Commentary 1

Title of the article: Tobacco tax increase to help control cigarette consumption: minister

Source of the article: Antara News

URL of the article:

https://en.antaranews.com/news/265115/tobacco-tax-increase-to-help-control-cigarette-consumption-minister

Date the article was published: 12 December 2022

Date the article was accessed: 19 December 2022

Date the commentary was written: 19 December 2022

Word Count: 799

Section of the syllabus the article relates to: Microeconomics

Key Economic Concept: Intervention

Article

Jakarta (ANTARA) - The government's policy to increase the excise on tobacco products (CHT) will automatically push up cigarette prices, and thereby, help control cigarette consumption, Finance Minister Sri Mulyani Indrawati has said.

"With excise as a fiscal instrument to control consumption, we hope that the excise will increase prices, which will then reduce the number of smokers," she informed during a working meeting with Commission XI of the Indonesian House of Representatives (DPR RI) in Jakarta on Monday.

The minister said that so far, Indonesia ranks first in the world in terms of the prevalence of adult male smokers, which has been recorded at 71.3 percent.

Meanwhile, the prevalence of adult smokers in Indonesia, which stands at 37.6 percent, is the fifth highest in the world.

She noted that the prevalence of smoking among children aged 10 to 18 years is still high: it was recorded at 9.1 percent in 2018, 9.87 percent in 2019, 8.99 percent in 2020, 9.18 percent in 2021, and 9.04 percent in 2022.

Meanwhile, the 2020–2024 National Medium-Term Development Plan (RPJMN) is targeting to bring down the prevalence of smoking in children to 8.7 percent by 2024.

The price of cigarettes in Indonesia is relatively cheap at just US$2.1, which is far below the global average of US$4 and much lower compared to Australia, where cigarettes are the most expensive at US$21, Indrawati said.

Therefore, the government is supporting an increase in excise rates on tobacco products to boost the cigarette price index since it has the potential to reduce the public consumption of cigarettes.

Moreover, cigarettes are among the two largest expenditure components for households in Indonesia, both in urban and rural areas, the minister noted.

In fact, an average poor household spends Rp246,382 per month on buying cigarettes, which should ideally be used to buy food to improve nutrition.

In addition, a 1-percent increase in cigarette spending would increase the potential of households becoming poor by 6 percent.

"This is a dilemma: how can we influence household consumption to prioritize more nutritious goods to help the growth of their children to become healthy and productive?" she asked.

Therefore, the government is planning to raise tobacco excise rates by 10 percent in 2023 and 2024 an average for hand-rolled cigarettes (SKT), with the maximum increase capped at 5 percent per year.

The government has also adjusted the minimum retail price (HJE) by considering the developments in market prices and the average increase in cigarette excise duty.

The government will also increase excise rates for all types of electric cigarettes (REL) by 15 percent and other tobacco products (HPTL) by 6 percent every year for the next 5 years.

Commentary

This article reports the decision taken by the Indonesian government to **intervene** and raise excise taxes—taxes levied on the consumption of a particular product—on cigarettes by 10%, followed by a maximum capped hike of 5% in the following years, to help decrease cigarette consumption.

