

The Paradox of Indonesia's Tobacco Excise Policy: A Literature Review of Effectiveness, Inequality, and Socioeconomic Impacts

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ABSTRACT

Indonesia's tobacco excise policy has revealed a paradox between its normative objectives and the realities of its implementation. On one hand, the policy aims to reduce cigarette consumption and increase state revenue. On the other hand, successive excise tax hikes have triggered a rise in illicit cigarette circulation, undermined legal small-scale tobacco industries, and exacerbated socioeconomic inequality. This study employs a qualitative approach through literature review to examine the dynamics of tobacco excise policy using public policy theory, policy effectiveness, and socioeconomic disparity frameworks. The findings show that ineffective enforcement, weak distribution systems, and the absence of stakeholder inclusion have prevented the policy from achieving its intended outcomes. The sharp increase in excise taxes without sufficient oversight has created economic incentives for black-market activity, while also driving mass layoffs in small and medium-scale tobacco manufacturing. These outcomes confirm the theory of circular cumulative causation: policies that fail to integrate with social-economic realities tend to reinforce cycles of inequality and regulatory evasion. Therefore, a reformation of Indonesia's tobacco excise policy is urgently needed—one that emphasizes fairness, effectiveness, and responsiveness through improved oversight, equitable fiscal distribution, and inclusive policymaking involving local communities and small businesses.

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1. INTRODUCTION

Tobacco excise policy in Indonesia over the past two decades has emerged as a prominent fiscal and public health instrument, yet it is not without paradoxes and mutually conflicting consequences. The government has consistently raised excise rates annually as a sign of its commitment to curbing

cigarette consumption while simultaneously boosting state revenue. These increases also align with global health agendas such as the Sustainable Development Goals (SDGs), particularly SDG 3.a on tobacco control. Within this framework, excise functions dually: on the one hand, as a deterrent against the consumption of high-risk products such as cigarettes, and on the other as a significant source of revenue for the State Budget (APBN). However, implementation on the ground often moves in a contradictory direction.

A body of empirical studies and field data indicates that higher cigarette excise rates do not automatically reduce tobacco consumption. Wardani (2022), for instance, finds that the policy prompts a shift from legal cigarettes to illegal products that are considerably cheaper and more accessible. This phenomenon has fueled an expanding black market for cigarettes, undermining tobacco-control efforts and eroding fiscal revenue. The Directorate General of Customs and Excise reported that in the first quarter of 2025 more than 257 million sticks of illegal cigarettes circulated in the market, signaling a growing scale of violations and weaknesses in enforcement (Bisnis.com, 2025).

To grasp this complexity, public policy theory offers a useful lens. Dunn (2018) defines public policy as “a series of governmental actions to resolve public problems through a systematic, ongoing, and reflective process.” Yet, as Sabatier and Weible (2014) emphasize, failures in building policy coherence—misalignments between a policy’s normative goals and its implementation outcomes—are common. In this case, the government’s intention to curb consumption does not correspond with societal outcomes. Rather than reducing use, the higher prices of legal cigarettes appear to push consumers toward cheaper, more readily available illegal alternatives.

This paradox has far-reaching ramifications across social, economic, and institutional domains. The legal cigarette industry—especially small and medium-scale firms—has been among the hardest hit by progressive excise tariffs. Fatmariyah et al. (2022) and Sondayani (2024) note that excise burdens function as a fixed cost that is particularly onerous for smaller producers. Amid stagnant purchasing power, many such firms have little choice but to cut output or cease operations altogether, with some drifting into the shadow market to cope with cost pressures. The result is a structural dualism within the sector: a regulated formal industry under stress versus an informal segment that operates beyond oversight and taxation.

Policy effectiveness can be assessed using Grindle’s (1980) approach, which stresses the alignment of inputs, processes, outputs, and outcomes. When the policy output of high excise rates fails to generate the intended outcomes—reduced cigarette consumption and increased state revenue—the policy is structurally ineffective. The progressive tariff regime insufficiently accounts for households’ economic capacity and diverse social conditions across regions. Moreover, Rahmawati and Rinardi (2020) show that the Tobacco Products Excise Revenue-Sharing Fund (Dana Bagi Hasil Cukai Hasil Tembakau, DBH-CHT), which is intended to support health and social programs, is frequently not allocated proportionately. Such disparities signal weaknesses in the system of subnational fiscal governance.

Socioeconomic inequality is another crucial dimension in evaluating the policy’s effects. Todaro and Smith (2015) argue that economic growth without equitable distribution deepens inequality. In the excise context, the fiscal burden falls disproportionately on lower-income groups. Owing to dependency and cultural factors, these groups often remain active smokers, yet face reduced access to legal products because of their higher prices. The result is a shift toward cheaper, riskier illegal cigarettes, creating a perverse incentive that harms the most vulnerable.

