

HIGHER TOBACCO TAX BENEFITS THE INDONESIAN ECONOMY

Policy Brief
Center for Indonesia's Strategic Development Initiatives
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BACKGROUND

Indonesia has one of the highest rates of tobacco use in the world: approximately 38% of the country's adult population consumed tobacco products in 2018 and use has been steadily increasing over the past decade. High smoking prevalence imposes a significant cost: in 2019, it accounted for 17% of deaths and 21% of chronic illnesses. Estimates for the direct health care costs from smoking attributable diseases in 2019 ranged from Rp17.9 trillion to Rp27.7 trillion, equal to 0.1 to 0.2% of gross domestic product.

Despite these catastrophic effects of smoking, tobacco control policy in Indonesia has not been adequate to markedly reduce tobacco consumption. The recurring argument of the crucial role of tobacco industry in generating tax revenue and creating jobs, and the adverse impact tobacco taxation would have on the industry and economy as a whole have created a formidable barrier to the implementation of effective tobacco control measures.

This policy brief is based on a recent study (Bella et al., 2021) on the impact of tobacco tax on the Indonesian economy, which estimates the impact on total output, income, and employment due to increasing excise taxes on kretek and white cigarettes.

APPROACH

Three tax increase scenarios were simulated: the first is the 2020 level of tax increases, in which kretek and white cigarette excise taxes are increased by 23.78% and 27.15%, respectively. The second and third scenarios assume that cigarette excise for both kretek and white cigarette are increased by 30% and 45%, respectively.

The Input-Output analysis estimates the economic impacts of tobacco tax through three pathways: (1) the increase of cigarette tax rate would drive up price, which in turn, would lead to a reduction in cigarette demand; (2) the reduction of cigarette demand would shift household spending allocation away from cigarettes to other commodities; and (3) the cigarette tax rate increase would generate additional revenue, which in the end, would be allocated to various sectors according to government expenditure policy.

KEY FINDINGS

A higher cigarette tax would lead to a greater reduction in cigarette consumption. As illustrated in Figure 1, it is estimated that the 2020 tax increase would reduce the quantity of consumed kretek and white cigarettes by 17.32% and 12.79%, respectively. Meanwhile, increasing the cigarette tax by 30% would decrease consumption by 20.62% of kretek cigarettes and 14.24% of white cigarettes. Furthermore, increasing the cigarette tax by 45% would reduce the demand for kretek cigarettes by 27.74% and would reduce demand for white cigarettes by 19.50%.

A higher cigarette tax would also generate higher tax revenue. Figure 2 shows that the 2020 rates of increase would generate an additional Rp 4.68 trillion (2.41%) in tax revenue from kretek and white cigarette sales. Meanwhile, increasing the cigarette tax by 30% and 45% would generate an additional tax revenue by Rp 5.72 trillion (2.95%) and Rp 7.92 trillion (4.08%), respectively.

Figure 1. Impact of cigarette tax increase on cigarette consumption

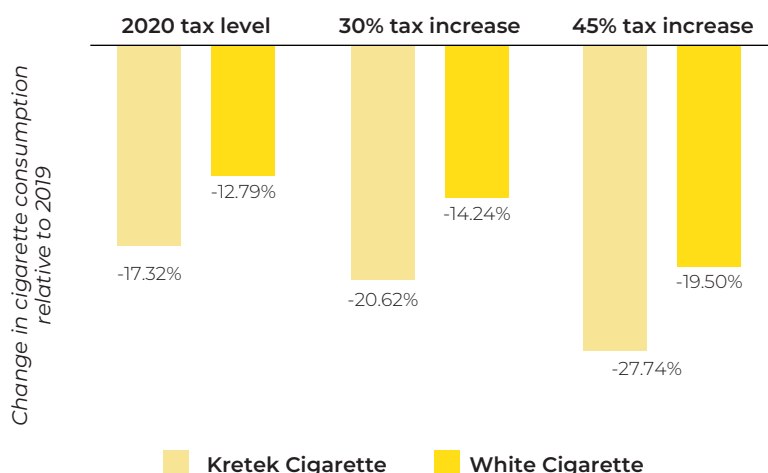
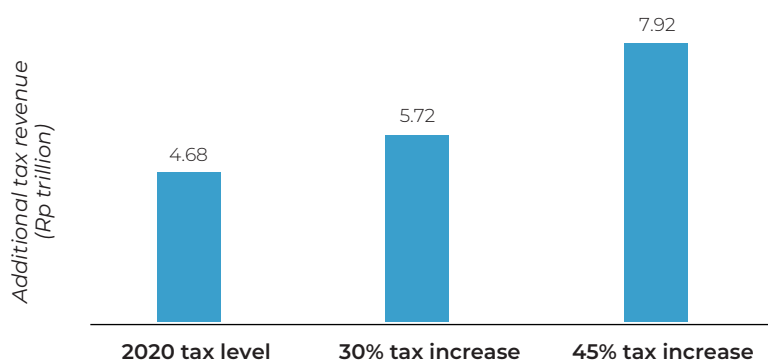


Figure 2. Impact of cigarette tax increase on tax revenue



A cigarette tax increase would bring a net positive impact in terms of aggregate economic output, employment, and income to the economy. The net positive impacts are largely from government spending as effects from reduced cigarette consumption and households' spending reallocation merely offset each other.

