

AN ASSESSMENT OF TOBACCO EXCISE ADMINISTRATION PRACTICES IN INDONESIA

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ABSTRACT:

The global economic slowdown has unquestionably brought down the performance of the Indonesian economy. This, in turn, presented an extraordinary challenge to the Directorate General of Customs and Excise (DGCE) in collecting excise revenues. In the last few decades, tobacco has contributed the largest part of excise revenue. Accordingly, it is inevitable for the DGCE to implement best practices in administering tobacco excise to optimize revenue collection, while at the same time, enhance public health. Conveniently, The World Health Organization (WHO) provides a series of extensive best practices in that particular field. This study is set as a comparative research which assessed tobacco excise administration practices performed by the DGCE and compared them against best practices set by the WHO. This study revealed that, in general, the DGCE has performed well in most of these best practices. However, there are some WHO's best practices which are unsuitable to be implemented in Indonesia. Unique fiscal, economic, political and social circumstances in Indonesia need to be taken into account in determining and establishing tobacco excise tax policy.

Keywords: tobacco excise, best practices, WHO, Indonesia

ABSTRAK:

Perlambatan ekonomi dunia telah nyata-nyata membawa pelemahan pada kinerja ekonomi Indonesia. Pada gilirannya, hal ini menghadirkan tantangan yang luar biasa bagi Direktorat Jenderal Bea dan Cukai (DJBC) dalam mengumpulkan penerimaan cukai. Dalam beberapa dekade terakhir, tembakau memberikan kontribusi terbesar dalam penerimaan cukai. Tentunya, tak dapat dipungkiri, DJBC perlu menerapkan *best practices* di bidang pengelolaan cukai hasil tembakau untuk mengoptimalkan pengumpulan penerimaan, sekaligus pada saat yang bersamaan meningkatkan kesehatan masyarakat. Untungnya, World Health Organization (WHO) menyediakan serangkaian *best practices* yang lengkap di bidang ini. Studi ini dilakukan sebagai suatu riset komparatif dengan melakukan suatu tinjauan atas praktek-praktek pengelolaan cukai hasil tembakau yang dilakukan DJBC dan kemudian membandingkannya dengan *best practices* yang disusun WHO. Studi ini mendapati, secara umum, kinerja DJBC dalam menerapkan sebagian besar *best practices* WHO tersebut sudah cukup baik. Namun, ada beberapa *best practices* WHO yang tidak sesuai untuk diterapkan di Indonesia. Kondisi fiskal, ekonomi, politik dan sosial Indonesia yang unik harus dipertimbangkan dalam menentukan dan mewujudkan kebijakan cukai hasil tembakau.

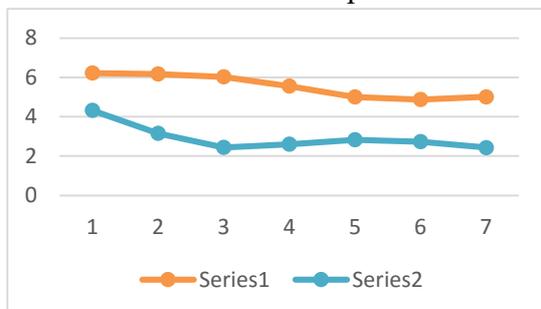
Kata Kunci: cukai tembakau, pengalaman terbaik, WHO, Indonesia

1. PREFACE

The World Bank noted the world economy continued to weaken in 2016. The economy only grew 2.07 percent, substantially lower than the 2.4 percent projection. This was disappointing indeed as the growth was even lower than 2015 which was 2.12 percent. The World Bank also observed that the emerging market and developing economies (EMDEs) faced tougher challenges as the growth of advanced economies weakened further, commodity prices continued to decline, along with global trade and capital flow kept on slowing down (World Bank Group, 2016, p. 3). In view of these challenges, the World Bank suggested that commodity producers, like Indonesia, should enhance their fiscal rules (World Bank Group, 2016, p. 104).

Naturally, Indonesia was affected by the global economic slowdown. As the economic growth of the world weakened from 4.32 percent in 2010 to 2.43 percent in 2016, the economic growth of Indonesia also waned from 6.22 percent in 2010 to 5.01 percent in 2016, as illustrated in Figure 1. The diminishing economic growth of Indonesia, to a certain degree, was affected by the sluggish growth of its exports. As the World Bank advised, Indonesia needs to strengthen its fiscal policy to keep its development rolling.

Figure 1.
GDP Growth comparison



Source: Adapted from the World Development Indicator, the World Bank

Excise tax has perpetually been an important source of government revenue in Indonesia. At average, excise tax accounted for 9.90 percent of total taxation revenue or 7.62 percent of total government revenue, as detailed in Table 1. Tobacco excise tax makes up roughly 95 percent of total excise tax revenue. Then, tobacco excise tax understandably becomes an imperative issue in the debate about financing the development in Indonesia. As the Government of Indonesia needs to strengthen its fiscal policy, once again the tobacco excise tax is put under the spotlight. With regard to increase government revenue, the DGCE, which has the mandate to levy tobacco excise tax, might need to enhance its capability. One strategy to do so is the implementation of best practices in administering tobacco excise tax.

Coincidentally, the WHO published a series of best practices which were gathered from the best tax administrators in the world. These best practices are preferred than others since they served two goals concurrently, specifically revenue collection goal and public health protection goal. Tobacco excise tax cannot be seen merely as a fiscal tool. It also serves as a tool for promoting public health. Accordingly, the best practices prepared by the WHO suit the need of the DGCE the best.

This study compared best practices in excise tax administration to actual practices performed by the DGCE. The aim of this comparison is to see how far the DGCE has instigated the best practices, to identify which administration practices of the DGCE need to improve and to identify which best practices unsuitable to be implemented in Indonesia. This study aims to encourage the DGCE to fulfill its vision which is to

become the leading customs and excise administration in the world.