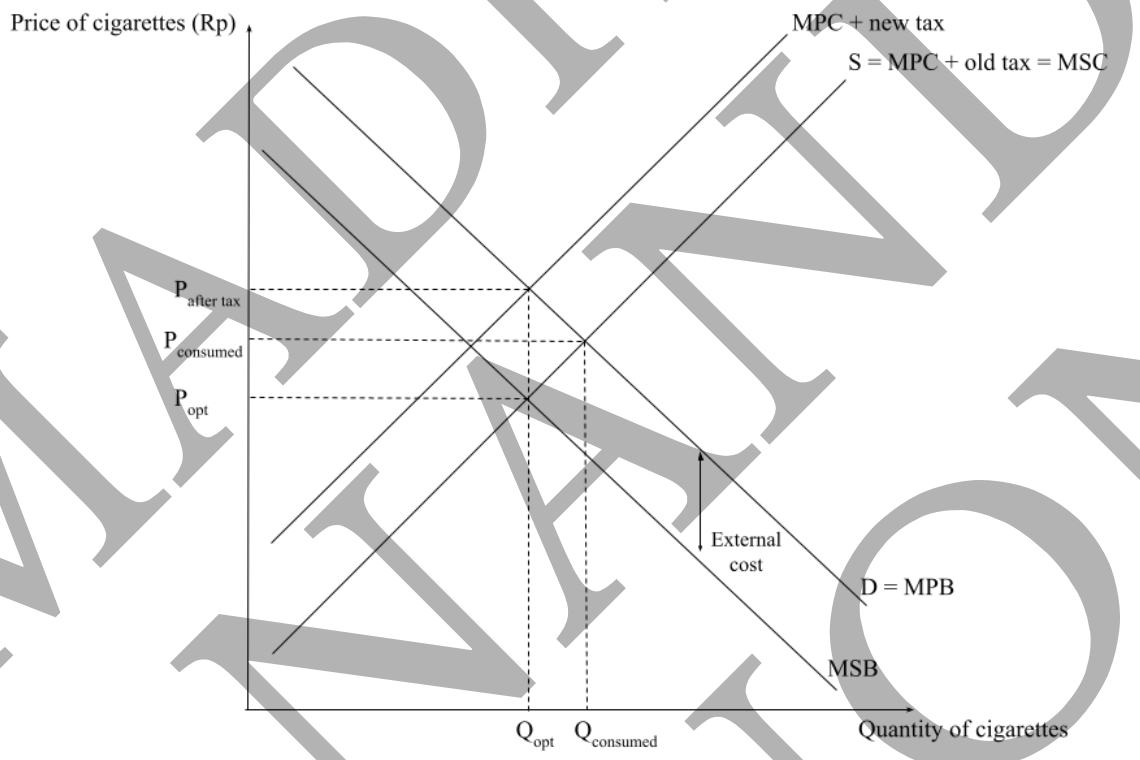

Fig 1. Effect of indirect tax on the market for cigarettes

Cigarettes are demerit goods—goods whose consumption results in negative spillover effects on third parties, such as the effects of second-hand smoking, to whom no compensation is paid. As a result, there are external costs that are manifested by the marginal private benefit (MPB) curve shifting to the left to form the marginal social benefit (MSB) curve. This represents the additional cost faced by society to consume one additional cigarette. As a result, the optimum quantity of cigarettes to be consumed falls to Q_{opt}, which implies that at the current level of

consumption $Q_{consumed}$, cigarettes are overconsumed leading to allocative inefficiency and market failure. To reduce the level of external costs and private costs such as the ill effects of smoking, the Indonesian government plans to **intervene** and increase the excise tax on cigarettes by 10%. This will shift the MPC curve (which already includes the original tax level) to MPC + tax, resulting in the price of cigarettes rising from $P_{consumed}$ to $P_{after\ tax}$ and the quantity consumed falling to Q_{opt}; this assumes the tax is ideal and the tax incidence is exactly equal to the external cost.

One advantage of the tax is that the tax burden falls entirely on cigarette smokers as producers shift the tax burden due to the inelastic nature of cigarettes. As a result, the negative externality is internalised which helps reduce third-party effects on society. Furthermore, assuming the tax is ideal, the increase in price will help reduce consumption as consumption falls to Q_{opt}. As the tax is expected to increase year on year, the government tax revenue which will now be equal to $(P_{after\ tax} - P_{opt}) \times Q_{consumed}$ is expected to also increase substantially. The higher tax revenue can be used to fund education policies in order to try and achieve the government's goals of reducing the level of child smoking by 8.7% and reducing Indonesia's rank of having the fifth highest level of adult smokers in the world. Finally, as Indonesia's average price of cigarettes is below the global average, the tax will help Indonesia align with international efforts to reduce the consumption of cigarettes and other tobacco products.

