

The tax rate of tobacco in indonesia economics essay



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" Indonesia is third country with the most smokers in the world, which reached up to 65 million" (Dwijayadi & Soebijoto, 2010). This is dangerous and also beneficial for the country at the same time. The benefit is government will get more revenue from the cigarette taxes and it also generates revenues for tobacco farmers. However, is the benefit of tobacco industry exceeds the danger of cigarettes?

Government gains huge revenue from tobacco industry. According to Khalid, the revenue that the government gained from cigarette tax is about 10 percent from the whole revenue in Indonesia (). However, the government still imposed low tax on cigarettes compared to ASEAN countries.

Government also did not want to join Framework Convention on Tobacco Control

The consumers are on the contrary suffering the negative impact of tobacco industry. Cigarettes are not only deteriorating the health of the smokers, it also affects the people around it (passive smokers). Health is not only the tobacco industry is attacking. According to smallcrab, a health website, cigarette consumption is one of the reasons that caused poverty in Indonesia ().

Farmers of tobacco are also affected by the policy that the government make regarding to the policy of cigarette tax. They are threatened to lose their job because the government is raising the cigarette tax. However, this does not happen overnight, government can create new work field for these tobacco farmers.

There are a lot of people that is being affected by tobacco industry. In this paper, writer will discuss about the impact of tobacco industry in Indonesia. Also, writer will determine whether government should increase cigarette tax or not.

1. Introduction

Cigarette has created mass amounts of revenue and contributed to Gross National Product in Indonesia. Many industries have produced cigarettes in all kinds of forms and prices. Currently, Indonesia placed as the third country who consumes most cigarettes. This is somehow beneficial and dangerous at the same time. The benefit is that the country adds their Gross National Product and increase revenue from the cigarettes. The dangerous part is that more consumers are potential to have lung cancer in the future.

Government has made a lot of regulations regarding to this problem. The objective is to decrease the consumers of cigarettes because it is degrading the health qualities of the consumers and deteriorating the nature. " The regulations that has been made in Indonesia regarding to cigarettes are 'Chapter 9 : Kawasan tanpa Rokok, Pembatasan Promosi Industri Tembakau untuk Anak dan Remaja, Kemasan dan Pelabelan, Peringatan Kesehatan dan Tuntutan Umum' ; this regulates the place to use cigarettes and the prohibited cigarette usage and promotion in Indonesia, 'PP no 19 : Tentang Pengamanan Rokok Bagi Kesehatan' ; 'UU Pajak Daerah dan Retribusi Daerah No 28 Tahun 2009 : Pajak Rokok' this regulates the prohibited usage of cigarettes for maintaining the society's health, ; this regulates the taxes levied on cigarettes, etc" (Siswanty, 2010).

" Currently, the taxes levied on cigarettes are varied depending on the type of cigarette. The prices of cigarettes are varied too according to the raw materials, the tax levied, and the brand image" (Djutaharta, Surya, Pasay, Hendratno, & Moetiniingsih, 2005). The more taxes levied on the cigarettes, the more expensive the price of cigarettes. The purpose of the excise tax on the cigarettes is to decrease the consumers of cigarettes. According to Adioetomo et al. (2001) " the increasing of tax on cigarettes by 10 percent will decrease the number of cigarette consumers by 3 percents, also increasing government revenue from the cigarette tax by 6, 7 percent" (Djutaharta, Surya, Pasay, Hendratno, & Moetiniingsih, 2005). This proves that the tax levied on cigarettes is beneficial to the government and to the environment. However, there are controversies relating to the increasing of cigarette tax in Indonesia. " The head of GAPRI (Gabungan Perserikatan Pabrik Rokok Indonesia), Ismanu Soemiran said that the tax levied on cigarettes could hurt the farmer of tobacco and clove" (Ketua GAPRI: Pajak Rokok Berganda Rugikan Petani, 2009). This is because factories will delay the purchase of the raw materials from the farmer and the farmer will suffer loss.

There are a lot of controversies regarding to the cigarette tax. It is said that the cigarette tax in Indonesia is low comparing to other countries such as Vietnam, Philippines, India, Bangladesh, and Thailand. In this paper, we will discuss and analyze the impact of increasing and decreasing of cigarette tax. Writer will also find out whether the government should increase the tax of tobacco in Indonesia considering the benefits government, consumers, and tobacco farmers.

