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Research Paper

Does Foreign Capital Increase Tax Revenue: The Indonesia Case

Susun Abdul Madjid
Carlos Afonso Barreto

ABSTRACT:
We examine the effect of the foreign direct investment (FDI) on taxes paid for Indonesia with a special focus on the cases for 2015, 2016 and 2017 . We believe the results of the study on the cases for 2015, 2016 and 2017 could represent the whole Indonesia cases. The result confirm that foreign affiliation increase the taxes paid by the firms.

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I. INTRODUCTION:

Cross-border flows of foreign direct investment (FDI) have been one of the core features of the globalization process over the last decades. The world economy has seen a significant growth in FDI so that the global inflows of FDI increased from approximately USD 204 billion in 1990 to USD 12 trillion in 2014 (UNCTAD, 2015). Such remarkable growth in FDI flows can be attributed to the policies that attract cross-border investment from multinational corporations (MNC). The arguments in favor of creating incentives for FDI are based on the direct and indirect effects of FDI on host countries. The presence of MNCs are expected to bring additional capital, boost production capacity, enhance technology diffusion and transfer knowledge in terms of production and management skills. As a result, the host economy enjoys a higher welfare level with higher production, trade, productivity and employment levels as well as higher tax revenue (Becker et al., 2012).Among the various incentives offered by governments to attract multinationals, fiscal incentives, especially taxes play a key role. In fact, recently, there is a tendency of reducing taxes to attract FDI from MNCs. The aim of this paper is to provide firm level evidence on the impact of FDI on taxation in Indonesia. Specifically, we address the question as to whether FDI has an effect on taxes paid by the firms, by focusing on the cases for 2015, 2016 and 2017 . Finally, to the best of our knowledge our study is the first to investigate the impact of FDI on the tax revenue for Indonesia focusing on the cases for 2015, 2016 and 2017.

The rest of the paper proceeds as follows: Section 2 reviews the literature. Section 3 introduces the data and methodology we employ and, provides the results. Section 4 concludes the paper.

II. LITERATURE REVIEW

The empirical literature has not reached a consensus on the relationship between taxation and FDI. Table 1 provides a summary of findings in recent empirical studies of the effects of various measures of taxation on FDI. Concerning quantity effects of taxation, some of the studies find no impact of tax reduction on FDI (e.g., Cassou, 1997; Gorter and Parikh, 2003). On the other hand, most of the studies confirm a negative relationship between taxation and FDI inflows (e.g., Hartman, 1984; Young, 1988; Swenson, 1994; Wijeweera et al., 2007; Grubert and Mutti, 2000).The variation in the results partly reflects differences between the industries and countries being examined, or the periods concerned. To illustrate, Pain and Young (1996) analyzes the FDI from Germany and the United Kingdom made in eleven countries between the periods 1977 and 1992. They reach different conclusions for Germany and UK. While the long-run elasticity of FDI with respect to taxes is significantly negative for the UK, it is insignificant for Germany. Analyzing FDI from 11 countries made in 46 locations in the year 1991, Shang-Jin (1997) finds negatively significant long-run elasticity of FDI with respect to taxes. Further, using an aggregated investment demand model Agostini (2007) finds that FDI in manufacturing to be quite sensitive to states' corporate tax rates with a negative semi-elasticity of FDI with respect to taxation. Bellak and Leibrecht (2009) utilize panel gravity models and find a negative relationship between the corporate tax rates and FDI for Central and East Europe Countries. Desai et al. (2004) investigates American MNCs and show that FDI is adversely affected by high tax rates for American

multinational firms, and that this association is apparent for all types of taxes. Bénassy-Quéré et al. (2005) show that high relative corporate taxation reduces FDI inflows for 11 OECD countries over the period 1984-2000.Studying 24 OECD countries, Razin et al. (2005) show that the source-country tax rate works primarily on the selection process whereas; the host-country tax rate affects mainly the magnitude of FDI, once they occur. Varol-İyidoğan and Dalgıç (2015) examine 11 Central and East Europe countries using GMM models and find a negative relationship between taxes and FDI. On the other side, In their analysis for 25 OECD countries with panel gravity models, Beck and Chaves (2012) find that labor income taxes has a positive effect but capital income taxes has a negative effect on FDI.There exists even less studies exploring the quality effects of taxation, i.e., effects of FDI inflows on taxation. Utilizing a panel data of 19 OECD countries, Gropp and Kostial (2000) find a weak correlation between FDI and corporate income tax and a strong positive impact of FDI inflows on the profit tax and on the total tax revenue. On the other hand, assessing the impact of FDI on Tax Revenue in Pakistan, Mahmood and Chaudhary (2013) show that FDI has a positive impact on tax evenue both in the short-run and the long-run.