This study is organized as follows. This section, the preface, provides a brief background of this study, expresses the research problem, and states the aims of this study. The second section conveys a concise literature review regarding the description of best practice and focusing on best practice in tobacco excise tax administration. The third one elaborates the research method, a qualitative study which utilizes unstructured open-ended questionnaire. The next section is the main part of this study which examines tobacco excise tax practices in Indonesia in comparison with the best practices. The last section concludes this study and offers several recommendations.

2. LITERATURE REVIEW

Public administration, just like many other applied fields, has involved in best practices research for a long time (Bretschneider, Marc-Aurele Jr., & Wu, 2005, p. 307). However, best practices were introduced in tax administration just recently (Hasseldine, 2007, p. 9). Best practices refer to a set of benchmarks which are adapted from the foremost practitioners in the particular field in order to induce improvements. This idea emerged from dissatisfaction caused by reviews and appraisals which only provided critiques to the existing practices without showing how to improve them (Mold & Gregory, 2003, p. 131).

Bretschneider, Marc-Aurele & Wu stated that the term “best practice” indicates that it is superior when compared with any other course of action and it is a practice which is designed to obtain the intended output (Bretschneider, Marc-Aurele Jr., & Wu, 2005, p. 309). In addition, Overman & Boyd defined best

practices as the selected practice of a collection of exemplars among various context with the purpose of obtaining more general principles and theories (Overman & Boyd, 1994). Both descriptions specify a collection of practice from which the best one is sensibly selected. The purpose of this selection is to develop more generalizable principles and theories from which the best output (in term of quantity as well as quality), can be obtained. These descriptions also emphasize that the selected practice must be second to none which means it is the-best-of-the-best.

Dr. Ala Alwan, then Assistant Director-General for Noncommunicable Diseases & Mental Health of the WHO, maintained that raising taxes, particularly excise, on tobacco had been proven as the most cost-effective measure for reducing tobacco consumption (World Health Organization, 2011, p. 9). Accordingly, the WHO urges member countries to raise excise tax rate so as to augment public health impact of tobacco excise taxes. Besides, the WHO maintains increasing excise tax rate would surely expand collected revenues which are in fact needed by the governments.

In the light of assisting member countries to bolster their tax administration capacity, the WHO published a series of best practice. These best practices are selected from the most effective and efficient practices performed by tax administrations of member countries. They are intended to assist the government of member countries in extending the impact of tobacco excise taxes in reducing tobacco consumption along with its economic and health consequences, while simultaneously improving their revenue generating capacity.

Aside from the above best practices, the Asia-Pacific Tax Forum along with the International Tax and Investment Center (ITIC) also published a series of best practices in excise tax administration to support ASEAN member countries in reforming their excise tax administration (Preece, Obradovic, & Cooper, 2015). Unlike the one prepared by the WHO, this set of best practices is essentially based on revenue concerns. These best practices do not entirely address tobacco excise tax, but also cover other excise tax imposed by ASEAN member countries. These best practices are intended as a roadmap toward the establishment of ASEAN Economic Community.

Another series of best practices in administering tobacco excise tax was also published by the International Monetary Fund (IMF) (Petit & Nagy, 2016). Similar to the one published by the ITIC, best practices advocated by the IMF is prepared from the economic perspective. These best practices cover several issues which include revenue potential, the selection of specific or ad valorem tariff, earmarking, and control measures.

One series of best practices in administering tobacco excise tax was also published by Center for Public Health Systems Science and the Tobacco Control Legal Consortium (Center for Public Health Systems Science, 2014). This publication mainly covers designing policy in determining retail price of tobacco products. The purpose of this publication is to assist governments in building effective and sustainable tobacco control programs.

Still, another series of best practices was published by Cancer Council Australia and National Heart Foundation of Australia (2009). This publication only made a comparison of 21% and 50%

increase of tobacco excise tax in Australia. This publication suggested that the Australian Government increase tobacco excise tax in two phases, first 21% (as an interim step) and then 50% on current price.

3. RESEARCH METHOD

This study employed best practices prepared by the WHO as a measuring instrument in assessing excise administration practices performed by the DGCE. The WHO accumulated these best practices from empirical evidence and published literature which are detailed in WHO Technical Manual on Tobacco Tax Administration (World Health Organization, 2011, p. 103). In this technical manual, the WHO presented an overview of different schemes of tobacco excise tax, along with strong and weak points of each scheme. This technical manual also discussed distinctive challenges, specifically technical and political, encountered in the implementation of each scheme. The best practices are the extraction of selected superior practices from the schemes. With this technical manual, the WHO offered guidelines for governments in maximizing benefits they can obtain from higher tobacco excise tax by identifying a series of best practices.

Furthermore, it is important to note, as this technical manual was provided by the WHO, it certainly put more emphasis on public health impact, while at the same time acknowledge the importance of generating revenue. Succinctly, these best practices are aimed to achieve two goals in unison. This uniqueness gave the WHO best practices incomparable advantage, with regard to public health, over best practices set by others. This is indeed the reason why this study opted for the WHO best practices.

These best practices covered the recommendations regarding the structure and level of tobacco excise tax, recommendations regarding the political economy of tobacco excise tax, recommendations regarding strengthening tax administration and enforcement, and more. This study addressed each one of the best practices and compared them with data and information obtained from the DGCE.

The data were gathered by means of interviewing the officials of the DGCE, particularly officials of the Excise Directorate, and studying reports as well as publications regarding the implementation of excise policy in Indonesia as well as other ASEAN member countries. In the interview with the officials, an unstructured open-ended questionnaire was utilized. The responses of the officials are synchronized and harmonized as one. In this interview, the officials were asked to elaborate their view regarding the implementation of each best practice suggested by the WHO. This study, afterward, augmented the responses of the officials with facts gathered from reports and publications. The responses of the officials as well as the facts obtained from reports and other publications are presented in the following section.

