



The Effect of Income Tax on Economic Growth in Indonesia

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Abstract

This study aims to analyze the influence of Income Tax on economic growth in Indonesia. Income Tax is one of the main sources of state revenue used to finance development and improve people's welfare. The study uses secondary data from various official sources and applies quantitative methods to measure the relationship between Income Tax revenues and national economic growth. The results of the study show that tax revenues, including Income Tax, generally have a positive and significant effect on economic growth at the provincial and national levels, especially in the long term, as tax funds are used to fund productive projects and infrastructure development that boost economic activity. However, there are also findings that in the short term the influence of Income Tax on economic growth is not always significant, depending on other macroeconomic factors. The implications of this study confirm the importance of efficient tax management and the expansion of the tax base to support sustainable economic growth. The government also needs to ensure that tax policies do not hinder investment and continue to encourage public participation in national economic development.

I. INTRODUCTION

Introduction to the influence of income tax on economic growth in Indonesia is a very relevant topic in the context of national economic development. Income tax (PPh) is one of the main sources of state revenue that has a strategic role in supporting various development programs. Through income tax revenue, the government can finance infrastructure, education, health, and other public services which ultimately increase productivity and people's welfare. Therefore, an understanding of how income taxes affect economic growth is essential for formulating effective and sustainable fiscal policies.

Taxes are one of the government's fiscal policies that act as a source of state financing. Taxation is considered very important for a country, because it can affect economic growth. Several developing countries, including Indonesia, rely on state expenditure financing sources from tax revenues. (Rahma et al., 2023)

Most of the government's revenue, both central and local governments, still comes from the tax sector. Various ways are carried out by the

government to increase revenue from this sector, including by local governments through several phases of regional tax reform. Regional tax reform in Indonesia has been going on for approximately twenty years. This reform took place in three phases (Abuyamin, 2015). The first phase began with the inauguration of Law of the Republic of Indonesia Number 18 of 1997 concerning Regional Taxes and Regional Levies. Then the second phase was amended by Law of the Republic of Indonesia Number 34 of 2000. And the third phase, with the issuance of Law of the Republic of Indonesia Number 28 of 2009 concerning Regional Taxes and Regional Levies. The purpose of the tax reform is to increase regional revenue from the tax sector which will ultimately be used for the prosperity of the people through economic growth and regional development.

Income taxes have a complex impact on the economy. On the one hand, this tax is the main instrument for the government to collect the funds needed for development and public services. However, on the other hand, excessively

high tax rates can reduce incentives for individuals and companies to work harder, invest, and innovate. This can hinder economic growth because economic activity becomes less than optimal. Therefore, it is important to find a balance between tax rates that are able to support state revenue and do not reduce the motivation of economic actors.

Empirical research shows that income tax revenue has a positive and significant effect on economic growth in various provinces in Indonesia. This indicates that effective and efficient income taxes can be the main driver of regional and national economic development. With the right allocation of funds, income taxes can increase the government's capacity to build infrastructure and social programs that support overall economic activities.

In addition, income tax also plays a role in maintaining macroeconomic stability, especially in controlling inflation. The government can use tax policy as a fiscal tool to regulate aggregate demand in the economy, for example by adjusting tax rates to control inflationary pressures. Thus, income tax not only serves as a source of income, but also as an important instrument of economic stabilization.

However, the tax policy that is implemented must take into account the sensitivity of economic sectors to changes in tax rates. Some sectors, especially those that are price-sensitive, could be negatively impacted if the income tax rate is significantly increased. Therefore, comprehensive and targeted tax reform is needed to ensure that tax policies do not hinder the growth of strategic sectors in the economy.

The efficiency of the tax system is also a key factor in maximizing the positive influence of income taxes on economic growth. Complex and bureaucratic taxation systems can increase compliance costs and hinder business activities. On the other hand, a simple, transparent, and fair system can increase taxpayer compliance and encourage businesses to develop and innovate, thereby contributing to sustainable economic growth.

