

## **Government Challenges in Simplifying Tobacco Excise Rate Structure to Minimize Cigarette Manufacturer Excise tax Avoidance in Indonesia**

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### **Abstract**

*The object of the research is to analyze challenges the government faces in its attempt to simplify the structure of excise tax on tobacco to reduce tax avoidance by Cigarette Manufacturers in Indonesia. The Indonesian government aims to simplify the tobacco excise rate structure from previously 12 to 5 layers as planned in 4 years during 2018 – 2021 period). Simplification of the excise tax structure on tobacco is expected to reduce tobacco consumption while at the same time increase tobacco tax revenues. The policy involves various actors, which is why it is perceived as having both merits and demerits in accordance with stakeholder perspectives. The research used a descriptive qualitative research methodology based on in-depth interview of key informants. Results showed that there is no indication that the implementation of regulation No.146 /PMK.10 /2017 has affected tobacco consumption. It is also revealed that tobacco industry stakeholders intervened in the drafting and implementation of the regulation, which in part created difficulties for the government to achieve agreement among the relevant stakeholders, exemplified by the postponement of the policy to simplify the tax structure.*

**Keywords:** Excise, excise avoidance, excise rate, negative externality economy of development, traditional market

## **INTRODUCTION**

Cigarette smoking poses serious risk to human health hence is associated with negative externalities. Cigarette contain various additive substances that are harmful to both active and passive smokers. Some of the health issues associated with cigarette smoking include cancer, heart disease, and sudden death. Statistics reveal that the highest death rates related to smoking cigarettes occurred in 2015 when 6.4 million people died (Hidayat & Surjono, 2016). In Indonesia, the number of cigarette smokers that die every year is in the order of 217,000 and 240,000 people (Arifin, 2016). There is a lot of previous research on the impact of excise structure on government revenue) (Goodchild, Sandoval, & Belausteguigoitia, 2017), the impact of the simplification of excise tax (Hidayat & Surjono, 2016) the impact of raising excise tax rate on tobacco prices (Chaloupka FJ, Powell L.M., 2012) and the influence of the excise tax rate on to the consumption pattern (Lestari, 2017); (Chaloupka FJ, Powell L.M., 2012). Concerns about dangers that are associated with cigarette smoking have led many countries to ratify the Framework Convention on Tobacco Control (FCTC). The FTCT is an international treaty of WHO member countries. In general, the treaty, regulates the demand for cigarettes and controls the supply of cigarettes through non-tax and tax regulations (Fttcuntukindonesia, 2015). The non-tax regulation relates to regulations that control

advertisement, promotion, and sponsorship of events by cigarette companies, as well as packaging and labeling of the cigarette products. However, to this day, Government of Indonesia has yet to ratify FCTC policies let alone implement its provisions into national regulations on tobacco, including imposition excise tax on Tobacco products.

To control rising cigarette consumption, the Indonesian government has relied much on increasing excise tax on tobacco products. Since 2015, to strengthen its control on cigarette, the Indonesian government has implemented a roadmap that is aimed at gradually simplifies the excise rate tiers on tobacco products. The expected impact is to raise the tax burden for all cigarette producers, large and small, which in turn, increases retail prices of cigarettes. The excise tax rate that applies in the following year is set in the previous year. The roadmap has timeline of 2015-2020 to achieve its goals. Based on pout knowledge there is yet no research that has assessed the impact of the roadmap on simplifying excise rate structure on the government and not state stakeholders.

To that end, there is need for research on the impact of the policy on key stakeholders, including tobacco products companies, tobacco farmers, the government and society at large). Specifically, the focus of this research is to identify challenges the Indonesian government has faced in

formulating and implementing the roadmap that aims at simplifying the excise rate structure on tobacco products, key factors behind such obstacles, and possible pathways to improve policy effectiveness in the future.

Regulation on excise tax on tobacco products in Indonesia has been characterized by frequent changes. In 2017, the government issued the Regulation of the Ministry of Finance No 146/PMK.10/2017 on excise tax rate on tobacco products. The regulation aims to tackle tax avoidance by some tobacco manufacturers by simplifying the excise rate structure into fewer layers. To achieve that, the regulation set a roadmap of reducing the number of layers of excise tax structure on tobacco during 2015-2021 period. Many tobacco companies exploit the existence of many layers in the excise structure on tobacco to split large companies into several business entities solely to avoid. This is because the multilayered excise tax structure favored tobacco firms that fell into lower rank layers than those in upper rank layers. Empirical research on the simplification of excise tariff shows positive relationship between a simplified tax structure and high cigarette prices, lower cigarette consumption, and an increase in government revenue than regular multilayer excise tax rate structure (Hidayat & Surjono, 2016)

Besides, the simplification of the tax rate structure make tobacco products more expensive for consumers, thereby reducing consumption. This is because, the simpler

