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SOUTHEAST ASIA TOBACCO CONTROL ALLIANCE

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ASEAN REGIONAL SUMMARY REPORT: AFTA AND TOBACCO

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1. INTRODUCTION

International trade has been regarded as an engine of economic growth that allows countries to enjoy better economic welfare through specialization and economies of scale. But, to assist in reducing the balance of payment deficit and to protect domestic industries against foreign competition, many countries opt to limit their imports by a variety of trade barriers, especially high tariff rates. The reasoning is that temporary protection may assist a young industry in competing with foreign competitors and develop its latent strength. It also turns the terms of trade against agriculture and, therefore, maintains low manufacturing wage rates by providing cheap food for the manufacturing workers. On the other hand, protection allows a domestic industry to produce at a higher cost and be inefficient. In addition, because prices are distorted by protection, resources are redirected away from more productive uses.

But the arguments for free trade are not applicable to tobacco and tobacco products which are a major cause of diseases that shorten the lives of millions of smokers. Lower cigarette prices that follow free trade among member countries would allow more cigarette consumption, both of locally produced cigarettes and imported cigarettes. Consequently, the health cost of smoking and the number of tobacco related deaths would rise. Not to mention the fact that tobacco tax revenue may also be reduced. Thus, specialization that follows free trade does not necessarily benefit all countries as in the case of other goods and services.

In 1992, during the Fourth Summit in Singapore, ASEAN decided to establish an ASEAN Free Trade Area (AFTA). Member countries agree to eliminate trade barriers on most goods and services, including tobacco and tobacco products, among themselves, while they continue to apply their own particular barriers against the rest of the world. This is expected to increase the efficiency and international competitiveness in the world market of products from ASEAN member countries. In order to achieve this objective, elimination of tariffs and non-tariff barriers is crucial.

Principally, the Common Effective Preferential Tariff (CEPT) scheme for AFTA is supposed to cover the liberalization of all manufactured and agricultural products that have at least 40% of ASEAN content. The tariff rates levied on these products traded within the region have to be reduced to 0 to 5%. Non-tariff barriers have also to be eliminated. Originally, the scheme was scheduled to be completed by 2008.

However, the timetables for reducing tariffs and eliminating non-tariff barriers differ across products and member countries. These are divided into four categories, namely Inclusion List (IL), Temporary Exclusion List (TEL), Sensitive List (SL) and General Exception List (GEL). Products in IL are to undergo immediate liberalization. Except the four new ASEAN member countries, tariff rates should have be decreased to 20% by 1998 and 0 to 5% by 2002. The schedules for the ASEAN Four, i.e. Viet Nam, Laos, Myanmar and Cambodia, are 2006, 2008, 2008, and 2010, respectively. Products can be temporarily excluded from the Inclusion List and placed on the Temporary Exclusion List (TEL). Ultimately, however, they should be brought back into the Inclusion List and undergo a liberalization process. Unprocessed agricultural products are in SL. The general timetable for these products is extended to 2010. For the four countries, the timetables are the years 2013, 2015, 2015 and 2017, respectively. There are a number of products that are permanently excluded from the free trade area for the protection of national security, public morals, the life of humans, animals and plants, health, and articles of artistic, historic and archaeological value. These are listed under GEL and cover around 1,036 tariff lines or only 1.61% of all ASEAN tariff lines.

The status of tobacco products in the CEPT scheme is different across AFTA member countries (Yong, 2003). For Brunei, 15 tariff lines of tobacco products are on GEL and 4 tariff lines are on IL. For Indonesia, Philippines, Singapore, Vietnam and Thailand, all tobacco products are on IL. For Malaysia, they are in SL and are allowed to be phased into the CEPT no later than 2010. In the case of Cambodia, these products are on TEL. For Cambodia, manufactured and unprocessed products are supposed to be brought back into the liberalization process no later than 1st of January 2007 and 1st of January 2010, respectively. In the case of Laos, 6 out of 9 tariff lines are on TEL and should be brought into the Inclusion List by 1st of January

2015. For the other 3 lines in SL, they are supposed to be brought into the process by 1st of January 2005 and 1st of January 2008, for manufactured products and unprocessed products, respectively.

