COVID 19 and Tax Policy Responses: An Academic Perspective

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Disclaimer
The material in this presentation is the author’s personal opinion and does not necessarily reflect the institutional opinion.
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
  
  \[ \text{Total Loss} = L_1(NCase_1, GDPReduction_1) + \beta L_2(NCase_2, GDPReduction_2) \]

  • \( GDPReduction_1 \) 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