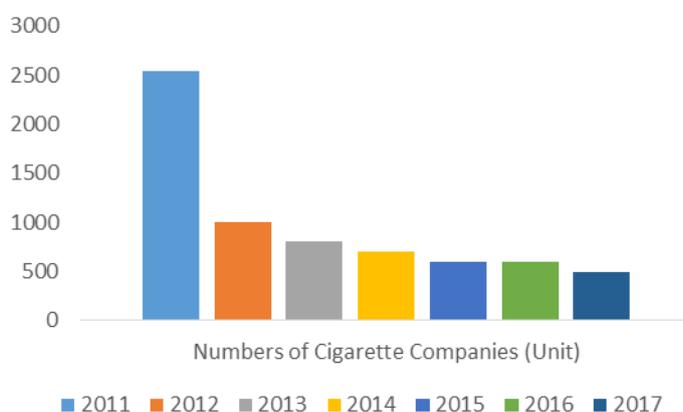
excise tax rate structure on tobacco reduces the incentive of tobacco consumers to shift to less-costly cigarettes. Moreover, simplification of the excise tax rate structure also reduces the likelihood of tobacco companies to engage in tax avoidance activities (Chaloupka & Powell, 2012).

The government intends to gradually simplify the tobacco products excise rate structure from 12 layers in 2015 to 5 layers in 2021. The simplification process will follow several stages, inter alia, 10 layers in 2018, 8 layers in 2019, 6 layers in 2020 and finally 5 layers in 2021. The excise tax rate structure policy involves various actors, including the Ministry of Finance, the Ministry of Industries, the Ministry of Agriculture, the Ministry of Trade, the Ministry of Manpower, Tobacco products industries, and association of tobacco farmers. However, enacting the regulation, which occurred in 2018, does not mean that the policy will be enforced given differences and diverging interests of the tobacco products industry, policy makers, and ranks within the tobacco products industry.

The implementation of the policy, which was supposed to be complete in the next three years, has been bedeviled by rising tension and widening differences among key actors. One of the main issue relates to the adverse impact of excise tax rate structure policy on operations on small tobacco product companies. Many small size tobacco product companies have been lured into bankruptcy as they are unable to compete

with large companies in the tobacco industry. The rise in the number of small tobacco product companies that have become bankrupt since the implementation of the excise tax rate structure simplification policy pose serious danger for the survival and sustainability of smallholder tobacco farmers and workers. This is borne out by data obtained from the Ministry of Industry, which shows that the number of cigarette companies that decreased from 2,450 in 2011 to 1000, 800, 700 and 487 in 2012, 2013, 2014, and 2017, respectively (Figure 1). Taking into consideration the adverse impact of the tax rate simplification policy on the tobacco products industry, the the Minister of Finance Indonesia announced the postponement of the implementation of the policy as planned with the excise rate structure for

paid, the excise rate structure simplification policy is considered to be fair because it has forced some players in the industry who benefitted from lower layer excise tax rates to upper layer rates. In addition, the implementation of the regulation has reduced excise tax avoidance, which is attributable to the existence of many layers in the applicable tax rates, allowing tax payers the opportunity to take measure that made them qualify for lower tax brackets (tax arbitrage). In other words, a multi layered tax structure system violates the excise burden fairness principle (Ostrom, 2015). Consequently, implementation of the policy, should in the long run increase fairness in tax returns among tobacco products companies, which in turn will contribute to higher tax revenues. Nonetheless, the regulation has



**Figure 1. Number of Cigarette Companies 2011 – 2017**

Source: The Ministry of Industrial Affair, 2018

2019 expected to remain unchanged from that applicable in 2018.

On the other hand, from the perspective of competition based on excise tax

another objective beyond increasing tax revenue, which is controlling the consumption of cigarettes in Indonesia, as well as strengthening existing mechanisms charged

with monitoring distribution sale of illegal cigarettes.

The concern is that an increase in the general excise tax burden, can trigger an increase in the trading and distribution of illegal cigarettes (Wicaksono, 2015). If that scenario were to materialize, it would undermine government's ability to restrain the distribution of illegal cigarettes. Based on figures released by the Faculty of Economics and Business, Gadjah Mada University, of the 322 billion cigarettes produced in 2018, approximately 27 billions were illegal or contraband. Based on such data, the implementation of the policy on simplifying excise tax rate structure, has led to an increase in seizure of illicit cigarettes from 5% in 2015 to 12.04 % in 2016, and 7.04 % in 2018. To that end, the implementation of the tax rate structure simplification policy faces a new challenge that needs urgent solution if the stages on the roadmap are to be achieved as planned. Thus, tackling the challenge, requiring efforts toward developing human resources by the Indonesian the government in general and the Directorate General of Customs Excise in particular (Sunahwati, Maarif & Sukmawati, 2019).

