



## **The Analysis of Indonesian Tobacco Industry: Regulations and Government Strategic Development**

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### **INTRODUCTION**

Indonesia ranks 5<sup>th</sup> as the world's largest tobacco producer and ranks second as the world's biggest tobacco consumer after China. Tobacco agricultural commodities are also the second largest sector in Indonesia that can help significantly reduce national poverty. They also contribute greatly and have a broad impact on the social, economic, and development aspects of the Indonesians. The tobacco industry also contributes to the enormous state revenue through taxes. Throughout 2018, cigarette tax revenues reached US\$ 10.7 billion. (Sukmana, 2019). Customs receipts in 2018 have met the targets in the 2018 State Budget. The realization grew 6.7 % compared to 2017. According to the Director General of Customs and Excise, the most significant revenue from Customs and Excise 2018 was contributed by a cigarette excise tax, which amounted to 98 % of the total state revenue on customs (Review of the Ministry, 2019; Directorate General of Estate Crops, 2017).

Meanwhile, domestically, the Indonesian tobacco industry is in a dilemma situation due to an increase in international concern about anti-smoking campaigns through the World Health Organization. The campaign has caused a decline in demand for tobacco, both domestically and globally.

In 2012, the central government issued a regulation to limit tobacco production as an addictive product that could endanger national health. To anticipate the national economy, the Ministry of Agriculture provides a solution for Indonesian tobacco farmers to begin diversifying crops other than tobacco commodities as their livelihood. However, this idea is still a controversy in the country because of the problem of the government's partiality to farmers, health, or the national economy.

Tobacco farming commodities in Indonesia have experienced a lot of controversies since the legal campaign reduced smoking from the policy of President Susilo Bambang Yudhoyono in 2012. The regulation is regulated in Government Regulation Number 109 the Year of 2012 concerning The Security of Ingredients Containing Addictive Tobacco Products for Health. As a result, the production

of cigarettes every year decreases along with changes in ministerial regulations such as Ministry of Agriculture, Ministry of Industry, Ministry of Health, and Ministry of Finance.

In addition, tobacco conditions in Indonesia appear unbalanced because the amount of consumption is far more significant than the amount produced (Ministry of Agriculture, 2019). Tobacco farmers in Indonesia themselves are reluctant to plant tobacco due to the frequent regulatory changes in tobacco and cigarettes, as the consequences, tobacco farmers, small-holders, and suppliers are often affected negatively. The central government is still not siding with the security and stability of the economy in the production of raw tobacco. However, the government even sided with cigarette producers by the assumption that they are the main contributors for customs and taxes in Indonesia as a state income.

All the controversies and issues that are currently occurring in Indonesia are analyzed by the regulatory analysis approach. The roadmap for regulations on tobacco and cigarettes is mainly regulated in several ministries such as the Minister of Industry, Ministry of Health, Ministry of Agriculture, and the Ministry of Finance.

This paper will discuss the analysis of regulations regarding tobacco commodities and cigarette products along with regulatory changes and the basis of the problem. The central part is a discussion of the controversy and issues that have occurred in Indonesia for the past few years. Since government regulations are regularly changing, this paper also presents the results of the Indonesian government's strategic development analysis and the consequences or effects of the strategic development design. The results of the study in this paper are then discussed with tobacco industry experts and researchers. The results of this discussion will be presented in the recommendations section.

## **THE GENERAL OVERVIEW OF INDONESIAN TOBACCO INDUSTRY**

The tobacco industry in Indonesia is a group of farmers, small-holders, and processing companies for tobacco products. Including in the industry are other actors who carry out development, preparation for the sale, delivery, advertising, and distribution of tobacco and tobacco-related products. Legally, in the Indonesian tobacco product industry, it is equated with the cigarette industry, which is broadly divided into machine-made industrial cigarettes (clove cigarettes and white cigarettes) and hand-made clove cigarettes.

Indonesia's cigarette market share is dominated by three large companies, namely: Philip Morris International-HM Sampoerna, Gudang Garam, and Djarum. These three companies dominate the cigarette market more than half of all Indonesian cigarette products. The Indonesian cigarette industry has contributed the most massive foreign exchange and state tax revenues from any plantation sector. The most significant percentage of Indonesia's workforce is the tobacco sector and the cigarette industry. Tobacco commodities are very strategic and valuable.