4. ANALYSIS AND DISCUSSION

The WHO proposes 20 best practices in the technical manual (World Health Organization, 2011, pp. 103-112). This part discusses the best practices one by one and compares them with current practices performed by the DGCE. This study, in addition, compares current practices performed by excise tax administrators in ASEAN.

The first best practice urges the increase of tobacco excise tax for reducing death and diseases caused by tobacco use. The WHO claims extensive researches provided scientific evidences that high tobacco excise tax effectively reduces tobacco use. In addition, the WHO maintains that, in the short and medium run, the increase in tobacco excise tax will generate considerable revenue. But, it will decline in the long run.

The DGCE explains the Government of Indonesia employs tobacco excise tax as a fiscal instrument to achieve several development goals, which include collecting revenue and controlling tobacco consumption. In the last several years, the excise tax policy has provided a considerable contribution to government revenue as well as effectively reduce tobacco consumption. Annually, tobacco excise tax collected by the DGCE increase by an average of 10-15 percent. Tobacco excise tax contributes around 95 percent of total excise tax revenue. At the same time, production of tobacco products declined 0.44 percent in the last 10 years. The most significant decline occurred in 2016 when production dropped 1.8 percent.

The DGCE understands that the tobacco industry might decline in the long run. Subsequently, the DGCE would make an adjustment in regard to fiscal and regulatory aspects. With the current specific tobacco excise tax structure, the revenue collected is determined by the tariff and the volume of production. The decrease in the volume of production would be compensated by increasing the tariff. Nevertheless, the correlation between them might not be linear. Eventually, the decline in revenue from tobacco excise tax is foreseeable.

Next, the second best practice recommends that tobacco excise tax

account for at least 70 percent of the retail price. The WHO perceives that price of tobacco products will rise substantially. In sequence, many consumers will quit, while non-consumers will be prevented from starting. The WHO believes the impact on the reduction of death and diseases caused by tobacco use will be immense. In addition, the WHO insists this large increase should be limited only to tobacco excise tax and not on all taxes, so as to increase the price of tobacco product relative to the price of other goods and services.

At present, the DGCE imposes tobacco excise tax below the ceiling stipulated in the Law Number 39 Year 2007, specifically 57 percent of the retail price. Tobacco excise tax of 70 percent of the retail price would be possible after the amendment of the Excise Law.

In term of tobacco excise tax burden as the percentage of retail price, Indonesia, with 57.5 percent is above the average of ASEAN countries. Thailand leads with 70 percent, tailed closely by Singapore and Brunei with 66.2 percent and 62 percent respectively. The lightest burden is imposed by Cambodia and Lao PDR with 25 to 31.1 percent and 16 to 19.7 percent respectively. In comparison with other ASEAN countries, Indonesia imposes a relatively heavy tax burden on tobacco products (Southeast Asia Tobacco Control Alliance, 2015, p. 6).

Furthermore, the ITIC published a report which reveals a disproportionate increase in tobacco excise tax can bring undesired consequences. This report mentions an excessive increase in tobacco excise tax may lead to increases in smuggling, counterfeiting, and other illicit activities. This report also highlights that many countries have suspended excise tax increase due to illicit trade concerns

(Oxford Economics, 2011, p. 2). Congruently, the WHO believes the decision to raise tobacco excise tax should be based on political considerations which include, but are not limited to, concerns regarding the impact on tax evasion and avoidance (World Health Organization, 2011, p. 75). The WHO also accepts excessive tobacco excise tax increase may offer financial incentives for fraud (World Health Organization, 2011, p. 83).

What's more, Cooper & Witt support the ITIC's claim by presenting experiences of G7 countries, Malaysia, Singapore and Ireland. They assert illicit tobacco trade are mainly driven by excessive tax levels which cause a sharp decline in tobacco products affordability and open the opportunity for lawbreakers to supply cheap illegal tobacco products to the market. As a final point, they forewarn increasing tobacco excise tax without taking into account purchasing power of consumers is detrimental to the market, unreliable to government revenues, and encouraging to the expansion of unregulated illicit markets (Cooper & Witt, 2012).

The third best practice endorses simplification of tobacco excise tax structure. The WHO highlights that simple structure will be easier to administer. It will also deter excise avoidance and evasion as well as prevent switching down to cheaper tobacco products. The WHO advises on reducing the variations in excise taxes along with the number of tiers over time with the aim of achieving single uniform excise tax.

The DGCE describes that, in the last 10 years, the structure of the tobacco excise tax has been simplified. This restructuring process was conducted gradually taking into consideration optimization of revenue, impact on

employment sustainability and illicit tobacco distribution. Currently, the government is reviewing medium term policy, especially restructuring tobacco excise tax for optimizing revenue and increasing compliance.

Moreover, the DGCE elaborates that, in comparison with other countries, Indonesia has a very heterogeneous tobacco industry. This industry has a very diversified tobacco products, manufactured simply by hand-rolling or by sophisticated technology in a wide range of factory, from home industries to multinationals. At present, there are 786 registered tobacco factories which employ around 403.2 thousand direct labor. The Government needs to differentiate tobacco excise tax imposed on these factories. The DGCE continues to simplify tobacco excise tax structure. In 2012, the DGCE reduced layers of tariff from 19 to 15. In 2014, the layers were reduced to 13, and lastly, in 2015 the layers were reduced again to 12. Further reduction of the layers might cause significant distortion to the tobacco markets. Therefore, it would be remarkably problematic for the Government to implement single uniform tariff. The DGCE sees single uniform tariff would be more feasible to be implemented in countries with a more homogenous tobacco industry.

