

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

### **Abstract**

In Indonesia, the culture of intensive tobacco consumption is deeply embedded and has traditionally spread throughout the country. The analysis of the study focuses on the impact of 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 as. Thirdly, to understand the effects on demand correctly, it would be rational to offer insight into the law of demand 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 provide an overall conclusion for the study.

### **Introduction**

The government plays an active role in policy-making. Policies are created to improve the welfare of citizens. However, it is important to recognize that policy has both short-term and long-term effects on the economy. Economists rationally internalize the externalities of policies so that, in the long run, these externalities maximize citizens' welfare. In this regard, the analysis in this paper will focus on policy-making and its 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 this influence will help analyze the application of different

microeconomic theories, such as the theory of demand and supply and the principles of supply and demand.

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

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

In a general context, tobacco is known as a demerit good. This attribute is a result of the negative externalities the good has on consumers. Commonly, tobacco consumption is closely linked to health hazards like cancer, kidney problems, breathing problems, and 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 one of the core sources of government revenue.

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

For addicts and regular smokers, the good would be considered an inferior good. An increase in the price of the product results in a decline in demand for the good due to the price effect. In this regard, it is rational to consider that tobacco products fall under different categories of goods. It is significant to identify that there are no close substitutes for tobacco, and therefore, this 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 public policy, it would be significant to first identify the principles of the law of demand and supply. According to microeconomic theories of demand and supply, different factors influence the demand for goods and services. The core factors include the prices of goods, tastes and preferences for the products, availability of substitutes, and the nature of the goods. An increase in the prices of products and services would result in a decrease in the demand for normal goods. The rationality behind the idea is that an increase in 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 price will act as a disincentive for the use of the good.

If the goods have close substitutes, and if the prices of the commodity increase, consumers will show a higher preference for the substitute rather than the original good (Renny, 2013). However, if the good has no substitutes, an increase in the price of the goods and services would imply that the demand for the good would remain unchanged. In an analysis of the nature of goods, there are four universal types of goods. Firstly, there are normal goods, which have been discussed above. There are also inferior goods, luxury goods, and other types of products, such

as Giffen, substitute, complementary, and Veblen goods. The different types of goods have different reactions to the law of supply and demand.

## **Price Elasticity of Tobacco**

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

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

Before analyzing the impacts of Indonesian public policy, it is important to fully understand the policy and its objective. According to World Health records, it is evident that Indonesia is the third-largest consumer of tobacco. As identified above, tobacco consumption is considered a demerit because it causes health hazards. This 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 tobacco consumption (Renny, 2013). In Indonesia, the problem would be termed chronic, as it is attributed to the culture of the nation.

The government strategies toward the inhibition of the habit include sales restrictions on the good, indirect taxation of the good, smoking restrictions, advertisement restrictions, and anti-smoking policies. The paper will offer brief insight into each policy and the objective of the policy.

## **Indirect Taxation**

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

The central objective of the policy is to reduce the demand for cigarettes. The economic principle under application in the policy is that taxes increase the prices of goods and services. It is common that producers will transfer the tax burden or share the tax burden. In either 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 principle, it is within the expectation that the policy would minimize the demand for the good substantially. The most feasible tax strategy is the specific tax compared to the ad valorem tax, as the impacts are great and significantly influence 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 nonsmoking areas are religious places, public transport, health facilities, offices, schools, study facilities, and related areas (WHO, 2013). Violation of the policy is attached to a court fine of not less than Rp 50,000,000 or imprisonment of not less than six months. City administrations have gone further with the policy by denying smokers and their family members free healthcare services. Public policy makers advocated that they would not waste resources on people who want to destroy their health status. Low-income families suffer the greatest cause of the policy, as they are dependent on the free medical care provided by the government.

## **Advertisement Restrictions**

The advertisement law on the adverse impacts of tobacco has been in effect since 2002. However, the implementation of the law has been termed very weak, and instead of serving its purpose, consumers are attracted to the consumption of cigarettes (Drope, 2011). The law requires that the side effects of cigarettes should be stated on the package so that users can understand the type of danger or risk they are bringing to their health. The strategy of the implementation of the policy is subliminal advertisement, which relates to the negative externality of the product.

The publication strategies further include TV programs structured to offer information on the adverse side effects of the consumption of goods and services. The challenge is that the strategy has negative impacts on people's attitudes toward the products. The contribution to TV

advertisement revenue accumulates by approximately 7%. The income from the advertising industry sector for tobacco goods has substantially increased. The challenge is that the advertisement strategy further offers free samples 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 of the adverse effects of tobacco product consumption (Patrick, 2013). The strategy involves posting posters that demonstrate the adverse effects of tobacco products.

The posters are placed in public areas where they help reduce the consumption of cigarettes (Ford, 2012). In the campaigns, some of the messages passed through public demonstrations include the annual death rates and health impacts the goods have caused through the consumption of tobacco. Some of the organizations that help raise awareness of the use of the product include NGOs like cancer organizations, the Tobacco Free Society, and smoking prevention organizations (L3M).

