

## Purchasing Power Under Pressure: Examining the 12% VAT Increase Amid Indonesia's Economic Recovery

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### Abstract

This study analyzes the impact of the increase in Value Added Tax (VAT) rates from 11% to 12% on the purchasing power of the Indonesian people. Using a quantitative-descriptive approach, this study observes how these policies affect consumption patterns, inflation, and general public welfare. The results of the study show that the low-income group is the most affected by this policy. The government has made efforts to reduce the negative impact by providing subsidies and other fiscal incentives. However, this analysis shows that these measures are still not fully effective.

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### Introduction

Value Added Tax (VAT) is a type of consumption tax that plays an important role in the tax system in Indonesia. As an indirect tax, VAT is charged on every transaction of goods and services along the production and distribution chain, but the burden is ultimately borne by the consumer. In recent years, the Indonesian government has continued to carry out tax reforms to increase state revenue, expand the tax base, and create a fairer and more efficient tax system. One of the strategic steps in this reform is to increase the VAT rate from 10% to 11% in 2022, which will then be followed by a policy of further increase to 12% starting in January 2025.

This policy has provoked various responses from the public, business actors, and academics. On the one hand, the government considers that the increase in VAT rates is an important effort to strengthen the state budget structure in order to fund infrastructure development, social protection programs, and economic recovery after the COVID-19 pandemic. On the other hand, many parties are concerned about the direct impact of this policy on the people's economy, especially in low- and middle-income groups who are more vulnerable to price changes.

Theoretically, an increase in VAT rates tends to lead to an increase in the price of goods and services at the consumer level because business actors will pass on the additional

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tax burden to buyers. This can trigger inflationary pressures which have an impact on decreasing people's purchasing power. In the context of Indonesia, which is still trying to maintain economic stability and reduce poverty, the issue of purchasing power is very important. If the increase in VAT is not balanced with an adequate compensation policy, the impact can worsen social inequality and slow down the national economic recovery.

The 12% VAT increase in 2025 specifically does not target all goods and services uniformly, but is focused on goods and services that are classified as luxurious. The government stated that basic needs such as foodstuffs, education, and health are still exempt from VAT or subject to zero percent rates. However, in practice, the domino effect of rising prices of luxury goods can affect other sectors, including daily necessities, due to changes in cost structure and distribution. In addition, public perceptions of price increases in general can also lead to changes in consumption behaviors, such as savings and postponement of purchases, which ultimately affect overall economic growth.

This study aims to analyze the impact of the 12% VAT rate increase on the purchasing power of the Indonesian people. The focus of the study includes the effect on inflation, changes in consumption patterns, and the distribution of impacts by income group. In addition, the study also evaluates the effectiveness of government policies in anticipating the negative impacts of tariff increases, including the provision of subsidies, fiscal incentives, and protection of strategic sectors. The results of the research are expected to provide input for policymakers so that the implementation of the VAT increase can run effectively without sacrificing public welfare.

This study is designed with the main objective of providing a comprehensive analysis of the impact of the increase in Value Added Tax (VAT) rates from 10% to 12% on the purchasing power of the Indonesian people. The main focus of the research is to understand how these changes in VAT rates affect people's ability to meet their daily consumption needs, especially in the context of the national economic recovery after the ongoing COVID-19 pandemic. Thus, this study aims to examine in depth several important aspects related to this fiscal policy.

First, this study seeks to analyze the effect of the 12% VAT rate increase on the purchasing power of the Indonesian people as a whole. Purchasing power is a key indicator that reflects people's economic well-being, and changes in VAT rates have the potential to affect the prices of goods and services consumed by households. Using empirical data and statistical analysis methods, this study aims to measure the extent to which the increase in VAT rates has an impact on consumption expenditure and the ability of people to meet their basic needs. This analysis is important to understand the direct implications of fiscal policy on people's welfare, especially economically vulnerable groups (Mankiw, 2018).

Second, this study examines the impact of VAT increases on inflation and household consumption patterns. An increase in VAT rates could theoretically trigger inflationary pressures because businesses tend to pass on the additional tax burden to consumers, leading to an increase in the price of goods and services. This study aims to identify how these price changes affect people's consumption patterns, whether there is a shift in consumption to cheaper goods, savings, or postponement of purchases. Understanding these changes in consumption patterns is very important to assess the macroeconomic impact of VAT policies, considering that household consumption is a major component of Indonesia's Gross Domestic Product (GDP) (Siregar & Wibowo, 2021).

Third, this study focuses on identifying the income groups most affected by the increase in VAT rates. Given the regressive nature of consumption taxes such as VAT, low- and middle-income groups are expected to be under greater pressure than high-income groups. This study aims to uncover the distribution of the impact of this policy based on income level, so as to provide a clearer picture of the social and economic justice of the

policy. This analysis is also important for designing compensation policies that are more targeted and effective in safeguarding the welfare of vulnerable groups (Musgrave & Musgrave, 1989).

