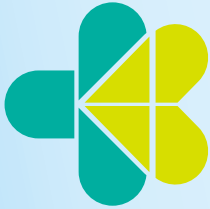




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Benefits of a Tobacco Tax Increase and the Tobacco Tax System Simplification in Indonesia

1. Higher tax rate and a simple tax system will reduce smoking prevalence and premature deaths especially among youth

Every year, smoking kills about 266,000 Indonesians and about 45,000 of these deaths are due to secondhand smoke exposure¹, and deprives the country with the loss of 6 million disability-adjusted life years (DALYs). Over 33.8% adults (age 15+) use tobacco including 62.8% men and 4.8% women². Among the youth (ages 13-15) 66.2% are exposed to secondhand smoke in enclosed public places, and 57.3% are exposed to secondhand smoke at home. By reducing the smoking prevalence, Indonesia can save lives, reduce suffering, improve labor productivity, and boost the preparedness to face the current and future pandemics.

A 20% tax increase and reducing the number of tax tiers from 10 to 8 tiers in 2022 will lower adult smoking prevalence from 33.8% to 32.8%, and youth smoking prevalence from 9.1% to 8.8%. This will result in about 453,000 fewer premature deaths among adults and about 26,000 fewer premature deaths among the young generation. Additionally, it will prevent almost 116,000 Indonesian children from starting to smoke (Table 1).

Leaving the tax policy unchanged in 2022 could have potentially harsh consequences, especially for human deaths and suffering. Indonesia would have 110,000 additional smokers, and 6,000 of these would be among very young people. This will lead to 25,000 additional premature deaths, including the youth (Table 1).

2. Higher tax rates will generate more revenue to fund economic recovery and disaster preparedness

The COVID-19 pandemic has resulted in a double shock - health and economic. Indonesia responded with rapid increase in government spending to combat the deadly pandemic, resulting in substantially increased its public debt. In 2021, the budget deficit is projected at approximately 5.5 percent of GDP or Rp 971.2 trillion.

1. *Global Burden of Disease (GBD) 2017*. Seattle, WA: Institute for Health Metrics and Evaluation (IHME), University of Washington; 2020
2. *Riset Kesehatan Dasar (Riskesdas) 2018*, Ministry of Health of Indonesia.
3. *Indonesia Global Youth Tobacco Survey (GYTS) 2019*. Centers for Disease Control and Prevention.
4. *WHO estimates, 2021*

Table 1: Estimated Impact of Tax Policy in 2022 Under Two Different Scenarios ⁴

Tax policy	2021	2022	
		Scenario 1 <u>20%</u> tax increase + reduction of tiers from 10 to 8	Scenario 2 Tax level and tax structure unchanged
Smoking Prevalence (%)			
- Adult	33.8*	32.8	33.9
- Youth	9.1*	8.8	9.1
Change in the Number of Smokers	NA	(2,037,376)	104,516
- Adult	NA	(115,888)	5,945
- Youth			
Premature Deaths Averted			
- Adult	NA	452,750	(23,226)
- Youth	NA	25,753	(1,321)
Nominal Excise Revenue (Rp Trillion)	184.0	210.1	186.5
Change in Nominal Excise Revenue (%)	NA	14.18	1.36
Cigarette Volume (million pieces)	307,009	288,739	307,946
Change in Cigarette Volume (%)	NA	(6.24)	0.31

Notes: * the latest available 2019 values; HH = household; GDP = Gross Domestic Product

Despite this shortfall, the government plans to spend Rp 169.7 trillion on health in 2021, a 38% increase compared to the previous year. The increased funding is being geared, among other priorities, towards the COVID vaccination, management of infectious diseases, accelerating stunting reduction, support for the national health insurance and integrated health system, and prevention⁶.

More spending on health is necessary for Indonesia in order to recover faster from the crisis and get back on the past to a sustainable and inclusive longer-term economic growth⁵. This will require fiscal adjustments and channeling funds where they are needed the most. The health sector can play an active role in contributing to tax reforms, most importantly by focusing on pro-health taxes that can expand fiscal space in order to mobilizing revenue⁵.

The World Bank recommends increasing pro-health taxes as a win-win solution for a healthy economic recovery⁵. These taxes have a positive and a long-term effect on population health while offering a sustainable health financing. The pro-health rationale makes raising these taxes more politically acceptable than tax changes whose primary goal is solely to increase government revenue.

