Evaluation of the Effectiveness of Post-Pandemic MSME Tax Incentives on Local Economic Performance

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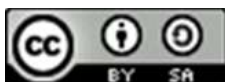IPOSS Jakarta

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ABSTRACT

This study evaluates the effectiveness of post-pandemic tax incentives for micro, small, and medium enterprises in Indonesia and examines their impact on local economic performance. Using a combined conceptual and policy analysis approach, the research assesses how behavioural, structural, and institutional factors mediate the ability of MSMEs to convert tax relief into meaningful economic outcomes. The findings indicate that MSME responses to tax incentives are strongly influenced by business formality, liquidity constraints, digital readiness, sectoral composition, and information accessibility. Regions with stronger administrative capacity, higher digitalization, and greater purchasing power demonstrate more substantial improvements in employment recovery, business reopening rates, and local consumption. Structural factors such as regulatory clarity, financial inclusion, supply chain integration, human capital quality, and infrastructure development further shape the sustainability of tax incentive impacts. The study concludes that while tax incentives play an important role in supporting MSME recovery, their long-term effectiveness depends on broader institutional reforms that enhance administrative capability, promote digital access, strengthen financial systems, and improve local governance. Strengthening these structural conditions will expand the capacity of MSMEs to benefit from fiscal incentives and contribute to more resilient and inclusive local economic growth.

Keywords: *digital readiness, local economy, MSME, tax incentive, economic recovery.*

INTRODUCTION

Micro, small, and medium enterprises continue to serve as one of the most essential pillars of economic development in emerging economies, with their contribution disproportionately influencing employment, productivity, and income distribution. Indonesia represents one of the most MSME-dependent economies in the world, where the sector accounts for approximately 61 percent of national GDP and absorbs more than 97 percent of total employment according to the Ministry of Cooperatives and SMEs. These statistics are consistent with global patterns observed in developing nations, where MSMEs constitute more than 90 percent of registered firms and generate the majority of jobs in local markets. UNCTAD (2022) similarly highlights that MSMEs contribute up to 70 percent of employment in low- and middle-income countries, demonstrating their pivotal role in promoting inclusive and resilient growth. Because of this structural importance, the economic disruption caused by the COVID-19 pandemic posed a serious threat to Indonesia's local economic stability, as MSMEs were disproportionately affected by declining consumer demand, supply chain dislocation, and liquidity constraints.

Disturbances in MSME operations during the pandemic were widespread and severe. A comprehensive survey conducted by the Asian Development Bank in 2021 indicated that 84 percent of Indonesian MSMEs experienced substantial income losses, with nearly 60 percent reporting that they had only enough cash flow to survive for less than two months. These findings align with global evidence. A study by Nyikos et al., (2021) showed that micro and small enterprises in the United Kingdom experienced steep revenue declines due to mobility restrictions, demand shocks, and market uncertainty. Similarly, research by Kim (2021) found that MSMEs in South Korea faced critical declines in operational capacity and liquidity shortages that increased bankruptcy risks. These international patterns demonstrate that the pandemic's impacts on MSMEs were not only severe but also globally uniform in their intensity. In Indonesia, where MSMEs form the backbone of local economies, the shock threatened community livelihoods and regional economic performance. This raised urgent policy needs for targeted fiscal interventions capable of supporting rapid recovery.

To stabilize small enterprises during the pandemic, governments adopted various policy measures such as tax reductions, subsidies, credit guarantees, and simplified compliance processes. Indonesia responded by implementing a series of tax incentives tailored to MSMEs, including reductions in the final income tax rate under Government Regulation No. 23/2018 and full exemptions for MSMEs under turnover thresholds, supplemented by tax payment assistance under the National Economic Recovery Program. Evidence from other economies suggests that such fiscal measures can play a significant role in supporting small business resilience. Nyikos et al., (2021) observed that targeted tax relief in the United Kingdom reduced firm closures and preserved employment. Kim (2021) similarly demonstrated that tax subsidies for microenterprises contributed to higher operational survival rates during the crisis. These global findings underscore the potential of tax incentives to mitigate business failures and stimulate post-pandemic recovery among MSMEs.