Also, the condition of tobacco producers and the cigarette industry in Indonesia is remarkably resilient. Despite many obstacles such as changes in laws and regulations, international policies and the

economic crisis, the Indonesian cigarette industry still prevails. Since 1995, the Indonesian cigarette industry has continued to increase until now. The monetary crisis in the regions of Southeast Asia did not affect cigarette production in Indonesia such as high inflation in 1997-1998 when inflation in Indonesia reached 70%, cigarette production in Indonesia was still in a stable condition. Even at a time when national economic growth is minus, such as the global financial crisis in 2008, at that time, Indonesian cigarette production increased (Ministry of Health, 2014).

### **Indonesia's tobacco policy analysis**

The Indonesian regulations governing tobacco commodities and tobacco products are regulated in several provisions, and each one is interconnected. Tobacco commodities in Indonesia are regulated by several ministries. The status of tobacco in Indonesia is the most strategic commodity to drive the economic and political wheels of many parties. To date, legally, the production of agricultural products in the tobacco industry in Indonesia is regulated in:

1. Regulation of the Minister of Finance of the Republic of Indonesia Number 156 /PMK.010/2018 (was: Number 146/PMK.010/2017) concerning Excise Tariffs on Tobacco Products
2. Regulation of the Minister of Finance of the Republic of Indonesia Number PER-5/BC/2019 concerning Excise on Other Tobacco Processing Results
3. Regulation of the Minister of Finance of the Republic of Indonesia Number 94/PMK.04/ 2016 concerning Taxable item
4. Minister of Industry Regulation Number 64 / MIND / PER / 7/2014 concerning Supervision and Control of Cigarette Industry Businesses

Then proceed with several other laws involving tobacco and cigarettes in the main section. The tobacco commodities also depend on several regulations below.

5. The Law of the Republic of Indonesia Number 36 the Year of 1999 concerning National Health
6. The Law of the Republic of Indonesia Number 39 the Year of 2007 (was: Law Number 11 the Year of 1995) concerning National Excise Tariffs.
7. Government Regulation Number 39 the Year of 2014 concerning List of Business Fields Open with Requirements in the Field of Investments
8. Presidential Regulation No. 28 the Year of 2008 concerning National Industrial Policy

The above regulation is a summary of the most important central government regulations. This excludes the regional or provincial regulations and each region might be different.

The list of laws and regulations is commonly used as a "guideline" in political debates on tobacco commodities, tobacco products, and cigarettes. Each political party has its mission and goals. In Indonesia, political parties through the people's representative council also hold durable power to contribute votes in the formation of state legislation.

### **The controversy of the Indonesian tobacco industry**

Tobacco commodities in Indonesia are highly controversial which harm many parties; however, among them, there are also those who benefit the most. Unfortunately, neither the media nor the central government provides clear information to the public about the government's plans or the conditions for this commodity. Therefore, the public is only considered consumers of tobacco products and tobacco farmers who always receive the impact of changes in the government's strategy for tobacco. Below are the results of the analysis produced in the discussion and analysis of problems with Indonesian tobacco business actors and experts of the tobacco industry. These points will explain in detail about the controversies that occur domestically at the moment.