The repercussions are not confined to consumers; they also affect workers in the cigarette industry. A Bisnis.com report (June 18, 2025) highlights fears among thousands of factory workers about the risk of mass layoffs. The article indicates that a principal driver of potential layoffs is the disproportionate rise in operating costs due to high excise rates, combined with intensifying competition from illegal cigarettes. This underscores how a fiscal instrument such as tobacco excise can directly reshape national labor structures, particularly in labor-intensive segments like hand-rolling and cottage-scale factories.

From the standpoint of Islamic economics, the principles of *maqasid al-shariah* also bring moral and ethical dimensions to public policy design. These principles prioritize the protection of life (*hifz al-nafs*) and property (*hifz al-mal*) and call for policies that advance the public good. When excise policy drives small producers into bankruptcy, workers into unemployment, and low-income consumers toward illegal products, the policy warrants ethical scrutiny. Fatmariyah et al. (2022) argue that inequitable distribution of fiscal benefits contravenes distributive justice in Islamic economics.

At the institutional level, Nurjihadi's (2016) concept of circular cumulative causation is germane. The interaction between an ineffective fiscal policy and weak governance can create a self-reinforcing cycle that aggravates inequality and legal violations. In the case of tobacco excise, frail oversight and inconsistent enforcement against illegal cigarettes enable the systemic growth of the illicit economy. Without reforms in distribution governance and monitoring, fiscal policy risks perpetuating a recurring cycle of problems.

International literature from the WHO and Tobacconomics similarly warns that the success of excise policy hinges not merely on higher rates but also on governance integrity and enforcement capacity. Countries that have succeeded in tobacco control typically deploy robust track-and-trace systems and ensure effective interagency coordination. This stands in contrast to prevailing conditions in Indonesia, where cigarette distribution remains relatively open and enforcement against excise violations is not yet consistently applied.

Considering these factors, Indonesia's tobacco excise policy exemplifies the paradox of public policy: it is designed to protect public health and strengthen fiscal capacity, yet in practice it risks exacerbating inequality, undermining the formal sector, and fostering the illicit economy. Policymakers should therefore reform the approach with closer attention to social equity, implementation effectiveness, and local structural and cultural contexts. Only through inclusive, responsive, and evidence-based policy can the tobacco excise paradox be unraveled and redirected toward its intended objectives.

2. METHODS

This study employs a qualitative approach using a library research method. This approach was selected to align with the study's objective: to examine, in depth, the paradoxes of Indonesia's tobacco excise policy through a systematic review of academic literature, policy documents, and other relevant secondary data. Qualitative inquiry is appropriate because the focus is not on statistical measurement but on understanding the context, meanings, and processes underpinning a social phenomenon. Consistent with Creswell (2016), the qualitative approach is used to explore and interpret the meanings constructed by individuals or groups regarding a social or policy issue. Accordingly, this research emphasizes an interpretive process concerning the fiscal policy of cigarette excise and its socio-economic implications.

Creswell also underscores that qualitative research seeks to build deep meaning from the standpoint of participants or data sources and employs a flexible design that evolves during the research process. In a literature-based study, "participants" are represented by documents and written references that capture diverse perspectives—from policymakers and academics to the broader public. The literature review enables a comprehensive understanding of the relationships among excise policy, implementation effectiveness, and the socio-economic inequalities that may result.

The data sources consist of secondary data obtained through documentary techniques. The documents analyzed include Law Number 39 of 2007 on Excise, derivative regulations issued by the Ministry of Finance, annual reports from the Directorate General of Customs and Excise (Direktorat Jenderal Bea dan Cukai, DJBC), and statistical data from Statistics Indonesia (Badan Pusat Statistik, BPS). Additional sources comprise national and international scholarly journals, textbooks on public policy and economics, and articles from reputable media outlets such as Kompas, Bisnis.com, and Merdeka.com. Literature searches were conducted systematically via scholarly databases including

Google Scholar, the Garuda Portal, and SINTA (Science and Technology Index) to ensure the validity, relevance, and coherence of the materials used.

Data analysis employed content analysis, a systematic method for interpreting textual material through coding and categorization. Analysis focused on identifying key themes related to tobacco excise policy, the effectiveness of its implementation, and associated socio-economic inequalities. Each document was examined in depth using a predefined theoretical framework: public policy theory, policy effectiveness theory, and socio-economic inequality theory, complemented by the concepts of regulatory capture and determinants of illicit trade drawn from WHO publications and international journals. In line with Creswell, the analytic process was simultaneous with data collection and evolved as the researcher's understanding of context and emergent patterns deepened.