2. Cigarette Tax in Indonesia

" Cigarette is a shredded tobacco that is wrapped in a cylindrical paper form" (Martin, 2008). Cigarettes have been used by people to smoke tobacco and could lead to addiction. This carries problem to both active and passive smokers. " Smoking could cause many problems and diseases such as heart attack, infertility, impotency, asthma, lung cancer, bronchitis, and other dangerous diseases" (Djutaharta, Surya, Pasay, Hendratno, &Moetiningasih, 2005). " It also causes the passive smokers to have breathing diseases and could cause sudden death to babies and infants" (Djutaharta, Surya, Pasay, Hendratno, &Moetiningasih, 2005). The number of deaths caused by cigarettes is increasing every year.

Cigarette usage in Indonesia is a serious concern to the government. Indonesia is the third country with the most smokers. According to Tobacco Economics in Indonesia, " In Indonesia, there are 57 million people smoking cigarettes, 63 percent of them are adult male smokers and 4, 5 percent of them are adult female smokers" (Barber, Adioetomo, Ahsan, & Setyonaluri) . This has been a concern of government. The numbers of smokers in Indonesia has been increasing throughout the year. " It can be seen in the chart 1. 1 that smokers in Indonesia have been increasing from 1970 -2001" (Djutaharta, Surya, Pasay, Hendratno, &Moetiningasih, 2005).

Chart 1. 1

In this chart, writer compares the number of consumers smoking to the price of real cigarettes. Apparently, it is shown in the chart that for the last 32 years, the number of smokers in Indonesia is constantly increasing despite

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the increasing price of cigarettes. It fluctuates, however still not decreasing the number of smokers. This proven that the society has not aware about the danger of smoking and what it does to other people.

Government has made regulations and restrictions due to this problem. The objective of the regulations and restrictions is to reduce the number of smokers in Indonesia. " In order to reduce the number of smokers, government has made regulations to all tobacco industry to put a label on a cigarette pack written 'Government warning: Smoking damages health'" (Djutaharta, Surya, Pasay, Hendratno, &Moetinarsih, 2005). Government also restricted public area to become a place to smoke. Government created non-smoking areas such as in restaurants, malls, hospitals, etc. " Cigarettes commercial also being banned by the government to show cigarettes commercial and only allowed to show it between 21: 30 - 05: 00" (Djutaharta, Surya, Pasay, Hendratno, &Moetinarsih, 2005). However, these regulations did not effectively reduce the number of people smoking.

Government then raises the tax levied on cigarettes. This has been the most effective way to reduce the number of smokers in Indonesia. According to Adioetomo et al. (2001), " the increasing of tax on cigarettes by 10 percent will decrease the number of cigarette consumers by 3 percents, also increasing government revenue from the cigarette tax by 6, 7 percent" (Djutaharta, Surya, Pasay, Hendratno, &Moetinarsih, 2005). This argument supports that the increasing tax of cigarettes connected to the decrement of smokers in Indonesia.

In chart 1. 1, it is shown that the number of cigarettes consumers fluctuates between year 1970 - 2001. It can be seen that the number of smokers is increasing every year this can be caused by two factors, low price of cigarettes and increasing income. During 1980 until 1982, the real price of cigarettes was at the peak and the consumers of cigarettes starting to decrease. From 1980, the price of cigarettes is increasing nominally from year to year. In 1990, it increases from Rp360, 00 per pack in 1980 to Rp700, 00 per pack. In 2000, the price of cigarette per pack is Rp2. 955, 00, however this does not decrease the number of smokers. This is probably because the increasing of income and purchasing power of consumers.

Chart 1. 2 : Cigarette Tax Rate 2004-2005

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

According to chart 1. 2, Indonesia still has the lowest percentage of cigarette tax comparing to other low income countries. The average of tax levied on tobacco is approximately 37% of sales price (Barber, Adioetomo, Ahsan, & Setyonaluri). " If compared to the global benchmark which is 70% of sales price, Indonesia cigarette tax rate is still low"(Barber, Adioetomo, Ahsan, & Setyonaluri). " Indonesia's government has regulated that the minimum tolerable cigarette tax is 31 percent of HJE (Harga Jual Eceran) and the maximum tolerable cigarette tax is 57 percent of HJE" (Barber, Adioetomo, Ahsan, & Setyonaluri). According to Wahyuningsih, WHO rate Indonesia as a country that is afraid of raising the prices and taxes on cigarettes

(Wahyuningsih, 2010). This is why the tobacco industry in Indonesia is successful. The government imposes low taxes and prices on the tobacco.