1. In the central government itself, tobacco products are a matter of debate because each ministry has its respective duties following the national strategic direction. For example, the Ministry of Health has to reduce tobacco consumption domestically, but the Ministry of Industry and Ministry must increase domestic tobacco products for the welfare of farmers. On the other hand, the finance minister must increase the Indonesian State Revenue and Expenditure Budget through rising excise rates. As a result, the three tasks of this ministry are always engaged in debates, particularly on the government's alignments and the direction of development.
2. The Minister of Health through Circular No. TM.04.01 / Menkes.314 / 2019 regarding the blocking of cigarette advertisements appealed to the Indonesian Ministry of Communication and Information Center to block cigarette advertisements on the internet, both websites and social media. The circular which discusses the request is intended by reason to reduce cigarette consumption among children. While tax income from cigarette advertisements on the internet is a top income for the State Department of Communication and Information, another impact is to reduce cigarette sales and trade competition which will also affect the amount of tobacco production. On this side, the Ministry of Finance, Ministry of Industry, and the Ministry of Agriculture will be affected by requests for blocking from the Ministry of Health.
3. The Framework Convention on Tobacco Control (FCTC) launched by the World Health Organization in 2003. The FCTC includes regulating cigarette promotions or advertisements, prohibiting smokers from smoking in public places and restricting cigarette consumption by increasing cigarette excise. But unfortunately, only Indonesia has not implemented and ratified the FCTC to date (Rahman & Widodo, 2015). Indonesia should achieve the FCTC by the World Health Organization. On the domestic side, Indonesia won the number of cigarette production, increased state income, and also revived business and economic flows. However, with the exclusion of Indonesia in FCTC, the consequences are:
  - i. Indonesia is the primary target market for low-quality cigarette industry which puts a lot of risks to national health. Cigarette consumption in Indonesia will increase sharply, especially among children, pregnant women, and the poor community. The continuous consumption of cigarettes will increase morbidity and mortality related to diseases caused

by tobacco. Meanwhile, the main impact on the state is to drain the national health department's budget for public health and public insurance costs.

- ii. Indonesia lost the opportunity to take part in the Conference of Party, which is a conference of countries that have ratified the FCTC to be involved in negotiating the application of FCTC guidelines and protocols.
- iii. Internationally, Indonesia is slowly losing its dignity as a country that protects and is responsible for improving public health. The world also considers Indonesia as less accountable for playing a role in protecting its national health and life.
- iv. Indonesia lost the opportunity with the FCTC and its members to provide opportunities for the development of cross-sector policies to control tobacco consumption problems. FCTC will encourage coordination of control of tobacco products between sectors so that it can provide effective solutions for handling the adverse effects of cigarette consumption (Ministry of Health of the Republic of Indonesia, 2013).

Domestically, the Indonesian Minister of Health desires to participate in ratifying the FCTC, but the consideration is prevented by the Ministers of State, the Minister of Industry, the Minister of Trade, and the Minister of Manpower and Transmigration. The main reason is to reconsider the status of the local cigarette industry, the condition of tobacco farmers, and the economic flow of state income. This condition is speculated as a mutually beneficial relationship between cigarette producers and the government members.

4. Based on research from the Ministry of Health, within the scope of the study are the poor citizens in the poorest regions of Indonesia. For the most impoverished population, expenditure on cigarettes is equivalent to 14 times higher than spending on meat; 6 times higher than expenses for milk and eggs; 7 times higher than education expenses and 11 times higher than health expenses. The investments of the poorest households for cigarette consumption of all costs spent over the past year defeats spending on increasing human resources such as nutrition, health, and education. Compared to the expenditure of the poorest households for investment in human resources, spending on cigarettes is many times greater (Ministry of Health, 2012). Based on the results of this research, other ministries are rejecting the Minister of Health's support for national health such as ratification of the FCTC's international policies.

### **The main issue of Indonesia's tobacco industry**

In addition to the issues that are controversial in government, business, and society, tobacco, and cigarette production in Indonesia still experience several vital matters that are detrimental to other parties. With qualitative and quantitative methods, various problems have gathered the focus on general topics that occur in almost all regions of Indonesia.

1. Instability in the development of the business of tobacco commodities. According to the Ministry of Industry, cigarette production in the period 2014 to 2018 dropped to 12 billion cigarettes. Production fell from 344.52 billion cigarettes in 2014 to 332.38 billion cigarettes in 2018. Also,

labor absorption fell at 11.86 %. According to the Indonesian Federation of Workers of Food, Beverages, Tobacco, and Cigarettes, for the past five years, there have been more than 32,000 workers who were laid off (Moneter, 2018). The reduction cuts state income by at least US\$ 84 million per year. The main reason is that government regulations are always amended by increases in cigarette excise and simplification of the excise layer by the policies of the Ministry of Finance.