Reports in this volume choose Indonesia, Thailand, and the Philippines as examples. These countries differ in terms of their trade openness, the structure of the tobacco industry, the size of the population, smoking prevalence, and the price responsiveness of cigarette demand. In terms of trade openness, they placed high tariff rates on the imports of tobacco and tobacco products. Following the AFTA's CEPT scheme, the rates have been reduced gradually. But their reduction timetables are different.

Because of this, the impact of AFTA's CEPT scheme on the tobacco industry in these countries is worth examining. The degree of the impact depends on the background of these countries. However, there has been no study that critically examines this important issue. Discussion in this summary report is drawn from results of the following four country reports, i.e. Saad (2006) for Indonesia, Austria (2006) for the Philippines, and Isra Sarntisart (2005) for Thailand.

2. RECENT STUDIES

There is a limited number of studies on the impact of tobacco trade liberalization. Taylor et al. (2000) attempts to investigate this relationship .Using annual data of 42 countries over the period between 1970 and 1995, the study found that trade liberalization increases cigarette smoking. This is very significant in low-income and middle-income countries, but insignificant in high income countries. The study provides an explanation for this difference as follows. Trade openness is positively related to economic growth, and the marginal effect of openness on growth decreases with an increase in income. Thus, the impact of trade liberalization on growth is larger for low income countries, followed by middle income and high-income countries, respectively. Since the income elasticity of demand for cigarettes is positive, this explains the higher degree of trade liberalization impact on cigarette smoking of lower-income countries.

The above discussion focuses on the income impact of trade liberalization but the impact of price reduction is also noteworthy. Because of tariff reduction, domestic prices of cigarettes will go down. The impact on demand depends on the degree of demand responsiveness to the changes in prices. Chaloupka et al. (2000) point out that research on tobacco consumption for low-income, middle-income and high-income countries reaches the same conclusion. Lower price would lead to more tobacco consumption but the degree of price responsiveness for high-income countries is found to be about a half of those of other countries. Taking into account the income and price impacts, the overall impact of trade liberalization on cigarette demand should be larger for low-income countries than for other countries.

The issues of tobacco control measures are well-discussed in Jha and Chaloupka (1999). The study examines economic questions that have to be addressed if policy makers want to exercise tobacco control measures. The report investigates smoking trends worldwide. It also discusses the health consequences of smoking and assesses the consequences of tobacco control in various aspects. It shows that many adverse effects of tobacco control are not significant. Examples of these effects are job losses and tax revenue decreases that may follow an increase in tobacco taxes.

Many past studies on tobacco consumption have been focused on tobacco consumption and taxation in many countries, including AFTA members. These studies are in the "Economics of Tobacco Control" sub-series of the Health, Nutrition and Population (HNP) Discussion Paper. The HNP Discussion Paper contains an economic analysis of tobacco control in many Asian countries. They provide estimates of the price elasticity of cigarette demand which are very important for an analysis of tax policies. Important for this volume is the estimate for Thailand (-0.3925) that is used in the country's report. However, taking into account estimates of other studies, the Indonesian report in this volume opts for a price elasticity of -0.61, while the Philippines report opts for the Thai estimate, i.e. -0.39. The background and the AFTA impact of these countries will be summarized in the following paragraphs.

3. COUNTRY BACKGROUND

3. 1 Tobacco Industry

Among all ASEAN member countries, Indonesia is the largest in terms of population and tobacco industry. In 2003, Indonesia a population of around 220 million and smoking prevalence rate was around 60%. It is also the world's fifth largest cigarette producer. In 2002, it had around 250 big cigarette factories producing more than 220 billion sticks of clove cigarettes or Kretek. The production of white cigarettes was very insignificant in comparison to clove cigarettes. In 2001, it was mainly for export of which more than 90% went to other ASEAN member countries, especial Thailand and Cambodia. The export of clove cigarettes was also significant, at around 20% of total cigarette exports, and three-fourths went to Malaysia in that year. It is because of cheap labor that Indonesia has become the heaven of many multinational corporations that utilize the AFTA's CEPT scheme to penetrate the ASEAN market. Thus, Indonesia has become a net exporter of cigarettes. On the other side, Indonesia also imports a small quantity of white cigarettes from non-ASEAN countries. Trade in raw tobacco is mainly with non-ASEAN countries where the impact of AFTA is negligible.

