



FACULTY OF
**ECONOMICS
AND BUSINESS**

COVID 19 and Tax Policy Responses: An Academic Perspective

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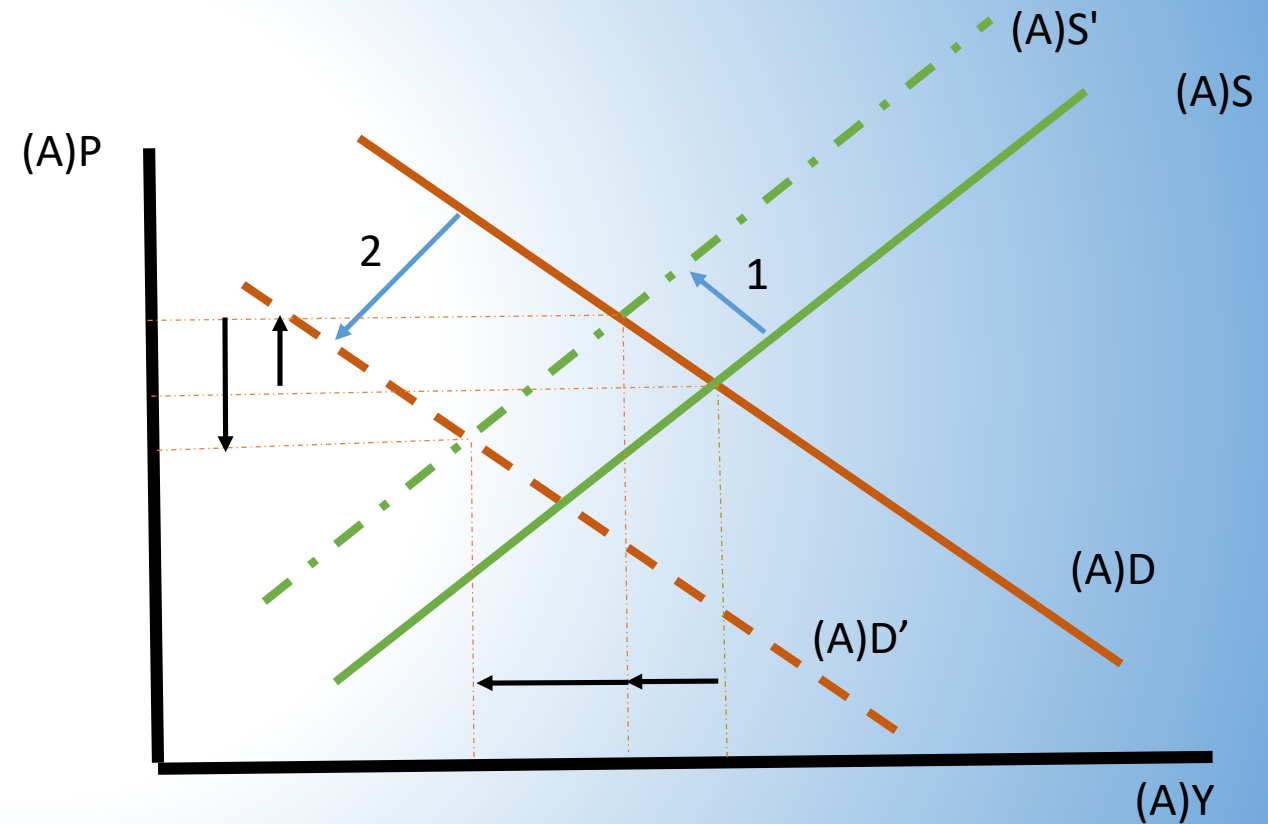
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The material in this presentation is the author's personal opinion
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Nature of Economic Slowdown

- **1st round: Supply Shock**
 - A shock in China affects the production process, causing a shift in the supply function
- **2nd round: Demand shock**
 - Increased risk of activities causes a reduction in the demand
- **Finished??**
 - Let's look at a more micro perspective



A Micro Perspective

- **All of us have 24 hours a day**
 - Everyone has its own optimal time allocation for work, leisure, and other activities
- **Everyone is on the supply side in the input (labor) market**
 - We spend the optimal amount of time to produce a given service/product
 - We get the income from our job
- **Everyone is also on the demand side in output markets**
 - We spend our earned income on consuming products/services
- **Under a normal condition, everyone will specialize in what they can do the best**