In the implementation of the excise policy, the government should consider various aspects such as citizens healthcare, labors, and the government's revenue. The objective of the excise policy has strong bearing factors that influence its performance (Agung, 1994). In other words,

strategic objectives influence the excise policy, including (i) changing the negative externalities into a positive opportunity by taking into consideration the production function of every producer, the automatic calculation and tax rate stipulation by maximizing the profit or minimizing the total cost, (ii) creating jobs, (iii) limiting consumption (iv) government revenue orientation.

Besides, the imposition of excise tax through the Customs and Excise Act on a particular commodity is aimed to directs and works in accordance with to the justice and equality principle, with excise tax only imposed on selected compulsory objects. In addition, all parties involved should be receive similar treatment, and the imposition of the excise should be neutral to avoid any distortions that may affect the economic activities in the economy (Agung, 2004; 7)

With respect to the goal of excise tax collection, (Cnossen, 2005) identifies several main goals that countries expect to achieve by imposing excise tax, including,

- i. reflecting the external cost. the economies or negative externalities constitute losses that are inflicted on society and economy as a result of economic activities of an individual or group of individuals. Specifically, costs are a source of inefficiency in the market. Specifically with respect to excise

tax imposition, the externalities are seen as a burden, which the government should bear as a consequence of the consumption of goods that are the subject to the excise tax. Cnossen gives several examples of products that trigger diseconomies or negative externalities such as pollution and global warming inter alia, pesticides, fertilizer, CFCs, and so on;

- ii. to discourage consumption. Excise tax can be used as instrument to prevent the consumption of products that are harmful to health, such as cigarette or alcohol. Generally, the government has two options it can use to control consumption, either raising excise tax rate or adopting preventative measures through counseling about the danger of consuming particular products that are harmful to the health;
- iii. to raise revenue. Like other taxes, excise is an instrument that has a budgetary function. Despite not being the main objective, imposition of excise tax is aimed at raising government revenue. As an example, Cnossen explains that excise tax revenues contribute 5.6% to the total *gross domestic*

product (GDP) in Denmark. In Indonesia, excise tax contributes 10% of the total government revenue from taxes; and

- iv. Others. Collecting excise tax can fund scientific research, improve the provision of job opportunities, and so on.

Nonetheless, given the nature of negative externalities, considering the adverse effects that arise from consuming cigarettes and other tobacco products, efforts should be made to restrict and reduce consumption. In fact the term excise emphasizes tax collection that serves purposes other than just collecting tax revenue. Thus, imposing consumption tax on tobacco products is one of the ways to restrict or dissuade or discourage consumption or. The calculation of excise tax may take the form of either a specific excise for each unit of product or proportional rate that is calculated on the basis of the maximum retail price (Thuronyi, 1996).

In economic activities, a cost that is not absorbed or incurred by one business actor can be either a profit or loss to other business actors. This condition reflects the externalities that occur in society as a whole. An externality is defined as an uncompensated impact of one's action to other people's welfare who are involved in the action. The externality emerges when a person is involved in an activity that influences other people's wellbeing who do

not pay for or receive compensation from the impact (Mankiw, N.G., 2012). If the impact generates benefits to other people, it is considered a positive externality, while if the externality causes disadvantages to other people it constitutes a negative externality.

## **METHODS**

The research is based on qualitative research design approach. The approach does not intend to test hypotheses, rather focuses on sharing, gathering and sharing understanding and perceptions of the parties involved, and explore and interpret the meaning behind such perceptions. Specifically the research describes a condition, phenomenon or social tendency that is related or associated with government efforts to simplify excise tax rate structure on tobacco products. Data collection techniques included literature review, and in-depth interview. To that end, data sources included collection of secondary data from various credible sources, while primary data was obtained through in-depth views conducted with various institutions the Fiscal Policy Agency, the Directorate General of Customs and Excise (DJBC), the Association of Indonesian White Cigarettes Producers (GAPRINDO), the Ministry of Health, the Ministry of Industry (Kemenperin), the Ministry of Agriculture, Tobacco Products Industry (IHT), tax practitioners, healthcare practitioners, and members of academia. The scope of the research is limited to issues that relate to of the excise tax rate structure before and after the implementation

of PMK 146/PMK.10/2017, at a time when the number of rate layers which initially were 12 during 2015 – 2017, had decreased to 10 layers in 2018; the main thrust of the regulation being the need to control cigarette consumption; challenges the government faces in its efforts to simplify the excise tax rate structure on tobacco products from the vantage point of fairness, monitoring the distribution of illicit cigarettes and control of cigarette consumption.

