restrictions in the country of origin; (2) Copy of the establishment's health license; (3) Original label of origin; (4) Original label with which it will be marketed in Mexico; (5) Proof of payment of fees.

In 2017, the government announced a strategy called *Aduana Siglo XXI* (21st-Century Customs) to modernize Mexican customs by incorporating the best international practices. Some of the actions contemplated are: the use of new technologies to improve the detection of illicit products, the modernization of points of inspection to automate customs clearance, the elimination of cash payments, the simplification of procedures, and the implementation of import permits readable with mobile devices, among others.

2.6 Key Institutions in the Fight against the Illicit Trade

In general, illicit trade takes the form of administrative offenses and/or tax-related crimes or counterfeiting, which fall under the jurisdiction of the Federal Government. The most relevant authorities in the fight against the illicit tobacco trade are: the COFEPRIS, charged with verifying compliance with health regulations (packaging, health import licenses, and permits); the SAT, responsible for monitoring compliance with tax and customs regulations (import taxes and requirements); the PGR, charged with initiating criminal proceedings when necessary; and the IMPI, responsible for issuing an opinion in counterfeiting proceedings. Coordination among these multiple institutions is critical.

One of the measures implemented to improve interinstitutional coordination was the establishment of the *Mesa de Combate a la Ilegalidad*, in April 2013, at the initiative of the SAT. In addition to the COFEPRIS, the PGR, and the IMPI, the Ministry of Economy (SE) and the Federal Consumer Protection Agency (PROFECO) from the public sector are also involved, along with the Mexican Confederation of Industrial Chambers (Confederación de Cámaras Industriales de los Estados Unidos Mexicanos, CONCAMIN), the Confederation of National Chambers of Trade, Services, and Tourism (Confederación de Cámaras Nacionales de Comercio, Servicios y Turismo, CONCANACO), and the Mexican Confederation of Associations of Customs Agents (Confederación de Asociaciones de Agentes Aduanales de la República Mexicana, CAAREM) from the private sector. The main purpose of this task force is to promote joint action to identify, prevent, and combat major illegal practices relating to five products: alcoholic beverages, tobacco, automobiles, footwear, and clothing. However, although reports available for 2015 and 2016 provide an account of various positive results for sectors other than tobacco (e.g., increase in revenue collection, auditing, cancellation of licenses, etc.), in the case of tobacco, they only report the incidence of cigarette destruction (283 occasions with 51.09 million cigarettes destroyed by customs officials in 2016). Moreover, this initiative ignores the fact that the FCTC establishes specific guidelines on how governments and the tobacco industry, which is part of CONCAMIN, should interact.

3. Outcomes of the Strategy to Combat Illicit Trade

The health markings required on cigarette packs since late 2010 have drastically changed their appearance and, therefore, facilitated identification of illegal products. However, the most important reform with respect to combating illicit tobacco trade has been the introduction of the security code. That said, as of this writing, the code has only been in use for a few months, and critical details about the way in which it is being applied are still unknown. Specifically, the RMF stipulates that only the SAT can generate the codes, but there is no information on the technology that is being employed and the process followed to acquire that technology, as no public bidding process took place. In addition, although the LIEPS originally contemplated that the printing of the codes, as well as the registration, storage, and submission of data derived from the codes would be done through previously authorized independent third parties, the RMF indicates that the SAT can directly provide the codes to the manufacturers/importers. Since the SAT has not published a list of authorized providers, it must be acting as the provider of the codes, but it is not clear whether this will continue in the future. Finally, if the SAT itself generates and distributes the codes, but the producers/importers print them and store the data generated, it is unclear how the SAT guarantees that the flow of information is transparent. Given these conditions, rather than seeking to evaluate the outcomes of the policies, a brief review was done of the status of the illicit trade in Mexico in recent years.

According to the GATS, less than 1 percent of Mexican smokers consumed illegal cigarettes in 2009 (Sáenz de Miera Juárez and Zúñiga Ramiro 2013). More recent data indicate that this percentage stood at 2.7 percent in 2015; that is, there was a slight increase (Sáenz de Miera Juárez, et al. 2018). However, these figures are considerably lower than the global average and lower than the estimates for other Latin American countries, which generally stand at approximately 10 percent (Ramos 2009).

It is worth highlighting that two of the factors associated with higher incidence of illicit trade are the presence of criminal organizations and high levels of corruption. Given that both are serious problems in Mexico, it is possible that some of the previously described improvements, such as strengthening health controls, may have counteracted those factors to some degree and helped maintain a low incidence of illicit trade. However, more detailed studies are needed to better understand the situation.

Small-scale smuggling associated with cross-border shopping is another issue that merits attention. While some reports suggest that Mexico is most commonly the source of illicit trade between Mexico and the United States, historical smuggling trends seem to suggest the opposite (Colledge 2013). A recent report by the United States Government Accountability Office (GAO) also points in that direction (GAO 2017). In particular, the GAO focuses on high-volume cigarette sales of US duty-free stores located near the border that are largely smuggled into Mexico or diverted into the US market. While the magnitude of this problem is not estimated, and seizures by Mexican Customs authorities are presented as the main evidence, the GAO indicates that most of the cigarettes smuggled into Mexico are from "non-traditional" brands, i.e., brands that according to COFEPRIS do not fulfill the Mexican regulations regarding packaging and/or import health permits. If this is the case, the consumption of these cigarettes would be accounted for in the estimates of illicit cigarette consumption mentioned above. In other words, although there is evidence of smuggling at the country's northern border, its magnitude would be small. In any case, this situation exemplifies a side of the illicit-trade problem for which international cooperation is indispensable.