Fourth, this study evaluates the effectiveness of government compensation policies implemented to reduce the negative impact of VAT increases. The Government of Indonesia has implemented various compensation programs such as food subsidies, direct cash assistance (BLT), and incentives for small and medium enterprises (MSMEs) as an effort to maintain people's purchasing power and support economic recovery. This study aims to assess the extent to which these programs have succeeded in reducing consumption and inflation pressures caused by the increase in VAT rates. This evaluation is important to provide input for policy improvement and ensure that social assistance can reach the most needy groups effectively and efficiently (Ministry of Finance of the Republic of Indonesia, 2023).

In addition, this study also emphasizes the importance of public perception aspects of VAT increase policies. Public perception of the long-term benefits and urgency of this fiscal policy can affect the level of public support and compliance, which in turn impacts the success of policy implementation. Therefore, this study also examines how public communication and fiscal education can play a role in building public understanding and support for these policies, thereby reducing social resistance and increasing trust in the government (Nugroho, 2020).

Overall, the purpose of this study is to provide an in-depth and empirical data-driven analysis of the impact of the 12% VAT rate increase on the purchasing power of the Indonesian people, focusing on economic, social, and compensation policy aspects. The results of the research are expected to provide policy recommendations that are more targeted and fair, which are able to maintain economic stability and community welfare in the midst of the national economic recovery process. Thus, this research contributes to the development of inclusive and sustainable fiscal policies in Indonesia.

## Methodology

### Types and Research Approaches

This type of research is a **descriptive quantitative research**, which aims to describe and analyze the effect of the increase in Value Added Tax (VAT) on the purchasing power of the Indonesian people. This study focuses on the measurement and analysis of numerical data obtained from the results of the distribution of questionnaires to respondents who meet certain criteria. The quantitative approach was chosen because it allows researchers to process the data statistically, so that the results are more objective and can be generalized in a broader context.

A descriptive approach is used to provide a factual picture of public perception of the impact of the 12% VAT increase policy, as well as to identify the most affected community groups. With this approach, researchers can find out how much of a decrease in purchasing power is felt, how consumption behavior changes, and how people respond to the fiscal policy. This research also provides an empirical basis for policy makers to design more targeted strategies in maintaining economic stability and community welfare.

### Data Sources and Types

The data used in this study consisted of:

- **Primary data:** collected through a survey of households from various income groups (low, middle, and high) in five major cities in Indonesia (Jakarta, Surabaya, Medan, Makassar, and Yogyakarta). This survey aims to find out the perception, changes in consumption patterns, and adjustments to public spending after the increase in VAT rates.

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- **Secondary data:** obtained from the Central Statistics Agency (BPS), Bank Indonesia (BI), and the Ministry of Finance (MoF), in particular data on the inflation rate, consumer price index, household consumption growth, and national income structure in 2019–2024.

### Population and Sample

The population in this study is all households in Indonesia. The sample was taken purposively taking into account the representation of geographic areas and income levels. The total sample was 300 households, 100 each from the low, middle, and high income groups. The sampling technique used *stratified random sampling* based on income groups.

### Data collection techniques

Data collection techniques are carried out through:

- The questionnaire is closed and open to households distributed online and offline.
- A brief interview to delve into the reasons behind changing consumption patterns.
- Documentation study of secondary data from official agencies and scientific journals.

### Data Analysis Techniques

The collected data is analyzed using the following techniques:

- **Statistical Descriptive Analysis:** to describe the average consumption expenditure of the public before and after the increase in VAT.
- **Pearson Correlation Analysis:** to find out the relationship between VAT rates and people's purchasing power.
- **Multiple Linear Regression Analysis:** used to measure the influence of VAT rates, inflation, and income on people's purchasing power, with the model:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + e$$

where:

- $Y$ : People's purchasing power
- $X_1$ : VAT Rate
- $X_2$ : Inflation
- $X_3$ : Household income
- $e$ : A term of error
- **Significance Test (t-test and F-test):** used to test the influence of each variable partially and simultaneously.

### Validity and Reliability of the Instrument

The validity test aims to measure the extent to which the research instrument is able to reveal data in accordance with the concept to be measured. In this study, validity was tested using the Pearson correlation technique (Pearson Product Moment), which is by testing the correlation between the score of each question item and the total variable score.

Each question item is said to be valid if it has a significance value (p-value) of  $< 0.05$  and a correlation coefficient ( $r$ ) that is positive and  $\geq 0.30$ . The results of the validity test showed that all items in the questionnaire had a significant correlation to the total score, so it can be concluded that all question items in this instrument were valid and suitable for data collection.

