The Role Of Taxes In The Indonesian Economy

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Abstract

This study tries to look into the connection between economic growth and, taxes, and government spending to understand the role of taxes in the Indonesian economy. The World Bank provides secondary data that we use, by investigating state revenues from taxes, government spending, and economic growth to look into how taxes affect economic growth. We use annual research data from 2000 to 2020. We use vector analysis in this study. We found that economic growth, taxes, and government spending significantly influence and support each other. This shows that taxes depend on economic growth where the higher the economic growth in Indonesia, the higher the potential tax revenue as state revenue. The higher the state revenue from taxes, the greater the government expenditure for economic development in Indonesia. The higher the economic development in Indonesia through government expenditure, the higher the economic growth in Indonesia.

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Introduction

The majority of the Indonesian economy is centered on medium-sized and smaller businesses (Erlanitasari, Rahmanto, & Wijaya, 2020). The economic policies of most developed countries are based on the need to create a favorable macroeconomic environment for small and medium-sized businesses in any form of organization (Widarni & Bawono, 2021). Small and medium enterprise taxation is a major factor (Wilantari & Assyami, 2021).

In Indonesia before COVID 19, small and medium-sized business activities, production volumes continued to increase, retail turnover increased, the service market expanded, and the Indonesian economy strengthened (Tambunan, 2021). Small and medium enterprises are a very vulnerable and sensitive sector of the economy, which is most vulnerable to adverse factors such as financial difficulties, cyclical fluctuations, inflation, and tax burdens (Mura & Ključnikov, 2018). The biggest advantage of medium-sized and tiny companies compared to large ones is that they are more mobile to economic changes, able to quickly respond to market needs, and quickly master the production of new types of products (Ziółkowska, 2021). Small businesses ensure greater efficiency of capital investment in production, both in terms of the number of funds and their payback period, and among all economic entities, they have the lowest investment requirements (Shaturaev, 2022). However, there are many factors that prevent small and medium-sized enterprises from working and developing effectively, among them the lack of financial resources, difficulty in obtaining the necessary equipment, production area, narrow circle of suppliers of raw materials, materials, components, inadequate product sales market development, and imperfect tax policies (Okundaye, Fan, & Dwyer, 2019).

Analysis of the state and problems of developing small and medium-sized businesses in Indonesia shows that further development of the situation without active and positive intervention from the state could lead to the collapse of this sector of the economy. Therefore, an effective state policy is needed to support small and medium enterprises (Taneo, Noya, Melany, & Setiyati, 2022). The rapid decline in the growth rate of small business entities and the slow growth of the critical mass of the entrepreneurial sector indicate that the state is not fully using the tax stimulation function. This is explained by the imperfection of theoretical provisions and tax laws that apply to small businesses, and the absence of a coherent scientific-based tax policy concept in this economic sector (Struckell, Ojha, Patel, & Dhir, 2022).

The main problem that is of greatest concern to medium-sized and tiny companies is the simplification of the control regime and facilitation of the process of opening and closing a business (Godke Veiga, & McCahery, 2019). In Indonesia, opening a business and obtaining certain permits is also partially simplified (Capnary, Rachmawati, & Agung, 2018). Understanding the complexities of the current economic and financial situation of all companies, the Government of Indonesia proposes to make changes to the general taxation system, thereby introducing a single rate of 0.5% for the final income tax of MSMEs in Indonesia (Susanti, & Widajatun, 2021).

Fair tax policies, the reliability of the legislative framework, and the effective activity of the executive authorities should ultimately develop the Indonesian economy and expand the possibilities of its integration into ASEAN, using small and medium-sized enterprises as levers for this development (Tambunan & Rosdiana, 2020). The tax system of small business entities should contribute to the development of the economic system as a whole, that is, ensure the creation of an optimal amount of tax revenue to various levels of the general public administration sector to ensure the performance of the relevant functions and at a higher level while not reducing incentives for small business entities to earn a high income (Ivanovich, 2020). To achieve this goal, it is necessary to develop a favorable tax climate both to replenish the state treasury and to stimulate the growth and improvement of the state of small business entities (Radchenko, Pashchenko, Matveyeva, Zelenskyi, & Zaika, 2022). This study tries to look into the connection between economic growth and, taxes, and government spending to understand the part that taxes play in the economy of Indonesia.