However, cigarettes are highly inelastic in demand due to their addictive nature. As a result, the tax may not be effective in reducing the quantity consumed as demand is going to be insensitive to a change in price. This is partly compounded by the fact that cigarettes are already one of the

largest expenditure components of the average Indonesian household. Furthermore, the tax may cause consumers to shift to parallel markets wherein cheaper cigarettes may have contaminated nicotine or higher levels of tar. As a result, it is likely that the magnitude of private costs may increase and the increase in tax revenue may be offset by the increase in government expenditure in order to **intervene** and shut down these parallel markets. Furthermore, indirect taxes are highly regressive which implies that lower-income households have a greater tax burden as they will spend a greater proportion of their income through tax. This is emphasised by the prediction that a 1 percent rise in spending will cause households to be 6% poorer. Thus, the tax may worsen Indonesia's income distribution. Although cigarettes are an inelastic good, there will be some level of decrease in consumption; this may cause unemployment in the cigarette industry as producers now earn a smaller price of P_{opt} and face a smaller quantity consumed. As cigarettes see high expenditure by households, it is likely that the cigarette market in Indonesia is large which could make job losses drastic.

Ultimately, the decision of the Indonesian government to **intervene** is a step in the right direction. It is highly unlikely that the government can effectively associate a monetary value to the external costs created by smoking. As a result, it is unlikely that the tax will be ideal and will equal the external cost; thus MPC will only shift in the right direction. Furthermore, as cigarettes make up a high percentage of household expenditure, the regressive nature of the tax may be more harmful than expected. Thus, additional **intervention** policies must be taken by the government in order to further reduce consumption while maintaining equity. For example, the government can pass legislation to increase the minimum smoking age in Indonesia and prohibit public smoking if it hasn't already. Thus, while the tax hike has the potential to be effective, it

must be complemented by other policies in order to help the Indonesian government achieve its goals successfully.

Works Cited

Faidlatul, Astrid, and Resinta S. 'Tobacco Tax Increase to Help Control Cigarette Consumption: Minister'. *Antara News*, 12 Dec. 2022, https://en.antaranews.com/news/265115/tobacco-tax-increase-to-help-control-cigarette-consumption-minister. Accessed 19 December 2022.

Tragakes, Ellie. *Economics for the IB Diploma*. Third ed., Cambridge University Press, 2020.

Commentary 2

Title of the article: Inflation in Sweden hits three-decade high

Source of the article: Alarabiya News

URL of the article:

https://english.alarabiya.net/News/world/2023/01/13/Inflation-in-Sweden-hits-three-decade-high

Date the article was published: 13 January 2023

Date the article was accessed: 09 May 2023

Date the commentary was written: 09 May 2023

Word Count: 800

Section of the syllabus the article relates to: Macroeconomics

Key Economic Concept: Economic well-being

Article

Inflation in Sweden surged to its highest point in three decades in December, fueled by soaring electricity prices that have hit the cost of living, official figures showed Friday.

The consumer price index (CPI) accelerated to 12.3 percent, up from 11.5 percent in November, Statistics Sweden said, the highest figure since February 1991.The main driver was the price of electricity, which rose 28.8 percent in December compared to the month before and 45.3 percent compared to a year earlier.

Sweden's inflation adjusted for fixed interest rates (CPIF) -- the figure used by Sweden's central bank to guide monetary policy -- jumped to 10.2 percent on an annual basis, up from 9.5 percent in November.

In a bid to counter soaring inflation, the Scandinavian country's central bank has sharply hiked its key interest rate in recent months, from zero in April to 2.5 percent currently, with its next monetary policy meeting scheduled for early February.

The bank has signaled that more increases are on the way.

Inflation has soared worldwide in the wake of Russia's invasion of Ukraine in February 2022, prompting central banks to hike interest rates.

But it has now eased for a sixth consecutive in the United States, with data on Thursday showing the consumer price index slowing to 6.5 percent in December.

Commentary

This article discusses the decision taken by Riksbanken—the central bank of Sweden which has the ability to control Sweden's financial system and monetary policy—to raise key interest rates to 2.5% to combat high inflation, a continuous increase in the general price level, and promote **economic-wellbeing**.