Nonetheless, the DGCE keep trying to simplify the structure. Table 2 shows cigarette excise tax increase from 2016 to 2017. It appears that the gap between layer 1 and 2 of the Machine-made Kretek Cigarette becomes wider while, while the gap between layer 2 and 3 becomes narrower. The same thing happens with Machine-made White Cigarette and Hand-rolled Kretek/White Cigarette with Filter. These facts indicate that the DGCE is trying to merge layer 2 and 3 so as to reduce the number of layers.

The Oxford Economics (OE) and ITIC perceive Indonesia as a country with the most complex tobacco excise tax structure in the world. They acknowledge the effort of the DGCE to gradually simplify the structure from 19 to 12 layers (2016, p. 66). The OE and the ITIC believe this complex structure led to illicit cigarette consumption by providing the opportunity and incentive for manufacturers to under-declare their liabilities to the DGCE (2016, p. 68).

The 4th best practice urges the use of specific excise taxes as the main instrument in increasing tobacco products retail price. The WHO believes greater reliance on specific excise tax would reduce the retail price gap between premium and low-grade tobacco products. The WHO also insists that this practice would limit the consumers from switching down in response to excise tax increase.

To date, the DGCE imposes the specific excise tax on all tobacco products. In addition, the DGCE makes annual adjustment to the minimum retail price. This specific excise tax has been employed since 2009. Previously, the DGCE employed mix excise tax from 2007 until 2008, and before that ad valorem excise tax.

Among ASEAN member countries, there is no consensus on the main instrument in increasing tobacco products retail price. Indonesia, along with Brunei, Malaysia, the Philippines and Singapore implements the pure specific system, which is in line with the best practice advocated by the WHO. Alternatively, Cambodia, Myanmar, and Vietnam employ pure ad valorem system. The other two countries, Lao PDR and Thailand, mix the two systems. Lao PDR relies on ad valorem system as the main instrument. Lao PDR plans to increase the ad valorem

tariff from the current 30 to 45 percent and 60 percent in 2018-2019 and 2020 respectively. Thailand, on the other hand, uses alternating system between 90 percent of ex-factory price or THB 1.1/gram, whichever value is higher (Southeast Asia Tobacco Control Alliance, 2015, p. 5).

Actually, the WHO does not sternly compel member countries to utilize specific excise tax on tobacco products. The WHO sees that specific excise tax is appropriate for increasing retail price and reducing the market share of cheap tobacco products. Additionally, the WHO recognizes that ad valorem excise tax can be imposed to alter quality and variety of tobacco product to reach an intended conditions. The WHO also understands there is no single rule where one size fits all (World Health Organization, 2011, p. 52).

The 5th best practice advocates the use of excise tax to replace import duties. As countries implemented trade agreements, import duties lost their effectiveness. The use of excise taxes would ensure sustainability of revenue. The WHO insists that the replacement process should make sure that the total imposed taxes are increasing.

The DGCE elaborates that principally excise tax and import duty policies are formulated separately. The DGCE increases the specific excise tax almost every year with the intention of making necessary adjustment for inflation as well as coping with the keep increasing target. In short, excise tax increase has not been intended to compensate the decrease in import duty.

The burden of import duty, even when is imposed at a trivial level, makes imported tobacco products more

expensive than the domestic ones. Indeed, levying import duty is always intended to make domestic products more competitive. In the bargain, levying the same level of excise tax on both kinds of tobacco products, imported and domestic ones, would not bring many differences. Accordingly, tobacco excise tax could not be used for replacing the diminishing import duty if the same level of excise tax is imposed on both products. Tobacco excise tax may be proper to replace import duty if only imported products can be charged with a higher level of tax than the domestic ones.

At present, there is only one layer of tobacco excise tax for imported products. The DGCE charges the imported tobacco products the same level of excise tax with the highest layer of domestic products. Consequently, the imported tobacco products are more expensive than the highest layer of domestic products. The gap of excise tax burden becomes even wider when compared with lower layers of domestic products.

The 6th best practice suggests countries to employ comparable excise taxes and comparably increase excise taxes. The WHO implies incomparable excise tax increase would encourage switching down behavior, thus reduce the impact of excise tax increase on consumption. In addition, a comparable increase on all tobacco products would generate larger revenue.

The DGCE explains that the yearly increase in excise tax has taken into consideration the type of tobacco products, the capacity of the factory, the technology employed (hand-rolled or sophisticated), and the price elasticity. Whenever possible, the DGCE makes the increase proportional to all manufacturers. Furthermore, the DGCE puts extra

attention to prevent switching down since it disrupts the market.

The 7th best practice advocates the elimination of tax- and duty-free sales of all tobacco products. The WHO claims that this best practice, by reducing the opportunity for tax avoidance, would increase the health impact of increasing excise while at the same time increase revenue.

The DGCE states, at present, there is no plan to eliminate tax- and duty-free sales of tobacco products. The existing law grant tax- and duty-free to passengers and crews for importing tobacco products up to the stipulated amount. Passengers may imports, upon arrival, up to 200 sticks of cigarettes, 25 sticks of cigars or 100 grams of tobacco. Crews may imports, upon arrival, up to 40 sticks of cigarettes, 10 sticks of cigars or 40 grams of tobacco (Ministry of Finance, 2010).

In addition, the law conventionally grants tax- and duty-free to members of the diplomatic corps and experts working for international agencies for purchasing tobacco products from duty-free stores. Tax-and duty-free is granted to members of the diplomatic corps on a reciprocal basis. Experts working for international agencies enjoy tax- and duty-free up to 300 sticks of cigarettes, 100 sticks of cigars or 500 grams of tobacco each month (Directorate General of Customs and Excise, 2013).

Among ASEAN member countries, Singapore and Brunei are the only countries which do not give duty-free allowance to international travelers for bringing tobacco products, as detailed in Table 3 (Southeast Asia Tobacco Control Alliance, 2015, p. 13). In contrast, Myanmar and the Philippines are the most generous countries for giving duty-free

allowance. All other countries, including Indonesia, give duty-free allowance at relatively similar level. In addition, the Philippines levies excise taxes on tobacco products sold in duty-free stores.