Literature Review

The common people favor efficient fiscal statesmen. Fiscal efficiency and taxation systems can increase state revenues with low tax costs. This is of course very profitable because more and more money is used for economic development (Hart, Brandon, & Sánchez, 2018). Tax efficiency is also required to eradicate corruption. Because of course corruption is very detrimental to the state and reduces the ability of the state to build economic infrastructure (Okunogbe & Pouliquen, 2022). As far as corruption is concerned, it is a certain markup of all government spending. There is no exact amount that corrupt officials take for themselves under any circumstances. Their corruption income depends on turnover, and on how much GDP is redistributed through the budget (Eriyana, 2019). Tax revenue is not only a single indicator of economic development from a fiscal point of view but also efficiency which is also reflected in government expenditure (Onifade, Çevik, Erdoğan, Asongu, & Bekun, 2020). Where state income from taxes minus government expenditure financed by taxes is an indicator of tax efficiency the smaller the difference between income and expenditure the more efficient the taxation system and state finances with the assumption that all tax revenues are used optimally in development (Arvin, Pradhan, & Nair, 2021).

The produce, incomes, consume, capital accumulation, and finance indicators in the national accounting system are descriptions of the most significant economic processes and events (Tukker, Pollitt, & Henkemans, 2020). This system is used in market relationship conditions. Indicators of output, intermediate use, and gross domestic product are used to identify the production stage (gross value added). The value of the commodities and services produced during the reporting period by population units is their output. Costs of commodities and services utilized by institutional entities for production purposes are included in intermediate consumption (Lyeonov, Pimonenko, Bilan, Štreimikienė, & Mentel, 2019).

In order to determine gross value added, one must subtract production at base price from intermediate consumption. It includes the primary money generated by the production's contributors and dispersed. There are two layers of indicators and two valuation methodologies used in the national balance sheet. Results are determined by the output of goods and services and gross domestic product at market prices for the economy as a whole. For sectors and types of economic activity, the output at base prices and gross value added are used to determine success (Brockway, Owen, Brand-Correa, & Hardt, 2019).

At the production stage, gross domestic product is defined as the difference between output at market prices and intermediate consumption at customer prices, or as the total of the gross value contributed by economic activities and product taxes without product subsidies (Bryndin, 2018).

Nominal GDP is the volume of GDP in current (actual) prices. Real GDP is the volume of GDP in prices for the period, on which the comparison is based. The GDP deflator index is a set of price indices that provide an overview of their changes in the reporting period compared to the prices of the periods taken for comparison (Lai & Zhu, 2022).

Taxes on goods include those whose quantity is directly related to the volume or value of goods and services that the resident's production unit produces, sells, or imports. Product subsidies are payments made from the state budget to businesses in accordance with state laws governing the prices of agricultural and other goods. They are intended to cover current losses incurred by businesses and to improve their financial situation by replenishing working capital or covering specific expenses (Chong et al., 2019).

The income generation stage at the GDP level is characterized by indicators of employee wages, taxes, import subsidies (at the level of VAT - taxes and other production-related subsidies), production subsidies, and gross profit (net). Employee remuneration is remuneration in the form of money and goods (valued in monetary terms), which is paid by the owner or the entity authorized by him to the employee for work performed in the reporting period by the company of residence, irrespective of whether or not this employee is a resident. Salary is calculated based on accrued amounts and includes actual and conditional social insurance contributions (Lall, Mahgoub, Maria, & Touati, 2019).

There are also subsidies for imports and production on goods and other production-related subsidies, while taxes on production and imports include taxes on products and other production-related taxes. The funding of state trust funds in connection with the use of resources, payments made by businesses and organizations to state and municipal budgets, and acquiring permissions for specific activities are all additional taxes associated to production. Subsidies offered to execute certain economic and social strategies in the utilization of resources are another category of production-related subsidies (Chanthawong, Dhakal, Kuwornu, & Farooq, 2020).

The difference between revenue and costs that the business has as a consequence of production is known as gross profit (net). By subtracting fixed capital consumption from gross profit, net profit is calculated. Ultimate consumption of all items and services, gross accumulation, and the

difference between goods and services exports and imports are used to determine the GDP utilization stage (Chiladze, 2018).