The stories of the Philippines and Thailand differ from that of Indonesia. The combined cigarette market of these two ASEAN countries is still smaller than that of Indonesia. The large part of the tobacco industry in Philippines consists of a number of private-owned factories and a state-owned cigarette factory in Thailand – all these factories produce local and foreign-brand cigarettes. The implementation of AFTA has pressed down domestic prices of imported cigarettes. Thus, there has been a huge decline in real tobacco prices in recent decades.

In the Philippines, the tobacco industry has played a relatively more important role than Thailand. It was an employment source of around 2 million jobs. Around three-fourths of tobacco production was for domestic production and the rest was for export. However, it recorded a negative growth rate of around 3.3% over the past decade. On the other hand, cigarette production grew at around 1.2%. Around 97%

of the production was to supply domestic consumption, and the rest was exported. Although the majority of cigarette exports went to non-ASEAN countries, the share of ASEAN has increased continuously since 1995. It should be noted that the increase was much more rapid in 2003. The Philippines tends to benefit from the CEPT scheme of AFTA. The substantial decline in tariff rates is one of the causes of the increase in the share of imported cigarettes in total cigarette consumption in the Philippines. The decrease in tariff rates have made imported ASEAN cigarettes cheaper, and also reduced the production cost of local cigarettes. However, the smoking prevalence rate that was more than 30% in the 1990s still went down to around 25% in 2001.

The role of tobacco and cigarette production in the Thai economy is very small. In 2003, the Thai population was slightly over 62 million and smoking prevalence was only around 25%. There is only one state-owned cigarette factory, while the importation of raw tobacco and cigarettes is allowed. The total share of tobacco, and tobacco and snuff was less than 1 percent of total production. In terms of the tobacco trade, Thailand is a net importing country. This is caused mainly by trade in cigarettes and other tobacco products. However, the trend was reversed in the first half of the 2000s. It is very important to note that this reversing trend in the tobacco trade deficit was mainly due to cigarette imports, especially from AFTA member countries. The share of cigarette imports from AFTA member countries, that was very low in the pre–2000 period, continuously increased and went up to nearly 81 percent by 2003. At the same time, the price ratio between tobacco products and all other consumer goods tended to decrease. This is probably the effect of Thailand’s commitment to the AFTA’s CEPT scheme that began to be effective over the years. A similar story can be found in the case of raw tobacco import.

3. 2 Price Policies

Price policies on tobacco markets in these ASEAN member countries are noteworthy. In Indonesia, the domestic prices of cigarettes are not market determined. All producers have to sell their products at prices not lower than the minimum retail prices that are decided by the government. The main purpose of price regulation is tax revenue that is predetermined by the government. The regulation divides cigarettes into three categories, i.e. machine-rolled clove cigarettes, hand-rolled clove cigarettes, and machine-rolled white cigarettes. It also sets higher minimum retail prices on cigarettes produced by larger scale producers. Cigarette producers are not prohibited to sell their products at prices higher than the minimum retail prices. In 1988, the minimum retail prices of the machine-rolled clove cigarettes were highest, while those of the second category were slightly higher than those of white cigarettes. Between 1998 and 2002, all prices increased significantly and continuously. But the prices of white cigarettes increased much slower. The tax system favors local cigarette producers. Local cigarette producers, through imported tobacco, face tariffs plus 10 percent of value-added tax and 2.5% of sales tax while cigarettes face the same value-added tax but do not face sales tax. Thus, the total tax on imported tobacco, for local cigarette production, is 17.5% while the total tax on imported cigarettes is 25%. The CEPT scheme allows local producers to lower cost of imported tobacco. Thus, the minimum retail prices of white cigarettes increased by around 10% between 2002 and 2003, while those of clove cigarettes did not change. In 2003, the minimum retail prices of clove cigarettes are at least 35% higher than those of white cigarettes.