The 8th best practice urges countries to increase revenue by increasing excise tax instead of increasing tobacco products sales volume. The WHO insists that relying on the increase of sales volume would surely impair public health. Moreover, the WHO maintains that countries should not rely on tobacco industries to increase retail price, since it would only generate unpredictable and unstable revenue.

The specific tobacco excise tax levied by the DGCE relies on tariff and production volume. The DGCE always tries to optimize both components. The DGCE would not increase tariff or encourages production as high as possible. Moreover, the DGCE takes into account revenue target and the volume of tobacco production in formulating tariff of tobacco excise tax. The revenue target is determined by the Government along with the Parliament. The DGCE always take this target for granted. The DGCE estimates the volume of tobacco production based on previous year data and the dialogue with the manufacturers. The tariff is set to ensure that the target is achievable. In brief, the DGCE always tries to balance revenue collection goal and public health goal.

The 9th best practice endorses automatic adjustment of specific tobacco taxes for inflation. The WHO implies the real value of tobacco excise would fall over time without regular adjustment for inflation. Consequently, its effectiveness on reducing tobacco consumption would be diminished.

The DGCE sees the increase of tobacco excise tax is mostly driven by consumption control and revenue collection goals. The DGCE also realizes that, to achieve consumption control goal, the increase of tobacco excise tax should be higher than inflation rate. This increase of tobacco excise tax is performed almost every year. However, the process is not automatic, the increase should be approved by the Minister of Finance.

Among ASEAN member countries, five of them regularly adjust their tobacco excise tax. They are Indonesia, Myanmar, the Phillipines, Singapore and Thailand. The other five countries are still struggling to regularly adjust their tobacco excise tax rate (Southeast Asia Tobacco Control Alliance, 2015, p. 3).

The 10th best practice urges countries to increase tobacco taxes high enough to reduce the affordability of tobacco products. The WHO advises that member countries increase tobacco excise faster than the increase of income. Otherwise, tobacco products would become more affordable. In other words, real price increase due to the rise in tobacco excise should be higher than real income increase.

The DGCE is well aware that tobacco excise tax has a consumption control goal besides revenue collection goal. The DGCE aims the consumption control goal through price mechanism. The DGCE almost every year increases tobacco excise tax along with the minimum retail price. The combination of the increase of these components raise the retail price even higher. The DGCE believes, in the last 5 years, tobacco products have become less affordable.

Nevertheless, SEATCA sees that in most ASEAN member countries tobacco

becoming more affordable in the period of 2000-2014 (Southeast Asia Tobacco Control Alliance, 2015, p. 2). SEATCA analyzes affordability of tobacco by calculating relative income price (RIP) which is the percentage of per capita GDP required to purchase 100 cigarette packs. In the period of 2000-2014, It was true that RIP in Indonesia decline slightly from 4.8 to 4.65 (Southeast Asia Tobacco Control Alliance, 2015, p. 3). Nevertheless, bearing in mind high economic growth of Indonesia during that period which was at average 5.329, the decline is quite trivial. The DGCE must have increased retail price by using tobacco excise tax increase, but the increase of tobacco excise tax increase was lower than the increase of income.

The 11th best practice supports the integration of tobacco excise tax increase into a comprehensive strategy of reducing tobacco use. The WHO recommends member countries to combine excise tax increase with implement comprehensive strategy which include, but not limited to, smoke-free policy, total ban of tobacco marketing, strong health warnings, wide-ranging assistance to quit smoking, and mass media campaigns.

The Government plays an important role in balancing the goals which are aimed through tobacco excise tax policy. The DGCE understands the idea of consumption control does not only mean lowering tobacco consumption. The DGCE performs consumption control by maintaining tobacco production at a predetermined level without any significant grow or decline.

The 12th best practice recommends a portion of excise tax revenue should be earmarked to finance tobacco control and other promotion efforts. The WHO asserts that public support for higher excise tax is

greater when a portion of the increase is used for supporting health programs. The WHO also notes that soft earmarking should be implemented if hard earmarking is not possible.

The DGCE explains that the Excise Law stipulated 2 percent of tobacco tax revenue should be distributed to local governments (province, city and regency) as revenue sharing fund. This fund is earmarked for several programs, including construction or maintenance health facilities and services for those impacted by tobacco consumption (Ministry of Finance, 2016). Beside excise tax, the DGCE collects tobacco tax which is a provincial government tax. This particular tax is also earmarked. The local governments should spend at least 50 percent of the collected tax for public health service and enforcement against illicit tobacco products (Republic of Indonesia, 2009).

The 13th best practice urges countries not to consider low excise tax and low price as a "pro-poor" policy. The WHO insists that the poor should not bear health and economic burden of tobacco consumption. Hence, tobacco consumption among the poor should be reduced so as to help them escape poverty.

In determining tariff of tobacco excise tax, the DGCE takes into account production capacity of the manufacturer. Manufacturers with large production using sophisticated technology bear the highest excise tax. On the other hand, small scale manufacturers producing hand-rolled products accept the lowest burden. However, these small scale manufacturers are declining constantly.

The 14th best practice insists that tobacco excise tax increase should not be hampered by tax regressivity concern.

Tobacco excise tax, especially specific tax, is regressive in nature. Poor people bear higher tax burden than higher income people. An increase in tobacco excise tax would impact poor people harder than higher income people. However, the WHO believes, given the differences in price sensitivity by income, tobacco excise tax might be progressive with higher income people pay more tax as their consumption declines less than poor people.

Tax regressivity is undoubtedly a crucial issue in increasing tobacco excise tax in Indonesia. If the burden imposed on the lower income consumer is too high they might turn to illicit products. They do not have any alternative to shift down to, other than the illicit ones. The manufacturers would lose their tiny niche. Accordingly, the DGCE would not be able to achieve the target as the revenue might fall.