## **FINDING AND DISCUSSION**

### **Overview of The Implementation of Excise Tax Regulation in Indonesia**

The enactment of regulation No. PMK 146/PMK.10/2017 concerning excise tax on tobacco products was the latest revision of the regulation on tobacco rate structure, as it replaced regulation No. PMK 147/PMK.10/2016. The previous regulation No. PMK 205/PMK.011/2014, which stipulated the existence of 12 layers, had been enacted to replace regulation No. PMK 179/PMK.011/2012. This means that the Indonesian government has maintained excise tax rate structure of 12 layers for 3 years from 2015 to 2017. During the timeframe, a significant differences are prominent related to the tobacco products excise rate and the limit of retail price. The highest retail price was raised to ensure that cigarette process in the domestic market were not too low..

Meanwhile, the government has tried to stabilize the increase in tobacco rate to ensure that it takes into account inflation,

economic growth, and the set price. Discussions on raising the excise rate involved the government and occurred the Indonesian national legislature (DPR RI).

However, prior to the discussions, the government had already set target revenue, which the tax on tobacco products was expected to be generated. This was highlighted in the national budget estimates and as well as had determined an alternative tobacco products excise policy that took into consideration the condition of the tobacco products industry and the aspiration of the tobacco products industry business actors. The government conducted discussion of the revenue target and alternative policy with the financial affairs commission (commission XI of the Indonesian legislative assembly). Specifically, discussions revolved around excise tax rate policy and the retail price limit that was initially intended to ensure that cigarette prices made it dear to consumer, thereby reducing consumption.

The prevalence of cigarette consumption, which was gleaned from results of a research conducted by survey conducted by Ministry of Health served as the general parameter used to control cigarette consumption. To that end, implementing the policy was expected to reduce cigarette consumption. Thus, setting the excise rate had to be in line with the objective that the policy wanted to achieve. In other words, the excise rate set should have corresponded to the targeted objective, *inter alia*, health, revenue, and others. The objective of the

excise tax was to control negative externality, which was to discourage cigarette consumption (La Foucade et al., 2018).

Cigarette consumption in Indonesia showed an increase during 2007-2013 period, with the latter year registering a drastic increase that was 2% higher than the previous 3 years. However, in 2016 cigarette consumption decreased slightly by 3.5% compared with the level consumed in 2013. This means that on average, cigarette consumption has decreased by 1.17% annually, which is in line with the expectation that is stipulated in the Ministry of Health regulation (Permenkes) No. 40 the year of 2013 concerning the Roadmap of Controlling the impact of Cigarette Consumption Public Health. The target of the regulation is to reduce the number of cigarette smokers by 1% each year during the 2015-2019 period, with the focus placed on reducing prevalence of smoking among underage children and low income earners. The regulation is based on the premise that children do not fully understand the harmful effects of cigarette smoking and are highly prone to health risk associated with smoking. The concern is shared among other developing countries such as Malaysia (Lim et al., 2018) India (Anjum, 2016), South Africa (Stacey, Summan, Tugendhaft, Laxminarayan, & Hofman, 2018), and Bangladesh (Cheruiyot Joan et., 2013), to name just a few cases. Meanwhile, low-income smokers are considered susceptible because of the detrimental effect that ciga-

rette smoking has on their economic condition .

Permenkes No. 40 / 2013 also stipulates the objective of reducing the number of beginner smokers by 1% annually during 2015-2019 period. . However, in 2014 the target was revised downwards to under 1 % by the Ministry of Health as it was considered too high, with the target of reaching the prevalence of 5.4 % children smokers by 2019.

Based on National Healthcare Indicator Survey (*Sirkesnas*) in 2016, the target was has not been achieved. On the contrary, based on data released by the of General Healthcare Research (*Riskesdas*) year in 2013, the prevalence of beginner smokers shows an upward trend from 7.2% in 2013 to 8,8% in 2016. This means during three years, the prevalence of beginner smokers has increased by 1.6% per year. The beginner smokers are those who are children and adolescents, hence have limited ability to pay for cigarettes compared with adults.

It is thus disconcerting to note that the number of beginner smokers is rising, which is cogent proof that cigarette smoking among children is inelastic to the increase in cigarette prices associated with the raising of excise tax rate on tobacco products. The problem is difficult to solve because based on research finding, underage smokers being adolescents do so mainly because of the pleasure they derive from the habit, which is

difficult to extricate given their immature psychological stage (Cheruiyot Joan et., 2013).

In 2018, in line with the phased implementation of the stage I of the tobacco excise rate structure simplification roadmap, the government raised the excise tax rate on tobacco products by 10.04% Prior to raising the excise tax rate in 2018, table 2 shows the status of retail selling price of cigarette during 2017-2018 period.

The simplification initiative was indicated by the combination of IIIA and IIIB categories, as well as HJE of category II on the SKT. The following, Table 1 show the outcome of the simplification initiative.

