IB Economics - Internal Assessment

Front Cover

School Code	Name Of School

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Indonesia reinstates temporary tax break for small-car sales

Gayatri Suroyo (Reuters) Jakarta • Fri, September 17, 2021

Indonesia has reinstated a temporary luxury-tax break on sales of smaller cars as the concession helped boost demand for vehicles, the Finance Ministry said on Friday.

The tax break, which had expired in August, will now be available till the end of the year, the ministry said in a statement.

Japanese brands such as Toyota, Daihatsu, Mitsubishi and Honda dominate Indonesia's domestic car market, Southeast Asia's biggest. Indonesia's biggest listed car distributors are Astra International and Indomobil Sukses Internasional.

Sedans and two-wheel drive cars with engine capacity under 1,500 cc will now be exempt from luxury tax until the year-end.

The ministry did not provide an estimate of revenue loss from the tax break.

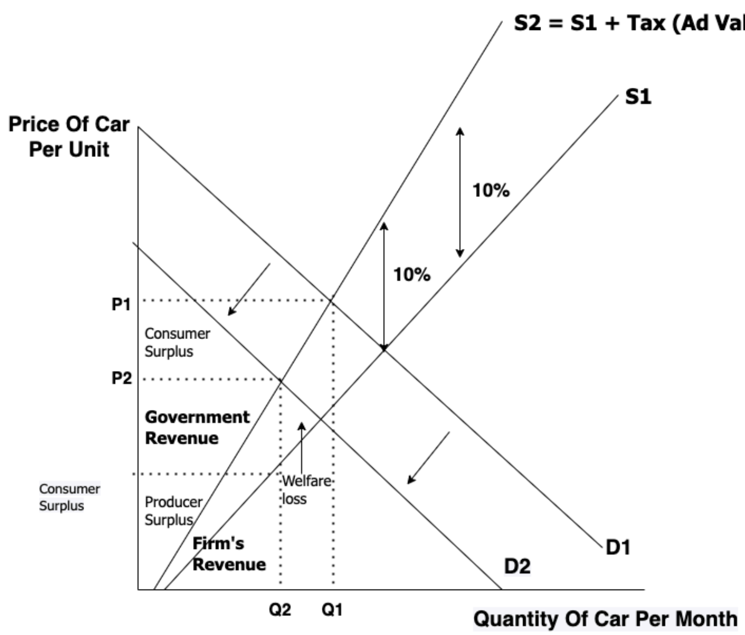
The government introduced the tax break in March to incentivize car purchases, which had been hit by an economic slowdown due to the impact of the coronavirus pandemic.

It was initially due to expire in June, but was extended until end-August.

Auto production rose 49 percent in January-July on a yearly basis, not just for domestic market but also exports, the ministry said. Monthly domestic sales have also recovered, with more than 83,000 units sold in August, close to pre-pandemic levels.

Indonesia’s automotive market has been hit by an economic slowdown due to the impact of the coronavirus pandemic. Customer’s buying power has weakened which impacted to sales of the automotive industry in Indonesia. The Indonesian Government decided to carry an intervention by reinstating a 100% tax break policy for cars below 1500 cc in order to boost automotive’s industries' sales. Where before, in march 2021 the tax break policy was firstly established by the Indonesian government and gonna expired in August 2021. The policy was proven to be able to support the automotive industry where it’s recorded that auto production rose 49 percent in January - July period.