Table 2 exhibits that the DGCE takes tax regressivity concern into consideration in increasing tobacco excise tax. The increase in the topmost layers machine-made kretek cigarette (sigaret kretek mesin or SKM), machine-made white cigarette (sigaret putih mesin or SPM) and hand-rolled kretek/white cigarette with filter (sigaret kretek/putih tangan filter or SKTF/SPTF) were the highest increase in 2016 and 2017. However, the lower layers of SKM group II, SPM group II and SKTF/SPTF group II increased higher than the layer above them. These facts indicate that the tax regressivity did not hamper DGCE in simplifying the tobacco excise tax structure.

The 15th best practice insists that tobacco excise tax increase should not be hampered by employment concern. The WHO maintains that the reduction of tobacco consumption would instigate higher consumption of other goods.

Accordingly, the reduction of employment in the tobacco related industry would be compensated by more employment in other sectors. The WHO also suggests that a portion of tobacco excise tax is used to assist workers of tobacco related industries in finding new jobs.

Employment is considered as a major issue in Indonesia. All government agencies need to consider the impact on employment in formulating any policy. The DGCE is not an exception. The DGCE needs to estimate the impact of tobacco excise tax increase on employment. Nonetheless, the DGCE always assesses all impacts proportionally.

The tobacco manufacturing sub-sector undeniably plays an important role in providing jobs for the people in Indonesia. The government sees the tobacco manufacturing as one of the dependable sub-sectors in solving the unemployment problem. This subsector is capable to retain at average 6.92 percent labor of the manufacturing sector during the period of 2010 to 2014, as detailed in Table 4. This proportion is considered quite large among the 34 sub-sectors in the manufacturing sector.

Moreover, the ITIC and the OE underline that job creation is recognized as one of the topmost among government's priorities in most economies. They appreciate the role of tobacco manufacturing, a legitimate economic activity, in creating both direct jobs in the industry itself and indirect jobs in its supply chain, from tobacco farmers up to the retail outlets (Oxford Economics, 2011, p. 10).

The 16th best practice insists that tobacco excise tax increase should not be hampered by inflationary concern. The WHO believes that in most countries

tobacco excise tax increase only has a small contribution to inflation considering the relatively low share of excise tax in retail price as well as the low effect of tobacco retail price in national price indices.

The Ministry of Finance, including the DGCE, take inflation as an important variable in formulating all fiscal policies. Consequently, the DGCE must assess the impact of tobacco excise tax increase on inflation. Naturally, assessment of the impact on inflation is a necessity in devising fiscal policy.

The 17th best practice promotes the strengthening of tobacco excise tax administrator in monitoring the market and evaluating the impact of excise tax increase. The WHO endorses the use of new technologies for monitoring the production and distribution of tobacco products. The WHO also recommends the establishment of audit department to monitor compliance. Moreover, the WHO encourages research on the tobacco products demand as well as the effectiveness of the current excise structure.

The DGCE runs a reporting system to monitor tobacco production. Large manufacturers perform this system online (real-time). This reporting system enables the DGCE to analyze the conformity between tobacco production and excise tax payment. This system also serves as an early warning system to detect excise tax avoidance and evasion. The DGCE also maintains a comprehensive manufacturer profile database. This database allows the DGCE to apply the appropriate level of control based on the profile of the manufacturer. Moreover, the DGCE conducts compliance audit to large manufacturers. Small scale manufacturers are not subject to audit. However, they are

obliged to have a simple book keeping which is relatively easier to check.

the 18th best practice endorses the use new technologies to strengthen tobacco tax excise administrator and minimize excise tax avoidance and evasion. The WHO urges the use up-to-date technologies to increase the efficiency of excise tax collection and reduce excise tax avoidance and evasion. These technologies include, but not limited to, excise tax stamp, track-and-trace technology, and monitoring system for assessing production and distribution of tobacco products. A portion of excise tax increase could be used to finance the procurement of these technologies.

The DGCE declares that up-to-date technology is utilized to minimize excise tax avoidance and evasion. One of them is the application of IT for managing production report, excise tax payment, tax stamp order, and excise tax installment. To identify paid tobacco products, the DGCE use state-of-the-art tax stamp, reinforced by security features such as watermark, visible and invisible fiber, microtext, invisible ink, and hologram.

The 19th best practice promotes the implementation of licensing for all engaged in the production and distribution of tobacco products. The WHO believes that licensing would assist excise tax administrator to monitor the market, to identify illicit products, and to detect excise tax avoidance and evasion.

The DGCE believes licensing is an important aspect of a sound excise tax governance. Accordingly, the DGCE obliges manufacturers and importers to obtain the license before they begin their business. The DGCE does not require such license from tobacco products distributors and retailers.

The 20th best practice advocates swift and severe penalties for those involved in an illicit trade of tobacco products. The WHO believes more severe penalties deter offenses. Additionally, stronger enforcement may be financed by the increase in excise tax.

The Excise Law differentiates misdemeanors from a felonies. The DGCE is authorized to charge a certain amount of fine for a misdemeanor. For a felony, the DGCE will conduct an investigation first, and then state prosecutor will prosecute the offender in court. The judge will then deliver the verdict for this felony. The process for settling misdemeanors is definitely simpler and speedier than the prosecution of felonies.

Some of the best practices recommended by the WHO seems to be difficult to be implemented by the DGCE. These best practices include the stipulation of tobacco excise tax at least 70 percent of the retail price, the simplification of tobacco excise tax structure to establish single uniform tobacco excise tax, and the dismissal of the impact of tobacco excise tax increase on regressivity, inflation and employment matters. The distinctive fiscal, economic, social and political circumstances in Indonesia get in the way of the DGCE to follow these best practices. These unique conditions are out of the DGCE hand. Thus, it would be unfair to judge the performance of the DGCE based on these particular best practices.