As this inflation was caused by an increase in electricity costs prompted by Russia's invasion of Ukraine, it is manifested as cost-push inflation. Cost-push inflation is defined as inflation caused by rising production costs due to a fall in aggregate supply, in this case, triggered by a supply shock.

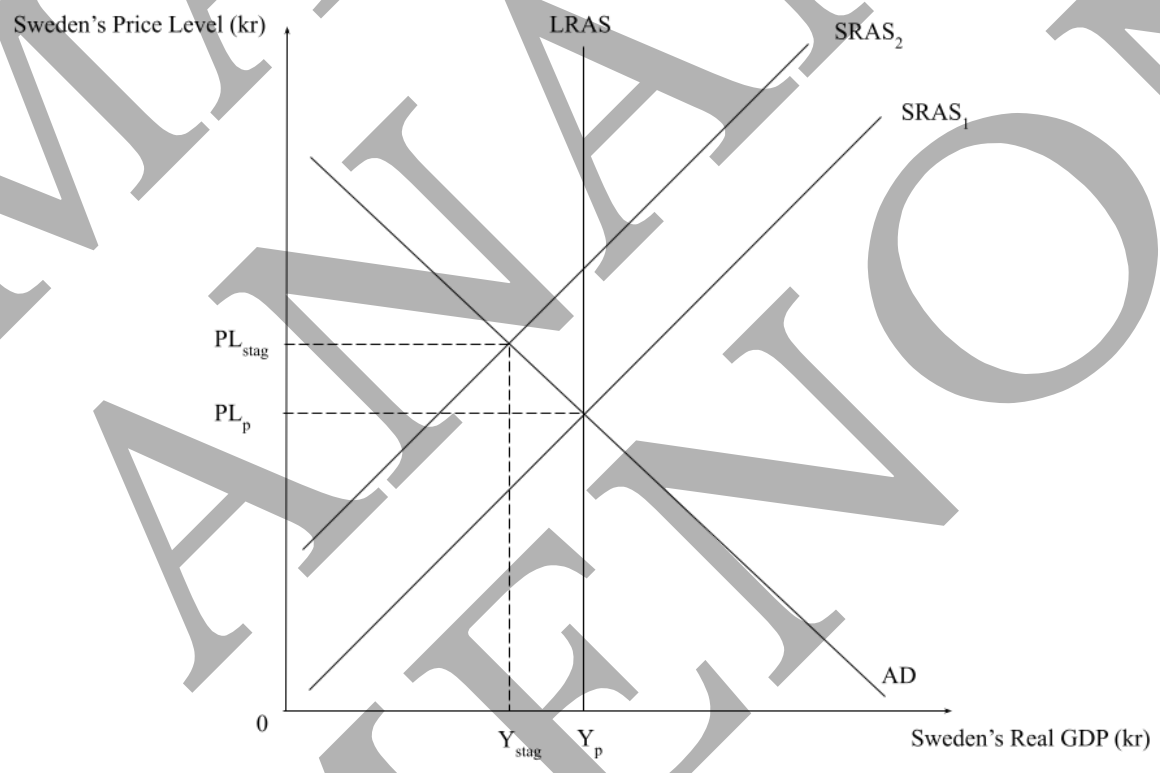

Fig 1. Cost-push inflation faced by Sweden's economy

The effect of this supply shock is illustrated in fig 1. as the short-run aggregate supply (SRAS) curve decreased by shifting to the left from $SRAS_1$ to $SRAS_2$. This consequently prompted price to rise from PL_p to PL_{stag} and output to fall from Y_p to Y_{stag}. This combination of rising prices and falling output is known as stagflation and is extremely dangerous for an economy. The decrease in output leads to unemployment as firms no longer have the incentive to produce at potential GDP, Y_p, and hence will lay off workers to maintain costs at an acceptable level. This rising unemployment, coupled with the rise in price levels significantly decreases the purchasing power of households which can lead to greater wealth disparities over time.