Cigarette taxation in the Philippines consists of tariff, excise tax, and value-added tax. As mentioned earlier, tariff rates on tobacco and tobacco products have been reduced gradually, especially for imports from ASEAN. The government opts for an excise tax system that divides the net retail prices of cigarettes into four classes namely very high prices, high prices, medium prices and low prices. The rates are higher on more expensive cigarettes. The value-added tax rate was 10% for all four classes of cigarettes. All rates are the same for both imported and locally produced cigarettes. Although the decreases in tariff rates have reduced the prices of imported ASEAN cigarettes and the production cost of local cigarettes, various smoking control measures have been implemented. This includes an increase in excise tax rate. Consequently, the smoking prevalence rate that was more than 30% in the 1990s went down to around 25% in 2001. However, the effectiveness of excise taxation is limited by the 1996 net retail prices of cigarettes that are the basis for taxation. Thus, despite the fact that the net retail cigarette prices have been increased many time since 1996, taxes on cigarettes are unchanged.

Thailand also employs a similar policy to Indonesia. The retail prices of cigarettes are determined by the government and differ across brands. Generally, domestic cigarettes are cheaper than imported cigarettes. Tax revenue has always been one of the main purposes of tobacco taxation. Taxes imposed on cigarettes consist of tariffs on imported tobacco leaves and cigarettes, excise tax, health tax, local tax, and the value-added tax. The applied tariff rates are ad valorem rates. The rate of excise tax was 75%[1] of factory prices or imported prices that include customs tariff and the excise tax. Since 7th of November 2001, a health tax is applied on all sticks of manufactured and imported cigarettes. The tax is 2% of and is on top of the excise tax revenue. The rates of the local tax are different across areas and can be as high as 0.05 Baht per stick. Value-added tax rate is 7%. These rates are the same for both imported and locally produced cigarettes. For many years, price policies through excise taxation, as well as many non-price measures, have been implemented to control smoking effectively. This has kept the total number of smokers at around 12 millions, of which around 10 millions are regular smokers.

3.3 Tariff Reduction

The three countries placed high tariff rates on the imports of tobacco and tobacco products. Following the AFTA's CEPT scheme, the rates have been reduced gradually. But the reduction rates are different across countries. For Indonesia, the AFTA rate is applied for raw tobacco but not for tobacco products including cigarettes. Tariff on raw tobacco, imported from all AFTA member countries, will be reduced from 5% to 0%. Tariff rates on cigarettes imported from all countries is 15%. It should be noted that imported tobacco faces tariff plus 10% of value-added tax and 2.5% of sales tax while cigarettes face the same value-added tax but do not face sales tax. Thus, the total tax on imported tobacco is 17.5% while the total tax on imported cigarettes is 25%. Consequently, the tax system is in favor of local cigarette producers. AFTA provides more relative benefit to local producers.

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[1] This was increased to 79% at the end of 2005.

TABLE 1: Indonesia's Tariff Rates on Cigarettes and Tobacco: 2003

Year	Cigarettes (%)	Tobacco (%)	
		General	AFTA
2003	15	5	0

Source: Saad (2006).

For the Philippines, the government has progressively reduced tariff rates through the tariff reform program (TRP) since 1981. Under TRP, the tobacco tariff rates are basically the same for tobacco leaves, cigars and cigarettes, and tobacco manufactures. The rate that was 50% in 1993 was reduced continuously to 20% in 1998, 10 percent in 2001, and 7% in 2003. Currently, the rate is 5%. However, under the CEPT scheme, tariff reduction was much faster. The rate on tobacco leaves went down from 15% in 1999 to 10% in 2000, 6% in 2001, and 3.67% in 2003. For cigars and cigarettes, the rate that was 50% in 1995 went down continuously to 11.67%, 8.33%, and 5% in 2000, 2001, and 2003, respectively. The rate on tobacco manufactures also went down continuously from 23.75% in 1995 to 7.75% in 2001 and 4% in 2003.

TABLE 2: The Philippines' Tariff Rates on Tobacco and Tobacco Products: 1988-2004.