Data credibility was ensured through source triangulation and source criticism. Triangulation was conducted by comparing information across multiple source types—academic publications, policy documents, and reputable media—to verify consistency and accuracy. Source criticism was applied to evaluate the authority and credibility of each document, considering both institutional provenance and substantive content. These procedures were conducted reflexively and iteratively to minimize interpretive bias and to ground conclusions in sound scientific reasoning. Through this approach, the study aims to contribute conceptually to understanding the dilemmas of tobacco excise policy implementation in Indonesia and to offer evaluative insights that may inform the formulation of fairer and more effective policies.

3. FINDINGS AND DISCUSSION

Research Result

This study finds that Indonesia's tobacco excise policy exhibits several paradoxes arising from misalignments between the policy's normative objectives and the realities of on-the-ground implementation. Based on a systematic review of the literature, policy documents, and other secondary data, the study identifies five principal findings:

3.1 Ineffectiveness in Achieving Normative Objectives

Increases in tobacco excise rates have not shown significant effectiveness in reducing cigarette consumption. Wardani (2022) and Rahmawati & Rinardi (2020) note that the public—especially lower-income groups—tends to shift consumption to cheaper illegal products. As a result, public health targets become harder to achieve while fiscal leakages rise. Data from the Directorate General of Customs and Excise (2025) indicate that more than 257 million sticks of illegal cigarettes circulated in the first quarter of 2025.

3.2 Widening Socio-Economic Inequality

The progressive excise structure places a heavier burden on small producers than on large firms. Sondayani (2024) finds that the fixed-cost burden of excise has pushed many small businesses to halt production or even move into the illegal sector. This widens the gap between large and small enterprises and triggers layoffs in labor-intensive segments such as hand-rolling workers, as described by Hikmah (2025).

3.3 Growth of the Informal Sector and Black Market

Weaknesses in oversight and distribution systems have expanded the operating space of the tobacco black market. Through the concept of circular cumulative causation, Nurjihadi (2016) explains how ineffective policies can generate systemic effects, including the expansion of the informal sector. Literature from the WHO and Tobacconomics likewise emphasizes that governance capacity—beyond fiscal instruments alone—is crucial to curbing illicit trade.

3.4 Policy Unresponsive to Social Context

Using responsive policy theory (Easton, 1965), the government's response to social dynamics appears insufficiently accommodative. The policy is implemented in a centralized manner without adequately incorporating the aspirations of affected communities. In addition, from a historical institutionalist perspective (Steinmo & Thelen, 1992), the excise policy inherits a colonial fiscal logic that sidelines distributive justice within Indonesia's political-economic system.

3.5 Emergence of Illegal Cigarettes as a Direct Response to Excise Hikes

Sharp increases in excise rates create economic incentives for the emergence and proliferation of illegal cigarettes. Rising prices for legal cigarettes open a market niche for non-duty-paid products that are nevertheless sold openly. This not only undermines the effectiveness of tobacco-control policy but also harms state revenues and worsens competitive conditions in the industry. Such illicit products are typically produced locally on a small, unlicensed scale or smuggled through unmonitored distribution channels. Evidence from the WHO and Tobacconomics indicates that surges in illicit cigarettes commonly follow steep excise hikes when not matched by strengthened oversight and law enforcement.

Discussion

The discussion from this study reveals that Indonesia's tobacco excise policy faces a serious paradox between its normative objectives and the realities of on-the-ground implementation. Normatively, the policy is designed to reduce cigarette consumption while simultaneously increasing state revenue. However, in practice, excise hikes have produced unintended consequences, most notably the expansion of illegal cigarette circulation and mounting pressure on small businesses and the informal sector. This phenomenon illustrates how a theoretically rational policy can lose its effectiveness when confronted with complex socio-economic dynamics.

Within Grindle's (1980) policy effectiveness framework, the success of a policy depends on a harmonious relationship between inputs (planning and resources), processes (implementation mechanisms), outputs (short-term results), and outcomes (long-term impacts). In the case of Indonesia's excise policy, the input—progressive regulation and tariff structures—has been consistently applied by the government. Yet, the implementation process shows significant weaknesses in distribution oversight, law enforcement against illegal cigarettes, and stakeholder engagement. The output—higher prices for legal cigarettes—has not translated into the intended outcome of sustained reductions in consumption and increased state revenue. Instead, many consumers, particularly from lower-income groups, have shifted to cheaper illegal cigarettes, eroding the legal market and causing fiscal losses.

These findings are reinforced by Wardani (2022), who notes that recent excise hikes have coincided with significant growth in the illegal cigarette market. Similarly, Rahmawati and Rinardi (2020) observe that price-based consumption control strategies have been ineffective without supporting policy infrastructure. The absence of a closed distribution system, weak track-and-trace technology, and limited regional enforcement capacity have allowed the illicit market to expand unchecked. In this context, Hogwood and Gunn's (1984) critique is relevant: policies will fail if objectives are unrealistic, implementation tools inadequate, and frontline actors lack the capacity or authority to manage implementation challenges.