Therefore, Riksbanken has chosen to limit this stagflation and improve **economic well-being** by implementing contractionary monetary policy—a policy that raises interest rates in order to increase the cost of borrowing.

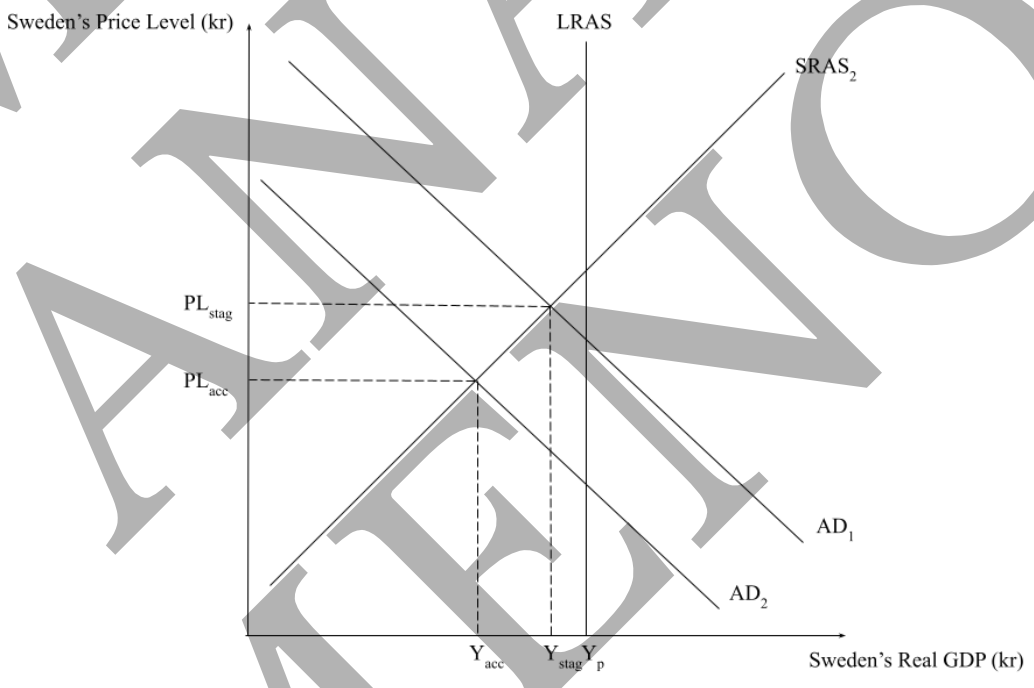

Fig 2. Implementation of contractionary monetary policy to control stagflation

The proposed monetary policy is depicted in fig 2. As the economy is experiencing stagflation, AD intersects the $SRAS_2$ curve below potential GDP. The implementation of the monetary policy aims to reduce AD by shifting the curve to the left from AD_1 to AD_2. The intended effect is to reduce the price level from PL_{stag} to an acceptable price level PL_{acc} as deemed by Riksbanken.

Since Sweden's CPI increased by 0.8% and is at its highest level in three decades, the increase in interest rates by 2.5% will lower price levels as consumers have a greater incentive to save since consumers will likely be uncertain about the state of the economy and may not be able to afford the rise in prices of goods and services. Hence, firms are signaled by the market forces of demand and supply to lower prices in order to attract consumers. This reduction in price levels will help consumers as they can now afford basic necessities. Thus, the likelihood of lower-income households entering poverty is reduced; this is beneficial as unemployment is expected to increase. Firms will have more incentives to save as the increase in interest rates of loans will increase their costs of production; higher interest rates can also cause the Krona to appreciate which will reduce the cost of electricity imports, the main driver of inflation. As AD = C + I + G + (X - M), the policy will decrease consumption and investment, and improve net export expenditure, causing AD to decrease from AD_1 to AD_2. This can be beneficial as sustaining inflation at an acceptable level will help the economy maintain a trend of positive economic growth which can not only promote **economic well-being** but also lead to economic expansion in the long run. This will help eliminate consumer scepticism as prices will be maintained, thus increasing consumers' marginal propensity to consume.