A Micro Perspective

- In the pandemic situation, our time allocation is **NOT** optimal
- Activities that require physical presence are reduced
- **Increased risk causes the demand to fall**
- **Increased risk causes the production cost to rise**
 - Demand for labor is reduced
 - Labor income will fall
 - **It will affect the demand for other goods/services**

Back to Macro Perspective

- **How bad is the impact on the economy?**
- **It depends on;**
 - When the pandemic will end
 - The extent of the population relies on income which requires physical presence
 - The government policy
- **Government Policies**
 - Increased the maximum cap of the budget deficit
 - Budget reallocation
 - Tax incentives
 - Social safety net programs

(Selected) Tax Incentives

- **PMK 44/2020**

- **Personal Income Tax (PPh 21)**

- Full waive for 6 months, Maximum Income of IDR 200 Million/Year
 - 1062 Sectors

- **Final Income Tax at 0.5% (PP 23/2018) is waived**

- 6 months, Less than IDR 4.8 Billion/year turnover

- **Income Tax on Import (PPh 22)**

- Full waive until September 2020

- **Income Tax Installment (PPh 25)**

- 30% reduction until September 2020

- **VAT refund**

- Advanced refund (less than IDR 5 Billion)

- **PMK 30/2020**

- Extending the deferred payment for excise band purchase from 2 to 3 months

Theoretical Impact of Tax Incentives

- Theoretically, the tax incentives will shift the marginal cost function (i.e., individual supply function) to the **Southeast**
- However, if the producers still expect a **low demand**, production will be less than the normal condition
 - The demand for labor will fall
- Those who are unemployed will experience a reduction in their income
 - **SOME** formal sectors, **MOST** informal sectors
 - They need money to consume at least the subsistence level
- **In short, only those who remain employed will enjoy the tax incentives**
- **The same logic is applicable for corporations**

Social Safety Net

- **For those who do not have resources to fulfill the basic needs**
 - The cost of staying at home will increase
 - The relative cost of making outside activities will fall
 - There will be more interactions
 - **INCREASED RISK OF PROLONGED SPREAD OUT**
- **Sufficient amount of cash transfer** may reduce the cost of staying at home for those severely affected by the pandemic
 - **It WILL cost the government in the short run**
 - More effective in breaking the COVID chain
 - **However, (I believe) it will bring more benefit in the long run**

Social Safety Net

- **Why will it bring more benefits in the long run?**
- Let me be a (typical) economist
- $Total\ Loss = L_1(NCase_1, GDPReduction_1) + \beta L_2(NCase_2, GDPReduction_2)$
- **$GDPReduction_1$ is a negative function of activities in $t=1$**
 - More limited activities cause a greater reduction in the GDP
- **$NCase_1$ is a positive function of activities in $t=1$**
 - Limiting activities will bring down the number of cases in $t=1$
 - The social safety net in $t=1$ is crucial to bring down the number of cases in $t=1$
- **$NCase_2$ is positively correlated with $NCase_1$**
 - Lower $NCase_1$ will be associated with lower $NCase_2$
- **Spending more on social safety in $t=1$ will bring down the not only $NCase_1$ but also $NCase_2$,**
 - Thus, more activities can be done in $t=2$

Social Safety Net

- In simple words, what I have tried to convey is

“Saving lives is saving the economy.”
- What is the solution given that the government has a limited budget for a social safety net?
- **Encourage citizen charities**
 - Donation is considered as amount paid taxes (i.e., **tax credit**).
 - Not just a reduction in the taxable income (i.e., **deductible expenses**)
 - However, practical implications and administrative costs of such a policy should be carefully considered.

Charities as Tax Credit

- **Pros:**

- **Most likely comes from the wealthy group**

- They have more than sufficient savings account
 - Treating charities as tax credit increases the benefit of giving a donation

- **Helping the economy by keeping the money in circulation**

- The wealthy usually spend on non-basic needs
 - The demand for non-basic needs falls drastically during the pandemic
 - The beneficiaries usually spend the money on basic needs

- **Less time**

- It comes from the accumulated saving account, not the on-going work

Charities as Tax Credit

- **Cons:**

- **Potentially increase the amount of tax refund claim?**
 - Consider a threshold for a maximum allowable tax credit
- **Potentially reduce the amount of tax payable?**
 - Compare with what would happen if the COVID crisis continues
- **Administrative**
 - Never been implemented
 - This is the best time to find a new solution
- **Verification ??**
 - Government creates an account specifically for donation
 - Transfer receipt can be used evidence for the tax credit

Thank You



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