Increasing the excise tax by 20% in 2022 and merging 10 tax tiers to 8 (Table 1) would generate Rp 210.1 trillion in 2022. This is more than the 2021-health budget and represents a 14% increase compared to the tobacco tax revenue expected in 2021. If no changes in tobacco taxes are made, the government will only collect Rp 186.5 trillion in 2022, or about Rp 23.6 trillion less. Following the established policy of

increasing excise taxes without fixing the inefficiency of the tier system is becoming less and less effective in generating the expected tax revenue, because consumers can do brand-switching, i.e., avoiding higher tax products by switching to a lower tax one.

Some of the newly generated tobacco tax revenue in 2022 could be dedicated to investing in post-COVID economic recovery and disaster preparedness.

3. Higher tax rates will generate more revenue to fund Universal Health Care (UHC)

The government of Indonesia has substantially increased its spending on health in 2021 and there are indications that this trend will continue in 2022. Such enhanced investment into human capital is aligned with the ambitious Indonesia Golden 2045 plan proposed by the President Joko Widodo. The investment priority in this sphere is aimed at an improvement in the national health insurance coverage, an enhancement of the integrated health system, and support for prevention efforts.⁶

A portion of the newly generated tobacco tax revenue in 2022 could be used for these important investments including reduction in the national health insurance deficit (i.e., the Jaminan Kesehatan Nasional- JKN) and expansion of the universal health coverage. In May 2020, even before the pandemic deepened the deficit hole, JKN was facing a cumulative deficit of IDR 31.7 trillion (US\$ 2.2 billion) while 70 million Indonesians, mostly those engaging in the informal sector, were still uninsured. The COVID crisis has further exacerbated the funding crisis by cutting the revenue of the Health Care and Social Security Agency (BPJS Kesehatan). Higher tax that would bring additional Rp 23.6 trillion to the state budget could easily cut the deficit in half in 2022 and then totally eliminate it in 2023 if the tax increases follow the WHO best practice.

4. Higher tax rates will generate more revenue to fund mitigation programs for tobacco farmers and tobacco industry workers

Another important component of the post-COVID economic recovery will be support for current tobacco farmers and workers to transition to alternative careers. Even though this transition is going to be slow (the overall cigarette production is expected to be declined by only about 6% in 2022 – see Table 1), it is important to plan for such diversification away from the tobacco sector, because growing tobacco is both detrimental to farmers' income as well as health of its family. In addition, tobacco use is responsible for almost a quarter of a million of premature deaths every year as well as for slowing down the economic growth. Findings of a 2020 qualitative study suggest that opportunities should be provided to tobacco farmers to transition to other crops, investment into infrastructure such as irrigation, transportation solutions, to facilitate the diversification, provision of vocational training for residents in the tobacco farming areas and support new start-up businesses in the affected areas by offering financing, especially for the young entrepreneurs. A portion of the newly generated tobacco tax revenue in 2022 could be used for these import investments.

5. Kurowski C, Evans DB, et al. *From Double Shock To Double Recovery-Implications And Options For Health Financing In The Time Of Covid-19*. 2021.

6. Sekretariat Kabinet Republik Indonesia. *Address of the President of the Republic of Indonesia on the Presentation of the Government Statement on the Bill on the State Budget for the 2021 Fiscal Year and Its Financial Note Before the Plenary Session of the House of Representatives of the Republic of Indonesia*. 2021

7. Statista. *Government budget for health in Indonesia from 2016 to 2020*. 2021; Available at : <https://www.statista.com/statistics/1147974/indonesia-government-health-budget/>

Recommendations:

1. Increase tobacco tax by at least 20% in 2022. A smaller tax increase will not decrease youth smoking prevalence and will not make a significant dent in the high adult smoking prevalence.
2. Simplify the tobacco tax structure by merging tiers in order to increase the impact of higher tax on lowering the prevalence and to enhance the tax revenue potential.
3. Use a portion of the tobacco tax revenue to finance post-COVID economic recovery to mitigate the impact of the pandemic.
4. Use a portion of the tobacco tax revenue to finance UHC, because such investment offers high returns and takes advantage of the demographic dividend, thus is aligned with the Indonesia Golden 2045 plan.
5. Use a portion of the tobacco tax revenue to finance mitigation programs for tobacco farmers and tobacco industry workers.

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