3. Implications of Tobacco Taxes

3. 1 The implications of Tobacco Industry on Indonesian Government

Tobacco industry sector is one of the popular topics relating to the economy. Many sources in media information inform that tobacco industry is a "gift" for the economy. On the contrary, there is also another group of people who does not agree with this statement. People who gain benefit and active in the industry of tobacco will tend to defend argument that supports the existence of tobacco. Others who disagree will always find the negatives of tobacco use.

For this section, this paper will examine the effect of tobacco industry towards sectors in economy and probably in other areas too.

One impact which is very "felt" by the government is tobacco taxes. Based on data from research and development of Ministry of Health Indonesia (Litbang Depkes) in year 2008, tobacco tax rate in Indonesia is placed in five from last position in ASEAN countries. As a matter of fact, six cigarette companies contribute around eighty eight percent of one hundred percent Indonesian government revenue from tobacco taxes (L. Barbara, et al; 2011). These facts shown that price of tobacco in Indonesia are quite cheap compared to other ASEAN countries. However, the two facts presented gives people assumption that even though Indonesia has a low tax rates; tobacco industry still become one of many sources of revenue stream for government.

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Increase in tobacco taxes is proven to reduce the consumption and demand of tobacco products (i. e. cigarettes). One research of the World Bank makes a strong statement that ten percent increase of tobacco products will reduce global demand about 4% - 8%, on average, and prevent the death of 10 million people (). As an addition, Universitas Indonesia conduct almost similar research which come up with a conclusion " 10% increase in cigarettes prices then it will reduce 17% consumption of poor family"()

Positive effect on the increase of tobacco industry will trigger the increase of government's revenue. A study from World Health Organization (WHO) in 2003 says that 10% increase in tobacco product price will increase government's revenue about 7% ().

Eventually, applying a concept to increase tobacco prices is not easy and caused several negative impacts on Indonesia. This policy will eventually trigger the decrease in terms of demand towards tobacco products. This is not good as production is about to be reduced and industry may cut their budgets on work force. In any case, it will decrease the distribution of tobacco to the Indonesia Tobacco Industry. Farmers will lose some of their income which could result on welfare of their family. Not only farmers, retailers also might get affected on their income.

The good news is the risk to apply an increase in tobacco products is not significant as it worried by the government upfront. This statement is supported by the data which is gathered from analysis of tobacco economy in Indonesia. Data from Ministry of Agricultural (2002) found out that 900.000 workers are equal to 2, 3 % of agricultural workers or 1% population of

100% formal workers in Indonesia (). Tobacco crops are also seasonal and its plantation is concentrated on several fields in Indonesia. In addition, fields used to plant tobacco is less than 1% of seasonal field crops which 96% of it located on Eastern Java, Middle Java, and Nusa Tenggara Barat ().

Badan Pusat Statistik Indonesia stated that tobacco industry is ranked at 48 out of 66 sectors referring to absorption of work force in Indonesia.

Contribution of tobacco industry towards work force absorption in industrial sectors was drastically decreasing from 28% in 1970s to less than 6% and below 1% of total work force absorption from all sectors. The reason behind these statistics is the mechanization in 1970s. This new technology allows technology to be able to replace human in manufacturing the cigarettes. The difference, in terms of cost, between manufacturing with mechanic and human is about 11%. Therefore, it is logical why tobacco industry choose mechanization manufacturing rather than human manufacturing. Total of cigarettes company fluctuated from time to time, but distribution keeps concentrating in 14 districts geographically during 1960 - 1990. Majority of these cigarettes industry is located on Eastern and Middle Java.

Based on Demographic Institution from Faculty of Economic University of Indonesia (2007), increasing tobacco taxes by 100 % will caused divert family spending from cigarettes to other goods and service products about 335 billion rupiah and increasing society income for 492 billion rupiah also creating about 300 thousands work force nationally.

Information which already explained before implicate the positive impact of increasing tax rate of tobacco is bigger rather than its negative impact. This

policy is appropriate for Indonesia as it could possibly affect the increase welfare level of its people.

In addition, the Indonesian government is not willing to sign the Framework Convention on Tobacco Control (FCTC) or tobacco control convention that has been signed by 160 countries.

according to Seputar Indonesia, tobacco industry in Indonesia believes that government must be more concerned with economic growth, including tax revenue than the health of its people.

According to smallcrab. com, a website on health and etc, states that perhaps, the reason why Indonesian government is unwilling to increase the tax on cigarette is that the cigarette tax produces large revenue to the country, it is said that it is around 10% of the country's revenue.