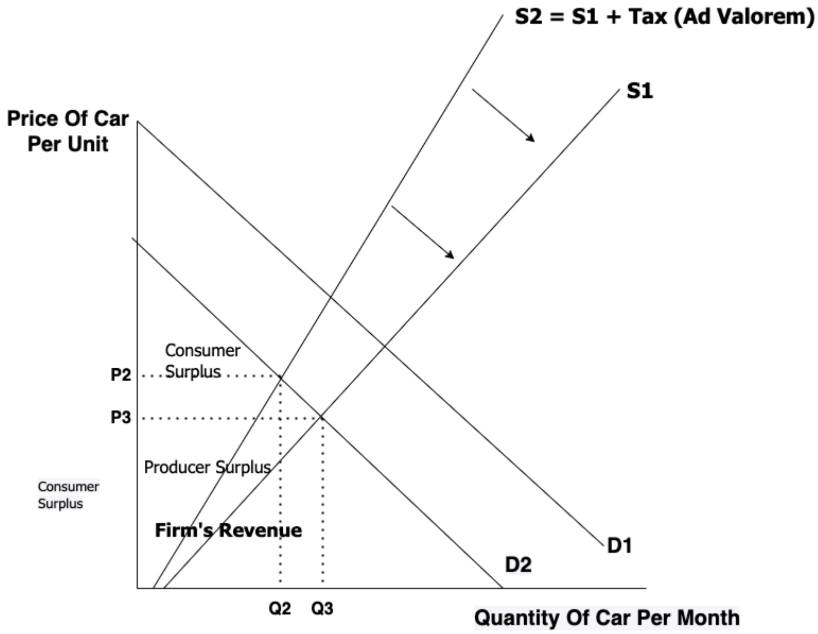
Supply And Demand Curve Of Car Below 1500cc During Pandemic



Assuming that cars below 1500cc producers in Indonesia produce in equilibrium where Qs = Qd. And the Indonesian government imposed a 10% tax policy for cars below 1500cc before the tax break policy. Due to the covid 19 pandemic, the automotive industry has been hit by an economic slowdown causing a decrease in demand. This caused the demand curve of cars below 1500cc to shift to the left from D1 to D2 indicating a decrease in demand. Which decreases the quantity supplied and quantity demanded of the car from Q1 to Q2 and also decreases the equilibrium price from P1 to P2. IThe left shift of the demand curve also decrease the firm’s revenue. Which indicated by the reduce of firm’s revenue box area.

The economic slowdown that the automotive industry experience gives a detrimental effect on many stakeholders. Where due to economic slowdown, producers need to produce less than before because there's a decrease in demand Where the production of cars in 2020 only reaches 690 thousand units, halve the number of cars produced in 2019. Which leads to a decrease in the firm's revenue. Especially due to the tax policy that the government impose for cars below 1500cc, causing a welfare loss where they weren't able to reach the optimal quantity of goods due to tax. There's also a possibility that many employees in the automotive industry would get laid off due to the decrease in car production, so they're considered redundant and got laid off in order to adjust the firm's cost of production.

Supply And Demand Curve Of Car Below 1500cc During Pandemic



This is why from march 2021 - august 2021, the government establish a tax break policy to cars below 1500cc and planning to reinstate it. The tax break policy removes the 10% tax policy that the government impose before. Causing the supply curve of cars below 1500cc to shift to the right as represented by the graph above. Indicating an increase in the supply of cars. Which decreases the price of a car per unit from P2 to P3, but increases the quantity demanded and quantity supplied of 1500cc cars from Q2 to Q3. Indicating there's an increase of consumer expenditure for cars below 1500cc. And also an increase of production for cars below 1500cc. Where it's recorded that there's an increase of auto production by 49% in the January - July period. And from January - to August 2021, retail car sales reached 545.424 units, equivalent to 68% growth compared to 2020. Closing to pre-pandemic level. Tax removal enables firms to reach their optimal quantity of goods where there is no more welfare loss due to tax. Meaning that they'll be able to produce and sell more cars, expanding the firm's revenue box.

The intervention that Indonesia's government does by establishing a tax break policy for cars below 1500cc in order to boost cars sales might be a good solution. Where the policy we're able to increase the production of cars until 49%. And also increase retail car sales until 68% which almost reach the pre-pandemic level. In short term, this tax break policy brings more revenues for automotive producers in Indonesia. Where there are more cars produced and sold leading to an increase in the firm's revenue. Consumers also benefited from this policy, where they can buy the car they want at a more cheaper price than before. Employees were also benefited, where due to no tax there was no deadweight loss, and firms can and will produce more. Opening possibilities of job creation and ensuring job security. However, tax break means there is no government revenue meaning the government will experience revenue loss. Leading to a decrease in the government budget which forces the government to decrease its expenditure. In the long run, tax break policy is not a sustainable solution, because if the condition in the future remains unchanged it's possible that the sales of cars fall again. Also, a tax break policy for cars will bring negative externalities where an increase in car sales means there are more cars in the street. This would make more pollution and more traffic, which gives a negative effect to the society as a whole.