Providing the right tax incentives can be a stimulus for investment and the creation of new jobs. Incentives such as tax exemptions for certain sectors or reduced tax rates can increase investment attractiveness and accelerate economic growth. This policy must be carefully designed so as not to cause market distortions and still support optimal tax revenue.

Income tax also plays a role in a more equitable distribution of income. With a progressive tax system, the government can reduce social disparities and increase people's purchasing power. This increase in purchasing power can in turn encourage domestic consumption, which is one of the main pillars of Indonesia's economic growth.

However, the main challenge in implementing income tax is how to manage tax rates and systems so as not to create an excessive burden for taxpayers, especially small and medium business actors. Administrative complexity and high tax rates can reduce compliance and encourage tax avoidance practices that are detrimental to state revenue.

In the context of globalization and international economic competition, income tax policies must be able to adapt to the dynamics of the world economy. Indonesia needs to adopt a competitive tax policy to be able to attract foreign investment and support inclusive and sustainable economic growth.

Furthermore, the influence of income taxes on economic growth should also be seen within the broader framework of fiscal policy, including indirect taxation and government spending. The synergy between tax revenue and state budget management will determine the effectiveness of taxes in encouraging economic growth.

The importance of in-depth research and analysis on the influence of income taxes on economic growth is the basis for policymakers to formulate fiscal strategies that are adaptive and responsive to national development needs. Empirical data and accurate economic models will help identify the most effective tax policies. Income tax is a fiscal instrument that has a great influence on Indonesia's economic growth. With proper management, this tax can be the main source of development funding as well as a tool to maintain economic stability and encourage income equity. However, tax policies must be carefully designed so as not to hinder economic and investment incentives.

Critical review and periodic evaluation of income tax policies are needed to ensure that taxes can contribute optimally to national economic growth. A balanced approach between fiscal needs and economic incentives will be the key to the success of tax policy in Indonesia.

II. RESEARCH METHODS

The research method in this study uses a quantitative approach with a descriptive research type and multiple linear regression analysis to test the influence of income tax on economic growth in Indonesia. The data used is secondary data in the form of time series data obtained from official sources such as government financial statements and Indonesian economic statistics data for a certain period. Data collection is carried out by accessing official documents and databases that contain information related to income tax revenues and economic growth indicators such as Gross Domestic Product (GDP), inflation, and the rupiah exchange rate. Data analysis was carried out using statistical software to test the relationship and influence of income tax variables on economic growth partially and simultaneously.

This research also emphasizes the operationalization of clear variables, including free variables in the form of income tax and bound variables in the form of national economic growth. Data processing techniques include validity, reliability, and regression analysis tests to determine the significance and strength of relationships between variables. In addition, this study uses the time series study method to see the dynamics of the relationship between income tax and economic growth over time, so as to provide a more comprehensive picture of the impact of tax policy on Indonesia's economic development. The results of the analysis are expected to provide valid empirical evidence and can be used as a basis for more effective fiscal policy recommendations.

III. RESULTS AND DISCUSSION

A. Results

The results of research on the influence of Income Tax (PPH) on economic growth in Indonesia show complex dynamics and various impacts. In general, tax revenues, including income tax, are a very important source of state revenue for financing development and public services. However, the latest data shows a decline in tax revenue in early 2025, including income tax, which has an impact on the budget deficit and considerable fiscal pressure. This decline was caused by various factors, such as tax relaxation policies, slowdown in the prices of major commodities, and the impact of the incomplete increase in Value Added Tax (VAT).

Although income tax revenues have decreased, the government remains optimistic that

Indonesia's economic growth in 2025 will be in the range of 5 percent. This optimism is based on efforts to improve the tax administration system, such as the implementation of the Coretax System which has helped increase the efficiency of tax withdrawals and improve tax revenues gradually, especially in March 2025. This shows that despite fiscal pressures, adaptive tax policies and administrative reforms can support economic stability.