2. The amount of cigarette production in Indonesia is very high, but it is imbalanced with the amount of raw tobacco production. Cigarette consumption in Indonesia is the largest in the world after China, but the amount of tobacco products is still very minimal. Based on data from the Ministry of Industry, the amount of tobacco production nationally only reached the range of 190,000-200,000 tons per year, far below the industry needs of 320,000-330,000 tons of tobacco per year. Indonesia still imports around 40% of total domestic needs of tobacco (Ministry of Industry, 2019).
3. The chain of tobacco products industry in Indonesia is too complicated. In general, there are at least five parties involved since harvesting tobacco to cigarette factories: farmers, collectors, intermediaries or middle-man, distributors, and ending up in cigarette factories. This trade chain is detrimental to farmers because the profits are shared with collectors and mediators. This condition is happening because of the rare cigarette factories that willing to build partnerships with farmers for reasons of quality protection and trust.
4. The Indonesian central government is still reluctant to implement alternative tobacco products. Studies and research on commodity products are still very minimal. Thus, the government is still unwilling to draft a plan to reduce the number of smokers without having to mitigate domestic tobacco production. In another impact, there is lack of access to tobacco marketing in Indonesia, which still relies on cigarette industry services as a sole distributor. This resulted in the selling price of tobacco in the market becoming unstable so that it would also affect the income of tobacco farmers.

### **Indonesia's central government strategy plan for tobacco production**

The central government, through the Ministry of Finance and the Ministry of Industry, wants to simplify the structure of excise on tobacco products. This is a big step to nourish national industrial competition. So far, the complicated customs tariff structure has led to an increase in illegal activities that oppose the legislation. In the Regulation of the Minister of Finance No. 146 of 2017, the government simplifies the level of cigarette excise tariffs gradually until 2021. From 2018 to 2021, cigarette excise rates are simplified every year in a row to 10, 8, 6, and finally five layers in 2021. In 2017, the cigarette excise tariff reached 12 layers.

The government's plan, through the Ministry of Agriculture, is to draft an exceptional law for tobacco commodity. At present, the existing regulations in Indonesia only include alternative tobacco products as other tobacco products regulated in Ministerial regulations. The Indonesian government is

expected to formulate specific provisions immediately and monitor alternative tobacco products to reduce confusing assumptions in the community regarding product profiles and the level of risk of their use. Special rules regarding alternative tobacco products are needed by the government to protect the public from the health and social aspects.

The Ministry of Industry will prepare new regulations on the tobacco products industry. This follows the development of alternative tobacco products in accordance with the industrial revolution 4.0. This technology is named iQOS, whose system only heats cigarettes with a smokeless method. With this system, it is expected to contribute to mitigating the risks and dangers of smoking.

The strategic design of the Government through the Minister of Health has drafted a vital development for 2020-2024 in the Roadmap to Control the Impact of Cigarette Consumption for Health. Based on the Minister of Health Regulation of the Republic of Indonesia Number 40 of 2013, government plans and target for 2020-2024 are: 1.) regulation of health warnings in the form of images and writings evaluated to be increased to plain cigarette packs; 2.) Intensification of awareness campaigns on the dangers of cigarettes for health; 3.) Escalation of the role of the network through regular communication and coordination; 4.) Applying all districts or cities to implement a Non-Smoking Zone system by Law Number 36 the Year of 2009 concerning National Health; 5.) 100% of all health service facilities owned by the central government and regional governments provide smoking cessation services integrated with disease control; 6.) Implementation of smoking cessation services that are integrated with the Primary Health Care System; 7.) Intensification decreases the prevalence of smoking on average by 1% per year (Ministry of Health, 2013).

The central government is still drafting a 2020 national strategic plan for tobacco commodities and the tobacco industry. Some ministries have taken a significant role because of their position towards the tobacco industry such as Ministry of Agriculture, Ministry of Industry, Ministry of Finance, Ministry of Health, and Ministry of Manpower. The five ministers and other ministers and state assemblies are still debating their respective interests and duties on tobacco commodities and their products.

The National Development Planning Agency is preparing a draft tobacco control. The plan is included in the National Medium Term Development Plan 2020-2024. As far as production aspect is concerned, the amount of tobacco production will be maintained. The government is not ambitious to increase tobacco production. To increase domestic income, the government will propose strict regulations for excise and consumer taxes.

