



# Extended Essay

## **To What Extent has the Indonesian Government's Policy on Tobacco Affected the Demand for Cigarettes**

### **Abstract**

In Indonesia, the culture that has embedded the nation is the intensive consumption of tobacco as it is traditionally spread through the country. The analysis of the study is to offer a focus on the impacts of the Indonesian Government Policy and how it has affected the demand for cigarettes. In this regard, the paper will provide an introduction to the research. Secondly, the study will provide inferences on the nature of tobacco and the type of product it can be categorized too, thirdly, to understand the effects on the demand correctly it would be rational to offer insight on the law of application and the price elasticity of the good. Additionally, the paper will provide a critical analysis of the law and how it impacts the market in Indonesia. Finally, the research will offer a recommendation on a possible strategy and finally offer an overall conclusion for the study.

### **Introduction**

The government plays an active role in policy making. The systems are made to improve the welfare of the citizens. However, it is important to identify that the policy has both the short term and the long term effects in the economy. The economists rationally internalize the externality of the policies so that the externality, in the long run, maximizes the welfare of the citizens. **In this regard, the analysis of the paper will focus on policy making and the aftermath effects. The central area of concentration is the Indonesian Government's policy on Tobacco and how it will influence the demand for Cigarettes.** The analysis of the influence will aid to analyze the

application of different microeconomic theories like the theory of demand and supply and the principles of supply and demand.

### **Nature of Tobacco as a Good**

Tobacco lies under different categories of products depending on the nature of the consumption by the user. Economists have continually argued on the nature of the good. To offer rational inferences on the influence of the Indonesian policy, it would be highly significant to first identify the nature of Tobacco as good(Kawanishi, 2016). The fundamental foundation of the economic theory is that an increase in the price of Tobacco would either increase or reduce the demand for the products of Tobacco.

On general context, tobacco is known as a demerit good. The attribute to the nature of the good is as a result of the negative externality the good has on the consumers. Commonly, tobacco consumption is closely linked to health hazards like cancer, kidney problem, breathing problems among other health risks. It is the reason different policies have established a high tax rate system on the goods to discourage their consumption. However, the challenge is that the policy has little impact on the expected output. Tobacco is considered to be one of the core sources of government revenue.

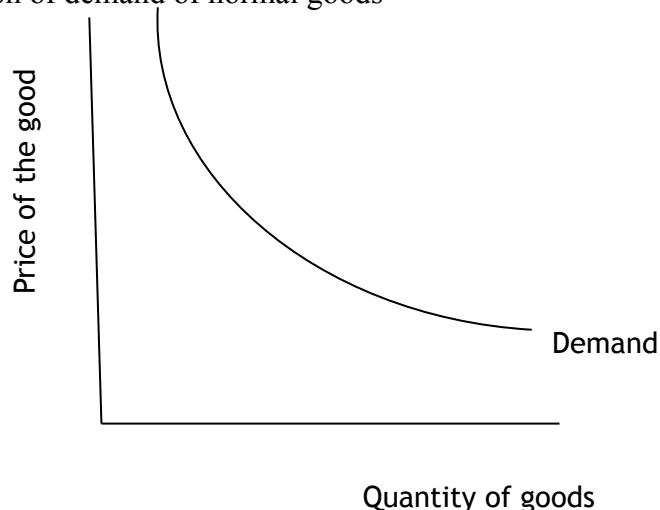
The focus on the nature of Tobacco products will be more anchored on the frequency of consumption and the different age groups that consume tobacco. In the occasional nature of smoking, the tobacco products are exemptions to the law of demand and supply. It, therefore, implies an increase in the price of good does not influence the demand for the good. It is mainly familiar to the young smokers who mostly smoke occasionally when they go out or when they are hanging with friends(Setio, 2010).

For the addicts and the regular smokers, the good would be considered as an inferior good. The increase in the price of the product results to decline in demand for the good due to the price effect. In this regard, it is rational to consider that the tobacco products fall under different categories of goods. It is significant to identify that there are no close substitutes for tobacco and therefore, the element has a significant influence on the forces of demand and supply of the commodity.