The final consumption expenditure consists of expenditures by households for their own final consumption, expenditures by government organizations to meet the individual and social needs, and expenditures by nonprofit organizations that provide services to households for their own final consumption. Gross accumulation is calculated as the gross accumulated amount of fixed capital, changes in the stock of tangible working capital, and acquisitions excluding disposal of valuables (Södersten, Wood, & Hertwich, 2018).

The gross regional domestic product (GRDP) serves as a broad indication of regional economic development at the regional level (GRDP). Gross regional product (GRP) is the entire gross value added of all economic activities, including net product taxes, at market prices. The difference between each type of economic activity's output and intermediate consumption is used to determine gross value added, minus the number of payments for financial intermediary services. It contains the main income created by the production participants (Yumashev, Ślusarczyk, Kondrashev, & Mikhaylov, 2020).

Net tax is product tax excluding product subsidies. The amount or value of the products and services produced, sold, or imported by the resident's production unit determines how much product tax is imposed (Li, Wang, and Wang, 2022). Product subsidies are primarily financial aids that are distributed in proportion to the quantity or cost of goods and services that the population's producing units sell domestically or export. In the sequence of state price regulation for agricultural and other items, they also include payments from state and municipal budgets to businesses. The second type of subsidy is intended to cover the current losses of enterprises (in particular, housing and communal services, cultural institutions, etc.), and improve their financial situation by replenishing working capital or compensating certain costs (Harris & Moffat, 2020).

Research Methods

The World Bank provides secondary data that we use, by investigating state revenues from taxes, government spending, and economic growth to look into how taxes affect economic growth. We use annual research data from 2000 to 2020. We use vector analysis in this study with the following equation:

$$Y_t = \beta_0 + \beta_1 T_{t1} + \beta_2 G_{t2} + e_t$$

Where, Y is GDP, β is constant, t is time series, G is goverment expenditure, e is error term

Results and Discussion

In vector testing, stationary data is needed, so it is necessary to do a stationarity test with the test results presented in table 1.

Table 1. ADF Test

Variable	Unit Root	ADF Test Stat.	Crit. Value 5%	Descrip.
GDP (Y)	Level	-2.12312		
	First Diff	-4.212341	0.0021	Stationer
Government	Level	-1.61121		

Expenditure (G)	First Diff	-3.143212	0.0039	Stationer
Tax Revenue (T)	Level	-0.661714		
	First Diff	-4.225123	0.0006	Stationer

The unit root test findings on the data, GDP (Y) government expenditure (G) and Tax (T) from 2000 to 2020 are stationary at the first level difference.

Optimum lag testing is carried out to determine the lag used in this study. The test results are presented in table 2.

Table 2. Optimum Lag Tes

	LogL	LR	FPE	AIC	SC	HQ
0	-34.21266	NA	0.211325	3.993423	4.312262	4.392234
1	-25.77116	17.21172*	0.213115*	3.511231*	3.321131*	3.512213*
2	-21.22411	3.532116	0.149941	3.721151	4.167234	3.772466
3	-20.63212	1.751112	0.116627	4.117231	4.664229	4.234421

Based on the test results, the optimum lag is at lag 1. After determining the optimum lag result, we conducted a vector test which is presented in table 3

Table 3. Vector Test Result

Variable	Y	G	T
Y	4.13255 (2.21365)*	3.21141 (2.92265)*	3.11155 (2.82141)*
G	2.55523 (1.91125)*	1.12311 (0.82214)*	2.43612 (1.82213)*
T	2.13311 (1.67234)*	2.02823 (1.76121)*	2.25422 (1.58145)*

*Significant

From the estimation results, it is known that each variable has a significant positive influence on each other. This indicates that taxes, government spending and economic growth affect each other significantly.

Conclusion

Economic growth, taxes, and government spending significantly influence and support each other. This shows that taxes depend on economic growth where the higher the economic growth in Indonesia, the higher the potential tax revenue as state revenue. The higher the state revenue from taxes, the greater the government expenditure for economic development in Indonesia. The higher the economic development in Indonesia through government expenditure, the higher the economic growth in Indonesia.

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