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 Indonesia:

- 34% of Indonesians smoke (2004), an increase from 27% in 1995.
- 63% of men smoke (up from 53% in 1995); 4.5% of women smoke.
- 97% of tobacco users smoke cigarettes; the majority of smokers (88%) use kreteks.
- 78% of smokers start before age 19. The average age of smoking initiation is 17.4 years.
- More than 97 million nonsmokers are regularly exposed to second-hand smoke, including 70% of all children under the age of 15.

### Impact of Tobacco Use

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

### 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 can be correlated to educational levels; 73% of males with no education smoke compared with 48% of males with college education—which suggests a need to clearly communicate health risks.
- Javanese boys ages 13-17 could repeat the health warnings on cigarette packs, but also claimed that smoking one to two packs per day was not harmful to health. Children are socialized early on to consider smoking as normal and socially acceptable.
Tobacco Taxes in Indonesia

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 regional averages.

<table>
<thead>
<tr>
<th>Tax Rate as a Percent of Price (2004 to 2005)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia 37%</td>
</tr>
<tr>
<td>Vietnam 38%</td>
</tr>
<tr>
<td>Philippines 55%</td>
</tr>
<tr>
<td>India 55%</td>
</tr>
<tr>
<td>Bangladesh 63%</td>
</tr>
<tr>
<td>Thailand 75%</td>
</tr>
<tr>
<td>Low income average 51%</td>
</tr>
<tr>
<td>Asia &amp; Pacific average 56%</td>
</tr>
</tbody>
</table>

Employment in Tobacco Farming and Manufacturing is Low
• Tobacco farming and manufacturing contributes less than 1% of total employment.12,13
• 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 (US$73) per month.14
• Despite preferential tax policies to promote production from small firms, small firms’ contribution to total production 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 Rp 335.4 billion (US$36.9 million), household income could increase Rp 491.6 billion (US$54.1 million).
• 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 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 (US$3.2 to 6.5 billion). 5.0 to 11.5 million smokers would quit smoking.* Younger people and low income people would benefit the most because they are more responsive to tobacco price increases.

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

<table>
<thead>
<tr>
<th>Price Elasticity (PE)</th>
<th>Current tax (37%)</th>
<th>57% tax, PE = -0.29</th>
<th>57% tax, PE = -0.4</th>
<th>57% tax, PE = -0.67</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tobacco tax revenue (Rp trillion)</td>
<td>120</td>
<td>100</td>
<td>80</td>
<td>60</td>
</tr>
<tr>
<td>Smokers (in millions)</td>
<td>120</td>
<td>100</td>
<td>80</td>
<td>60</td>
</tr>
<tr>
<td>Deaths of current smokers due to smoking (in millions)</td>
<td>40</td>
<td>30</td>
<td>20</td>
<td>10</td>
</tr>
</tbody>
</table>

**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.

**Tobacco Economics in Indonesia** is one of a series of reports on tobacco taxation funded by the Bloomberg Philanthropies as part of 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.
8 Kosen 2004.
12 Ministry of Agriculture, December 2006, BPS (Sakernas) and Ministry of Agriculture, various years. Demographic Institute, University of Indonesia.
13 World Bank, Ministry of Industry, Demographic Institute, University of Indonesia.