While the indirect goal of the regulation as stipulated in Article 2 of the regulation PMK 146/PMK.10/2017 on the simplification of the excise tax rate structure is to control cigarette consumption, the explicit goal as stated in the regulation is to increase revenues from excise tax, reduce liability of cigarette companies, and to simplify the excise tax administration system. It is thus, apparently that the objective of increasing tax revenue takes precedence over the objective to control the consumption of cigarettes.

It is thus obvious that the main objective of the regulation which is to control cigarette consumption is not in line with the objective of simplifying excise rate structure on tobacco products. If the government were intent on reducing cigarette consumption, it would not be hesitant in raising ex-

**Table 1. The Limit Retail Selling Price (IDR)\* 2017**

No	Cigarette Producers		Year 2017		Year 2018	
	Level	Cat	Limit of Retailing Selling Price(IDR)	Excise (IDR)	Limit of Retailing Selling Price(IDR)	Excise (IDR)
1	SKM	I	≥ 1.120	530	≥ 1.120	590
		II	> 820 655≤x≤ 820	365 335	> 895 715≤x≤ 895	385 370
2	SPM	I	≥ 1.030	555	≥ Rp 1.130	625
		II	>900 585≤x≤ 900	330 290	> Rp 935 640≤x≤ 935	370 355
3	SKT or SPT	I	> 1.215	345	>1.260	365
			860≤x≤ 1.215	265	890≤x≤ 1.260	290
	II	≥730	165	≥ 470	180	
		470≤x≤ 730	155	NA	NA	
	IIIA	≥ 465	100	≥ Rp 400	100	
IIIB	≥ 400	80	NA	NA		

\* 1 USD = IDR 13.500

Source: Ministry of Finance Regulation No. PMK 146/PMK.10/2017

cise tax rate on cigarette to a level that smokers would not afford it. In other words, by trying to pursue a policy that while raises cigarette prices it does not so high that would make many smokers would stop buying, attests to the reality that the main objective of the policy is to increase tax revenue which is achievable through a modest increase in the tax rate (Stacey et al., 2018).

As regards the impact of the new regulation on controlling cigarette consumption, based on results of a survey or *Riskesdas* conducted by the Ministry of Health in 2018 showed that the prevalence

of beginner smokers falling in the 10-18 year age bracket was 9.1%. To that end, the prevalence of child smokers was of 0.3% and 1,9% higher than the rate in 2016 and 2013, respectively. The implication thus is that the prevalence of child smokers show an increasing divergence from the target of 5.4% set by the Ministry of Health. In other words, controlling consumption through raising the excise tax rate has so far failed to achieve the objective.

Meanwhile, the regulation on simplifying the excise rate structure on revenues has been positive. In 2018, government col-

lected

**Tabel 2. Excise Tax rate Structure of SKT 2017-2018**

but

Cigarette Producers		Year 2017 (PMK 147/PMK.10/2016)		Year 2018 (PMK 146/PMK.10/2017)	
Types	Level	Batasan (IDR)	Excise Rate (IDR)	Batasan HJE (IDR)	Excise Rate (IDR)
SKT atau SPT	I	> 1.215	345	>1.260	365
		$860 \leq x \leq 1.215$	265	$890 \leq x \leq 1.260$	290
	II	$\geq 730$	165	$\geq 470$	180
		$470 \leq x \leq 730$	155	NA	NA
	IIIA	$\geq 465$	100	$\geq 400$	100
	IIIB	$\geq 400$	80	NA	NA

IDR 153

trillion

of reve-

nue, which represented an increase of 3.24 % over the revenue target set in the national budget. The tax collected was also higher than the level achieved in IDR 147.49 trillion in 2017 was by a magnitude of 0.14 %. Looking closely at the phenomenon, the conclusion that can be made is that the policy has succeeded in achieving the goal of raising government revenues from tobacco products. Nonetheless, the increase in government revenue is attributable to an increase in the tax rate on tobacco products as well as an increase in cigarette consumption.

To That end, the two goals of increasing tax revenue and controlling consumption, are complementary rather than mutually exclusive. This is because cigarette smoking is not a normal good, the demand for which declines with an increase in price,

an ostentatious good and an addiction, the consumption of which, is inelastic. Raising prices on goods of ostentation is the best way to increase revenue as it does not have significant impact on consumption.

Nonetheless, there is another positive development that is associated with the policy. This is the increase in the seizure of illicit cigarettes from the market. In 2018, the government reduced illicit cigarettes in circulation by 5.1%, which was higher than that in 3.56% and 0.36% in 2014 and 2016, respectively. The achievement was largely thanks to strong enforcement measures that involved sting operations in the domestic market, which were well organized and structured; and a series of anti-illicit cigarette preventive campaigns conducted by the Directorate General of Customs and

their businesses. Since the implementation of the roadmap that is aimed to simplify excise rate structure, the reality on the ground reflects a situation that is characterized by a growing number of small-scale producers scaling down productions, reducing workers, and closing operations. Small scale craft tobacco producers have borne the brunt of the fallout.