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

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

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

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

People would always consume whether or not they have income. Consumption at zero income levels is considered dissaving, which is funded either by credit or loans. However, the general impact of the policy is that it has reduced the demand for the consumption of tobacco (Judith, 2012). The increment of the prices of tobacco products has diminishing returns. It, therefore, implies that the increase in 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 short-term.

In the long run, citizens get accustomed to the policies, and therefore, the prices become friendly as the economy rises (Patrick, 2013). Economists, therefore, suggest that the prices of tobacco products should constantly be increased to influence consumption behavior. An increase in the prices of tobacco is only valid if it gets to a specific percentage. For example, if the excise taxes are raised to approximately 10%, the side effects are felt. However, if the excise taxes are lower than 10%, they have little effect on the consumption of cigarettes or 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 young adults and children. The strategy of policy formulation has aggravated the levels of tobacco consumption, 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 among teenagers.

## **Impacts of Smoking Restrictions**

Smoking restrictions are aimed at reducing the consumption habits of smokers. The government, therefore, implements the strategy to regulate the number of people smoking and create restrictions on smoking areas (Kelley, 2013). However, the aftermath of the habit is that people transfer the behaviors and attitudes to society, where the people who suffer the consequences and 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 the effects of passive smoking on the public. However, in a real sense, the problem is not fundamentally solved.

Other strategies that the government advocates toward the decline of demand for the consumption of tobacco products are through the government offering disincentives. The restrictions on the incentive of free public health are aimed at reducing health services to people with side effects associated with smoking and to the victims and their family members. The policy has been partially effective, but only for low-income earners, who are reliant on public health services (Proctor, 2012). However, for high-income earners, the policy has not been effective because the population has alternative forms of healthcare services, such as private health services. Secondly, high-income earners have also enrolled in insurance covers, and

therefore, they do not find any significance in public health services. The application of disincentives to public health services is, therefore, limited.

## **Influence of Advertisement Restrictions**

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

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

Besides the application of the strategy in 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 smokers are prohibited from smoking in public. As identified, the objective of the policy is to discourage 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 that among the objectives of the policy is to reduce the impacts of passive smoking on the public.

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

## **Reasons for Failure or 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 that the tobacco venture has a significant influence on the provision of employment to the citizens of Indonesia (Kawanishi, 2016). Therefore, farmers, producers, and other related units are

threatened with losing their only source of income, while 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 to revenue accumulation is significant in the economy. For example, the regulation on the consumption of cigarettes is more pronounced than the controls on the supply or production of tobacco (Hoover, 2012). If the amounts of tobacco produced remain the same, the consumption habits would be difficult to regulate because black markets will exist to sell all the manufactured cigarettes. Therefore, there is a need to amend the policies to achieve the objective of reducing the demand for tobacco products. Most essentially, it is critical to ensure that the welfare of citizens is fully maximized.

## **Recommendations**

It is important to first identify that breaking the demand among 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 is highly ranked as more efficient is the use of indirect taxes.

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

As the prices of the good continue to increase, the demand for the good would decrease, primarily among young adults who have no source of income and among children (Proctor, 2012). The strategy would, therefore, be feasible in the reduction of the demand for cigarettes. Research holds that an increase in excise 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 excise taxes should be directed to the areas that have received the negative externality of tobacco consumption (Jarman, 2014). Furthermore, it should be implemented in other backup solution strategies to reduce the consumption of cigarettes. Some of the backup procedures include anti-smoking campaigns, advertisement strategies, and sales and smoking restriction policies (Kelley, 2013).

The federal unit plays an active role in the regulation of the production of goods and services in the nation (Ford, 2012). Through policy formulation, the government of Indonesia should restrict the amount of production by manufacturing plants. The strategy would help regulate the supply of the commodity. It would, therefore, imply that the supply of the good would be limited as the amount released into 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 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 on tobacco activities as a source of income (Judith, 2012).

Other policy strategies that can aid in the regulation of the demand for smoking habits include sales restrictions. It is evident that in Indonesia, there are no policies that restrict the consumption of cigarettes among the young generation (Setio, 2010). This is the reason that the initiation of the habit begins at a very young age, and it is further developed into addictive behavior. The policies should restrict the consumption of tobacco, especially among children and teenagers below the age of 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 parents would play an active role in ensuring that their children do not indulge in the behavior of illegal tobacco consumption. The parents' aggressiveness would be focused on the avoidance of fines, as funds are limited. The habits would further force parents to be good role models to their children, and therefore, the parents would also reduce consumption. The policy has a double effect on the reduction of demand for tobacco use.

## **Conclusion**

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

types of products and services. Most importantly, the application of consumption behaviors of tobacco has been very resourceful.

There is a major challenge, as the application of the policies is 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 Indonesia has been reluctant in the implementation of the policy. There is a need for a revolution of the systems to ensure that demand is reduced. The strategy would require that the government implement a policy such as sales restrictions. Furthermore, the other procedures should be given more effort and emphasis. Most importantly, the revenue accumulation from the sector should be directed to 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 curative procedures.

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