4. Recommendations

One of the main weaknesses of Mexico's strategy to combat the illicit trade in tobacco products was for many years the absence of a system for monitoring and tracking products manufactured in the country. Such a mechanism is indispensable to prevent tax evasion and to identify potential diversion of products for their illegal distribution, whether domestically or in other countries. However, with the implementation of the security code visible on Mexican cigarette packs since late 2017, it is possible for the first time to obtain data on characteristics including: the production line and location from which a pack originated; the production machine used; the date, time, and place of manufacture; the brand and commercial features; the number of cigarettes per pack; the country of origin and customs declaration number (in the case of imported cigarettes); and the Federal Taxpayer Registry (RFC) and name of the manufacturer or importer. Yet, because of the lack of transparency regarding the generation of the codes, it is unclear if this process is independent and free of conflicts of interest. As is stipulated in the rules included in the RMF, it is critical that the tax authority publish the list of security code service providers and periodically supply information about how the data generated are used. It is also important to consider that the security features of the code are relatively basic. Other successful tracking and tracing systems, such as the one implemented in Brazil, combine visible and non-visible elements to improve efficacy.

However, while control of domestic production is essential to combating illicit trade, the available evidence (e.g., alerts from COFEPRIS) indicates that the bulk of illegal tobacco products in Mexico are cigarettes that were illegally brought into the country. In this sense, although the process of enhancing the customs authority has begun, border controls must be strengthened, particularly at the country's southern border, where the presence of free zones impedes inspection processes. Regional cooperation in the drive to combat the illicit trade is indispensable.

Recent action to strengthen interinstitutional collaboration is certainly a positive step. However, given the tobacco industry's participation in the *Mesa de Combate a la Ilegalidad*, details of concrete collaborative actions between government bodies and the industry should be made public to eliminate possible conflicts of interest.

Also, it is important for the country to officially monitor the illicit trade in tobacco products. Even though in recent years the SAT has improved the recording of data on embargos in general, it does not have its own indicators of the magnitude of, and trends in, the illicit trade.

Finally, Mexico's relatively low rate of smuggling and relatively strong administrative capacity, including tax and customs, reinforce the arguments for the country to undertake much more vigorous action on tobacco tax reform. This is all the more the case as evidence accumulates that it is the effectiveness of customs and tax administration, and not comparative tax rates, that primarily drive illicit tobacco trade (World Bank 2017).

It is unfortunate that the affordability of tobacco products has been allowed to increase over the past six years, even though Mexico has otherwise been making efforts to reduce tobacco consumption and the resultant death and disease. Total cigarette excise taxes, specific and ad valorem, account for only 53 percent of the retail price of cigarettes in Mexico in 2018 (Fundación Interamericana del Corazón México 2018), as compared to the WHO recommendation of at least 70 percent (WHO 2010). Relevant steps called for by the World Bank (2017) include: "Go big, go fast. Attack affordability. Change expectations. Tax by quantity: replacing ad valorem excises with specific, preferably uniform, excise taxes." Following these steps maximizes health benefits by reducing "downward substitution," as well as increasing tax revenues and simplifying tax administration.

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"To tackle illicit trade is to tackle accessibility and affordability of tobacco products, to be more effective on the control of the packaging and to reduce funding of transnational criminal activities whilst protecting the governmental revenues from tobacco taxation." [i]

– Dr. Vera Luiza da Costa e Silva
Head of the Secretariat of the WHO Framework Convention on Tobacco Control

"Governments around the world must waste no time in incorporating all the provisions of the WHO Framework Convention on Tobacco Control into their national tobacco control programmes and policies. They must also clamp down on the illicit tobacco trade, which is exacerbating the global tobacco epidemic and its related health and socio-economic consequences." [ii]

– Dr. Tedros Adhanom Ghebreyesus, Director-General
World Health Organization

"Tobacco still remains the biggest avoidable cause of premature death in the EU, and the illicit trade in tobacco facilitates access to cigarettes and other tobacco products, including for children and young adults. In addition, millions of euros in tax revenues are lost every year as a result of the illicit trade. [iii]

– Commissioner Vytenis Andriukaitis
Health and Food Safety / European Commission

"Given their light weight, small size, and high value, tobacco products are susceptible to fraud through illegal trade, production, and cultivation. . . Illegal trade is a context-specific activity that has various modus operandi and therefore requires multi-dimensional context-specific solutions." [vi]

– Patrick Petit (Senior Economist) & Janos Nagy (Senior Economist)
Fiscal Affairs Department / International Monetary Fund

"Effective tobacco tax regimens that make tobacco products unaffordable represent a 21st century intervention to tackle the growing burden of noncommunicable diseases. We are convinced that, working together with WHO and other partners in support of countries, we will be able to prevent the human tragedy of tobacco-related illness and death, and save countless lives each year." [v]

–Dr. Tim Evans (Senior Director) & Patricio V Márquez (Lead Public Health Specialist)
Health, Nutrition and Population Global Practice / World Bank Group