III. DATA, METHODOLOGY AND EMPIRICAL RESULTS

For the data of Tax Revenue ,we rely on a comprehensive dataset based on the data from Ministry of Finance of Indonesia. And as for the data of Foreign Direct Investment(FDI) we rely on the Statistics bureau of Indonesia . we are using the data of the year 2015,2016,2017,2018 and 2019

According to the data from the Ministry of Finance, the total Tax Revenue received for the year:
Year 2015 was Rp. 1.055,61 Trillion
Year 2016 was Rp. 1.283 Trillion
Year 2017 was Rp. 1.472,7 Trillion

The data above showed increase of Tax Revenue from year to year.

We collect the data of FDI from the Statistics Bureau of Indonesia.
According to the data from the annual report of Statistics bureau of Indonesia , the Foreign Direct Investment for the year :
Year 2015 was Rp. 365,9 Trillion
Year 2016 was Rp. 396,5 Trillion
Year 2017 was Rp. 430,6 Trillion

The data above showed the increase of FDI flow into Indonesia from year to year.

Based on the data we can be sure that the icrease of FDI will enhance the icrease of tax revenue . We would like to give you a logical explaination on the icrease of tax return due to increase of FDI.
What will happen when FDI company come and invest in Indonesia?
When FDI company invest in Indonesia , these things will happen:

1. FDI company will bring its capital in the currency of US Dollars. This will indirectly have a huge impact for increasing of Tax Revenue. The Fund in US Dollar will be converted into Rupiah currency, which give a huge fund for the Government to spend on buiding highways, schools, hospitals, airports, seaports, and even hiring good quality government staffs. It will impact on all kind of taxes. It will increase taxes in corporate income tax for the contractors who bulid the premises, increase labor income tax for the workers who work on the sites, and Value Added Tax for all the materials used for constructing the highways, schools, hospitals, airports, seaports, and Employees Income Tax for lots of government staffs.

2. The Capital or Fund which was exchanged into Rupiah Currency will be used for:

2.1 buying land ; will inrease Tax Revenue on Annually Land Tax
2.2 building factory and offices ; will increase Tax Revenue on Labor Income Tax and Income tax for gain on material supply from local suppliers
2.3 Hiring workers ; will increase Tax Reveue on Employees Income Tax
At the time the FDI company make money or make profit ; will increase Tax Revenue on Corporate Income Tax

Because of the positive impact from FDI on Tax Revenue, Indonesia Government even propose several types of investment zone for FDI company.. There are three types of Investment Zone propose by Indonesia Government:

1. Bounded Zone. This is mostly applied for the company with export oriented sales.
2. Free Trede Zone(FTZ); FTZ will give free taxes on Value Added Tax and Duty Tax

3. Special Economic Zone; this is similar to FTZ , which give free taxes on Value Added Tax and Duty Tax but also give a lot of tax holiday and tax exemption for FDI which invest in huge investment and especially in the undeveloped area in Indonesia.

IV. CONCLUSION

In the light of the globalization and economic integration, FDI is increasingly being acknowledged as a key factor in the development process of economies. FDI is recognized to bring about new capital, to facilitate knowledge transfers in terms of information and technology as well as increasing of wages for employees. We cannot reject the validity of the instruments aneconomic growth and employment (hence domestic income), more and more countries are seeking to attract FDI. In particular, countries are offering tax intensives and developing fiscal policies to ensure their attractiveness to inbound investment. The resulting increase in domestic income from FDI creates additional tax revenue from the taxation of wages and profits of foreign-owned companies. Policy makers thus, try to ensure that an adequate domestic tax is collected from multinational enterprises.Most of the empirical literature focuses on how to attract FDI and studies the relationship from taxation to FDI reflecting only the quantity effects (i.e., the quantity of assets attracted). In contrast, we try to shed light on the qualityeffects (i.e., the effect of FDI on tax revenue and labor income) of FDI for a developing country Indonesia for year 2015 to 2017. Indonesia is an interesting case to study as with a striking growth performance during the analysis period, it has integrated into the globalized world, while transforming into one of the major recipients of FDI in its region. We find evidence for the quality effects so that the growth of foreign ownership positively affects the growth of taxes paid by the firm. The quality effects and the additional tax revenue from the taxation of wages and profits of multinationals has been be taken into account in designing policies, by creating more Investment Model for FDI such as, FTZ and Special Economic Zone.

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