Meanwhile, reliability tests are used to measure the extent to which instruments produce consistent data when measured again under similar conditions. The test was conducted using Cronbach's Alpha method, which measures the internal consistency between items in a single variable.

The instrument is considered reliable if Cronbach's Alpha value  $\geq 0.70$ . The test results showed that the Cronbach's Alpha value for all items in the questionnaire was 0.851, which means that this instrument is very reliable and can be used to support further analysis in this study.

## Results and Discussion

This study shows that the increase in the Value Added Tax (VAT) rate from 11% to 12% has a significant impact on the purchasing power of the Indonesian people. Data obtained from a survey of 300 households in five major cities indicated a decrease in average consumption expenditure by 6.7% after the VAT rate hike was implemented. This decline was more pronounced in the low-income group which experienced a decrease in spending of up to 10%, compared to the middle and high groups which experienced a decrease of 7% and 3% respectively. This indicates that low-income groups are more vulnerable to changes in fiscal policy that have a direct impact on the prices of goods and services.

Pearson's correlation analysis which yielded a value of  $r = -0.62$  with a significance level of  $p < 0.01$  strengthened the finding that there was a strong negative relationship between the increase in VAT rates and people's purchasing power. This means that the higher the VAT rate, the more people's purchasing power will decrease. This decline in purchasing power is also exacerbated by the increase in inflation that occurs along with this policy. Cost-push inflation caused by rising prices of goods and services due to higher VAT rates adds to the burden on household spending, especially for those with fixed and limited incomes.

The multiple linear regression model used in this study revealed that VAT rates and inflation have a significant negative influence on purchasing power, while household income has a positive effect. The negative regression coefficient on the variables of VAT rates and inflation shows that the increase in tax rates and inflation directly reduces household consumption expenditure. Conversely, an increase in household income may increase purchasing power, but this positive effect is not strong enough to offset the negative impact of rising VAT rates and inflation.

In terms of consumption patterns, this study found a change in consumer behavior after the increase in VAT rates. People tend to shift their consumption to cheaper goods or delay the purchase of non-urgent goods. This can be seen from the decline in purchases of electronics, clothing, and other luxury goods, while spending on basic necessities was maintained even with a reduction in quantity or quality. This change in consumption patterns has the potential to pressure certain sectors in the economy that depend on public consumption, so that it can have an impact on overall economic growth.

Compensation policies implemented by the government, such as direct cash assistance (BLT) and food subsidies, have been proven to help mitigate the negative impact of the increase in VAT rates on people's purchasing power. However, the effectiveness of this policy is still limited due to the uneven scope of assistance and the amount of assistance that is not fully able to keep up with the increase in the price of goods and services. Therefore, there is a need for evaluation and improvement in the mechanism of distributing social assistance to be more targeted and effective in maintaining the purchasing power of the community, especially vulnerable groups.

In addition, public perception of the VAT rate increase policy also affects the level of support and tax compliance. The study found that people who understood the long-term goals of these policies tended to be more accepting and supportive of the policies, despite feeling the short-term negative impacts. Conversely, the lack of fiscal socialization and education leads to resistance and dissatisfaction that can pose the risk of tax evasion and decreased compliance.

Macroeconomically, the increase in VAT rates contributes to the increase in tax revenues needed to finance state development and spending. However, if not balanced with effective compensation policies and inflation control, these policies can put pressure on domestic consumption, which is one of the main pillars of Indonesia's economic growth.

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Therefore, fiscal policies must be designed holistically taking into account social and economic impacts so that development goals can be achieved without sacrificing people's welfare.

This research also opens up opportunities for more in-depth follow-up research using broader household microdata and more complex econometric methods. Comparative studies with other countries that implement similar policies can also provide additional insights into the best strategies for managing tax policies and their impact on society.

### **Policy Implications**

The increase in the Value Added Tax (VAT) rate from 11% to 12% is a strategic step by the government in order to increase state revenue to finance various development programs and state expenditure. However, this policy has quite complex implications, especially on people's purchasing power and the economy as a whole. Directly, the increase in VAT rates causes an increase in the price of goods and services that are taxed, so that people have to spend more money for their daily consumption needs. This impact is most felt by low- and middle-income groups, whose proportion of consumption expenditure to their income is very high. This decrease in purchasing power has the potential to reduce the level of household consumption, which has been one of the main drivers of national economic growth. If consumption decreases, the demand for goods and services will also decrease, which can ultimately slow down the pace of economic growth and have an impact on labor absorption.

In addition, the increase in VAT rates also contributes to cost-push inflationary pressures, namely increases in the prices of goods and services caused by increased production and distribution costs. Rising inflation will further burden people, especially those with fixed or low incomes, as their purchasing power decreases. In the short term, this can lead to social dissatisfaction and lower consumer confidence in economic conditions. Therefore, the government needs to anticipate the impact of this inflation with the right supporting policies.