However, this contractionary monetary policy can also have negative implications for the economy. The economy was already facing unemployment as its output level was less than Y_p due to the leftward shift of SRAS. Implementing this policy will further exacerbate unemployment as the new equilibrium level of output is even smaller than Y_{stag}. As Sweden is a developed country, a large proportion of its labour force will be skilled labour. Hence, there will be a significant loss in the productivity of the economy. A reduction in spending will decrease government tax revenue, which can exacerbate any wealth disparities that the war may have caused. The Swedish government may have to increase government borrowing to compensate for the decrease in tax revenue, thus increasing government indebtedness which results in the government being unable to spend on areas like infrastructure and healthcare. Since Sweden is running the risk of stagflation, it is possible that this monetary policy may not work as demand-side policies are generally ineffective as a means of countering supply-side instabilities.

Ultimately, this policy is a step in the right direction to achieve **economic well-being**. While it will lead to unemployment, this unemployment, along with the other shortcomings of the policy, may be deemed necessary in order to stave off inflation. It is recommended that this policy is supplemented with appropriate supply-side policies in order to ensure that aggregate supply will once again be at par with aggregate demand.

Works Cited

‘Inflation in Sweden Hits Three-Decade High’. *Al Arabiya English*, 13 Jan. 2023, https://english.alarabiya.net/News/world/2023/01/13/Inflation-in-Sweden-hits-three-decade-high. Accessed 09 May 2023.

Tragakes, Ellie. *Economics for the IB Diploma*. Third ed., Cambridge University Press, 2020.

Commentary 3

Title of the article: UK trade agreement could see India lowering EV import taxes

Source of the article: CNBC

URL of the article:

https://www.cnbctv18.com/economy/uk-trade-agreement-could-see-india-lowering-ev-import-taxes-18275231.htm

Date the article was published: 08 November 2023

Date the article was accessed: 20 November 2023

Date the commentary was written: 20 November 2023

Word Count: 799

Section of the syllabus the article relates to: The global economy

Key Economic Concept: Interdependence

Article

India is proposing reducing import taxes on some electric vehicles from the UK in an effort to clinch a free-trade deal between the two nations by the end of the year, according to two people familiar with the discussions.

New Delhi is considering a concessional tariff of 30% on 2,500 electric vehicles imported annually from the UK priced above $80,000, the people said, asking not to be identified as the talks are private. India currently levies taxes between 70% and 100% on cars imported as completely built units, depending on their value.

The UK's demand for import concessions on electric vehicles is one of the few outstanding issues in the free trade talks. Prime Minister Rishi Sunak and his Indian counterpart Narendra Modi had hoped to finalize the agreement by the end of last month, but it's unlikely a deal will now be announced until December, Bloomberg News previously reported.

India's trade ministry didn't immediately respond to a request for information. A spokesperson for the UK Trade Department declined to comment as the talks are still ongoing.

India is the world's most populous country, with demand for electric vehicles rising among middle-class and wealthy buyers. The adoption of EVs in the country has been held back by the high cost of the cars, a dearth of options and lack of charging stations. Opening up the EV segment of the market could also speed up cleaner transport in a nation with the world's most toxic air.

Electric vehicle sales in India stood at 49,800 last year, making up just 1.3% of the 3.8 million passenger vehicles sold, according to BloombergNEF.

In India's cost-conscious market, the country's best-selling electric car, Tata Motors Ltd.'s Nexon.ev, is priced at less than 1.5 million rupees ($18,000). German luxury automakers BMW

AG, Mercedes-Benz Group AG and Volkswagen AG's Audi sell electric cars above $80,000 in India.

Modi's government is treading cautiously on EV imports as it seeks to build a domestic manufacturing industry for electric vehicles and parts. The government in 2021 announced a $3.1 billion production-linked incentive program for local EV production.

A final decision on India's position on import duties on EVs has yet to be made, according to people familiar with the discussions.

India and the UK had already softened their position on a number of issues, including reducing tariffs on British cars and scotch whisky, Bloomberg News previously reported.

