

# P R A K A R S A *Policy Brief*

March 2019

## Illicit Cigarettes in Indonesia are Not the Problem the Tobacco Industry Claim it to be

### Key Points:

- Illicit cigarettes are rare in Indonesia. Less than 2% of cigarettes packs collected in a recent national survey were illicit.
- Illicit trade has declined over time, continuing a trend described by previous research. These declines coincided with the largest increases in excise taxes and cigarette prices in Indonesia.
- The low level of illicit trade is likely a function of market domination by kretek cigarettes which are unique to Indonesia, while the decline in illicit trade is likely a result of improved tax administration and enforcement, including consolidation of excise tax tiers and improvements in tax stamps.
- The low levels of illicit trade and high levels of compliance should encourage further tax reforms, including tier consolidation and increases in excise taxes.

**T**his policy brief is based on a more extensive report entitled "The Illicit Cigarette Trade in Indonesia".

### Background:

- In Indonesia, Law No. 39 of 2007 (Amendments to Law No. 11 of 1995) allows excise taxes of up to 57 percent of the selling price of cigarettes. Currently, though, cigarette taxes comprise significantly less (approximately 40 percent). This results in Indonesia having, undoubtedly, some of the lowest cigarette prices in the Southeast Asian region.
- Global evidence has shown that increases in cigarette excise taxes which result in price increases reduce tobacco use (The Economics of Tobacco and Tobacco Control, 2018).
- While the Government of Indonesia has taken steps to increase cigarette excise taxes and simplify excise tax tariffs in recent years, the Minister of Finance Regulation (PMK 156) not to raise the cigarette excise in 2019 has dealt a blow to these efforts. Furthermore, the Minister of Finance Regulation (PMK 146), which planned to simplify excise tax tiers further, was also stopped in this decree.
- The government's reluctance to raise the cigarette excise tax is caused by concerns rooted in the tobacco industry's argument about the potential for increased illicit trade if the cigarette excise is raised. The Indonesian Association of Cigarette Entrepreneurs (GAPRI) claims one of the reasons for the increase in illegal cigarettes and the decline in cigarette production is because of the high price of cigarettes due to the increase in excise tariffs (Kompas, July 2018). Furthermore, the industry also constructs narratives where the increase will lead to uncontrolled consumption and harm due to the loss of tax revenues.
- Limited research on illicit trade and the impact of increases in excise tax have resulted in ineffective policies and undermined efforts to reduce the smoking prevalence in Indonesia.

### The Burden of Tobacco Use in Indonesia:

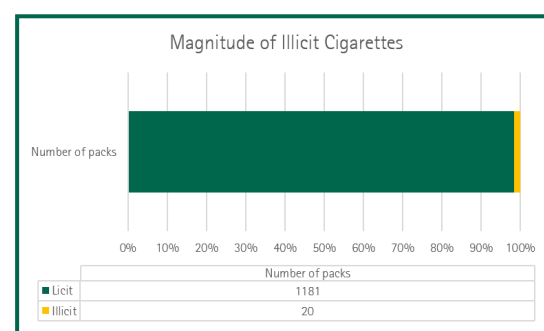
- Total medical expenses for smoking related diseases such as chronic obstructive

pulmonary disease (COPD), coronary heart disease, and certain perinatal and cancer disorders caused by tobacco use in 2010 reached 1.85 trillion rupiah (IAKMI, 2010).

- In 2010, productivity losses due to early mortality and disability due to tobacco consumption were more than 3.5 million disability-adjusted life years (DALY), equivalent to an economic loss of 106 trillion rupiahs.
- In 2015, cigarettes were the second largest household expenditure after rice. Indonesian households spend three to five times more on cigarettes than education. Cigarette expenditure in households causes low investment in child development.
- Cigarettes are one of the contributors to catastrophic diseases which are the largest portion of BPJS Health costs up to 4.6 trillion rupiahs (BPJS Kesehatan, 2018).