To mitigate these negative impacts, the government usually issues compensation policies in the form of social assistance, food subsidies, or other social protection programs. This policy aims to maintain the purchasing power of vulnerable groups so that they can still meet their basic needs despite price increases due to VAT. However, the effectiveness of this compensation policy is highly dependent on the accuracy of the targets, the smooth distribution, and the amount of assistance provided. If the assistance is not on target or the amount is inadequate, then the negative impact of the VAT increase on people's purchasing power will not be resolved properly.

In addition, the policy of increasing VAT rates also requires effective communication and education to the public. A good understanding of the goals and long-term benefits of these policies can increase public support and reduce resistance to changes in tax rates. The government needs to explain that the increase in tax revenue will be used to finance infrastructure development, education, health, and social programs that will ultimately improve the welfare of the community as a whole.

From the business side, the increase in VAT rates can increase the burden of production and distribution costs, which has the potential to reduce profit margins or force them to increase the selling price of products. This can affect the competitiveness of domestic products, especially when compared to imported products that may have different tax rates. Therefore, the government also needs to consider supporting policies for business actors, such as tax incentives, ease of licensing, or training programs so that they can adapt to changes in tax policies.

Macroeconomically, the increase in VAT rates is part of tax reform aimed at strengthening the tax base and increasing state revenue in a sustainable manner. Greater tax



revenues allow the government to reduce budget deficits and increase public investment that can drive long-term economic growth. However, the success of this policy depends heavily on the balance between increased revenue and the socio-economic impact it causes. Therefore, the policy of increasing VAT must be accompanied by comprehensive mitigation measures so as not to cause excessive pressure on society and the economy.

## Conclusions and Suggestions

This study concludes that the increase in Value Added Tax (VAT) from 10% to 12% has a significant impact on the purchasing power of the Indonesian people, especially for low- to middle-income groups. In the context of the national economy, which is still in the post-COVID-19 pandemic recovery stage, this policy has multidimensional implications – both in terms of household consumption, inflation, and public perception of government fiscal policy.

From the results of the study, it is known that vulnerable groups tend to experience higher consumption pressure due to increased price burdens. The increase in VAT causes an increase in the price of goods and services, which then reduces people's ability to meet basic daily needs. As a result, purchasing power is declining and domestic consumption – which is the main driver of national economic growth – has the potential to slow down.

Furthermore, the inflationary effect of this policy also needs to be a major concern, especially in the sectors of basic necessities and basic services. Producers and traders tend to shift the burden of VAT to the end consumer, which indirectly increases price pressures. This poses short-term risks in the form of increased living costs and decreased welfare, especially for groups of people who do not have savings or fixed income.

Nevertheless, the VAT increase can still be maintained as a strategy to increase state revenue, as long as it is balanced with a measurable and fair compensation policy. The government needs to ensure that the additional revenue from VAT is used effectively to improve social security, direct assistance, and public service infrastructure. That way, the tax burden borne by the community will be proportional to the social benefits received. Here's a suggestion for the next researcher:

### **1. Conducting quantitative analysis based on household micro data (BPS data)**

The next research is suggested to use microdata such as the National Socio-Economic Survey (Susenas) or household expenditure data from the Central Statistics Agency (BPS) to measure the impact of numerical VAT increases on the consumption of each income group. This approach will provide a more precise picture of the distribution of tax burden and the elasticity of consumption.

### **2. Building econometric models for targeted policy simulations**

It is recommended that future researchers develop computable general equilibrium (CGE)-based simulation models or input-output models to project the short- and long-term effects of VAT increases on specific economic sectors. This will help in designing more targeted mitigation policies.

### **3. Integrating the sociological and psychological dimensions of society in general**

Future research should not only focus on economic aspects, but also explore public perceptions, attitudes, and responses to the VAT increase policy. This can be done through in-depth survey or interview methods, so that policymakers understand the social and public communication challenges that may arise.

### **4. Conducting a comparative study of policies in several countries in the world**

The next researcher is advised to compare the impact of the VAT increase in Indonesia with other countries that have implemented similar policies, such as Japan, India, or European countries. This comparative study will help identify best practices and potential mistakes that can be avoided.

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5. **Assessing the effectiveness of compensation policies provided by the government** In addition to assessing the impact of VAT, it is important for researchers to evaluate the effectiveness of social assistance programs provided by the government as a counterbalance. Is the program successful in maintaining purchasing power? Is the distribution even and on target? These questions are crucial to ensuring social justice in fiscal policy.
6. **Expanding the scope and analysis such as to informal sector workers and MSMEs** This research can be expanded with a special focus on micro, small, and medium enterprises (MSMEs) and informal sector workers, who are often unreached in formal tax policies. The impact of VAT on business continuity and their income needs to be studied to support inclusive incentive design.

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