Year	AFTA Rates (%)			TRP Rate (%)		
	Raw Tobacco	Cigar and Cigarette	Others	Raw Tobacco	Cigar and Cigarette	Others
Before 1996	NA	50	23.75	50	50	20 and 50
1996	NA	30	18.75	30	30	10 and 30
1997	NA	25	15	20	30	10 and 20
1998	NA	20	11.5	20	20	3 and 20
1999	15	15	9	10 and 20	20	3, 10 and 20
2000	15	11.67	7.75	10 and 20	20	3, 10 and 20
2001	6	8.33	4	10	10	3 and 10
2002-3	3.67	5	4	7	7	3 and 7
2004	NA	NA	NA	5	5	3 and 5

Note: NA = Not available.
Source: Tables 24 and 25, Austria (2006).

In Thailand, cigarette production has been under a state monopoly and has been highly protected from international competition by high tariffs. Before 1996, the rate was 60% on all types of tobacco and tobacco products. In 1998, under World Trade Organization (WTO), the rates were differentiated among different products. Since then, the rates have been 22.5% on cigarettes, and 45 or 60% on other tobacco products. Under AFTA, the rates have been reduced continuously since 1998, and the reduction was faster for imported cigarettes than other tobacco products. Since 2003, the rates on imports of tobacco, cigarettes and other tobacco products from ASEAN were reduced to 5%.

TABLE 3: Thailand's Tariff Rates on Tobacco and Tobacco Products: 1988-2004.

Year	AFTA Rates (%)				WTO Rate (%)	
	Tobacco	Cigarette	Cigar & Cheroot	Others	Cigarette	Others
Before 1996	60	60	60	60	60	60
1996-97	60	60	45	60	60	60
1998-99	20	15	20	20	22.5	45,60
2000	15,20	10,20	15	15,20	22.5	45,60
2001	15,20	10,20	15	15,20	22.5	45,60
2002	10,20	5,20	10	10,20	22.5	45,60
2003	5	5	5	5	22.5	45,60

Note: Where there are two rates, the first rate is applied on certain types of tobacco and cigarettes that are the majority of tobacco or cigarette imports of Thailand.
Source: Table 13, Isra Sarntisart (2005).

4. COMPARATIVE RESULTS: IMPACT OF AFTA

Theoretically, the welfare impact of a free trade area consists of two parts. The first part is called “Trade Creation” in standard international trade textbooks. It reflects the welfare gain from an increase in international trade between an importing country and other countries that result from tariff reduction or elimination for imports from these countries. Another part, Trade Diversion, measures the welfare change that follows the redirection of international tobacco trade from more efficient non-member countries to less efficient member countries. This is because of higher tariff rates on non-member products that raise the domestic prices of imports from these countries above those of imports from member countries. Thus, because of cheaper domestic prices, local consumers are encouraged to buy products imported from member countries. Consequently, values at the world prices, the importing country has to pay more for imports from other member countries, instead of paying less for imports from non-member countries.

However, the impact of including tobacco and tobacco products in a free trade agreement such as AFTA differs from that of other goods and services. As reviewed from past studies, for the tobacco industry, the CEPT scheme has two major consequences. Firstly, the overall tobacco consumption has risen. Rather than better economic welfare, more consumption leads to higher economic cost, i.e. health cost and the number of deaths caused by tobacco related diseases, through decreases in domestic cigarette prices, an increase in cigarette demand, and a change in tax revenue. Secondly, because of relative price decreases, imported cigarettes have become more popular and have gained more market share. Moreover, as already discussed, these countries have different backgrounds in terms of income level, the share of AFTA trade in total imports, the share of total import in total domestic demand, and consumption behavior. Thus, the degree of impact of the AFTA’s CEPT scheme differs across countries.

Despite the gigantic size of cigarette market, the impact of AFTA on Indonesian smokers is limited. This is because of smokers’ loyalty to clove cigarettes, and the share of ASEAN tobacco and cigarettes in the Indonesian market. Clove cigarettes represents nearly 90% of the Indonesian cigarette market. The share of ASEAN cigarettes in total Indonesian imported cigarettes (0.63%) and the share of imported cigarettes in total cigarette consumption (less than 0.15%) are very small. The share of ASEAN tobacco in domestic production is also small, i.e. only 2.3%. Thus, tariff removal through AFTA implementation will not have any significant impact on domestic cigarette prices and demand. However, a simulation on a 10% decrease in cigarette prices shows that demand will increase by 6.1%. With the total number of smokers more than 132 million, the number of smoking attributable deaths will be striking. Long term health cost will be as much as US$ 21 billion, much larger than the impact on other ASEAN countries.