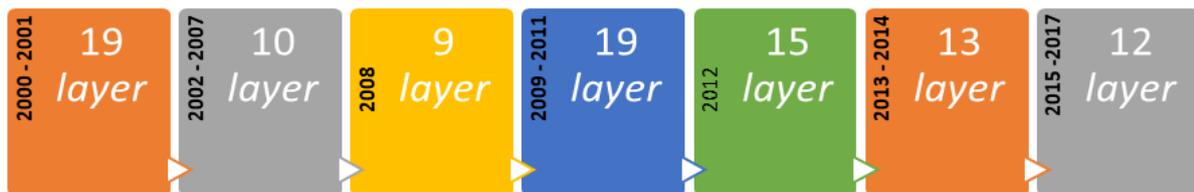
**Challenges faced in Simplifying Excise tax structure on Tobacco products**

In general, the policy of simplifying excise tax rate structure on tobacco products is not a new thing in Indonesia. However, the main goal of the simplification is sometimes not clear or is fraught with inconsistency. This is reflected in the inconsistencies between policy implementation and roadmap stages. The following section looks closer at such inconsistencies.

There is need to reiterate that ac-

those that are generated by another. In addition, research shows that the intended goal should influence the setting of the excise rate. That is, reducing consumption can be achieved setting higher price which should make the product unaffordable by the targeted population with strict monitoring of the policy integral component of the policy (Whitehead et al., 2018). Nonetheless, if the goal of the government is to achieve all the goals, it can set a moderate excise tax rate.

In 2002, the government simplified the excise rate structure from 19 layers to 10 layers for all categories (SKM, SPM, dan SKT). However, in 2009 the government decided to fall back to the original excise rate structure that comprises 19 layers. This attests to the inconsistency in the overarching goal of levying excise tax. Similar to the Ministry of Finance, the Ministry of Indus-



**Figure 2. Number of Layers of Cigarette Categories**

Source: Directorate General of Customs and Excise (2018)

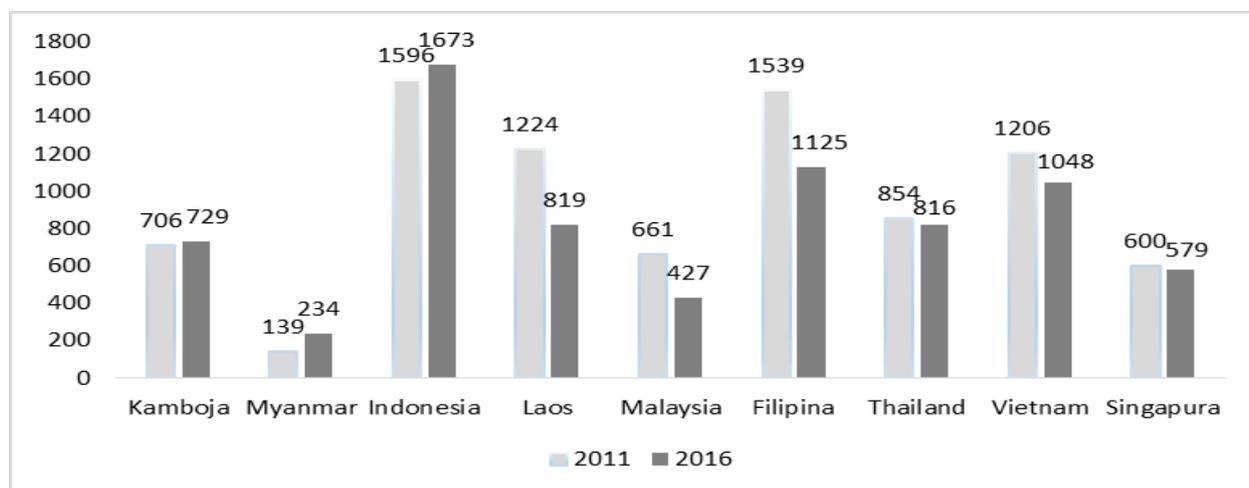
According to Cnossen (2005), setting an excise rate aims at achieving one of the following goals, inter alia, discourage consumption, raise revenue, and reduce externality. Consequently, the choice of any policy is bound to have consequences that may differ from

tries uses the excise rate structure in the 2007-2020 roadmap regulates tobacco products. However, the simplification roadmap implemented by the Ministry of Industries did not adopt the target of reduc-

Asia. Figure 2, which depicts data for 2018 on per capita tobacco consumption in South East Asia released by Southeast Asia Tobacco Control Alliance (SEATCA) provides ample evidence of that. Figure 3 shows that cigarette consumption per capita in Indonesia is the highest in ASEAN. In 2016, Indonesians consumed an average of 1673 cigarettes, which is very high for a country with a population that while is the largest in ASEAN, it is not predominantly

top policy priorities of the Indonesian government.