In accordance with Presidential Regulation No. 28 of 2008 concerning the National Industrial Policy, Tobacco Products Industry (IHT) and Minister of Industry Regulation No.117 / M-IND / PER / 10/2009 concerning Roadmap for the Development of Tobacco Products Industry Cluster 2007-2020 with priority phases as follows. 2007 - 2010: Priority on aspects of labor balance, public acceptance and health, in 2010 - 2014: Priorities on issues of revenue, health, and labor and in 2015 - 2020: Top priority on Health aspects rather than aspects of Labor and Acceptance (Ministry of Industry, 2007).

## **RECOMMENDATION**

1. Current government regulations have not regulated alternative tobacco products. Mostly, the government controls all aspects of tobacco farming commodities as general commodities which are equated with other agricultural products. More than that, the existing regulations of tobacco are still compared with cigarette products. As a result, if there is a change in laws or a national strategic plan for cigarette products, it can affect significantly to the tobacco farmers. The government, through the Ministry of Agriculture, should immediately prepare a special regulation for tobacco commodity, which separates the rules of tobacco products from the states of cigarette products. Notably, the Agricultural Ministry shall develop specific laws to protect tobacco farmers and their tobacco commodities.
2. The central government should study the market conditions and the readiness of the community for each decision for changes in legislation law. A significant increase in excise tax as in 2016 caused a rise in illegal cigarettes. This is known to occur because of the inability of cigarette producers, especially the small enterprises, financially and management, for significant regulatory changes. Illegal cigarette production is indeed detrimental to state revenues. However, the government should study market readiness between consumers and producers. Otherwise, the market will oppose government policies and will destroy public trust in the central government.
3. Tobacco commodities are vulnerable to infiltration of foreign interests. The House of Representatives is concerned about weak government regulations and uncertain strategic development. This provides a loophole for external parties through non-governmental organizations in Indonesia to conduct investment or trade activities and foreign influence on the domestic market. Indonesian tobacco commodities are very strategic commodities. Therefore, the central government should take decisive and responsive steps to internal problems in the country. Especially reconciling the debates that always occur between political party factions.
4. At present, there are many restrictive regulations and laws, so that more stringent regulations are not needed which will only harm tobacco farmers and suppress small tobacco industries. Home industries or smallholders do provide small amounts of state tax. However, strict regulations have drastically reduced the performance of their economic stability for a few years ago.
5. The central government should improve the national communication system. The media of communication between the government, cigarette producers, tobacco farmers, and the community as consumers is still fragile. On social media or mass media always disseminate different information. As a result, there are doubts and any changes in regulations or appeals from the central government, and the information would not reach to the producers, farmers, and communities. The government should control the information and communication media, mainly to spread the appeal of the president or the central government.

## **CONCLUSION**

The tobacco commodity industry in Indonesia is in a complicated position. The central government is also challenging to determine a clear policy direction for the development of tobacco production in Indonesia. Private sector and farmers also began reluctantly to take the most appropriate steps for the progress of this commodity. According to regulatory analysis and problem analysis, mainly, there are three issues: the impact of tobacco on national health, protection of tobacco farmers and small enterprises, and protection of state income from foreign investments.

In addition, the legal structure in the Republic of Indonesia states that individuals, communities, non-governmental organizations, tobacco farmer organizations, tobacco distribution business organizations, associations of tobacco and cigarette industries, and other organizations have the power to respond to government decisions through the House of Representatives which are then considered central government or state ministries in determining legislation law.

The central government is also tough to regulate specific regulations because of the insistence of various parties, especially political parties, cigarette industry business people, and the citizens. However, so far, the achievements and performance of the central government of the Republic of Indonesia in developing countries are outstanding. Primarily the government seeks the stability of the domestic tobacco industry, efforts to protect tobacco workers and farmers, try to maintain the balance of the state income budget, and maintain national security and defense from the efforts of foreign investors who able to dominate the Indonesian tobacco market.

The analysis of this paper is carried out by the results of case studies and exploratory research. Primarily, this study method uses regulatory analysis of tobacco, cigarettes, and other regulations related to tobacco and cigarette status in Indonesia. In advanced, the secondary analysis uses qualitative research methods from the results of opinion gathering through interviews with government officials, Indonesian tobacco farmer organizations including smallholder tobacco farmers and cigarette producers as well as business actors such as members of the cigarette product distributor networks.

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