As illustrated in Figure 3, it is estimated that a tax increase similar to that in 2020 under the current spending allocation would increase the total output by Rp 15.14 trillion (0.05%),

while the 30% and 45% tax increases would increase it by Rp 18.70 trillion (0.06%) and Rp 26.24 trillion (0.08%), respectively. In terms of employment (Figure 4) and income (Figure 5), the 2020 tax increase would generate 75.89 thousand (0.06%) additional jobs and Rp 4.07 trillion (0.08%) more income to the economy. Meanwhile, increasing the tax by 30% would add over 99.14 thousand (0.08%) new jobs (Rp 4.89 trillion or 0.09% of additional income) and a 45% tax increase would result in over 148.81 thousand (0.12%) additional jobs (Rp 6.61 trillion or 0.12% of additional income).

Figure 3. Impact of cigarette tax increase on economic output

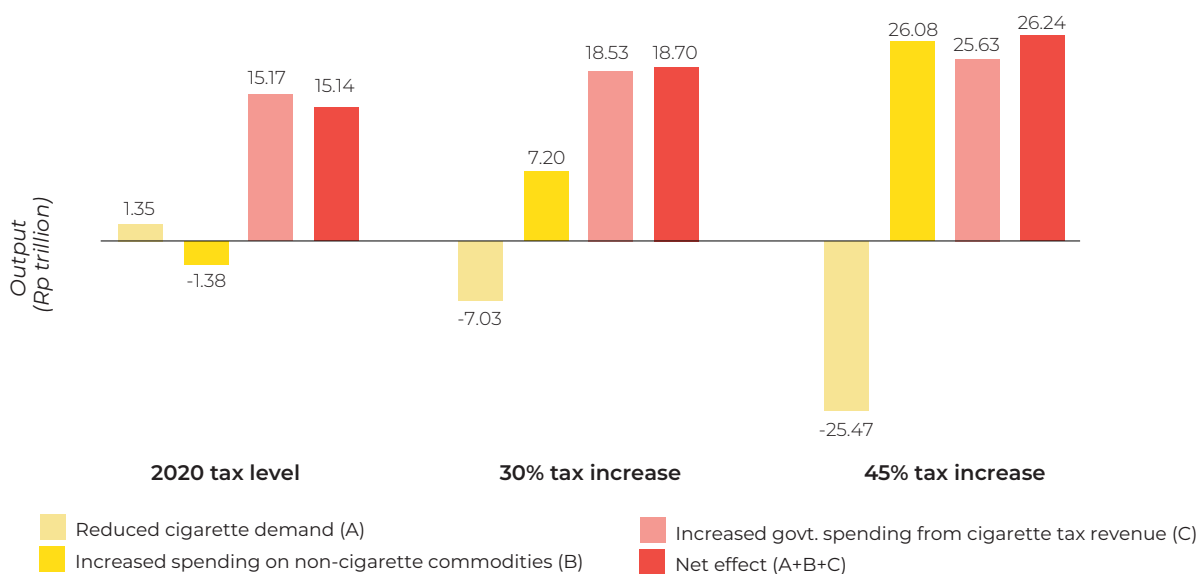


Figure 4. Impact of cigarette tax increase on jobs

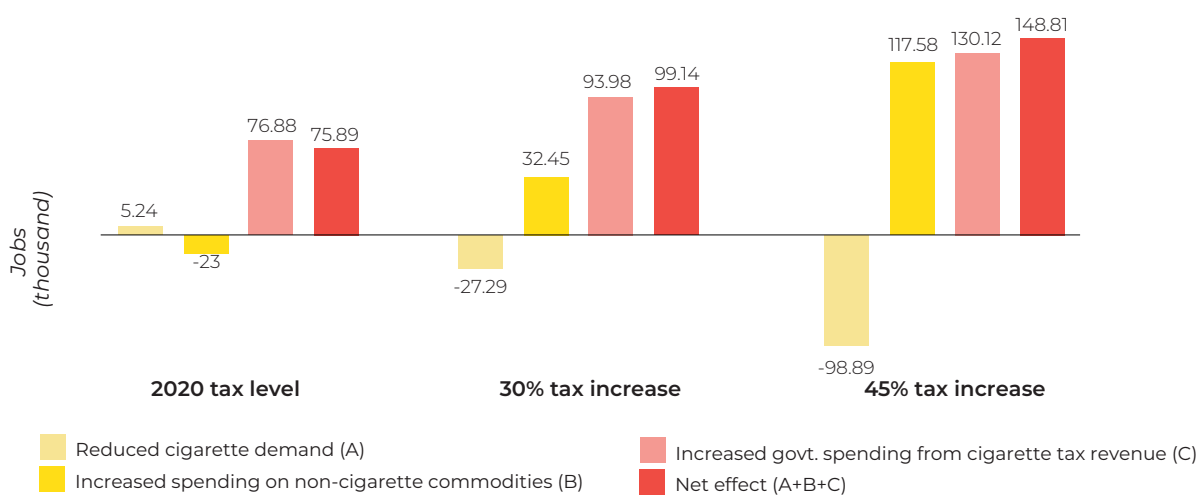
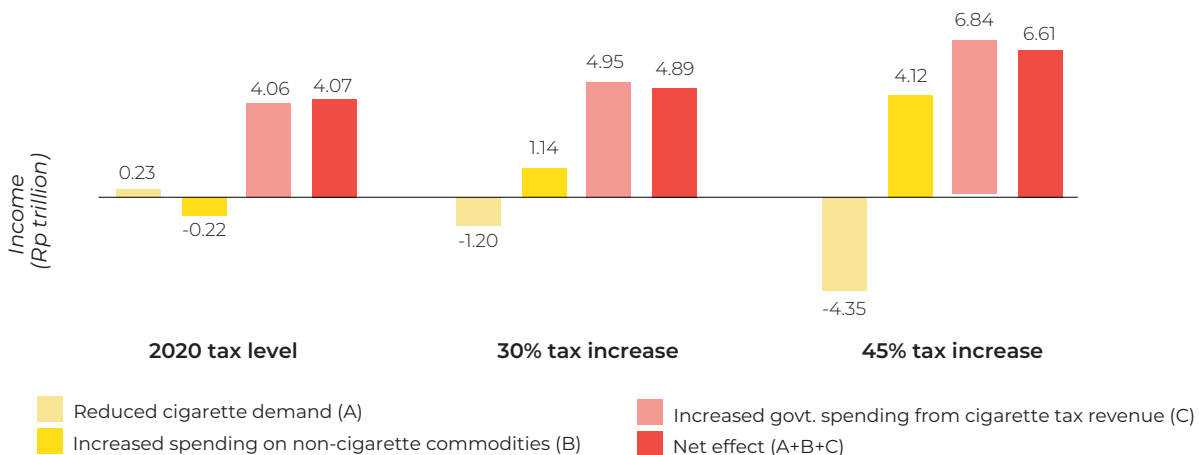


Figure 5. Impact of cigarette tax increase on income



POLICY RECOMMENDATIONS

Therefore, the following policies are recommended:

1. Significantly increase the tobacco tax.

The findings reiterate long-standing evidence of effectiveness of price measures in reducing cigarette consumption. Increasing the cigarette tax is not only effective in reducing smoking, but also benefits the economy, as it would generate a net positive impact in terms of total output, employment, and income.

2. Accelerate the simplification of cigarette tax tiers.