Pros:

The government will lose revenue if they raise taxes on the tobacco industry because fewer people will buy cigarettes.

Cons:

The evidence is clear: calculations show that higher taxes would indeed reduce cigarette consumption but does not reduce government revenue, quite the opposite. This could occur because the amount of decrease in cigarette consumers is not comparable with the amount of tax increase. Consumers who are already addicted to cigarettes will usually respond slowly to rising prices (will keep buying). Furthermore, the

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amount of money saved by those who quit smoking will be used to purchase other goods (the government will continue to receive income). Instead, raising cigarette taxes, no matter how high, will never cause a reduction in government revenues.

3. 2 The implications of Tobacco Industry on Consumers

In this section, we will discuss on the implications of the tobacco industry on Indonesian people especially consumers. As we know, cigarettes have a bad impact on people whether it is active smokers or passive smokers. It deteriorates the health of people and causing dangerous disease. However, it is not the only problem; cigarettes also have a bad impact on welfare of people. According to a researcher of Demographic Institute Faculty of Economics, University of Indonesia, Abdillah Hasan, he said " I've found the testimony there is a driver earning 50 thousand a day with four children, two children not attending school by reason of cost. Strangely, the driver was able to spend money Rp24 thousand per day to buy three pack of cigarettes. "() This is a huge problem to the economy of Indonesia. According to a smallcrab. com, a website about health, consumption of cigarettes is believed to be one of the indicator of poverty in Indonesia over the years, it results in not only reduced revenue, reduced monthly family expenditures, it also leads to death ().

There are many smokers in Indonesia who are addicted to cigarettes. According to Khalid, people believe that addiction to cigarettes is so high, raise taxes cigarettes will not reduce demand for cigarettes. Therefore there is no need to raise the cigarette tax. The fact is raising cigarette taxes will

reduce the number of smokers and reduce deaths caused by smoking. Increased cigarette prices would make some smokers to quit and prevent others to become smokers. Cigarette tax increase also will reduce the number of people who resumed smoking and reduce cigarette consumption in people who are still

smoking. Children and adolescents are groups that are sensitive to cigarette price increases and therefore they will reduce the purchase of cigarettes when cigarette taxes are raised.

In addition, people with low income are also more sensitive to price increases; therefore increasing cigarette tax would greatly affect the purchase of cigarettes in developing countries.

The model developed by the World Bank in its report *Curbing the Epidemic* shows the increase in cigarette prices as much as 10% because of higher cigarette taxes will make 40 million people living in 1995 to quit smoking and prevent at least 10 million tobacco deaths.

3. 3 The implications of Tobacco Industry on Tobacco Farmer

The tobacco industry has a great impact on people, especially for its' own producer, tobacco farmer. Setting stricter law against the tobacco industry will result in job losses at the level of tobacco farmers and cigarette manufacturers. How often we hear that 2 million tobacco farmers would lose their jobs. Then 1. 5 million clove farmers, 600, 000 workers in cigarette factories, 1 million people cigarette merchants, and

1 million workers on printing, advertising and transportation services also will lose their jobs.

However, research conducted by the World Bank proved the contrary. World Bank demonstrates that in general the country will not suffer from unemployment if cigarette consumption is reduced. Some countries will even gain a new advantage because consumers of cigarettes will allocate the money to buy other goods and services. This course of action will open up opportunities for the creation of new jobs.

4. Analysis

Tobacco taxes bring both advantages and disadvantages to the country as a whole. As for the Indonesian government side, it chooses to gain revenue from the tobacco taxes by not raising the tax equally to other ASEAN countries. Consumers are not aware that cigarette taxes regulation are beneficial only to the government and not to them. As for the farmers of tobacco taxes, they are also suffering for the cigarette taxes which are being levied in Indonesia.

4. 1 The effect of Raising Cigarette Tax on Government

According to Adioetomo et al. (2001), " the increasing of tax on cigarettes by 10 percent will decrease the number of cigarette consumers by 3 percents, also increasing government revenue from the cigarette tax by 6, 7 percent" (Djutaharta, Surya, Pasay, Hendratno, & Moetinarsih, 2005).. It is proven that the increment of taxes will generate more revenue to the government. It is also said, according to the study from WHO (World Health Organization) in

2003 says that 10% increase in tobacco product price will increase government's revenue about 7% (). Even though the government still increase the tax over the years, the value of the tax is still much lower than other countries such as ASEAN countries. According to chart 1. 2, "Indonesia still has the lowest percentage of cigarette tax comparing to other low income countries." The average of tax levied on tobacco is approximately 37% of sales price" (Barber, Adioetomo, Ahsan, & Setyonaluri) ." If compared to the global benchmark which is 70% of sales price, Indonesia cigarette tax rate is still low" (Barber, Adioetomo, Ahsan, & Setyonaluri).

