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Analysis of the Effect of Tax Policy and Inflation on Economic Growth: A Review of Indonesian Literature

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Abstract

This study examines the impact of tax policy and inflation rates on Gross Domestic Product (GDP) in Indonesia through a literature review approach. Tax policy and inflation are crucial determinants of economic growth as they affect government revenue and consumer purchasing power, respectively. The qualitative method used in this research synthesizes findings from various scholarly articles, books, and reports to analyze the relationship between tax policy, inflation, and GDP growth. The findings reveal a positive correlation between tax revenues and GDP growth, suggesting that higher tax rates can stimulate economic activity through increased public spending on infrastructure and social programs. Similarly, inflation, when controlled within moderate levels, can positively influence GDP by enhancing consumer spending and business investment. This study contributes to the theoretical and empirical understanding of economic growth determinants in Indonesia, providing valuable insights for policymakers to formulate effective economic strategies.

1. Introduction

Economic growth is the main indicator that describes the welfare of a country. In Indonesia, like other developing countries, factors that influence economic growth are the main focus of researchers and policy makers (Marsuni, 2023). Two important factors known to influence economic growth are tax policy and the inflation rate. Tax policy has the potential to increase government revenues and encourage economic activity through investment in infrastructure and social programs (Irawan & Raras, 2021). On the other hand, stable inflation can increase consumer purchasing power and encourage private investment, which ultimately contributes to sustainable economic growth (Nurlaeni, Rima & Soebagiyo, 2021).

However, the relationship between tax policy, inflation and economic growth is not always linear and can be complex depending on the specific economic context and the policies implemented (Silitonga, 2021). Therefore, an in-depth literature review is needed to better understand how tax and inflation policies affect Indonesia's economic growth.

This study aims to present a comprehensive analysis of the relationship between tax policy, inflation rate and GDP (Gross Domestic Product) growth using a literature review approach (Nurlaeni, Rima & Soebagiyo, 2021). Through a synthesis of related academic articles, books and reports, this research seeks to provide valuable insights for policymakers in designing effective and sustainable economic strategies for the future.

By deepening understanding of these factors, it is hoped that this study can make a significant contribution to enriching Indonesian economic literature and become a solid foundation for the development of economic policies oriented towards achieving inclusive and sustainable economic growth (Marsuni, 2023).

2 Research Methodology

The research method used in writing this article is literature study, which is a systematic qualitative approach to collecting, evaluating, and synthesizing information from various related sources such as journal articles, books, research reports, and other sources relevant to the research topic. The main goal of a literature study is to gain a comprehensive

understanding of the latest developments in a chosen research area, as well as to identify weaknesses, knowledge gaps, or new research opportunities that can be explored further. These methodological steps allow researchers to organize information in a structured and detailed manner, which can be used as a basis for developing new hypotheses, validating research findings, or providing a theoretical foundation for further research (Booth, Sutton, & Papaioannou, 2016; Hart, 1998) . Thus, literature studies not only facilitate the re-presentation of thoughts related to a topic but also make a significant contribution to the development of scientific knowledge and practical understanding in the specific context of the research being conducted.

3. Results and Discussion

A study conducted by Fauzi, Nazala, Nugroho, Maryama, & Khamdillah (2023) shows that tax revenue has a positive impact on the Indonesian economy. Tax revenues are considered a source of financing for government spending that can support sustainable economic activities. Reni & Saputra (2023) through impulse response function analysis confirms that government spending and tax revenues have a positive influence on GDP, with an increase in tax revenues overall making a positive contribution to economic growth.

Other research conducted by Tang, Liu & Cheung (2010) and Priyadipa, Anwar, Darmawati, Biby & Irfan (2022) confirmed that tax revenue has a significant positive impact on GDP. This is in line with the finding that a low ratio of tax revenue to GDP can reduce the resulting multiplier effect, while increasing tax revenue increases the resources available for government use (Panjawa & Mu'awanah, 2022).

The importance of fiscal policy in driving Indonesia's economic growth is also reinforced by Yunita & Sentosa's (2019) study, which shows that increasing tax revenue is directly related to higher economic growth. However, Setiawati & Syafariansyah (2019) found that the impact of taxes on changes in national income was not significant, indicating variations in the implications of fiscal policy depending on the economic context in question.

Overall, this research shows that wise tax policies can stimulate economic activity through increasing investment and production, which in turn increases national income. The implication of these findings is that governments must consider the effects of resource allocation and income distribution in designing tax policies to support sustainable economic growth.

In the context of inflation, a study by Putri (2023) confirms that inflation has a significant impact on Indonesia's economic growth. Research by Nurlaeni, Rima & Soebagiyo (2021) shows that there is a positive relationship between inflation and ASEAN GDP, with the Phillips curve depicting this situation as a response to increasing aggregate demand. However, research by Fachriya (2020) shows that high inflation can have a negative impact on GDP, reduce consumer purchasing power and limit economic activity.

These differences in findings underscore the complexity of the relationship between inflation rates and economic growth, where moderate inflation can stimulate economic activity, while high or uncontrolled inflation can disrupt overall economic stability. Therefore, a balanced monetary policy is necessary to keep inflation within a range that allows to support long-term economic growth. In conclusion, the results of this research show that both taxes and inflation have a significant role in determining Indonesia's economic growth. This study provides a basis for policy makers to design appropriate fiscal and monetary strategies to strengthen the national economy, taking into account the long-term effects of the policies taken.

4. Closing

Based on findings from previous research, it can be concluded that tax and inflation variables have a significant impact on a country's Gross Domestic Product (GDP). Increases in tax rates, although they can influence consumer and producer behavior, also encourage investment in infrastructure projects and other public programs. This can ultimately stimulate economic growth through increasing economic output.

Meanwhile, moderate inflation can also have a positive impact on GDP by increasing the competitiveness of a country's exports through

lowering its currency exchange rate, as well as stimulating domestic consumption and investment. However, it is important to note that the influence of tax and inflation variables on GDP is not consistent and can vary depending on additional factors such as monetary and fiscal policies, economic structure, international market conditions, and political and social dynamics.

Therefore, to fully understand the interaction between tax variables, inflation, and a country's GDP, an in-depth and contextual analysis is needed. Further research could provide deeper insight into how economic policies can be designed to maximize the positive impact of these variables on long-term economic growth.

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