### **Law of Demand and Supply**

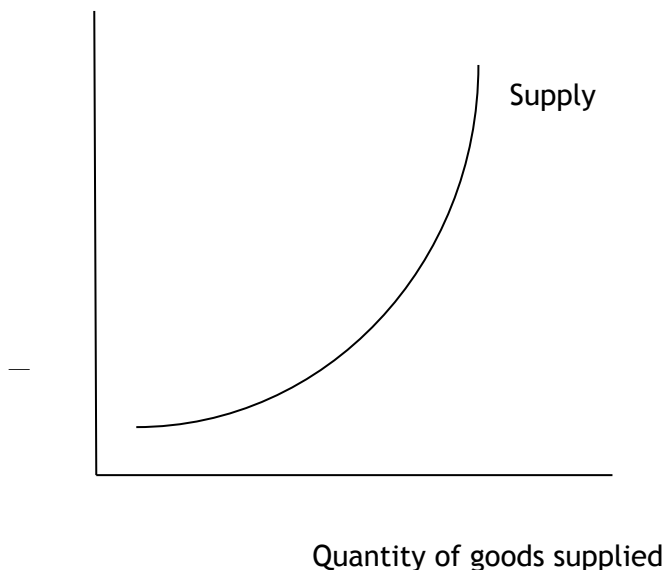
Before we analyze the impacts of the public policy, it would be significant to first identify the principles of the law of demand and supply. According to the Microeconomic theories of demand and supply, different factors influence the demand for the goods and services. The core factors include the prices of the goods, tastes, and preferences of the products, availability of substitutes, and the nature of the goods. An increase in the prices of the products and the services would result in a decrease in the prices of normal goods. The rationality behind the idea is that an increase in the price will limit the ability of the consumer to take a higher bundle of consumption due to the limitation of income. Therefore, the increase in the price will act as a dis-incentive for the use of the good.

A Graph of demand of normal goods



If the goods have close substitutes if the prices of the commodity increase consumers will show a higher preference for the substitute rather than the right(Renny, 2013). However, if the good has no substitutes an increase in the price of the good and services would imply that the demand for the good would remain unchanged. In an analysis of the nature of goods, there is four universal nature of goods, firstly, the normal goods which have been discussed above, the inferior goods, luxury goods and other types of products like giffen, substitute, complementary and Veblen goods. The different types of goods have different reactions to the law of supply and demand.

#### Graphical Representation of Supply of Normal goods



#### **Price Elasticity of Tobacco**

The analysis of price elasticity is mainly focused on the rate at which the changes in the prices of goods affect the rate of change demand. It is important to identify that there is perfect and imperfect elasticity. In perfect elasticity, an increase in the price of tobacco by one percent results to increase in demand by 1%(Setio, 2010). In imperfect elasticity an increase in the prices of one %, it would lead to a decrease in the demand for less than one or more than a percent. On the other hand, it would result in an increase in the demand for the good by more than or less than 1%. Depending on the frequency of consumption of tobacco the elasticity of the good also varies substantially.

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## **Indonesian Government's Policy on Tobacco**

Before the analysis of the impacts of the Indonesian public policy, it is important to understand the policy and the objective of the policy fully. According to the World Health records, it is evident that Indonesia is the 3<sup>rd</sup> largest consumer of tobacco. As identified above, tobacco consumption is considered as a demerit as it causes health hazards. It is the reason the government of Indonesia has found significance in the formulation of policies that will aid in the regulation of the amount of consumption of tobacco (Renny, 2013). In Indonesia, the problem would be termed as chronic as it is attributed to the culture of the nation.

The government strategies towards the inhibition of the habit include the sales restriction of the good, indirect taxation of the good, smoking restriction, Advertisement restrictions and the antismoking policies. The paper will offer a brief insight of each of the policy and the objective of the policy.

### **Indirect Taxation**

There different types of indirect taxes imposed to regulate the consumption of tobacco among the taxes include the exercise taxes, import duties and the general tax on consumption of the good. The exercise tax refers to the additional tax added to certain kinds of good like gasoline, alcoholic beverages, and cigarettes. The objective of the policy is to increase the revenue accumulation by the government and regulate the consumption of tobacco in Indonesia. The income reports of Indonesian government give credit to the contribution of exercise tax on tobacco in the accumulation of income.