Moreover, the Government of Indonesia and the DGCE hold the sovereign right to fully comply with the best practice or not. The WHO, as mentioned in Article 6 of the WHO Framework Convention on Tobacco Control, acknowledges the sovereign right of member countries to determine and

establish their own taxation policies (World Health Organization, 2003, p. 8). Besides, the WHO sees a deep insight of the political and economic circumstances of each particular country is vital to successfully implement tobacco excise tax policy (World Health Organization, 2011, p. 75). Correspondingly, the ITIC and the OE value the importance of national fiscal sovereignty to policy makers, particularly in the case of tobacco excise tax which is an essential source of revenue for many governments (Oxford Economics, 2011, p. 5).

For that reason, it is definitely important to note that the best practices set by the WHO should not be accepted as “one size fits all”. Distinctive fiscal, economic, social and political circumstances in a particular country need to be taken into consideration in determining and establishing one’s tobacco excise tax policy. The DGCE must prudently select and implement the WHO best practices which are appropriate for Indonesia’s condition.

5. CONCLUSION AND RECOMMENDATION

At large, the DGCE has implemented most of the best practices advocated by the WHO. The DGCE has utilized specific tobacco excise tax since 2010. The DGCE uses it as the main instrument to increase the retail price of tobacco products. With this increase, the DCGE intend to achieve both revenue collection goal and public health protection goal. Therefore, the DGCE does not rely on increasing production of tobacco products to achieve revenue target. The Government of Indonesia sees tobacco excise tax as part of a comprehensive strategy for controlling tobacco consumption.

Additionally, the DGCE regularly adjust tobacco excise tax to keep up with inflation and higher revenue target. Even though the DGCE has not set tobacco excise tax rate 70 percent of retail price, excise tax burden in Indonesia is quite comparable to leading ASEAN member countries, such as Thailand, Singapore, and Brunei. This increase of tobacco excise tax is an effort by DGCE to make tobacco products less affordable. The DGCE makes this increase proportional to all tobacco products so as to avoid switching down behavior. Besides, the DGCE does not see the low retail price as pro-poor policy.

The DGCE also implements the WHO’s best practice on other aspects of tobacco control. The DGCE employ up-to-date technology, such as information technology, audit scheme, and excise tax stamps, to strengthen its capability in monitoring tobacco production and distribution. The DGCE also utilizes licensing scheme for tobacco products manufacturers and importers. This monitoring structure is reinforced by a swift and severe penalties for offenders. Lastly, the DGCE ensures that a portion of collected tobacco excise tax revenue is earmarked for developing and maintaining public health facilities.

However, the country specific context of Indonesia hampers the DGCE from implementing several best practices recommended by the WHO. It would be daunting for the DGCE to set tobacco excise tax at 70 percent of the retail price. It would also be problematic to further simplify tobacco excise tax structure as the government still needs to preserve small scale tobacco industries. Moreover, in formulating tobacco excise tax policy, the DGCE is obliged to take into consideration the impact of excise tax increase on revenue collection, inflation, and

employment. Assessment of these impact is required by the government and by the parliament before tobacco excise tax increase is approved.

Furthermore, there are some aspects of the best practices that the DGCE can do more. Firstly, the DGCE need to consider the removal abolition of tax- and duty-free scheme for sales tobacco products. This scheme dampens the impact of tobacco excise tax increase on revenue collection as well as protection of public health. To effectively achieve both goals. The DGCE must abolish this scheme. Secondly, the DGCE must realize that Indonesia experiences high economic growth which raises purchasing power parity of the people. This high growth opens an extensive fiscal space for DGCE to increase tobacco excise tax even higher. The GDP percapita of Indonesia is higher than the Phillippines, hence the retail price of tobacco products in Indonesia should be higher than in the Phillippines. Thirdly, the DGCE need to consider the use of tobacco excise tax in compensating the decline of import duty. The tax burden imposed on tobacco products must be maintained or increased continuously. Otherwise, tobacco products may become more affordable. Thus, it is surely a necessity for tobacco excise tax to replace the keep diminishing import duty.

In a nutshell, the DGCE has done the best it could to implement the WHO best practices. Still, some of the best practices are not suitable to be implemented in Indonesia. A concise assessment of the implementation of the best practices suggested by the WHO is presented in Table 5. The WHO, the ITIC, and the OE recognize the need to take the distinctive condition of Indonesia into consideration in determining and establishing tobacco excise tax policy. It can be concluded that the implementation of these best practice should make allowance for the country

specific condition as “one size does not fit all”.

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Annex 1. Tables

Table 1.
Excise Tax, Government Revenue and Taxation Revenue

	YR2010	YR2011	YR2012	YR2013	YR2014	YR2015	YR2016
Government Revenue	992,249	1,205,346	1332323	1,432,059	1,545,456	1,496,047	1,784,250
Taxation Revenue	723,307	873,874	980,518.1	1,077,307	1,146,866	1,240,419	1,539,166
Excise	66,166	77,010	95,027.9	108,452	118,085.5	144,641.3	148,091.2
Excise as percentage of Gov. Revenue	9.15%	8.81%	9.69%	10.07%	10.30%	11.66%	9.62%

Excise as percentage of Taxation Revenue	6.67%	6.39%	7.13%	7.57%	7.64%	9.67%	8.30%
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Source: Adapted from Actual Government Revenues (Billions Rupiahs), BPS – Statistics Indonesia