However, Indonesia's MSME sector exhibits structural diversity across regions, which complicates the assessment of tax incentives' effectiveness. Local economic systems vary widely in the degree of formality, sectoral orientation, digital readiness, and administrative capacity. A study by Rosyidiana & Narsa (2024) indicated that the effectiveness of MSME tax policies in Indonesia is often hindered by high informality rates, limited awareness of incentive schemes, and low digital literacy. Abdi et al., (2022) similarly reported that MSMEs with low access to digital platforms are less likely to participate in tax programs and tend to benefit less from incentives. These dynamics highlight a need to analyze policy impacts not only at the national level but also across local economic contexts.

Tax incentives for MSMEs are also associated with broader macroeconomic objectives, including employment recovery, consumption reactivation, and local investment stimulation. Research in Latin America by Jenkins et al., (2025) confirms that targeted tax reductions for small businesses can support municipal-level economic regeneration by enabling liquidity expansion, supporting labor retention, and increasing local spending. In Southeast Asia, similar patterns have been observed, where MSME-focused fiscal interventions improved community-level economic indicators when combined with business development programs and credit access. Yet despite the relevance of MSMEs to Indonesia's regional economies, comprehensive studies evaluating the post-pandemic impact of tax incentives on local economic performance remain limited.

The literature demonstrates several gaps that justify the need for this research. The first gap emerges from the study by Nyikos et al., (2021), which examined the

impact of tax relief on small businesses in the United Kingdom but did not explore how variations across regions influence policy outcomes in developing countries. This limits its applicability to Indonesia's decentralized local economic structures. A second gap arises in the work of Kim (2021), which assessed the impact of subsidies and fiscal assistance on MSME survival in South Korea but did not differentiate between tax incentives and other forms of fiscal support, nor did it evaluate broader local economic indicators such as employment recovery and consumption. A third gap is identified in Rosyidiana & Narsa (2024), whose analysis focused on MSME tax compliance rather than the economic performance outcomes associated with tax incentives. These gaps collectively highlight the absence of studies that integrate fiscal policy assessment with local economic dynamics in the Indonesian post-pandemic context.

The novelty of the present study lies in its integrated evaluation of MSME tax incentives' effectiveness in stimulating local economic recovery after the pandemic. While prior research has largely evaluated tax incentives in terms of compliance or business survival, this study examines their broader impact on local economic indicators, including employment, business reopening rates, and regional consumption. It also incorporates regional heterogeneity by analyzing how local administrative capacity, business formality, and digital readiness shape the uptake and effectiveness of tax incentives. This approach acknowledges that Indonesia's local economies do not respond uniformly to national fiscal policies. The objective of this research is therefore to evaluate the extent to which post-pandemic MSME tax incentives influence local economic performance in Indonesia, with emphasis on understanding regional variations and the behavioral responses of small enterprises.

METHODS

This study employs a mixed conceptual and policy analysis design to evaluate the effectiveness of post-pandemic MSME tax incentives on local economic performance in Indonesia. The first methodological component uses doctrinal analysis to examine the legal and regulatory framework governing MSME tax incentives, drawing on the analytical principles described by Hutchinson (2017). Regulatory instruments such as Government Regulation No. 23/2018 and fiscal measures introduced under the National Economic Recovery Program are analyzed to clarify their objectives, operational mechanisms, and intended impact on business liquidity and recovery.

The second component uses comparative policy analysis grounded in economic evaluation frameworks such as those proposed by Ordynskaya et al., (2016). This approach synthesizes empirical findings from global and Indonesian studies to assess local economic indicators relevant to MSME performance, including business reopening rates, employment patterns, and regional consumption activity. The analysis compares regional variations to identify factors that influence incentive effectiveness, such as administrative capacity, informality levels, access to digital tax platforms, and sectoral composition. This combined methodological approach enables a holistic evaluation of MSME tax incentives within both regulatory and economic dimensions.