The two countries expect the free trade deal would double bilateral trade by 2030 through lower tariffs and increased market access. It would also be a political win for both leaders, with the UK-India pact seen as a key prize of Brexit and a way to boost India's manufacturing ambitions.

India imposes a range of import duties on cars. For vehicles purchased from overseas unassembled, the tax ranges from 15% to 35%.

Commentary

This article reports the proposal by the Indian government to reduce import tariffs—taxes levied on imported goods—on electric vehicles (EVs) from the UK to promote a free-trade agreement (FTA). FTAs are a type of trading bloc wherein countries eliminate certain trade barriers between themselves while retaining the right to pursue their own trade policy with other non-members—and **interdependence** between the two nations.

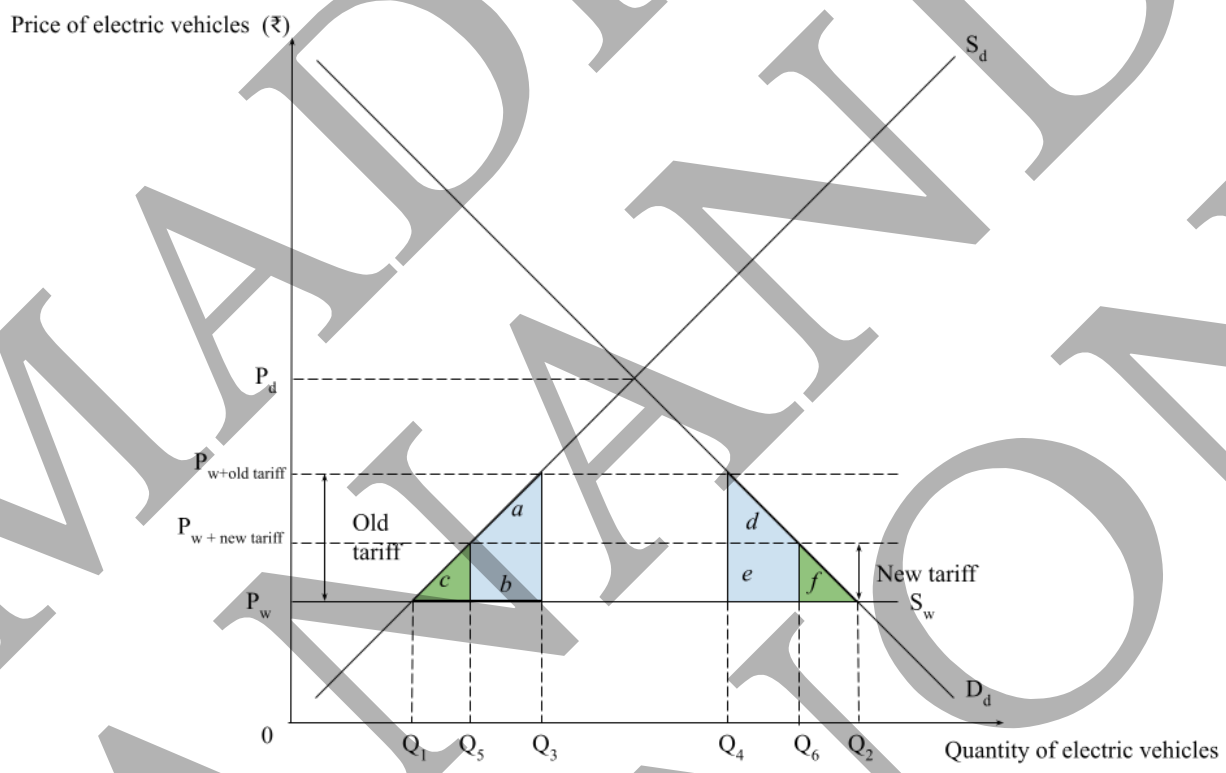

Fig 1. Effect of reducing import tariffs on Indian market for EVs

Fig 1. shows the effect of reducing import tariffs on the Indian market for EVs. The world price of EVs is at P_w which is lower than the domestic price P_d. As a result, Q_2 units of EVs are demanded while Q_1 units are supplied domestically. Thus, a quantity of $Q_2 - Q_1$ is imported. With India's original tariff in the range of 70-100%, the price increases to $P_{w+old\ tariff}$. Thus, demand contracts to Q_4 while supply extends to Q_3, reducing the quantity imported to $Q_4 - Q_3$. The