The policy's impact has also deepened socio-economic inequalities. From the perspective of Todaro and Smith (2015), economic growth without fair benefit distribution widens the gap between rich and poor, between large and small enterprises, and between the formal and informal sectors. In the tobacco excise context, large producers remain relatively unaffected thanks to their strong capital base, efficient production systems, and robust distribution networks. In contrast, small businesses—particularly home-based factories and local industries in tobacco-producing regions—struggle under high excise burdens as fixed costs disproportionate to their production capacity. They face two difficult options: drastically cut production or enter the illegal market to survive.

Sundayani (2024) notes that the current excise regime has forced many small producers to cease operations, while others have resorted to illicit production to sustain household and community livelihoods. Inequality is further exacerbated by disproportionate allocations of excise revenue-sharing funds (DBH-CHT). The central government, as policy administrator, retains the largest share, while producing regions such as Jember receive only limited allocations—despite bearing heavier social and economic burdens. Hikmah (2025) confirms that the socio-economic fabric of tobacco-farming communities in Jember has grown increasingly fragile under a policy framework that neglects local actors.

This inequality extends beyond the economic domain to directly affect employment conditions. When small and medium-sized enterprises cannot survive, layoffs become inevitable, particularly in labor-intensive segments such as hand-rolling workers and tobacco farmers. This leads to sustained social instability, as displaced workers lack comparable alternative livelihoods. In the long term, these structural pressures risk increasing poverty in producing regions while accelerating urbanization and social strain in urban areas.

One of the most visible consequences of this combined ineffectiveness and inequality is the proliferation of illegal cigarette factories operating beyond state oversight. Higher legal cigarette prices due to excise hikes have created lucrative market opportunities for illegal producers. Small-scale unregistered units and smuggled products have quickly grown to meet demand for cheaper cigarettes. Nurjihadi's (2016) concept of circular cumulative causation helps explain this phenomenon: policies insensitive to social realities create snowball effects—poor policy generates negative side effects, which in turn reinforce existing structural barriers.

International literature from the WHO and Tobacconomics warns that high excise rates without adequate tracking and enforcement systems tend to expand black markets. Indonesia is a concrete example of this condition. The absence of a closed distribution system and weak inter-agency coordination among law enforcement bodies leave excise policy operating in isolation, without synergy from supporting instruments. Within Easton's (1965) responsive policy framework, public policy should be a form of response to social pressures within the community. Unfortunately, in this case, the policy has been implemented in a top-down manner, driven by fiscal logic but allowing little space for dialogue with affected groups such as farmers, hand-rollers, and small producers.

From the perspective of historical institutionalism, as outlined by Steinmo and Thelen (1992), Indonesia's tobacco excise policy cannot be separated from its colonial legacy, in which the tobacco sector served as a primary source of state revenue since the Dutch East Indies era. This historical legacy has entrenched a strong fiscal orientation in current policy design. When fiscal considerations take precedence over social justice, policy structures tend to produce systemic inequality and social resistance. The emergence of illegal cigarette factories is thus not merely a legal violation, but also a structural response to the state's failure to create a fair, efficient, and socially responsive fiscal system.

Overall, this discussion demonstrates that Indonesia's tobacco excise policy is problematic not only in technical terms but also in structural and ethical dimensions. The disharmony between normative objectives and implementation realities, weak oversight infrastructure, and inequitable benefit distribution render the policy ineffective in the long term. Moreover, it creates fertile ground for the growth of the illicit economy and deepens economic disparities. Therefore, excise policy reform cannot rely solely on raising rates; it must also involve improvements to distribution systems, stronger enforcement, and active engagement of small businesses and local communities in the policy formulation process. An inclusive, responsive, and equitable policy is essential to resolving the paradox that has long surrounded Indonesia's tobacco excise regime.

4. CONCLUSION

Indonesia's tobacco excise policy, aimed at suppressing consumption and increasing state revenue, has instead created an implementation paradox. The significant increase in excise rates has not been accompanied by effective oversight and distribution, thus encouraging the circulation of illegal

cigarettes and weakening the legal industry, particularly small businesses. Within the framework of policy effectiveness theory, this reflects a failure to align policy inputs, processes, and outputs. Meanwhile, from the perspective of socioeconomic inequality, the unequal tariff structure increases the burden on lower-income groups and small economic actors, widening the gap between the formal and informal sectors.

The emergence of illegal cigarette factories is not merely a violation of the law, but a structural response to an unfair fiscal system unresponsive to social realities. The legacy of fiscal colonialism, which still dominates, reinforces the logic of state revenue without regard for distributive justice. Therefore, reformulation of excise policy must consider aspects of economic justice, social responsiveness, and strengthening governance. Only through an inclusive and systemic policy approach can the government address the dilemma between fiscal objectives and the social impacts of tobacco excise policy.

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