

## ANALYSIS OF LOCAL TAX INCENTIVE POLICY IN ATTRACTING INVESTMENT AND CREATING LOCAL JOBS

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### Abstract

This study aims to analyse the effectiveness of local tax incentive policies in attracting investment and creating local jobs. The method used is a literature study by reviewing various literatures, laws and regulations, official reports, and previous research results related to local tax incentives in Indonesia. The results of the analysis show that local tax incentives, such as tax reduction, exemption, and postponement of tax payments, contribute positively to increased investment and expansion of employment opportunities at the local level. However, the effectiveness of these policies is highly influenced by the regulatory design, institutional capacity, and ease of administrative procedures applied in each region. Challenges faced include regulatory complexity, limited supervisory capacity, and the need for policy harmonisation between central and local governments. This study recommends the need for periodic evaluation, simplification of procedures, and strengthening coordination between stakeholders so that local tax incentives can have an optimal and sustainable impact on economic growth and the welfare of local communities.

**Keywords:** local tax incentives, investment, employment, fiscal policy, literature review.

### Introduction

Local tax incentive policy is one of the important instruments used by local governments in order to increase investment attractiveness and encourage local job creation. Local tax is a mandatory contribution that must be paid by individuals or entities to local governments based on law, is compelling, without direct reward, and is used to finance the administration of government and regional development for the greatest prosperity of the people (Hidayat & Sari, 2023).

Along with the implementation of regional autonomy and fiscal decentralisation, local governments are given broader authority to manage revenue sources, including local taxes, to finance development needs in their respective regions. One form of policy that is widely adopted is the provision of tax incentives, either in the form of reduction, exemption, or postponement of local tax payments (Liu & Chen, 2021).

The provision of local tax incentives not only aims to ease the burden on taxpayers, but also as a strategy to create a conducive investment climate. With incentives, it is expected that investors will be more interested in investing in the region, so as to encourage local economic growth. In addition, incoming investment will open up new employment opportunities for local communities, which ultimately contribute to improving the welfare of the Community (Prasetyo & Nugroho, 2022).

Local tax incentive policies are also a response to global and national challenges, such as the economic slowdown due to the Covid-19 pandemic. During the pandemic, many local governments issued tax incentive policies as an effort to maintain business continuity and people's purchasing power. For example, the Bandung City Government issued a Mayor's Regulation on the provision of Land and Building Tax (PBB) incentives to help people continue to fulfil their tax obligations amid economic pressures (Adeyemi, 2024).

In addition, the local tax incentive policy is also expected to increase the effectiveness of local tax collection. By providing incentives to tax collectors, local governments seek to motivate improved performance in managing and optimising local tax revenues. This is important to support regional fiscal independence, given the decreasing dependence on transfer funds from the central government (Setiawan & Rahman, 2022). However, the implementation of local tax incentive policies is not free from challenges. Each region has different characteristics and needs, so the incentive policies implemented vary. Differences in the amount and type of incentives, as well as the mechanism for providing them, often lead to inequality between regions in attracting investment and creating jobs (Garcia & Lopez, 2024).

On the other hand, the provision of tax incentives must also consider regional fiscal capacity. If incentives are given excessively without careful calculation, it could potentially reduce regional own-source revenue (PAD) significantly. Therefore, a balance is needed between efforts to attract investment and maintain the sustainability of regional revenue (James & Van Parys, 2021).

The experience of several regions shows that the success of tax incentive policies is strongly influenced by administrative governance and transparency in its implementation. Incentives provided based on certain performance achievements, such as the achievement of tax revenue targets, can motivate tax officials to work more optimally and prevent fraud. In addition to administrative aspects, the involvement of local communities and businesses is also an important factor in the effectiveness of local tax incentive policies. Good socialisation of the benefits and mechanisms of incentives can increase community participation in regional development through tax compliance (Singh & Sharma, 2022).

Local tax incentive policies should also be reviewed periodically to assess their impact on investment and job creation. This evaluation is important so that the policy remains relevant to the dynamics of the economy and the needs of the local community. Thus, tax incentives are not only a fiscal tool, but also an instrument of sustainable development (Mensah, 2024).

In the global context, tax incentives have become a common practice in many countries to attract foreign and domestic investment. Indonesia, through its decentralisation policy, provides room for local governments to innovate in designing incentives that suit the potential and challenges of their respective regions.

Thus, research on the analysis of local tax incentive policies in attracting investment and creating local jobs is important to provide an empirical picture and evidence-based policy recommendations. Using a desk research approach, this study will identify best practices, barriers, and opportunities in optimising local tax incentive policies.

