

# The Impact of the 11% VAT Rate Increase on Economic Stability in the Post-Pandemic Recovery Period

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## Abstract

Indonesia is in a period of economic recovery after the COVID-19 pandemic. In 2022, the Government of Indonesia officially increased the value-added tax (VAT) rate from 10% to 11%. The increase in tax rate is by Law No. 7 of 2021 concerning Harmonization of Tax Regulations (HPP). This study aims to determine the background of the increase in the VAT rate to 11% in 2022 and its impact on the Indonesian economy. The research method used is the literature study by collecting and analyzing data and literature from various sources. The results of the study found that the background of the government in increasing the tax rate is: (1) to increase state revenue so that the state budget revenue target from the tax sector can be achieved, (2) to reduce the debt-to-GDP ratio, which reaches 40% during the pandemic, (3) improve health facilities and education facilities and strengthen national defense and security. The impact of the VAT increase on the economy is: (1) People's purchasing power decreases, (2) the distribution of goods is hampered, and the turnover of entrepreneurs decreases, (3) national income decreases, and the inflation rate increases. The government must provide subsidies or social assistance to increase people's purchasing power and maintain Indonesia's economic stability during the economic recovery.

Keywords: VAT 11%; economic recovery; macroeconomics; economic stability

## 1. Introduction

Taxes are an important instrument in fiscal policy. Taxes automatically affect state revenue, as taxes are the largest contributor to state revenue. Data from the Central Statistics Agency (2022) shows that the percentage of tax contributions to state income since 2020 has increased yearly. The percentage of tax contributions to state income sequentially from 2020 to 2022 was 78.9%, 79.4%, and 81.9%.

Based on the Ministry of Finance of the Republic of Indonesia (2022), taxes are classified into several types, namely land and building tax (PBB), import and exit duties, excise, sales tax (PPn), value-added tax (VAT), sales tax on luxury goods (PPn-BM), and income tax (PPh). Data from the Central Statistics Agency (2022) shows the proportion of each tax to the state budget as follows:

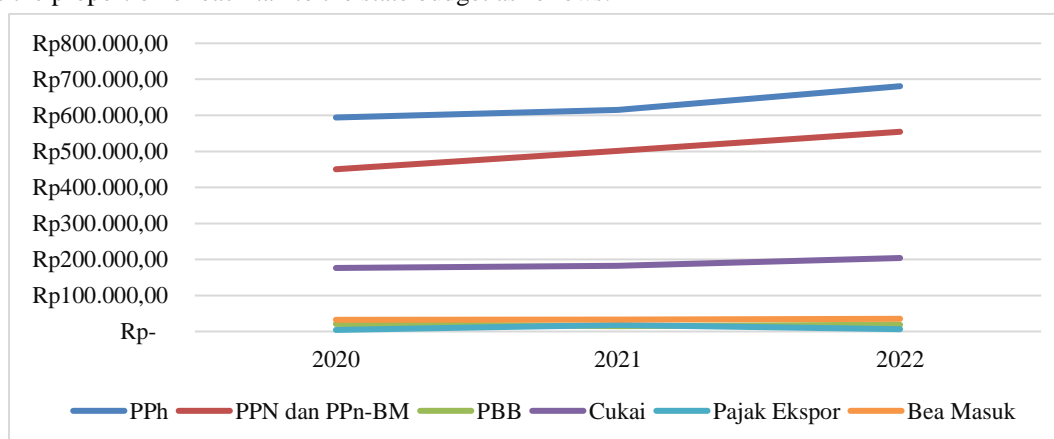


Fig. 1. Proportion of taxes to the State Budget (in Billions of Rupiah)

Source: Central Statistics Agency (2022), processed

Figure 1 shows that the largest proportion comes from income tax, followed by VAT and PPn-BM as the second largest contributors. Income tax can contribute a large income sourced from Indonesian citizens who earn

income and comply with paying taxes according to their income level. Similarly, VAT occupies the second proportion because the tax is applied to all goods and services traded in Indonesia, except for certain goods that are not taxed according to applicable regulations.

However, in April 2021, the Government of Indonesia passed Law No. 7 of 2021 concerning Harmonization of Tax Regulations (HPP). The regulation stipulates that the VAT rate has increased from 10% to 11%, effective from April 1, 2022. In addition, it is also stipulated that VAT will change to 12%, which will take effect from January 1, 2025.

