

Tobacco Taxes in Indonesia

Based on: *Tobacco Economics in Indonesia*. Sarah Barber, Sri Moertiningsih Adioetomo, Abdillah Ahsan, Diahadi Setyonaluri. 2008.

Low real cigarette prices, population growth, rising household incomes and mechanization of the *kretek* industry have contributed to sharp increases in tobacco consumption in Indonesia since the 1970s. The customs law states that excise tax should be used to reduce consumption of tobacco products. Increasing tobacco taxes is the most cost-effective way to address the health and economic loss due to tobacco consumption.

Tobacco Consumption is High

There are 57 million smokers in Indonesia¹:

- 34% of Indonesians smoke (2004), an increase from 27% in 1995.
- 97% of tobacco users smoke cigarettes; the majority (88%) of smokers use *kreteks*.
- 78% of smokers start before age 19. The average age of smoking initiation is 17.4 years of age.
- More than 97 million nonsmokers are regularly exposed to second-hand smoke, including 70% of all children under the age of 15.

Figure 1: Percentage of People that Smoke, by Gender, in Indonesia, 2004



Source: Prevalence data based on SUSENAS estimates of smoking prevalence and reports of smoking among family members, in the Tobacco Sourcebook, Ch 2, 2004.

Lack of Information

Indonesians lack information and are misinformed on the risks of tobacco and the addictive nature of tobacco.

- Striking differences in smoking prevalence are correlated with educational levels: 73% of males with no or incomplete primary education smoke, compared with 48% of males with college education²—which suggests a need to clearly communicate health risks.
- Javanese boys 13-17 years of age could repeat the health warnings on cigarette packs, but also claimed that smoking one to two packs per day was not harmful to health.³ Children are socialized early on

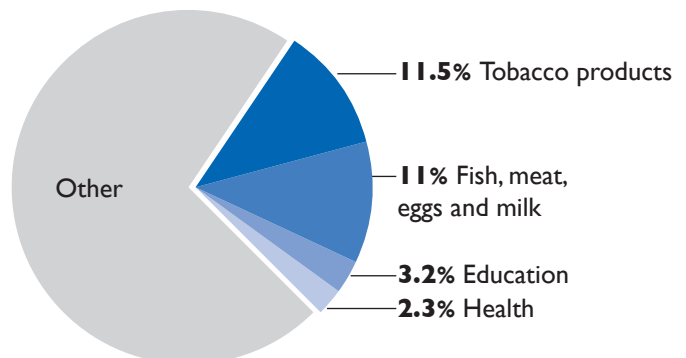
to consider smoking normal and socially acceptable.

- Unlike those who use highly addictive but illegal substances, smokers have many opportunities to purchase tobacco and are confronted with advertisements that promote tobacco use as socially acceptable.⁴ In a survey conducted between 2004 and 2006, nearly all (89 to 95%) of the young people surveyed saw a cigarette billboard advertisement in the past month.⁵

Impact of Tobacco Use

- Smoking kills at least 200,000 people each year in Indonesia.⁶ The disease burden and mortality rate will continue to increase over the upcoming decades at current consumption levels.
- Up to one-half of current smokers will die of tobacco-related diseases.⁷
- Health care costs for tobacco-related illnesses in Indonesia could amount to between Rp 2.9 and 11.0 trillion per year (\$484 million USD to \$1.2 billion USD.)^{8,9,10}
- High household expenditures on tobacco have serious welfare implications. In 2005, Indonesians spent 11.5% of household income on tobacco products, compared with 11% of available income on fish, meat, eggs and milk combined, 3.2% for education, and 2.3% on health.¹¹

Figure 2: Household Income Expenses in Indonesia, 2005



Source: SUSENAS, Tobacco Sourcebook, Ch 2, 2004.

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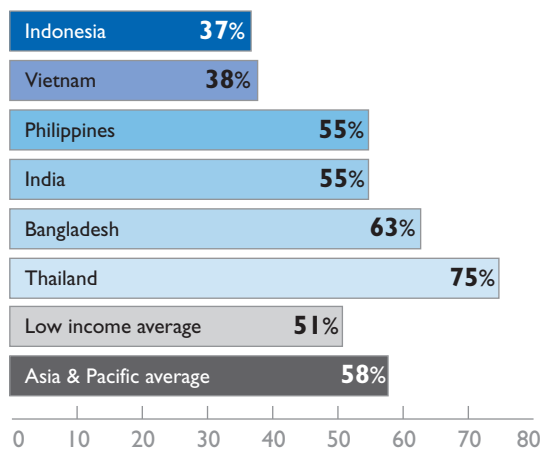
Higher Taxes Reduce Smoking

The most effective way to reduce tobacco use is to raise the price of tobacco through tax increases. Higher prices discourage youth from initiating cigarette smoking and encourage current smokers to quit.

Tobacco Taxes in Indonesia are Low

Cigarette prices and tax rates in Indonesia are low relative to other low-income countries and the regional average.

Figure 3: Tax Rate as a Percent of Price (2004 to 2005)



Source: Ayda Yurekli, Presentation to meetings on tobacco economics, Bloomberg Foundation, New York, November 2007

- Tobacco products have become more affordable over time as prices have remained stable, household income has grown, and tobacco products are made available at disparate prices that are affordable for all income groups.
- The current tobacco tax structure is one of the most complex in the world—based on the type of tobacco production, mode of production (machine or hand-rolled) and industry production scale. The tax system promotes gaps in prices between products.
- The tobacco tax averages 37% of sales price.¹² This is low compared with the global benchmark of 70% of sales price. The tax rate is 31% of the government

retail price (HJE); the maximum allowable tax rate by Indonesian law is 57% of HJE.