The central objective of the policy is to reduce the demand for cigarettes. The economic principal under application in the policy is that taxes increases the prices of goods and services. It is

common that the producers will transfer the tax burdens or share the tax burden. In either of the strategy, the prices of cigarettes would increase (Setio, 2010). According to the laws of supply and demand, an increase in the prices of goods would increase the supply of the good. On the other hand, it would reduce the demand for the good. Based on the principal it is within the expectation that the policy would minimize the demand for the good substantially. The most feasible strategy tax is the specific tax compared to the ad valorem tax as the impacts are great and it significantly influences the demand for goods and services.

### **Smoking Restriction**

The government has strict restrictions on smoking in public places. Among the public places that have been declared as nonsmoking areas include in the religious places, in public transport, health facilities, offices, school, study facilities and such related areas(WHO, 2013). Violation of the policy is attached to a court fine of not less than Rp 50, 000.000 of imprisonment of not less than six months. The city administrations have gone further with the policy to the denial of the smokers and the family members of free healthcare services. The public policy makers advocated that they would not waste the resources to the people who will want to destroy the health status. The low-income families suffer the great cause of the policy as they are dependent on the free medical care provided by the government.

### **Advertisement Restrictions**

The advertisement law on adverse impacts of tobacco has been in effect since 2002. However, the implementation of the law has been termed so weak, and instead of serving its purpose the consumers are attracted to the consumption of cigarettes(Drope, 2011). The law

requires that the side effects of cigarettes should be stated in the package so that the users can get to understand the type of danger or risk they are getting to their health. The strategy of the implementation of the policy is the subliminal advertisement which relates to the negative externality of the product.

The publication strategies further include the TV programs structured to offer information on the adverse side effects of the consumption of the goods and the services. The challenge is that the strategy has negative impacts on the attitude of people on the products. The contribution on TV advertisement revenue accumulates by approximately 7%. The income from the ad industry sector for the tobacco goods has substantially increased. The challenge is that the ads strategy further offers samples freely that are used as strategies to demonstrate the adverse side effects.

### **Anti-Smoking Campaign**

The campaigns on Smoke-Free Jakarta have constantly been contested by the government of Jakarta and further the consumers of Indonesia. The purpose of the campaigns is to raise awareness on the adverse effects of consumption of the tobacco products (Patrick, 2013). The strategy involves sticking of the posters that demonstrate the adverse effects of the tobacco products.

The posters are trapped in the public areas where they help to reduce the consumption of cigarettes (Ford, 2012). In the campaigns, some of the messages passed through the public demonstration include the annual death rates and health impacts the goods have caused in the consumption of alcohol. Some of the organizations that help to raise awareness on the use of the product include the NGOs like the Cancer Organizations, Tobacco Free Society and the Smoking Prevention Organizations (L3M).

## **The Effects of the Policy on Demand**

In the analysis of the impacts of the consumption of cigarettes, the study will focus on the influence of each of the policy. Most substantially, the report will offer inferences on how effective or non-effective the system is in the society.

### **Impacts of Indirect Taxes on the Demand for Tobacco**

The indirect taxes have a significant effect on the reduction of demand to the low-income earners and especially to the regular users of tobacco. As identified above, regular smoking is considered as an inferior product and therefore an increase in the price of the commodity results to decrease in demand for the product(Proctor, 2012). However, to the high-income earners, the effect may be different, and it does not reduce the rates of consumption. It is important to identify that even to the low-income earners the impact may non-effective as consumption in some instance is not only influenced by the income.

People would always consume whether or not they have income. The consumption at zero income levels is considered as de-saving which is funded either by credit or loans. However, the general impact of the policy is that it has reduced the demand for consumption of tobacco(Judith, 2012). The increment of the prices of the tobacco products has diminishing returns. It, therefore, implies that the increase in the prices initially reduces the consumption of tobacco upon the introduction of the policy for a short period. Therefore, the side effects of the policy would be considered to be short term.

In the long run, the citizens get accustomed to the policies and therefore, the prices become friendly as the economy rises(Patrick, 2013). The economists, therefore suggest that the prices of the tobacco products should constantly be increased to influence the consumption behavior. An



increase in the prices of the tobacco is only valid if it gets to a specific percentage. For example, if the exercise taxes are raised to approximately 10% the side effects are, therefore, felt. However, if the activity taxes are lower than 10%, they have little effect on the consumption of cigarettes or the tobacco products.