The analysis on the Philippines shows two alternatives. Firstly, the reduction of the tariff rate from 11.67% to 5% in 2003 will decrease cigarette prices by 5.45%. Consequently, demand will increase by 2.14% or 4.62 million packs. This will lead to a 93.85 net increase in the number of smoking attributable deaths in the next 20 years, i.e. in 2023. Instead, a decrease in the tariff rate from 11.67% to 0% will have stronger impact. This will reduce cigarette prices by 9.54% and will increase cigarette demand by 3.74% or more than 6.5 million packs. The additional number of smoking attributable deaths in the next 20 years will be 95.32.

Secondly, the government may decide to increase the excise tax. This will offset the impact of AFTA partly. The case in which the tariff rate is reduced to 5% will lead to a smaller impact, a 4.10% decrease in price, and a 1.61% increase in demand or less than 4 million packs. The case of tariff reduction to 0% will lead to an 8.19% decrease in prices, a 3.21% increase in demand or around 6 million packs. However, as mentioned in previous section, the effectiveness of excise taxation is limited by the 1996 net retail prices of cigarettes that are the basis for taxation. Unless the base prices are indexed to inflation, taxes on cigarettes will be unchanged and the real prices of cigarettes will decrease over time.

Regarding Thailand, the impact will be much stronger since her cigarette import come mainly from ASEAN countries, especially Indonesia and the Philippines. Two possible scenarios are investigated. Firstly, the government may decide not to change cigarette prices and, consequently, demand will be unaffected. Analysis shows that a decrease in tariff rates on tobacco and tobacco products will reduce the tax burden on importers and the local producer Thailand Tobacco Monopoly (TTM), and adversely affect the revenue of the Thai government. In the case of imports, total government revenue will be reduced by around 11% of the pre-AFTA value or nearly 1,200 million Baht while cigarette importers will earn more profit by around 12%. For TTM cigarettes, total tobacco tax revenue will decrease by over 7 million Baht.

If the government decides to lower the retail prices of both types of cigarettes, demand will increase. In this situation, imported cigarettes will gain more benefit and market share. Demand for imported cigarettes will increase by nearly 2.20% and demand for TTM cigarettes will increase by only 0.003%. Based on the most recent data in 2002, this is equivalent to around 89 million and 0.68 million cigarette sticks, respectively. Consequently, the government tobacco revenue will decrease by around 1,034 million Baht. In the long term, there will be a negative subsequent impact in terms of smoking related diseases and more health cost. A very optimistic estimate shows that the enforcement of AFTA in 2003 will lead to an additional 134 tobacco related deaths in the next 20 years or 2023. This will cost the Thai economy around 82 million Baht or more than US$2 million in terms of forgone future income in that year and in each of the years after. Not yet mentioned is the health care cost of all tobacco related diseases. Moreover, estimates also show that the increase in cigarette demand will be more among urban smokers than among rural smokers, especially those who are in lower income classes, and will also be stronger among middle aged and child smokers.

It should be noted that the above discussion, on all three countries, does not take into account two important points. As pointed out by Taylor et al. (2000), Free Trade Agreements (FTAs) have some positive impacts on economic growth, i.e. income, which will raise demand for cigarette as well as other goods. But it is very difficult, if not impossible, to design a policy to offset or to eliminate this increase in cigarette demand without suppressing demand for other goods. Another point is the health impact on second hand smokers. An increase in cigarette demand will lead not only to deaths of smokers but also to those of second hand smokers. This indirect impact is believed to be significant. However, it is not in the scope of this report.

5. CONCLUSIONS AND IMPLICATIONS FOR TOBACCO CONTROL

The above results point to many important conclusions and policy implications.

Firstly, evidence shows that the CEPT scheme is relatively in favor of imported cigarettes. This is because of the import content of imported cigarettes which is naturally higher than that of locally produced cigarettes. Thus, sooner or later, imported cigarettes will gain more market share. All parties should realize that future smoking control measures will face tougher resistance from foreign tobacco producers.