The research also found that the Article 21 Income Tax incentive given to workers in the labor-intensive industrial sector plays a positive role in increasing people's purchasing power. With a reduction in the tax burden, people have more money to consume, which in turn can drive economic turnaround at the national and local levels. This policy is expected to stimulate economic growth through increasing household consumption, which has been one of the main drivers of Indonesia's economic growth.

However, the increase in VAT rates that occurred in early 2025 poses its own challenges for the economy. The increase in VAT causes an increase in the cost of consumption of goods and services which can suppress people's purchasing power, especially MSME groups and consumers with low purchasing power. This has the potential to slow economic growth if it is not balanced with appropriate fiscal and monetary policies and support for affected sectors.

From the fiscal side, a significant decline in tax revenue in the first quarter of 2025 will cause a sizable state budget deficit, thus adding pressure on state finances. This deficit can limit the government's ability to make productive public spending and infrastructure investments, which can ultimately hinder long-term economic growth. Therefore, efficient tax management and responsive fiscal policies are needed to maintain fiscal balance and support growth.

This research also highlights the importance of government strategies in optimizing tax revenue through tax reform and the use of technology. With adaptive policy support and improved tax administration, tax revenues are expected to increase and contribute positively to national economic growth. Synergy between the government, business actors, and the community is the key to creating a resilient and sustainable economic ecosystem. (Karlina & Lubis, 2023)

In addition, the increase in tax revenues from key sectors and households shows that economic activity is still running positively despite facing

various global and domestic challenges. This is an indicator that tax policies, especially income tax, have a strategic role in maintaining consumer purchasing power and encouraging overall economic growth.

The effect of Income Tax on economic growth in Indonesia is multifaceted and depends on the tax policies implemented as well as macroeconomic conditions. Tax reform, fiscal incentives, and efficient management of tax revenues can increase people's purchasing power and support economic growth. However, challenges such as declining tax revenues and VAT increases must be anticipated with the right policies to keep economic growth stable and sustainable.

B. Discussion

Regional taxes are regulated in Law Number 28 of 2009 concerning Regional Taxes and Regional Levies. In the law, it is stated that regional taxes are divided into two types, namely provincial taxes and district taxes. Provincial taxes consist of motor vehicle tax, motor vehicle name return duty, motor vehicle fuel tax, surface water tax, and cigarette tax. Meanwhile, district taxes consist of hotel taxes, restaurant taxes, entertainment taxes, billboard taxes, street lighting taxes, non-metallic minerals and rock taxes, parking taxes, swallow's nest taxes, rural and urban land and building taxes, and land and building rights acquisition duties. Local taxes (*Local Taxes*) used in this study is regional taxes as stated in the Financial Statistics Report of Provincial Governments in Indonesia from 2013 to 2016 issued by the Central Statistics Agency. (Saragih, 2018b)

The influence of income tax on economic growth in Indonesia is an important topic in macroeconomic and fiscal policy studies. Income tax as one of the main sources of state revenue plays a strategic role in financing development and providing public services that support economic activities. Empirical studies show that tax revenues, including income tax, have a positive and significant influence on economic growth in various provinces in Indonesia, especially when they are used productively to fund development and infrastructure projects.

The effect of income tax on economic growth is not always unconditionally positive. An overly high income tax rate can reduce incentives for individuals and companies to work harder, innovate, and invest. This can reduce productivity and overall economic competitiveness. Therefore,

income tax policies must be carefully designed so as not to hinder economic motivation and still encourage productive activities.

An effective and efficient tax policy can increase state revenue which is further allocated to infrastructure development, education, and other important sectors. This investment in infrastructure and human resources will strengthen the economic foundation and drive long-term growth. Conversely, a complex, unfair, or corrupt tax system can create inequality and hinder economic growth through decreased investment and business.