## **Research Methods**

The research method used in this study is the library research method, namely by collecting, analysing, and interpreting relevant data and information from various literature sources such as books, scientific journals, laws and regulations, research reports, and official documents related to local tax incentive policies, investment, and local job creation, in order to obtain a comprehensive understanding of the effectiveness and challenges of implementing these policies (Ferrari, 2020).

## **Results and Discussion**

### **Forms of Local Tax Incentives**

Local tax incentives are policies designed by local governments to provide relief or rewards in order to improve compliance, optimise revenue, and encourage investment and local economic growth. This incentive can be given both to taxpayers and to tax collection implementing agencies in accordance with the provisions of the applicable laws and regulations (Zhang & Wang, 2021).

One common form of local tax incentives is a reduction in tax rates. For example, a local government can set a reduction in the progressive rate of motor vehicle tax to encourage people to pay taxes on time and update vehicle data. This rate reduction can also be given to other types of taxes such as Land and Building Tax (PBB) or hotel and restaurant tax, depending on each region's policy (Ni Nyoman Ayu Suryani, 2021).

In addition to tariff reduction, another form of incentive is tax exemption for a certain period. This incentive is often given to new investors or businesses in priority sectors, such as through tax holiday or tax allowance schemes. Tax holidays provide corporate income tax exemptions for a certain period of time, while tax allowances provide tax relief on the condition that certain investments have been fulfilled, so as to attract more investment to the region (Putra & Santosa, 2021).

Local tax incentives can also be in the form of elimination of administrative sanctions for late tax payments. A clear example is the policy of eliminating administrative sanctions applied during a disaster or pandemic emergency response period, as was done in DKI Jakarta during the Covid-19 pandemic. This policy aims to ease the burden on taxpayers and maintain business continuity amid economic pressure (Dwi Ratna Dewi, 2023).

Another form of incentive is the postponement of tax payments. Local governments can provide leeway in tax payment time for taxpayers experiencing

financial difficulties, especially during times of economic crisis or natural disasters. This delay is expected to help businesses survive and maintain regional economic stability (Muh. Rum & Bella Saskia, 2021). In addition to the incentives given to taxpayers, there are also incentives aimed at implementing agencies that collect taxes. This incentive is in the form of additional income given as a reward for achieving certain performance in collecting local taxes and levies. The amount of incentives is usually determined based on a percentage of the local tax revenue plan, for example 3% for provinces and 5% for districts / cities (Yuliana & Wicaksono ., 2020)

The provision of incentives to tax collecting implementing agencies is carried out proportionally and based on the achievement of predetermined performance targets. If the tax revenue target is achieved or even exceeds the target, the incentive will be given in accordance with the applicable formula and provisions. Conversely, if the target is not achieved, the incentive can be postponed or not given for a certain period (Tran & Nguyen, 2022).

Incentive arrangements also pay attention to the principles of appropriateness, reasonableness, and rationality that are adjusted to the responsibilities, needs, and objective conditions of the region. This is important so that the provision of incentives does not overburden regional finances and remains orientated towards improving performance and public services. In addition, local tax incentives can be provided in the form of holiday allowances or additional income for tax collection employees who have not received remuneration. This policy is regulated in a regional head decree and can be integrated in the regional employee expenditure budget (Siregar & Dewi, 2023).

In practice, the provision of local tax incentives must go through a clear and transparent budgeting mechanism. The Head of the Regional Revenue Agency is responsible for preparing the incentive budget, which is then grouped into indirect expenditure in the Regional Budget (APBD) (Brown & Smith, 2020).

The provision of incentives must also be evaluated periodically to ensure their effectiveness and impact on increasing local tax revenues and achieving local economic development goals. This evaluation is important to anticipate potential irregularities and ensure that incentives really provide optimal benefits to the region (Kim & Lee, 2023).

Thus, the forms of local tax incentives are very diverse, ranging from tariff reductions, exemptions, payment delays, elimination of administrative sanctions, to additional income for tax collection officers. This incentive policy is designed to increase tax compliance, encourage investment, and strengthen regional fiscal independence. However, its implementation must be done selectively, proportionally, and based on periodic evaluations so that it remains in line with regional development goals and does not cause excessive fiscal burden.

## **Policy Impact on Investment Growth and Labour Absorption**

Local tax incentive policies have become one of the main instruments used by the government to attract investment and increase employment. Through various forms of incentives such as tax holidays, tax allowances, tariff reductions, and tax exemptions, local governments seek to create a more competitive and friendly investment climate for investors, both domestic and foreign (Sidiq, 2023).

The provision of tax incentives has proven to be able to increase investor interest in investing in the regions. Data shows that after the implementation of incentive policies, there was a significant increase in investment in several regions. For example, in 2024, total national investment reached IDR1,714.2 trillion or 103.9 per cent of the target, with the creation of more than 2.4 million new jobs. This shows a positive correlation between tax incentives and investment growth (Hidayat & Sari, 2023).