### **Impact of Sales Restrictions**

The government of Indonesia has not implemented the sales quota strategy, and therefore, the sale, of tobacco is not restricted to the young adults and children as well. The strategy of the policy formulation has aggravated the levels of consumption of tobacco and therefore, addiction continues to develop at a young age. There is a need for the government to look into the strategy to regulate the levels of addiction to the teenagers.

### **Impacts of Smoking restrictions**

Smoking restrictions are objected at reducing the consumption habits of the smokers. The government, therefore, implements the strategy to regulate the number of people smoking and creating restrictions on the areas of smoking (Kelley, 2013). However, the aftermath of the habit is that people transfer the behaviors and the attitudes to the society where the people who suffer the consequences and the effects are the immediate family members. The problem is, therefore, just transferred from one place to another. The policy is resourceful in the reduction of effects of passive smoking to the public. However, in a real sense, the problem is not fundamentally solved.

Other strategies that the government advocates towards the decline of demand for consumption of tobacco products are through the government offering disincentives. The restrictions on the incentive of free public health are objected at reducing declining health services to people with side effects associated with smoking to the victims and their family members. The policy has been partially effective but only to the low-income earners whereby they only reliant on

public health services (Proctor, 2012). However, to the high-income earners, the policy has not been effective because the population has an alternative form of healthcare services like the private health services. Secondly, the high-income earners also have enrolled for insurance covers, and therefore, they don't find any significance of the health services from the public. The application of dis-incentive to public health services is, therefore, limited.

### **Influence of the Advertisement Restrictions**

It is an irony that people continue to consume a good despite the knowledge on the side effects of the product (Kelley, 2013). Psychologists have conducted a study to analyze the attributions of the adverse reactions to the products results advertisements. Among the factors that contribute to the continuous consumption of the commodity regardless of the knowledge of the side effects is attributed to the evidence of the incidents. Furthermore, some of the advertisements are highly exaggerated and therefore, the users are slow to respond.

The effectiveness of the advertisement strategies have on the reduction of levels tobacco consumption has proved to be futile (Kawanishi, 2016). The ad strategies are ineffective because instead of encouraging the side effects they are used for brand promotion of the tobacco products. Furthermore, the approach introduces intensive use as the samples are used to demonstrate. The users find the use of the product as lavish and stylish and therefore, the attachment of the class of smoking making smoking look admirable rather than introducing adverse impacts of smoking.

Besides the application of the strategy in the smoking, the strategy is further employed on other goods that have negative side effects. The problem is that the negative consequences are in some incidents highly exaggerated and therefore, the implications do not reflect the expectation. Therefore, in the end, it has resulted in increased consumption of the product.

## **Impacts of Smoking Restrictions**

The demand for the policy implies that the smokers are prohibited from smoking in public. As identified the objective of the policy is to discourage the users of the product. Although the responses of the administration have been valid and in order, the concern is the implication the policy has on the demand for the good. It is important to identify among the objective of the policy is to reduce the impacts of passive smoking to the public.

The second objective achievement is a big challenge as the smokers are forced to transfer the habits back at home where the impacts of smoking are partially passed to the direct family members. The impact of the policy on demand for tobacco has little or minimal effects. The elasticity is imperfect whereby the influence on the policy has reduced the rate of smoking with smaller ratios than expected. Statistics show that upon the implementation of the plan, the number of smokers increased significantly. For example, according to the ANTARA News, the number of female smokers increased by 50.6% which is contrary to the central objective (Inc, 2015).

## **Reasons for Failure of Success of the Policies**

It is evident that the formulated systems are substantially resourceful in the reduction of demand for cigarettes. However, the challenge is that the application of the system is faced with a lot of reluctance. The systems are not successful in the implementation of the proposed policies. Some of the factors that have inhibited the reduction of demand for cigarettes are attributed to the influence the consumption of tobacco has on the economy of Indonesia. It is evident the tobacco venture serves a significant influence in the provision of employment to the citizens of Indonesia (Kawanishi, 2016). Therefore, the farmers, producers and other related units are threatened to live

their only source of income while the employment opportunities are limited due to increasing population growth rates.

The efforts of the government in the implementation of the policy are also reluctant as the contribution of the activity in revenue accumulation is significant in the economy. For example, the regulation on consumption of cigarettes is more pronounced than the controls on supply or production of the tobacco (Hoover, 2012). If the amounts of tobacco produced remain to be the same, the consumption habits would be difficult to regulate because black markets will exist to sell all the manufactured cigarettes. Therefore, there is need to amend the policies to achieve the objective of the reduction of the demand for tobacco products. Most essentially, it is critical to ensure that the welfare of the citizens is fully maximized.