Income tax also plays a role in economic stabilization. In situations of high inflation, the government can use income tax as an instrument to control aggregate demand by raising rates or reducing certain tax incentives. This step can help suppress inflation and maintain economic stability conducive to growth. (Wahyuningrum & Juliprijanto, 2018)

As a source of state revenue, the realization of tax revenue will later be used as state expenditure that produces various outputs. Taxes collected from the community will be returned to the community in the form of routine government expenditures and development expenditures aimed at common welfare. Waluyo (2017) stated that in its implementation, taxes are used as a source of funding that is used as financing government expenditures and on the one hand also as a medium that regulates social and economic policies. For example, taxes on luxury goods are intended to regulate people's consumption patterns. (Pane et al., 2024)

In terms of consumption, income tax has a complex impact. An increase in income tax can reduce people's disposable income, thereby reducing consumption. However, this reduction in consumption can have a positive impact on national revenues in the long run if the tax is used to finance productive projects that increase the capacity of the national economy.

Quantitative research using panel data from various provinces in Indonesia shows that tax revenues, including income tax, significantly affect economic growth in the short and long term. Other variables such as domestic investment and labor also contribute positively to economic growth, while foreign investment has a less significant influence in the Indonesian context.

Tax revenues in Indonesia still face challenges such as investment fluctuations and uncertainty in economic growth. The increase in tax revenue

is not always directly proportional to economic growth, so it is necessary to conduct an in-depth study to formulate appropriate and sustainable tax policies.

The tax reform that has been going on for two decades in Indonesia aims to increase regional and national tax revenues as a source of development financing. The success of this reform is highly dependent on the continuity of tax revenues and their use for productive projects that can accelerate regional and national economic growth.

The right tax incentives can encourage investment and job creation, thus making a real contribution to economic growth. Simple, transparent, and fair tax policies are urgently needed to increase taxpayer compliance and reduce corrupt practices that can eat into state revenue.

The effect of income tax on economic growth must also be seen in the context of income distribution. Progressive taxes can help reduce social inequality and strengthen the purchasing power of lower-middle-class people, which in turn can increase consumption and foster inclusive economic growth.

In a simulation of fiscal policy, the increase in consumption and national income resulting from good tax management can significantly increase economic growth. Studies show that an increase in consumption of 31.36% and national income of 19.72% contribute to economic growth of up to 21.19% in certain simulations.

High income taxes without adequate incentive compensation can reduce economic efficiency and stifle investment. Therefore, the government needs to balance the needs of state revenue and incentives for economic actors so that economic growth is maintained.

Taxes also function as a fiscal policy instrument that supports economic stability. With good tax management, the government can control inflation and ensure fiscal sustainability that is the foundation for long-term economic growth.(Pratama et al., 2024)

Income tax has a dual role in encouraging Indonesia's economic growth. On the one hand, these taxes provide an important source of funds for development and public services. On the other hand, improper tariffs and tax policies can distort the economy and reduce incentives for growth. Therefore, tax reform that focuses on efficiency, fairness, and transparency is needed to maximize

the positive impact of income taxes on economic growth.(Ahmad et al., 2024)

The influence of income tax on economic growth in Indonesia is complex and multidimensional. The success of tax policies in encouraging economic growth is highly dependent on optimal tariff design, taxpayer compliance, and the use of tax revenues for productive investment and infrastructure development. The government needs to continue to evaluate and adjust tax policies in order to support sustainable and inclusive economic growth in Indonesia.(Saragih, 2018a)

Tax incentives, such as tax exemptions or tariff reductions for certain investments, have the purpose of encouraging the development of strategic sectors in the economy. Tax policy in Indonesia covers various types of taxes, which have the following objectives:(Purwitasari et al., 2024)

1. State revenue is an important thing to get an income for the state, especially the Indonesian state.
2. Income redistribution, through a progressive tax policy, the government has efforts to reduce income inequality by collecting higher taxes from higher-income individuals or companies and using the funds for social welfare programs.
3. Encouraging investment, this government can provide various tax incentives to attract investment, both domestic and foreign. These incentives include tax exemptions or reductions in tax rates for certain sectors that are considered strategic for economic growth.
4. Economic stability is a tax policy that can be used to control inflation and maintain economic stability.