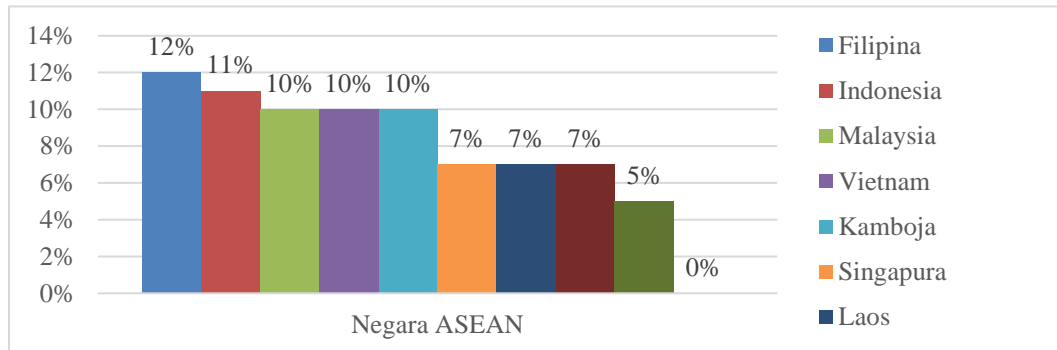


Fig. 2. VAT rates in ASEAN

Source: Databoks (2022), processed

The increase in the VAT rate has led Indonesia to become the second highest in ASEAN to implement value-added tax or its equivalent (Figure 2). Other countries in ASEAN are also adjusting the VAT rate, such as Singapore, which plans to increase the VAT rate to 9% in 2023 or 2024. Meanwhile, Laos lowered VAT to 7% to accelerate the country's economic recovery after the pandemic. The VAT rate shows that each country's economic recovery strategy is different.

In Indonesia, enacting these laws and regulations is certainly motivated by something and will impact various economic sectors in Indonesia. This is because Indonesia is in a period of economic recovery after the Covid-19 pandemic, and April 2022 is the month of Ramadan and approaching Eid al-Fitr for Muslims, that month, the needs of the community increased drastically.

Based on the explanation above, it is necessary to know the background of the increase in the VAT rate to 11% in 2022 and its impact on the economy in Indonesia, both from the public as consumers and producers and from macroeconomic points of view. Thus, an evaluation analysis of implementing the VAT rate increase policy can be carried out.

## 2. Research Methods

The research method used in this study is a literature study. The data collected is sourced from various literature, including books, journal articles from previous research, data collected by BPS and Bank Indonesia, and actual news. From the data that has been collected, an analysis is then carried out to answer the research objectives. The analysis is carried out by sorting data from the most relevant to the moderately relevant and is supported by the latest research to the older research. Next, read the abstract or summary of each data to assess the suitability of the problem discussed with the problem under study. Then, record the important parts and the problem under study and list the sources. Finally, the records are compiled systematically until a conclusion is reached that can solve the problem.

## 3. Results and Discussion

### 3.1 Background to the 11% VAT Rate Increase

Trading activities cannot be separated from the lives of today's people (Pradana, 2022). The community carries out these activities to meet life's needs. The increase in the tax rate is by the HPP Law article 7, paragraph 3, where the government has the power to change the tax rate in the range allowed by the VAT Law, which is 5% - 15%. The increase in the VAT rate in 2022 will certainly affect people's lives, inseparable from these buying and selling activities.

The Covid-19 pandemic has had a tremendous impact, including on state revenues; where during the pandemic, tax revenue data only realized 30% of the state budget target in April 2020 (Sayyid & Nataliawati, 2022). Meanwhile, the government must spend funds on various incentives, including procuring vaccines and

social assistance during these conditions. As a result, in 2020, Indonesia's government debt reached 40% of GDP, worth IDR 6,000 trillion (Ministry of Finance of the Republic of Indonesia, 2020).

Mrs. Sri Mulyani, in the Cabinet Secretariat of the Republic of Indonesia (2022), gave a statement and emphasized that the increase in the VAT rate is a form of cooperation of Indonesian citizens towards the post-Covid-19 economic recovery. During the pandemic, the government has set various flexible policies to spur economic growth, such as applying tax incentives (Daud & Mispa, 2022) to tax holidays. However, Rulandari, Pohan, Sofyan, & Lestari (2021) found that tax policies during the pandemic, especially tax holidays, did not go as planned because Indonesia faced several obstacles, such as regulations on decision-making in companies.

The taxes paid by the people will be returned to the people to improve their welfare of the people. In addition, a strong tax foundation is needed to improve the low quality of Indonesia's health and education facilities and strengthen Indonesia's defense and security through the TNI and Polri.