RESULTS AND DISCUSSION
MSME Behavioural Responses to Post-Pandemic Tax Incentives and Their Influence on Local Economic Dynamics

The effectiveness of post-pandemic tax incentives for MSMEs is fundamentally shaped by the behavioural responses of small enterprises, which determine whether fiscal interventions translate into measurable improvements in local economic performance. Understanding these behavioural mechanisms is essential, because tax incentives do not operate in isolation; they interact with MSME motivations,

perceptions, liquidity constraints, and operational capacities. Literature in small business taxation consistently shows that behavioural and contextual variables strongly influence the uptake and impact of tax incentives. A study by Nyikos et al., (2021) demonstrated that in the United Kingdom, small firms' willingness to utilize tax relief mechanisms significantly shaped the effectiveness of fiscal support, with behavioural barriers such as low awareness and administrative difficulty reducing policy uptake. Similar dynamics are present in Indonesia, where a significant proportion of MSMEs operate informally or semi-formally, limiting their visibility to the tax system and constraining their ability to benefit from tax incentives.

Behavioural responses are closely tied to the level of business formality. In Indonesia, informality remains pervasive, with more than 60 percent of MSMEs operating outside formal regulatory frameworks. Rosyidiana & Narsa (2024) emphasize that MSMEs in informal status rarely access tax incentives because they lack tax identification numbers, avoid engagement with administrative procedures, and perceive formal registration as costly or unnecessary. This behavioural tendency reduces the reach of tax incentives and constrains their effectiveness in stimulating local economic recovery. Abdi et al., (2022) further argue that the formalization rate correlates strongly with business survival, suggesting that tax incentives may have limited effectiveness when the foundational issue of informality remains unaddressed. The local economic implications of this behavioural constraint are significant because informality weakens fiscal transmission mechanisms and reduces the magnitude of aggregate recovery.

Liquidity constraints also play a central role in shaping MSME responses to tax incentives. During the pandemic, many MSMEs faced severe cash flow shortages, and the relief provided by tax incentives may have been insufficient to offset these liquidity challenges. Evidence from Kim (2021) shows that tax incentives have stronger effects when combined with liquidity-support instruments such as subsidized credit or grants. This complementarity suggests that in Indonesia, where MSMEs often struggle to access formal finance, tax incentives alone may be inadequate to stimulate meaningful economic activity unless paired with broader support. Local economies with higher financial inclusion therefore tend to respond more strongly to tax relief policies. The behavioural dimension of liquidity management further shapes how MSMEs deploy tax savings; some may prioritize debt repayment, others may allocate resources to inventory restocking, while others may increase operational expenditures. These differences in behavioural choices directly influence the magnitude and distribution of local economic impacts.

Digital readiness significantly influences the extent to which MSMEs benefit from tax incentives. Abdi et al., (2022) highlighted that MSMEs with higher digital literacy are more likely to understand, access, and correctly apply available incentives, especially those delivered through digital tax platforms. During the pandemic, Indonesia accelerated tax digitalization, including the adoption of online reporting systems and simplified compliance mechanisms. However, regional disparities in digital access persist. MSMEs in urban centres generally exhibit higher digital adoption and faster recovery in revenue and employment, whereas rural MSMEs face persistent barriers. Studies in Southeast Asia show that digital capability not only facilitates tax incentive uptake but also enhances market access, operational efficiency, and local value creation (Jenkins et al., 2025). Thus, variations in digital readiness amplify differences in local economic outcomes, making policy effectiveness uneven across regions.

Sectoral characteristics further influence how MSMEs respond to tax incentives. Sectors heavily dependent on face-to-face interactions such as retail, hospitality, and

personal services experienced deeper contractions during the pandemic and tend to respond more intensely to temporary tax relief. Nyikos et al., (2021) observed that small enterprises in service-oriented sectors exhibited stronger behavioural elasticity when receiving tax relief compared to manufacturing-based enterprises. In Indonesia, regional economies dominated by service sectors were disproportionately impacted during the pandemic and remain more sensitive to fiscal support. The behavioural responsiveness of MSMEs in these sectors may accelerate local consumption recovery, thereby contributing to positive multiplier effects in the community. In contrast, manufacturing MSMEs may experience slower responsiveness due to the capital-intensive nature of their operations, requiring broader interventions beyond tax incentives alone. Understanding these sectoral distinctions is essential for interpreting the differentiated local economic outcomes that follow tax incentive implementation.