The influence of a policy on taxes on the economy, which exists in Indonesia, is:(Saragih, 2018b)

1. The rate on the tax on an income, is a competitive tax that can attract investment and increase economic competitiveness.
2. An increase tax on a value is a tax on consumption that can be imposed on the sale of goods and services. An increase in this tax can reduce people's purchasing power and can reduce consumption, which can be a major component.
3. Tax incentives, i.e. tax exemptions or tariff reductions for investments in certain sectors, can encourage economic growth by attracting new investment. However,

these incentives must be carefully designed to avoid market distortions and ensure that the benefits outweigh the costs incurred.

There are challenges in tax policy, according to the Indonesian people: (Rozy et al., 2023)

1. Tax compliance, is one of the main challenges is to improve tax compliance. Many individuals and companies still avoid taxes, which reduces state revenue.
2. The complexity of the tax system, is that the tax system that is too complex can confuse taxpayers and increase compliance costs. Simplifying the tax system can help improve efficiency and compliance.

The existence of a gap in taxes, that is, the gap between a potential tax and the tax that is actually collected is a problem that needs to be overcome to increase the effectiveness of tax policies.

IV. CONCLUSIONS AND SUGGESTIONS

A. Conclusion

The effect of income tax on economic growth in Indonesia shows a complex and multifaceted relationship. Income tax is one of the main sources of strategic state revenue in financing various development programs, such as infrastructure, education, and public services that contribute to increasing productivity and community welfare. Thus, effective income tax revenues can support economic growth significantly through the proper allocation of funds for economic development and stability.

An income tax rate that is too high can have negative effects, such as a decrease in incentives to work harder, invest, and innovate. This has the potential to hamper economic activity as individuals and businesses may reduce their economic activities to avoid heavy tax burdens. Therefore, a balanced and efficient tax policy is needed so as not to reduce the motivation of economic actors while being able to optimize state revenue.

A simple, transparent, and fair tax system is an important factor in improving taxpayer compliance and tax revenue effectiveness. Tax administration efficiency can reduce compliance and bureaucratic costs that burden business actors, thereby encouraging economic growth through increased investment and job creation. Tax reform that focuses on simplification and the provision of targeted incentives has proven to be

able to stimulate strategic sectors in the Indonesian economy. (Mononimbar et al., 2017)

Income tax has a dual role as a source of state revenue and an economic policy instrument that can affect economic growth positively or negatively. The success of the influence of income tax on economic growth depends heavily on the design of tax policies that are able to balance the needs of state revenue and incentives for economic actors. Therefore, reform and proper management of the tax system are essential to support sustainable economic growth in Indonesia

B. Suggestions

Based on the results of the research, the government needs to continue to strengthen the tax administration system through technology-based digitalization, such as the development of Coretax, in order to improve the convenience, transparency, and accuracy of reporting and payment of income tax. An integrated system is expected to encourage taxpayer compliance and expand the tax base without increasing the burden on the community and business actors. In addition, the provision of income tax incentives needs to be carried out selectively and on target, especially for MSMEs and strategic sectors, as an instrument to maintain purchasing power and encourage economic growth, as reflected in the Income Tax Article 21 Government-Borne policy.

Adjustment of income tax rates also needs to prioritize the principles of fairness and progressivity, by providing relief for low-income groups and MSMEs and increasing the contribution of high-income groups, so that state revenues remain optimal without hindering investment and consumption. On the other hand, strengthening tax education and socialization must continue to be improved to build public awareness and compliance with the importance of taxes for national development. As a long-term measure, diversifying tax revenues, including the development of wealth taxes targeting the super-wealthy, can be considered to increase the tax ratio and encourage economic equity without burdening the lower middle class.

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