Nonetheless, government policy continues to emphasize generating tax revenue as the centerpiece of its excise tax policy rather than efforts to control cigarette consumption. The roadmap on simplifying excise rate structure implemented since 2002, which has experienced a number of revisions, attests to the fact that the excise



**Figure 3. Cigarette Consumption per Capita of ASEAN Countries**

Source: SEATCA, 2018

cigarette smokers. WHO data corroborates the above data which describes the Indonesian cigarette market is the third largest in the World after China and India. Another aspect of cigarette smoking in Indonesia relates to the fact that while the habit is facing a downward trend in other countries, cigarette consumption per capita in Indonesia is among the three countries that experienced an increase during 2011-2016 period. Consequently, controlling cigarette consumption should be among the

rate has not been raised to such a level that would discourage cigarette smokers from reducing consumption, which supports the argument that the overarching goal of the excise rate structure simplification is to increase revenue rather than controlling cigarette consumption.

It is also true another implication of the roadmap on simplifying excise rate structure is tying tax rates that apply to production volumes and scale. Firms do not have the flexibility to change level of

Based on 4, the first stage simplification for hand-made or craft cigarette (SKT) involved combining IIA and IIB and IIIA and IIIB. If the simplification is aimed to control consumption, the government should not target the SKT level. However, the trend of SKT consumption has declined in the past few years. Some of the SKT consumers are currently using the SKM. This is supported by the market share of SKM, SPM, and SKT over the last five years, as depicted in the following figure 3.

That may explain why the roadmap on excise rate structure simplification of the

the smallest market share of all cigarette types. To that end, government efforts to combine the three types of SKT as attempt to control consumption can only have little impact of total cigarette consumption. That said, such a policy should generate higher revenue from excise tax.

Nonetheless, the second stage of the simplification process is appropriate as it combines categories IIA and IIB of SKM and SPM. This is because given the large market share of the two cigarette types, combination of the two categories increases the capacity of the policy to control cigarette consumption as it affects large number of cigarette smokers. Moreo-

**Table 3. Summary of the Excise Rate Structure Simplification Roadmap on Tobacco Products Excise**

Types of Cigarette	2018	2019	2020	2021
SKM		IIA and IIB combined	SKM I and SPM I combined	
SPM		IIA and IIB combined	SKM II and SPM II combined	
SKT	IIA and IIB combined			IA and IB combined
	IIIA and IIIB combined			

Source: BKF(2018)

tobacco products encapsulated in regulation PMK 146/PMK.10/2017 is essentially flawed as a policy tailored toward controlling cigarette consumption. Categories of tobacco products and producers is one of the areas that not in line with the professed goal of controlling cigarette consumption. Table 4 shows the categories in detail.

Figure 4. shows that the market share for SKT and SPM has continued to decline in the last three years, while that for SKM shows an upward trend since 2013. This means that smokers' preference for SKM cigarette products has been rising and getting higher. It is also true that SKT market share is the smallest among the three types of tobacco products. In any case, SKT has

ver, merging the two categories of the two key players in the tobacco product industry, the policy affects not only many tobacco consumers but also producers. To that end, the policy is unlikely to trigger conflicts among producers.

Nonetheless, decision on government policy to take should also take into consideration the possibility of intervention from some of the key stakeholders who deem it not in line with their interests. Intervention if not countered or dealt with wisely can hamper or even derail efforts to achieve policy objectives, controlling consumption and generating revenue through the simplification of the tax rate structure. In that end, the success of the policy in part depends on the way and capacity of the government to deal with intervention into the policy implementation process.. According to results of a SEATCA study on Tobacco Industry Interference Index

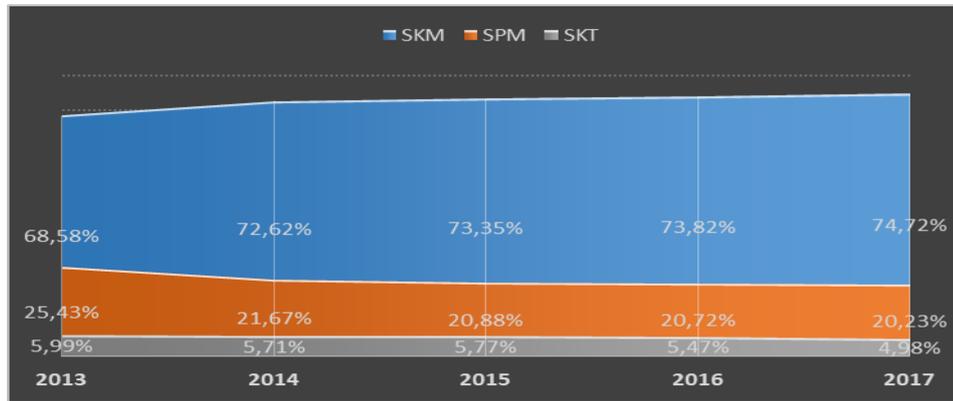


Figure 4. Market Share of Each Category Tobacco Products 2013 – 2017

Source: Fiscal Policy Office (2018)