Employment in Tobacco Farming and Manufacturing is Low

- Tobacco farming and manufacturing contributes less than 1% of total employment (1996-2006 data).^{13,14}
- The contribution of cigarette manufacturing to total manufacturing employment has declined steeply over time from 28% in 1970 to less than 6% today.
- Tobacco manufacturing wages rank low, at 20th of 24 manufacturing sectors—an average of Rp 660,000 (\$73 USD) per month.¹⁵
- Despite preferential tax policies to promote tobacco production by small firms, contribution to total production by small firms declined from 23% in 2000 to 11% in 2005; 71% of market share is held by three companies.
- Farmers that cultivate tobacco and clove already have very diverse crop holdings and engage in other farm and non-farm enterprises. Alternative crops exist.

Raising Tobacco Taxes has a Positive Impact on the Economy

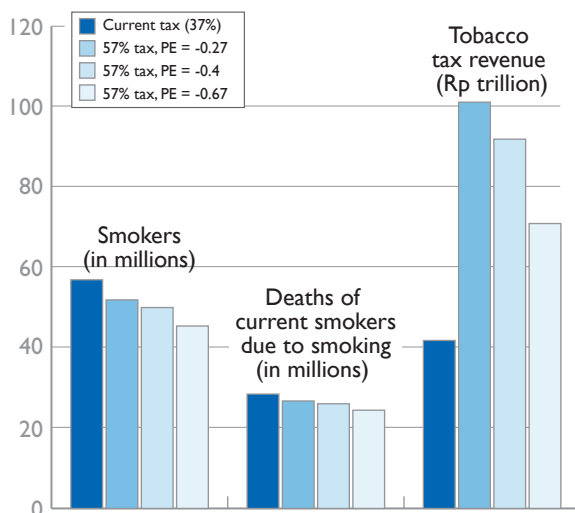
- Simulations that predict the overall economic impact of doubling the tobacco tax rate report a net positive economic output. These simulations suggest that 60 economic sectors would benefit from a decline in household spending on tobacco, which is reallocated to other commodities or investments. Economic output could increase by Rp 335.4 billion (\$36.9 million USD); household income could increase by Rp 491.6 billion (\$54.1 million USD).
- Tobacco taxes would have a net positive effect on employment and the economy. Research simulating a doubling of the tobacco tax reports a net positive increase in employment of 281,135 jobs. This is primarily because farming and manufacturing are not ranked high in terms of economic output, employment and wages in Indonesia.

Tobacco Taxes in Indonesia

Tobacco Taxes Save Lives, Increase Government Revenue, and Improve the Economy

Implementing the maximum legally allowable tax rates could prevent 1.7 to 4.0 million tobacco-related deaths and generate additional revenues of Rp 29.1 to 59.3 trillion (\$3.2 to 6.5 billion USD). 5.0 to 11.5 million smokers would quit smoking. Younger and low income people would benefit the most because they are more sensitive to tobacco price increases.

Figure 4: Impact of Increasing Tobacco Tax to the Maximum Legally Allowable Rate (57% of Government Retail Price [HJE]) Using Three Price Elasticity (PE) Estimates



Recommendations

- Use the earmarked tobacco excises to support local economies that could be negatively affected by reductions in tobacco consumption, and to implement tobacco control programs more broadly.
- Set tax rates at a level to correct for market failures related to lack of information regarding the risks of tobacco and the addictive nature of tobacco, and to reflect the true costs of smoking to individuals and society.
- Simplify the excise tax system by:
 - eliminating production tiers,
 - using a uniform specific tax,

- implementing tax increases across all tobacco products, and;
- automatically adjusting the specific tax for inflation.

- Implement the maximum legally allowable excise tax rate for all tobacco products.
- Re-examine the employment generation goal of the tobacco tax system to determine whether other programs or policies would be more effective.

This research was funded by the Bloomberg Initiative to Reduce Tobacco Use.

- 1 Prevalence data based on SUSENAS estimates of smoking prevalence and reports of smoking among family members, in the Tobacco Sourcebook, Ch 2, 2004.
- 2 National Socio-Economic Survey 1995, 2001, 2004. Aceh and Maluku not included in 2001. Respondents in 2004 were 15 years and older.
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- 4 Jha P, Chaloupka FJ, Moore J, Gajalakshmi V, Gupta PC, Peck R, et al. Tobacco addiction. Disease Control Priorities in Developing Countries (2nd Edition), ed. , 869-886. New York: Oxford University Press. DOI: 10.1596/978-0-821-36179-5/Chpt-46, 2006.
- 5 Centers for Disease Control and Prevention, Global Youth Tobacco Surveys Country Fact Sheets. Indonesia, 2004-2006.
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- 8 Kosen 2004.
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- 11 SUSENAS, Tobacco Sourcebook, Ch 2, 2004.
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- 13 Ministry of Agriculture, December 2006, BPS (Sakernas) and Ministry of Agriculture, various years. Demographic Institute, University of Indonesia.
- 14 World Bank, Ministry of Industry, Demographic Insitutute, University of Indonesia.
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