The findings suggest that smokers substitute more expensive white cigarettes with less expensive kreteks, thereby undermining the effectiveness of cigarette tax in reducing tobacco consumption. This is particularly the case in Indonesia which currently has ten tiers of cigarette price. Therefore, the government should follow through on implementation of the Ministry of Finance's roadmap to simplify cigarette tax into five tiers by 2021.

3. Manage the transaction costs created by declining cigarette consumption.

Reducing cigarette consumption is mandated by the Medium-Term National Development Plan (RPJMN). Certainly, any rapid decline in tobacco consumption could create transitional problems, which are manageable through collaboration. The National Development Planning Agency (Bappenas) and the Coordinating Ministries should instruct the Ministry of Manpower to provide transitional income support and job training to affected workers; the Ministry of Agriculture to strengthen the supply and value chains for alternative products in tobacco-and clove-growing areas; the Ministry of Social affairs to deliver support through existing social assistance programs; and the Ministry of Cooperatives and SMEs to facilitate access to credit for farmers.

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About CISDI

CISDI is a civil society organization whose area of focus include strengthening health policy implementation in Indonesia, empowering youth, and communities at the grassroots level, as well as advocating the mainstreaming of the SDGs into the National Development Agenda. Related to tobacco control specifically, CISDI has supported the advancement of tobacco control policy in Indonesia through research and community mobilization.

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