### Research Results:

- Prakarsa conducted a nationally representative survey of 1440 smokers in 6 districts (Malang, South Lampung, Tangerang, Gowa, Bandung and Banyumas Districts) in 2018. Cigarette packs were collected from 1201 survey respondents to identify illicit cigarettes through the validity of excise tapes and health warning images.
- The benchmark criteria of illicit cigarette packs in this study are missing excise tape, missing pictorial health warning, inappropriate excise tape and inappropriate pictorial health warning.
- This study found that the volume of illicit cigarettes in Indonesia is very small, less than 2 percent. Only 20 packets of cigarettes were identified as illicit without excise bands, fake excise bands or health warnings.



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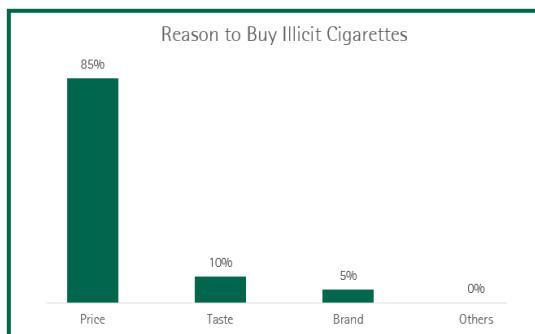
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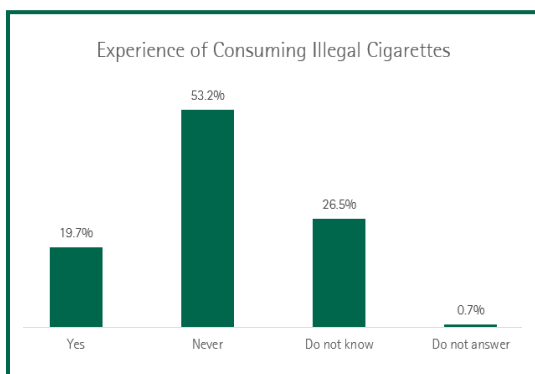
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- Respondents who consume illicit cigarette stated that the low price of the illicit cigarettes is the main factor for them to buy it.

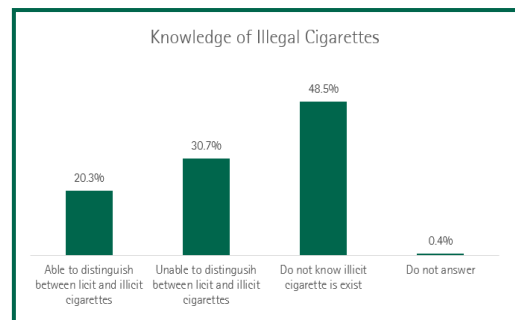


- Twenty percent of respondents stated that they had smoked illicit cigarettes at least once. Higher income smokers were less likely to have smoked an illicit cigarette. Approximately 43 percent of smokers who have smoked illicit cigarettes had an income of less than Rp1.500.000 per month, while only 1.8 percent of smokers who have smoked illicit cigarettes had an income of more than Rp5.000.000 per month.



- Even though people with lower incomes were more likely to smoke illicit cigarettes, consumption of illicit cigarettes is not a long-run behaviour. This is indicated by the significant differences between the proportion of smokers who have smoked illicit cigarettes (20 percent). However, the findings of this survey indicate that illicit cigarettes only account for 2 percent of the market.
- Illicit cigarettes in Indonesia are very different from illicit cigarettes in many countries. In general, illegal cigarettes come from smuggling. However, because the majority of smokers in Indonesia prefer kretek cigarettes, which are produced domestically and largely unique to Indonesia, illicit cigarettes due to smuggling is very limited. Illicit cigarettes in Indonesia likely come from small and micro-scale producers.
- Meanwhile, the penetration of illicit cigarettes is most likely due to encouragement from the producers, not consumers. Of the 1440 respondents surveyed, approximately 80 percent

of smokers knew that cigarettes were taxed. Moreover, half of smokers did not know that illicit cigarettes exist. Furthermore, only 20 percent of smokers could distinguish between legal and illicit cigarettes.



### Policy Recommendations:

- There remains a need to increase cigarette excise taxes in order to increase cigarette prices and make cigarettes less affordable.
- Illicit cigarettes in Indonesia are rare and, contrary to the claims of the tobacco industry, do not undermine the objectives tobacco tax policy.
- The government should continue to simplify excise tax tiers and invest in tax administration and enforcement as the best means of combating illicit trade.

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