reduction of import tariffs to 30% for EVs priced above $80,000 now causes the import tariff per car to fall to $P_{w + new\ tariff}$. Thus, demand extends to Q_6 while supply contracts to Q_5. Thus, the new quantity imported is $Q_6 - Q_5$.

The reduction in tariffs can have numerous benefits for the economy. Firstly, it contributes towards the transition to green technology. This is beneficial as India is said to be a nation with the world's most toxic air; greater use of EVs can help promote sustainability in the long run and lead to lower negative externalities such as harmful gases emitted from traditional cars. Furthermore, a reduction in tariffs increases the consumption of EVs towards more efficient foreign producers as domestic producers are less protected by the lower tariff, thus there is a reduction in allocative inefficiency as represented by a reduction in welfare loss from $a + b + c + d + e + f$ to $c + f$. As the EV sector is relatively small in India, a greater adoption of EVs could lead to technological advancements as car parts and other technologies are now introduced into the country. This could lead to higher levels of productivity and economic growth in the long run. Finally, as India and the UK have already boosted trade via a concession in tariffs on scotch whisky, this will further boost bilateral trade and increase relations between these two economic superpowers, thereby promoting **interdependence**.

However, the lower tariff decreases government revenue from $(P_{w+old\ tariff} - P_w) \times (Q_4 - Q_3)$ to $(P_{w+new\ tariff} - P_w) \times (Q_6 - Q_5)$. This is disadvantageous as India already has an insufficient number of charging stations, thus implying that there will be infrastructural challenges if EVs are adopted at a larger scale. The government may have to increase expenditure to install more electrical grids and charging stations which can put a strain on the government budget exacerbated by a

decrease in tariff revenue. Furthermore, India already seeks to foster a domestic manufacturing industry. Larger market access for British EV firms can increase competition as consumers are more likely to default to lower-cost imports. As India already has a low EV sector, it is unlikely domestic firms can compete with these low prices, thus potentially causing higher job losses and a decline in the domestic EV industry. Hence, India may impose administrative barriers such as ensuring the batteries only use up a certain amount of electricity. This can affect trade and **interdependence**. Additionally, the reduction in import tariffs is only expected for cars priced greater than $80,000. As EVs had a low sales rate of 1.3%, it is unlikely many consumers are going to buy EVs above this price. Thus, the old tariff still applies to all other EVs which can be regressive for middle-class earners as they have to pay a larger proportion of their income on tariffs, thus worsening income distribution.

Ultimately, the decision of the Indian government to lower tariffs to promote the FTA and increase **interdependence** is a step in the right direction. Although the Indian government will see a decrease in tariff revenue, this is largely offset by greater adoption of sustainable technology and the benefits received from free trade. The negative effects on income distribution due to the original tariff still persist for cars priced above $80,000. Thus, the Indian government may want to consider the tariff concession for a greater price range. However, they should keep in mind that this will further hinder their goal of boosting the domestic EV industry. Thus, they may want to provide a subsidy greater than $3.1 billion and offer other incentives such as tax cuts for domestic EV producers. Nevertheless, as India and the UK are already strong trading partners, the increase in trade will only continue to benefit these two economic superpowers and lead to increased overall levels of **interdependence**.

Works Cited

Bloomberg. 'UK Trade Agreement Could See India Lowering EV Import Taxes'. *CNBCTV18*, 8 Nov. 2023, https://www.cnbctv18.com/economy/uk-trade-agreement-could-see-india-lowering-ev-import-taxes-18275231.htm. Accessed 20 November 2023.

Tragakes, Ellie. *Economics for the IB Diploma*. Third ed., Cambridge University Press, 2020.