

Benefits Of A Tax Increase On Tobacco Products In Indonesia

The Union



1. HIGHER TAX WILL REDUCE SMOKING PREVALENCE, ESPECIALLY AMONG YOUTH

Every year smoking kills about 225,700 Indonesians and deprives the country of 6 million disability-adjusted years of life. Lower smoking prevalence will save lives, improve labor productivity, and reduce suffering among Indonesian people.

A 25% tax increase in 2021 will lower adult smoking prevalence from 33.8% to 32.0%, and youth smoking prevalence from 9.1% to 8.6%. This will result in 340 000 fewer premature deaths and prevent about 200 000 Indonesian children from starting to smoke. At the same time, labor productivity will increase due to better health of the population, and the economy will generate 126 000 new jobs by the end of 2021 due to household expenditures shifting away from tobacco sector. (Table 1)

Table 1: Impact of annual 25% tax increase

Smoking Prevalence in 2021 (%)		Premature deaths averted (000)	2021 Nominal Excise Revenue (164.9 Rp. Trillion)	Net Employment Impact (000)		Change in HH income %	Change in GDP %
Adults 33.8%	Youth 9.1%			Person	% change in Total employment		
32.0	8.6	340	226	126	0.10	0.03	0.0026

Notes: * 2019 values use as the baseline; HH = household

Source: Proposed Inter-sector Strategy on Tobacco Control in Indonesia. Bappenas, 2020.

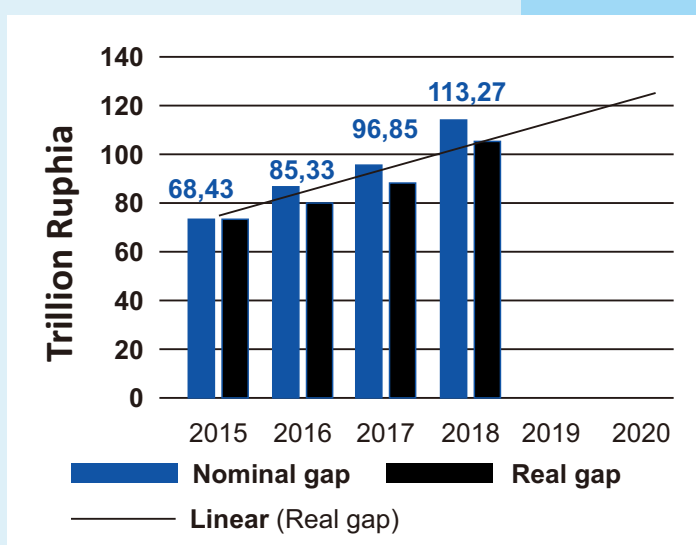
2. HIGHER TAX WILL REDUCE THE COSTS OF SMOKING AND FREE UP HEALTH CARE CAPACITY

A lower smoking prevalence will reduce the cost associated with tobacco use that amounted to at least Rp 441 trillion in 2019 (Kosen, et al. 2017 and inflation adjustment) and is increasing.

Smoking was responsible for at least Rp 19 trillion in excess demand for health care in 2019 (Kosen, et al. 2017 and inflation adjustment), or about 20% of JKN (Indonesia's national health insurance scheme) expenditures (BPJS, 2019).

Excise taxes on cigarettes are too low to pay for the costs smoking imposes on society and this tax gap is increasing over time (Figure 1 indicates gap between tobacco excise tax revenues and costs of smoking over time).

Figure 1: Indonesia: Tobacco Tax Gap (Rp Trillion)



Source: David P. Tobacco Control 2019;28:558–561 and author's calculation

In 2019, the economy (measured by GDP) lost at least Rp 300 for each cigarette consumed in Indonesia (Table 2). If the cost of addiction is added (measured by the HHs expenditures on cigarettes by those addicted to smoking), the loss reaches almost Rp 1000 per cigarette stick. Many smokers would like to quit but cannot due to their addiction to nicotine. Taxes need to increase by at least Rp 620 - Rp 1288 per cigarette just to compensate the government for the costs of smoking.

¹This takes into account both backward and forward linkages of the tobacco industry.

Table 2: Cost-benefit Analysis, 2019

	Costs of cigarette use (Rp trillion) ²	Cigarettes produced (billion)	Cost per cigarette (Rp)	Econ. benefits: Average retail cig. price ³ (Rp 944)		[Costs – Benefits] per cigarette (Rp)	
				Industry price (i.e. contribution to GDP)	All taxes (i.e. compensation for costs of smoking)	Economic loss = cost – retail price	Government loss = cost – tax
Excluding addiction costs	680.97	356.5	1910	322	622	966	1288
Excluding addiction costs	442.61	356.5	1242	322	622	298	620

Source: Proposed Inter-sector Strategy on Tobacco Control in Indonesia. Bappenas, 2020. HHs = households

3. HIGHER TAX WILL GENERATE REVENUE TO FUND UHC, DISASTER PREPAREDNESS AND ECONOMIC RECOVERY.

Increasing the excise tax by 25% annually and dedicating half of the new revenue to UHC would cause the JKN deficit to disappear by 2023 and allow expansion of UHC afterwards. The other half of the newly generated revenue (about Rp 30 trillion in 2021 and more each additional year) can be invested in disaster preparedness and post-Covid economic recovery, including support for current tobacco farmers and workers to transition to alternative careers. The tobacco sector is depriving Indonesia of lives and faster economic growth.

RECOMMENDATIONS

1. Increase tobacco tax annually by at least 25% in 2021. A smaller tax increase will not make a significant dent in the high adult smoking prevalence, will not decrease youth smoking prevalence, and will increase the gap between the tobacco tax revenue and the costs of smoking.
2. Simplify the tobacco tax structure by merging tiers in order to increase the impact of higher tax on lowering the prevalence (by reducing the industry price manipulation that results in substitution to lower-priced cigarette brands) and to enhance the tax revenue potential (by reducing the opportunity for tax avoidance and evasion).
3. Use a portion of the tobacco tax revenue to finance UHC (because such investment offers high returns and takes advantage of the demographic dividend) and post-Covid recovery to mitigate the impact of the pandemic on the overall economy.

² Cumulative inflation 2015 - 2019 was 14.14%.

³ Calculated as a weighted average of SKM, SKT and SPM prices in 2019.