The process of national economic recovery should be a good influence in efforts to build a strong tax foundation. Through a strong tax foundation, the increase in the VAT rate can help the government achieve the state revenue target so that the state can finance efforts to recover the national economy. Thus, this increase in tax rates does not conflict with the national economic recovery process (Istiqomah & Rahmah, 2022).

The increase in tax rates is also claimed to be one of the state's efforts to minimize income inequality between social groups. Wildan, Qadri, Sakti, & Ikhsan (2020) found that during the distribution of social aid programs during the pandemic, problems occurred, such as data on social aid recipients that were not integrated so that the assistance provided was mistargeted.

### 3.2 Impact of 11% VAT Rate Increase on Indonesia's Economy

The implementation of Law No. 7 of 2021 poses a dilemma in the community because this 11% VAT is objective, not cumulative, and includes indirect taxes (Pradana, 2022). The tax is imposed on consumption that occurs in the country, and both are carried out by the Government, business entities, and individuals included in the taxpayer. The impact of the increase in the VAT rate is felt by various levels of the general public, the private sector, and producers, so it can affect the Indonesian economy macro. The impact is described as follows:

#### 1) Impact of VAT Increase on Society

VAT, in its application, is not paid directly by the public or entities to the state treasury but through the party who collects the tax, so this tax includes indirect taxes. In addition, this VAT is also objective; that is, it generalizes the taxpayer, regardless of the state of the tax subject. This can lead to injustice in tax collection (Pradana, 2022). The injustice has implications for the VAT levy norms.

On the other hand, based on the Consumer Confidence Index by Bank Indonesia (2022), the level of consumer confidence is lower, along with job opportunities that are not as optimistic as before—coupled with the prediction of future economic conditions, which results in consumers' perception of the economy increasingly pessimistic. This means that people's income is currently unable to keep up with inflation, as seen from the increase in prices in general.

The momentum of increasing the VAT rate in April 2022, which coincides with the month of Ramadan, has resulted in higher price increases. The cycle of price increases that automatically occurs in Indonesia every month of Ramadan is caused by greater demand than supply, coupled with external factors such as distribution channels and weather that increasingly hinder the distribution of goods so that prices are getting higher (Aziz, 2008).

The increase in the VAT rate, along with the momentum of the month of Ramadan, has increased the prices of goods in general. The general increase in the price of goods indicates inflation (Todaro & Smith, 2011). Meanwhile, inflation can double the number of poor people and bring the economy to the brink of recession (Pradana, 2022). The increase in the VAT rate, which is automatically accompanied by an increase in prices in general, will impact people's purchasing power, decreasing. Coupled with the VAT charged to consumers, it further suppresses purchasing power (Istiqomah & Rahmah, 2022).

#### 2) Impact of VAT Increase on Producers

Private entrepreneurs, in this case, are assumed to be private companies, industries, or privately owned enterprises (BUMS). These parties are currently in a period of struggle and transition of harmonization to be accepted in this modern market (Djufri, 2022). These parties also felt the impact of the 11% VAT rate increase in the production process and the turnover they obtained.

Putri & Subandoro (2022) found that company turnover decreased in April – May after implementing the new tax rate. In addition, there was an increase in suppliers' raw materials, so the company also increased its selling price. The decrease in turnover automatically causes a buildup of stock and uneven cash flow.

The decrease in sales turnover indicates an uneventfulness in the distribution of production results. This will trigger a reduction in production scale, which will affect the absorption of labor. If labor absorption is reduced, people's income and consumption will automatically decrease (Istiqomah & Rahmah, 2022). Djufri (2022) also

found that an 11% increase in the tax rate decreases confidence in business actors. They worry that prices will increase drastically, resulting in the inability of entrepreneurs to pay taxes.

From the opposite point of view, a decrease in the VAT rate can increase business volume, both in production and trade (Pradana, 2022), to improve economic efficiency based on the theory of economies of scale. Improving economic efficiency will encourage national economic competitiveness and increase the profits of business actors until, finally, the income tax paid will also increase.

### 3) Impact of VAT Increase on Macroeconomics

The VAT rate, which changes to 11% macro, will affect Indonesia's economic stability, especially in terms of economic growth and national savings rates. Anojan's research (2015) found that VAT positively correlates with economic growth as measured through GDP. They are also supported by Wijaya (2013), who found a positive relationship between VAT receipts and GDP so that VAT can affect economic growth. Liyana (2021) has also proven that an increase in the VAT rate will increase tax revenues, while VAT itself has a positive and significant impact on economic growth seen through GDP, where an increase in VAT of one trillion rupiahs will increase GDP by 28.5 trillion rupiahs. If GDP increases, then economic growth will also increase.