Secondly, the Indonesian case shows that loyalty to domestic brands prevents local smokers from the adverse effect of the AFTA’s CEPT scheme. Indonesian smokers are loyalty to local clove cigarettes. Although clove cigarettes do not have much benefit from AFTA through imported raw materials, the future is not always positive. With the number of population of more than 220 millions and smoking prevalence more than 60%, infiltrating Indonesian cigarette market is still a target for foreign cigarette producers. If price reduction is sufficiently large, eventually Indonesian smokers will switch to imported white cigarettes. FTAs with countries such as China and India are still a threat to Indonesia and, also, other ASEAN countries. The two countries are labor intensive and can produce white cigarettes at much cheaper cost.

Thirdly, price control will not allow cigarette demand to change but may have some adverse effects. This is the case especially for Thailand, and has some implications for Indonesia and other countries that opt for cigarette price regulation policies. Since the government’s foregone tax revenue will go to cigarette producers and importers in terms of more profit. The producers and importers may decide to use the additional profit for political lobbying, non-price promotion and other activities that will offset various smoking control measures. Thus, some policies are needed urgently to overcome this unfavorable impact.

Fourthly, an increase in the rate of excise tax is the best alternative to protect ASEAN smokers. Estimates for the Philippines and Thailand show that this will reduce the adverse impact of the AFTA's CEPT scheme. To some extent, it will reduce the decrease in prices, the increase in demand and the subsequent increase in health cost. Moreover, as demonstrated by the Thai case, this will allow the government to gain back some or all of her foregone tobacco tax revenue adversely affected by the CEPT scheme. Thus, the government should step up the excise tax on cigarette at a higher rate than the fall in tariff rate to maintain or to increase cigarette prices. Without such policy, the main beneficiary of AFTA will be foreign cigarette producers who can make more profit. However, more smuggling and "back door" production must be closely monitored.

Fifthly, although rolling back the trade liberalization process by excluding tobacco from the AFTA' CEPT scheme is the best solution for all ASEAN countries, this move is difficult to implement and may not be feasible. However, the inclusion of tobacco in the AFTA's CEPT scheme is an important lesson for all countries and the mistake should not be repeated in FTAs with other countries, especially China and India. These two countries can produce and export much cheaper cigarettes that may lead to an influx of imported cigarettes to all ASEAN countries. The same suggestion can be applied to other addictive products such as alcoholic beverages.

Sixthly, a decrease in the relative prices of cigarettes over time is common in many countries. This has encouraged more smoking. Results of many studies suggest that the government should increase the rate of excise tax to offset this unfavorable change. Moreover, excise tax indexation with inflation can be an effective instrument that will keep the real cigarette prices and cigarette demand unchanged.

6. RECOMMENDATIONS

1. Tobacco and tobacco products must not be included in the future FTAs with any countries, especially China and India. The same suggestion can be applied to other addictive products such as alcoholic beverages.

2. For countries that opt for cigarette price regulation policies, cigarette excise tax or cigarette corporate income tax must be increased to overcome the unfavorable impact of the AFTA. Otherwise, the government's foregone tax revenue will go to cigarette producers and importers in terms of more profit that can be used to offset smoking control measures.

3. All FTAs are relatively in favor of imported cigarettes. Thus, sooner or later imported cigarettes will gain more market share in all ASEAN countries. Anti-smoking organizations should prepare to face tougher resistance from foreign tobacco producers

4. Indonesia must prepare for a worse case. Although loyalty to domestic brands prevents local smokers from the adverse effect of the AFTA, with the number of population of more than 220 million and smoking prevalence more than 60%, infiltrating Indonesian cigarette market is still a target for foreign producers.

5. In the long term, excise tax indexation with inflation can be an effective instrument that will keep the real cigarette prices and cigarette demand unchanged.

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About SEATCA

The Southeast Asia Tobacco Control Alliance (SEATCA) works closely with key partners in ASEAN member countries to generate local evidence through research programs, to enhance local capacity through advocacy fellowship program, and to be catalyst in policy development through regional forums and in-country networking. By adopting a regional policy advocacy mission, it has supported member countries to ratify and implement the WHO Framework Convention on Tobacco Control (FCTC)

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