Information barriers remain a persistent behavioural determinant of policy effectiveness. Many MSMEs in Indonesia report limited awareness of available tax incentives, with communication gaps between government agencies and local business actors contributing to underutilization. This mirrors findings from international research. A study by Zafri et al., (2024) in Malaysia found that low awareness significantly reduced small firms' utilization of tax support programs during crisis periods. In Indonesia, these information asymmetries are exacerbated by heterogeneity in administrative capacity across regions. Regions with higher institutional capability tend to disseminate policy information more effectively, resulting in higher incentive uptake and stronger local economic impacts. Conversely, regions with weaker administrative infrastructure may experience minimal behavioural response, thereby diminishing the overall effectiveness of national tax policy.

Behavioural responses to tax incentives also interact with social and community networks. Research in Latin America by Jenkins et al., (2025) indicates that MSME adoption of fiscal incentives is strongly influenced by peer learning within local business communities. In Indonesia, local entrepreneur associations, cooperatives, and community groups often play a central role in disseminating knowledge about tax programs. MSMEs embedded within stronger networks may therefore exhibit more positive behavioural responses, leading to better economic outcomes at the local level. Conversely, isolated or micro-scale enterprises may remain disconnected from such networks, creating gaps in incentive uptake. These behavioural disparities contribute to uneven local economic recovery patterns across Indonesia.

The behavioural dimensions outlined above collectively shape how tax incentives influence local economic outcomes. MSME responses determine whether relief measures translate into higher business survival, employment retention, and local consumption activity. Regions demonstrating higher formality, digital readiness, administrative capacity, and sectoral diversity tend to convert tax incentives into stronger economic gains. This relationship underscores the importance of aligning fiscal interventions with behavioural realities on the ground. For Indonesia, understanding these behavioural mechanisms is critical for optimizing post-pandemic recovery strategies and designing more effective tax policies that can enhance both MSME resilience and local economic performance.

Local Economic Impacts of MSME Tax Incentives and Regional Variations
The effectiveness of post-pandemic MSME tax incentives can be observed through their contributions to local economic indicators such as employment recovery, business reopening rates, consumption activity, and local investment patterns. Empirical research in comparable emerging economies indicates that small business tax

incentives can generate meaningful positive effects on local economic dynamics when properly targeted and adequately implemented. For example, Jenkins et al., (2025) found that small business tax cuts in Chile resulted in enhanced cash flow, increased hiring intentions, and improved community-level consumption. In Indonesia, early administrative reports from the Ministry of Finance suggest that MSMEs receiving tax relief exhibited higher rates of operational renewal after the pandemic, especially those engaged in retail and service sectors. However, the magnitude of these impacts varies significantly across regions due to differences in administrative effectiveness, digital readiness, and economic structure.

Local employment recovery is a primary indicator of MSME incentive effectiveness. Research by Kim (2021) shows that tax incentives contribute to employment stabilization by improving business liquidity and allowing firms to rehire workers more quickly after economic disruptions. In Indonesia, regions with stronger formal MSME sectors tend to experience more pronounced employment gains following tax relief measures. For instance, provinces such as West Java and East Java, which have higher rates of MSME registration and stronger administrative infrastructure, show faster employment rebounds compared to regions with high informality such as East Nusa Tenggara. This pattern aligns with international evidence that formalization enhances fiscal transmission, enabling tax incentives to exert stronger positive effects on labour markets (Liu et al., 2022).

Business reopening rates constitute another critical dimension of local economic impact. Many MSMEs suspended operations during the pandemic, and reopening decisions depend significantly on cost considerations, expected demand, and available fiscal support. Studies in Asia show that tax incentives reduce operational burdens and encourage businesses to resume activity earlier than they otherwise would (Zafri et al., 2024). In Indonesia, tax exemptions and reduced rates appear to have facilitated reopening among micro and small enterprises, particularly in densely populated urban areas where consumption recovered more rapidly. The strength of these reopening effects is mediated by local digital adoption, because MSMEs with access to digital payment systems and online marketplaces experienced faster revenue normalization and thus made more effective use of tax savings (Abdi et al.,, 2022).