### **Recommendations**

It is important, to first identify that breaking of the demand to the addicted group would be a big challenge. However, among the identified policies some policies have proved to be more efficient and effective than others. The government should put emphasis on the plan and use the others as backup strategies (Drope, 2011). In this regard, the system that highly ranked to be more efficient is the use of the indirect taxes.

In Indonesia, the consumers of tobacco range the cigarettes to be relatively affordable, and it is the reason breaking the habits has been a big challenge. The prices are affordable even for children from the low-income families (Patrick, 2013). To reduce the affordability of the commodity, there is a need for a solution strategy which would include induction of the prices. The prices of the tobacco products can be induced through the addition of the indirect taxes.

As the prices of the good continue to increase the demand for the good would decrease primarily to young adults who have no source of income and to the children (Proctor, 2012). The strategy would, therefore, be feasible in the reduction of the demand for cigarettes. Research holds that an increase in the exercise taxes by approximately 10% would always reduce the demand for the commodity significantly and the revenue of the government would increase by approximately, 7.6%.

The distribution of the revenues accumulated from the exercise taxes should be directed to the areas that have received negative externality of the consumption tobacco (Jarman, 2014). Furthermore, it should be implemented in other backup solution strategies to reduce the consumption of cigarettes. Some of the backup procedures include the anti-smoking campaigns, the advertisement strategies and the sales and smoking restrictions policies (Kelley, 2013).

The federal unit plays an active role in the regulation of production of goods and services in the nation (Ford, 2012). Through policy formulation, the government of Indonesia should restrict the amount of production by the manufacturing plants. The strategy would help to regulate the supply of the commodity. It would, therefore, imply that the supply of the good would be limited as the amount released in the market is regulated (WHO, 2013). The consumption habits would, therefore, conform to the availability of the commodity. Every production company should have an established limit for the production of the cigarettes. Most importantly, the funds can alternatively be directed to other productive sectors of the economy that would aid in the generation of employment opportunities to reduce the dependency levels of tobacco activities as the source of income (Judith, 2012).

Other policy strategies that can aid in the regulation of the demand of smoking habit include the sales restriction. It is evident that in Indonesia, there are no policies that restrict the consumption of cigarettes to the young generation (Setio, 2010). It is the reason that the initiation of the habit

begins at a very young age and it is further developed to addictive behaviors. The policies should restrict the consumption of tobacco especially to children and teenagers below the age 16 or 18 years.

Violation of the policy should attract penalties like court fines and rehabilitation of the victims. The strategy would be effective as the parents would play an active role to their children to ensure that they don't indulge in the behavior of illegal consumption of tobacco. The parent's aggressiveness would be focused in the avoidance of the fines as funds are limited. The habits would further force the parents to be good role models to their children, and therefore the parents would also reduce the consumption. The policy has a double effect in the reduction of demand for the use of alcohol.

### Conclusion

It is evident that in Indonesia the consumption of tobacco is the main challenge. The government has played an active in the regulation of the consumption behaviors among the users which are not a simple task. Among the policies that the government has implemented include the indirect taxes, the sales restriction, the anti-smoking campaigns, the public smoking restrictions among others. The objectives of the policies are to reduce the demand for consumption of tobacco and the regulation of the side effects of use to the passive consumers. The economic principles of application in the study include the law of demand and supply, the price elasticity of goods and services and the different nature or types of products and services. Most importantly, the application of consumption behaviors of tobacco has been very resourceful.

There is a major challenge that the application of the policies is highly faced with many problems, and the success of the policies is limited. The ability of the policies to reduce the demand

for tobacco products has low impacts. The factors that lead to the limitation include the contribution of tobacco to the economy through employment. Furthermore, the government of the Indonesia has been reluctant in the implementation of the policy. There is a need for a revolution of the systems to ensure that the demand is reduced. The strategy would require that the government, implement a policy like sales restrictions. Furthermore, the other procedures should be given more effort and emphasize. Most importantly, the revenue accumulation from the sector should be directed to the other strategies that reduce the consumption of cigarettes. Cigarettes affect the health of the citizens of Indonesia which is an additional expense to the government. Preventive strategies are better than the curative procedures.

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