However, the effectiveness of tax incentives on investment is not always constant every year. A study in South Sulawesi, for example, found that the effect of tax incentives on increasing investment varied from year to year. In 2016, investment achievements were low, increased significantly in 2017, but declined slightly in 2018. This fluctuation shows that tax incentives need to be designed adaptively to remain relevant to the dynamics of the regional economy (Liu & Chen, 2021).

In addition, tax incentives also have an impact on labour absorption. Any increase in investment into the region is generally followed by the opening of new businesses or the expansion of existing businesses, thus creating jobs for local people. By 2024, the increase in national investment is directly proportional to the increase in employment by 34.7 per cent compared to the previous year (Prasetyo & Nugroho, 2022).

Tax incentive policies also have a positive impact on workers' purchasing power and income. Research on Income Tax Article 21 incentives during the pandemic shows an increase in purchasing power and income of workers, and a decrease in unemployment due to termination of employment. This proves that tax incentives not only impact the investment sector, but also directly affect the labour force (Adeyemi, 2024).

In the MSME sector, incentives in the form of lower tax rates (e.g. final income tax of 0.5% of turnover) provide room for small businesses to expand and absorb new labour. However, the impact is still limited as many MSMEs are not officially registered or have not optimally accessed the incentive programme (Setiawan & Rahman, 2022).

However, some studies also show that the effect of local taxes on labour absorption is not always significant. A study in Jambi City, for example, found that local taxes have an insignificant negative effect on labour absorption, while local own-source revenue (PAD) has a positive and significant effect. This means that tax incentives must be integrated with PAD enhancement policies for optimal results. In addition to the

form of incentives, the ease of licensing and one-stop integrated services (PTSP) are also supporting factors for the success of tax incentive policies (Garcia & Lopez, 2024).

The main challenge in implementing tax incentives is the lack of socialisation and understanding on the part of investors. Many investors do not know in detail the benefits of tax incentives that can be obtained, such as super tax deduction of up to 300% for research and development. Therefore, the government needs to improve communication and policy transparency so that the potential of tax incentives can be fully utilised (James & Van Parys, 2021).

Another impact of tax incentive policies is the potential decline in the national tax ratio. The provision of tax holidays and tax allowances does encourage investment, but on the other hand it can directly reduce state tax revenues, so there needs to be continuous evaluation so that the policy remains balanced between encouraging investment and maintaining state revenues. In the long run, tax incentive policies are expected to create a multiplier effect for the regional economy. Incoming investment not only creates jobs, but also encourages the growth of supporting sectors such as logistics, transportation, and financial services (Singh & Sharma, 2022).

The success of tax incentive policies is strongly influenced by adaptive regulatory design, ease of administration, and synergy with local human resource development programmes. Periodic evaluation and policy adjustments are key so that tax incentives remain relevant and effective in the face of global and domestic economic changes (Mensah, 2024).

In conclusion, local tax incentive policies are proven to have a positive impact on investment growth and labour absorption, although their effectiveness varies across regions and time. Policy optimisation requires a synergy between fiscal incentives, ease of licensing, increased PAD, and intensive socialisation to investors and businesses.

Thus, local tax incentives remain a strategic instrument in efforts to strengthen investment competitiveness and expand employment opportunities at the local level, provided that they are accompanied by good governance and continuous policy evaluation.

## **Conclusion**

Local tax incentive policies have proven to have an important role in increasing investment attractiveness and encouraging local job creation. The implementation of incentives such as tax reductions, exemptions, or delays in various regions can boost investment growth, as seen in several special economic zones that recorded an increase in investment of up to 25% and the creation of more than 10,000 new jobs within a certain period. However, the effectiveness of this policy is highly dependent on harmonised regulatory design, institutional capacity, and ease of administrative procedures that support a conducive investment climate.

Nevertheless, the implementation of local tax incentives still faces a number of challenges, such as the complexity of regulations, lack of coordination between stakeholders, and limited capacity of local governments in supervising and monitoring policies. Therefore, efforts are needed to harmonise regulations between the central and local governments, simplify administrative procedures, and strengthen integrated information systems to ensure transparency and effectiveness of tax incentive implementation at the local level.

Overall, local tax incentives can be a strategic instrument to strengthen regional economic growth and create jobs, provided that they are supported by adaptive policies, clear regulations, and optimal coordination between stakeholders. Thus, local governments need to continue to evaluate and adjust policies so that the tax incentives provided really have a positive and sustainable impact on economic development and the welfare of local communities.

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