However, Miki's research (2011) shows that an increase in tax rates leads to a decrease in economic growth in the short term. Hakim, Karia, & Bujang (2016) reinforce these results through their research which found that taxes have a constructive impact on developed countries but instead harm developing countries.

Regarding national savings, VAT significantly positively impacts national savings in Pakistan and Japan (Alm & El-Ganainy, 2013; Dahri, Shaikh, & Shah, 2019; Sthanumoorthy, 2006). The strengthening of national savings will increase foreign investment, which is expected to impact national financing positively. Liyana (2021) found that VAT and national savings are positively and significantly related, where when VAT increases by one trillion rupiahs, national savings will increase by 9.3 trillion rupiahs.

However, theoretically based on the Keynesian approach, fiscal policy in the form of tax cuts will stimulate household consumption to greater (Mankiw, 2013). This means that fiscal policy in the form of increased tax rates will have the opposite impact, namely reducing household consumption.

The increase in the tax rate will automatically increase prices, starting with the price of raw materials, which means increased production costs. As a result, the selling price of goods has also increased. This will shift the aggregate supply (US) curve to the left and be followed by the equilibrium point or general equilibrium to the left. The illustration can be seen in Figure 3 below:

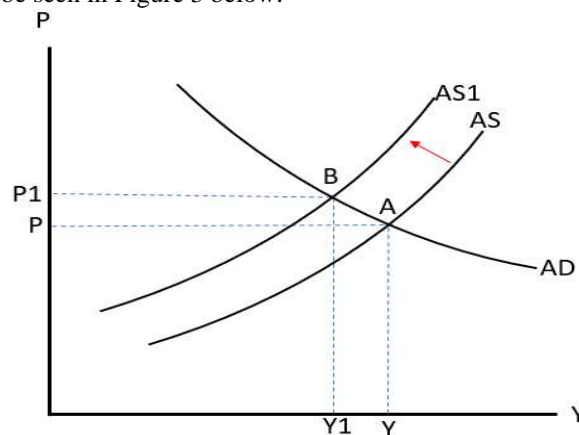


Fig. 3. Shifting US Curve after VAT hike.

Figure 3 illustrates the shift in aggregate supply (US) from US to US1, which shows an increase in prices due to rising VAT because the rising price of raw materials means that production costs have increased. The price increase causes the AD curve to move from point A to point B, which means a decrease in the number of goods that the public can consume due to price increases. This automatically shifts the equilibrium point from A to B, where Y (output) reflects national income and decreases from Y to Y1. Meanwhile, P, which reflects the inflation rate, has increased from P to P1. This is in line with the results of Liyana's research (2021), which states that an increase in the VAT rate cannot increase consumption and economic growth reflected through GDP but instead increases inflation. This can be seen from the drastic increase in inflation from March to April, and inflation continues to increase in the following months, as shown in Figure 4 below:

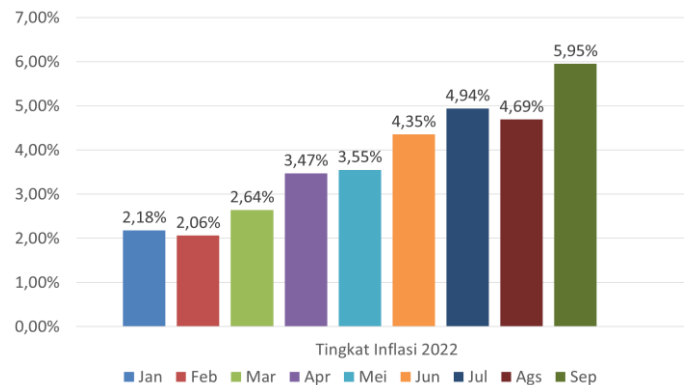


Fig. 4. Inflation rate in Indonesia in 2022

Source: Bank Indonesia (2022a)

Therefore, for the economy to remain stable and control inflation, the VAT rate increase must be balanced with greater government expenditure (G). This means that the government can provide subsidies or social assistance that is right on target so that the price increase due to the increase in the VAT rate can be offset by an increase in people's purchasing power through the provision of social assistance/subsidies.

#### 4. Conclusion

The presentation of evidence and the results of the analysis can lead to the conclusion that an increase in the VAT rate can increase state income so that it can help achieve the state budget target and reduce the debt-to-GDP ratio that had increased during the pandemic. However, the increase in the VAT rate is not offset by an increase in government expenditure (G) through subsidies or social assistance. In that case, it can reduce national income (GDP) because people's purchasing power decreases, so consumption decreases and increases the inflation rate.

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