In addition, Indonesian government is not willing to sign FCTC (Framework Convention of Tobacco Control) which have been signed by more than 160 countries (). The FCTC is convention about a treaty that addresses cigarette industry advertisement prohibition and also the termination of cigarette smuggling that is often by tobacco industries in many countries. This proves the statement of WHO stated previously that Indonesian government is afraid to raise cigarette tax.

Government is reluctant to increase tax as they afraid of the assumption of increasing tax will lead to the decrease of country's revenue, while in reality it does not reduce their income. However, according to Khalid, calculations shown that higher cigarette taxes would not reduce government revenue (). This might occur because the reduction of cigarette consumers is not equally as the amount of tax increase. Addicted smokers are responding to price that raise slowly. They will keep buying even though the price of cigarette is increasing. This is clear that the raising of tax would not reduce government revenue.

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4. 2 The effect of Raising Cigarette Tax on Indonesian People

The raise of cigarette tax apparently brings positive effects on the people in Indonesia. It will affect the number of smokers in Indonesia. As said before, the increasing tax of cigarette by 10 percent will effectively reduce the consumers of cigarettes by 3 percent. Also, one research of the World Bank makes a strong statement that ten percent increase of tobacco products will reduce global demand about 4% - 8%, on average, and prevent the death of 10 million people (). As an addition, Universitas Indonesia conduct almost similar research which come up with a conclusion " 10% increase in cigarettes prices then it will reduce 17% cigarettes consumption of poor family"(). This proves that increasing the tax of cigarette can effectively reduce the number of smokers, which means that it can increase the health of people in Indonesia .

Besides giving positive impact on health, the increment of tax could also lead to the increasing of people welfare. Based on Demographic Institution from Faculty of Economic University of Indonesia (2007), increasing tobacco taxes by 100 % will caused divert family spending from cigarettes to other goods and service products about 335 billion rupiah and increasing society income for 492 billion rupiah also creating about 300 thousands work force nationally (). Also, according to the model developed by the World Bank in its report Curbing the Epidemic shows the increase in cigarette prices as much as 10% because of higher cigarette taxes will make 40 million people living in 1995 to quit smoking and prevent at least 10 million tobacco deaths ().

This proves that the increment of taxes is not only increasing the quality of health in Indonesia, it is also increasing welfare of the people in Indonesia.
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4. 3 The effect of Raising Cigarette Tax on Farmer

The obvious impact on raising cigarette tax on farmer is that some of them will lose their job. Cigarette industry will try to cut costs since the tax is increased. By this, some workers such as tobacco farmers that are previously employed will be fired. According to Ananta, " government's reason not to increase the tax because it will cause 2 million tobacco farmers would lose their jobs" (Ananta, 2010). " This will also cause 1. 5 million clove farmers, 600, 000 workers in cigarette factories, 1 million people cigarette merchants, and 1 million workers on printing, advertising, and transportation services also will lose their jobs" (Ananta, 2010).

However, this does not happen overnight. Government can anticipate this and prepare for an orderly transition. Data from Ministry of Agricultural (2002) found out that 900. 000 workers are equal to 2, 3 % of agricultural workers or 1% population of 100% formal workers in Indonesia (). Tobacco crops are also seasonal and its plantation is concentrated on several fields in Indonesia. In addition, fields used to plant tobacco is less than 1% of seasonal field crops which 96% of it located on Eastern Java, Middle Java, and Nusa Tenggara Barat. This small percentage of tobacco farmers among agricultural industry means that the loss of jobs of tobacco farmers does not really have a huge impact on the economy (). Instead some countries will even gain a new advantage because consumers of cigarettes that have stopped smoking will allocate the money to buy other goods and services. This course of action will open up opportunities for the

creation of new jobs. Therefore, it is beneficial for the whole nation to increase the cigarette tax.

5. Conclusion

Based on the analysis that writer has conducted, the government should increase the cigarette tax in Indonesia. It will help increasing the health of the consumers; also it will increase the welfare of Indonesian people. If the government increases the tax, it will not affect their revenue and they will have the same amount of income. Also, tobacco farmers will get a new job and do not have to worry about losing their job. Therefore, raising the tax of cigarette will be a win-win solution for the whole people in Indonesia.