Table 2.
Specific Tariff Increase 2015-2017

	Group	Specific tariff			Increase				Gap with lower layer		
		2015	2016	2017	2015-2016	2016-2017	2015	2016	2017		
Machine-made Kretek Cigarette (SKM)	I	415	480	530	65	15.66%	50	10.42%	110	140	165
	II	305	340	365	35	11.48%	25	7.35%	40	40	30
Machine-made White Cigarette (SPM)	I	265	300	335	35	13.21%	35	11.67%			
	II	425	495	555	70	16.47%	60	12.12%	155	190	225
Hand-rolled Kretek Cigarette (SKT)	I	270	305	330	35	12.96%	25	8.20%	50	50	40
	II	220	255	290	35	15.91%	35	13.73%			
Hand-rolled Kretek Cigarette (SKT)	I	290	320	345	30	10.34%	25	7.81%	70	75	80
	II	220	245	265	25	11.36%	20	8.16%	80	90	100
		140	155	165	15	10.71%	10	6.45%	15	15	10
	III A	125	140	155	15	12.00%	15	10.71%	40	50	55
III B	85	90	100	5	5.88%	10	11.11%	5	10	20	
Hand-rolled Kretek/White Cig. w/ Filter(SKTF/ SPTF)	I	80	80	80	0	0.00%	0	0.00%			
	II	415	480	530	65	15.66%	50	10.42%	110	140	165
	II	305	340	365	35	11.48%	25	7.35%	40	40	30
		265	300	335	35	13.21%	35	11.67%			

Source: Adapted from the Ministry of Finance (2014), (2015), & (2016)

Table 3.
Duty-free Tobacco Products Allowance for International Traveller in ASEAN Countries

Country	Allowance
Brunei	No allowance
Cambodia	200 sticks of cigarettes, 50 sticks of cigars or 250 grams of chopped tobacco
Indonesia	200 sticks of cigarettes or 25 cigars or 100 grams of rolling tobacco
Lao PDR	200 sticks of cigarettes or 50 cigars or 250 grams of tobacco
Malaysia	200 sticks of cigarettes or 225 grams of other tobacco products
Myanmar	400 sticks of cigarettes, 100 sticks of cigars, 250 grams of pipe tobacco
Philippines	400 sticks of cigarettes or 50 cigars or 250 grams of pipe tobacco
Singapore	No allowance
Thailand	200 sticks of cigarettes, 500 grams of other tobacco products
Vietnam	200 sticks of cigarettes or 20 cigars or 250 grams of tobacco

Source: Adapted from SEATCA (Southeast Asia Tobacco Control Alliance, 2015, p. 13)

Table 4. Workers in Tobacco Manufacturing Subsector

	YR2010	YR2011	YR2012	YR2013	YR2014
Tobacco Manufacture	329,877	304,243	324,614	362,933	356,117
Manufacturing Sector	4,501,145	4,629,369	4,928,839	5,004,912	5,180,531
Percentage	7.33%	6.57%	6.59%	7.25%	6.87%

Source: Adapted from Total Workers of Large and Medium Manufacturing by Subsector, BPS – Statistics Indonesia

Table 5.

Concise Assessment of the Implementation of the WHO Best Practices

Best Practices	Review
Use tobacco excise tax increases to achieve the public health goal of reducing the death and disease caused by tobacco use	Confirmed, the DGCE takes public health into consideration in setting excise tax policy
Set tobacco excise tax levels so that they account for at least 70 percent of the retail prices for tobacco products	Not confirmed, the Excise Law does not permit excise tariff higher than 57 percent of the retail price
Simpler is better	Confirmed, the DGCE keeps simplifying the excise tax structure
Rely more on specific tobacco excises as the share of excise taxes in retail prices increases	Confirmed, the DGCE has imposed full specific excise tax
Rely more on excise taxes than on import duties	Not confirmed, excise tax policy and import duty policy are set separately
Adopt comparable taxes and tax increases on all tobacco products	Confirmed, the DGCE impose excise tax increase proportionally to all manufacturers
Eliminate tax and duty free sales of tobacco products	Not confirmed, the DGCE has not considered the elimination of duty free sales of tobacco products
Where revenue increases are a goal, rely on tobacco tax increases to achieve revenue increases	Confirmed, the DGCE relies on excise tax increase to achieve revenue increase
Automatically adjust specific tobacco taxes for inflation	Not confirmed, the DGCE needs the approval of the Minister of Finance for adjusting excise tax
Increase tobacco taxes by enough to reduce the affordability of tobacco products	Confirmed, the DGCE takes tobacco products affordability in increasing excise tax
Include tobacco excise tax increases as part of a comprehensive strategy to reduce tobacco use	Confirmed, excise tax has been a dominant part of the strategy
Use a portion of tobacco tax revenues to support other tobacco control and/or health promotion efforts	Confirmed, a portion of excise tax revenue is earmarked for health promotion program
Do not view low taxes and prices for some tobacco products as a “pro-poor” policy	Confirmed, the DGCE does not view excise tax as “pro-poor” policy
Do not allow concerns about the regressivity of higher tobacco taxes to prevent tobacco tax increases	Confirmed, concerns about the regressivity do not prevent excise tax increase
Do not allow concerns about employment impact to prevent tobacco tax increases	Not Confirmed, employment is still considered as a major issue in Indonesia
Do not allow concerns about the inflationary impact of higher tobacco taxes to deter tax increases	Not confirmed, The Ministry of Finance and the DGCE, take inflation as an important variable in formulating all fiscal policies
Strengthen tobacco tax administrators’ capacity to monitor tobacco product markets and evaluate the impact of tobacco tax increases	Confirmed, The DGCE runs a reporting system to monitor tobacco production
Adopt new technologies to strengthen tobacco tax administration and minimize tax avoidance and evasion	Confirmed, the DGCE implement IT system and tax stamp for minimizing excise tax evasion and avoidance
Strengthen tobacco tax administrators’ capacity by licensing all involved in tobacco product manufacturing and distribution	Confirmed, The DGCE believes licensing is an important aspect of a sound excise tax governance
Ensure certain, swift and severe penalties for those caught engaging in illicit trade in tobacco products	Confirmed, the Excise Law allows for swift and severe penalties

Source: Summarized by the author