Indonesia has a score of 79 on the index, which is only second from Japan, which has largest score of 85 on the index. Based on the index, Indonesia ranks among the countries with very high intervention in tobacco product industry, highest score in ASEAN, and second only to Japan, on the index. In one of the indicators used in compiling the index was degree of participation in the tobacco product policy process.

of excise tax policy on tobacco product industry. Participation in the tobacco product policy occurs in the form of lobbying of producers to key policy makers and politicians which in part played a role in delaying and watering down the policy of

Intervention in the excise rate structure simplification policy is evident in the postponement of the



Figure 5. Intervention by the Tobacco Products Industry in Several Countries of Asia

Source: SEATCA (2018)

Indonesia received a high score of 15 out of 20 on that indicator alone, which reflects the high involvement of nonstate actors in shaping the composition and direction

continuation of the stages of the road by Indonesian Minister of Finance. In an announcement in early

roadmap that would have envisaged an increase in the excise rate on tobacco products and by implication higher cigarette prices, complicated the task even the more.

Nonetheless, the hope is that the postponement is temporary, with the hiatus giving the government and all key stakeholders time to work out an arrangement that will lead to an improvement in the roadmap prior to its continuation and restoration. However, even if the roadmap were to resume, some adjustments in its timeline will have to be made since an 8-tier framework that was envisaged to occur in 2019 is no longer possible. To that end, prior to re-launching the new policy, coordination with relevant ministries, including Minister for the coordination of economy affairs and other nonstate stakeholders, is imperative.

Based on the existing legal framework which is embodied in Presidential Instruction No. 7 / 2017, reaching decisions on policies that by nature are of immense and nationwide importance and relevancy, as gauged by the impact they have on the population, the line ministry and head of the government institution have an obligation to deliver the draft policy plan to the President for subsequent discussion in the Ministerial Meeting, plenary cabinet meetings and Closed Cabinet meetings.

The postponement of the implementation of the roadmap in 2018, is a repeat of what occurred in 2014. It happens that both 2014 and 2018 had one

commonality which is that they were years when the government as gearing itself toward an intensely contested general elections. Thus, in both 2014 and 2018, the government temporary halted the implementation of excise rate tax increase that would have occurred, an action, that can be interpreted as aimed to reduce political knock-on effects among voters. To that end, the direction of policy on tobacco products in Indonesia, is heavily influenced by intervention, both direct and indirect. The implication of this is that politics, which is short term in nature, can trounce long term considerations such as economic rationale and protecting the health of a country's citizens.

## **CONCLUSION**

Based on research results government policy on simplifying excise rate structure on tobacco products, which has the goal of reducing the prevalence of child smokers, has yet to be achieve it. Despite a decline in the prevalence rate of all smokers that currently stands at 3.5%, the prevalence rate of early age smokers (10-18 years), shows a steady increase of 7.2%, 8,8% , and 9.1% in 2013, 2016, and 2018, respectively. To that end, as a policy with an expressed aim of controlling cigarette smoking among children and adolescents, it has failed. The prevalence rate of early age cigarette smokers prevalence in 2018. On the contrary, the government has achieved marked success in its goal of increasing tax revenue from excise tax on tobacco

The government should focus on the main goal of excise tax on tobacco products, at the same time, minimizing the influence that the strong lobby from large cigarette products producers have on the structure, composition, and targeting of the simplified excise tax rate structure. which is to control consumption rather than as an avenue to generate as much tax revenue as possible. One of the ways to achieve that is to ensure that sharing of revenue that is generated from excise tax collection *Dana Bagi Hasil Cukai Hasil Tembakau* (DBHCHT) should also be put to better use in supporting activities that control cigarette consumption including counseling on health matters, establishment of alternative economic activities and training current tobacco workers and farmers in preparation for new livelihood after cessation of employment in the cigarette industry.

- 2) Effective control of cigarette consumption should be reflected in the restructured excise rate that is higher on SKM and SPM cigarette products than on SKT.

Improving and enhancing coordination of policy design and implementation with relevant stakeholders, particularly the Ministry of Industry and the Ministry of Health, and not stakeholders, including tobacco product producers, tobacco product workers or their representatives, civil society organizations

with interest on tobacco product industry and public health. To prevent a repeat of biased policy and the conflicts it generated within the tobacco product industry, the resumption and continuation of the roadmap, should only occur after key sticking points that are the source of disagreement are resolved, but at the same time, minimizing the influence that the strong lobby from large cigarette products producers have on the structure, composition, and targeting of the simplified excise tax rate structure.

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