Local consumption activity is also affected by MSME tax incentives through multiplier effects. MSME operations contribute directly to household incomes and indirectly stimulate local demand for goods and services. Evidence from Latin America suggests that tax incentives for small enterprises can generate local consumption increases between 1.5 and 2.5 times the fiscal relief provided (Jenkins et al., 2025). In Indonesia, consumption patterns vary across regions, with urban centres experiencing faster recovery due to higher consumer purchasing power and stronger integration with digital commerce. Tax incentives help reinforce this recovery by enabling MSMEs to restock inventory, invest in marketing, and expand operations, thereby stimulating further local demand. However, in regions where MSMEs face persistent infrastructural limitations, the translation of tax incentives into consumption gains remains constrained.

Investment activity at the local level is another indicator influenced by tax incentives. While MSMEs often prioritize operational spending, reductions in tax burdens can indirectly enable micro-investments such as equipment purchases, store renovations, and capacity enhancements. Studies in Southeast Asia show that such micro-investments contribute cumulatively to local production capacity and economic dynamism (Kim , 2021). In Indonesia, MSMEs in manufacturing-adjacent sectors demonstrate a stronger tendency to convert tax savings into investment, although this

varies across regions. High-growth regions with diversified economic structures tend to show greater investment responses compared to structurally weak areas with limited market access.

Given these variations, it is necessary to synthesize the main regional determinants influencing the local economic impact of MSME tax incentives. The following table provides a structured overview.

Before presenting the table, it is important to note that the synthesis is grounded in validated literature and Indonesian contextual analysis. The table summarizes five core determinants that most strongly influence the effectiveness of MSME tax incentives in generating positive local economic outcomes.

Table 1. Key Regional Determinants Influencing Local Economic Impact of MSME Tax Incentives

Determinant	Mechanism of Influence on Incentive Effectiveness	Empirical Insight (Literature)
Business Formality Levels	Higher formality increases policy uptake and fiscal transmission	Nasution & Octavia (2021)
Digital Readiness	Enhances access to tax platforms and accelerates revenue recovery	Abdi et al., (2022)
Administrative Capacity	Determines quality of policy dissemination and compliance monitoring	Zafri et al., (2020)
Sectoral Composition	Service-heavy regions respond more strongly to tax relief	Nyikos et al., (2021)
Local Purchasing Power	Higher purchasing power magnifies fiscal multiplier effects	Jenkins et al., (2025)

After reviewing the determinants, it becomes clear that local economic impacts of tax incentives are not uniform across Indonesia. Regions with strong administrative structures, high levels of digitalization, and greater business formality are more likely to experience positive outcomes including job recovery, increased business reopening, and stronger consumption multiplier effects. Regions with structural disadvantages such as high informality, limited digital access, and low purchasing power exhibit weaker responses, suggesting that tax incentives alone may be insufficient to stimulate recovery. These differences underscore the importance of aligning national fiscal measures with regional development strategies to ensure equitable local economic recovery.

Structural and Institutional Factors Affecting the Long-Term Effectiveness of MSME Tax Incentives in Strengthening Local Economic Performance

The long-term effectiveness of MSME tax incentives in Indonesia depends not merely on the behavioural responses of enterprises and regional economic conditions but also on structural and institutional factors that shape how fiscal policies translate into sustained economic improvements. Tax incentives operate within an institutional ecosystem involving administrative capacity, regulatory clarity, market structure, access to finance, and local governance. Evidence from international studies

consistently highlights that fiscal instruments yield stronger long-term outcomes when supported by capable institutions and coherent regulatory frameworks. For instance, Ordynskaya et al., (2016) emphasize that the success of tax incentives is contingent upon administrative efficiency, particularly in contexts where SMEs interact frequently with tax authorities. In Indonesia, structural weaknesses such as inconsistent policy implementation, informational asymmetries, and fragmented governance across regions may limit the ability of tax incentives to produce lasting economic gains. Examining these structural and institutional dimensions is essential to understanding the sustainability of local economic recovery following the pandemic.

Administrative capacity remains one of the most critical institutional determinants of tax incentive effectiveness. Studies in emerging economies demonstrate that weak administrative infrastructure undermines policy implementation by reducing policy reach, increasing compliance burdens, and generating administrative uncertainty. Zafri et al., (2024) reported that during the pandemic, regions in Malaysia with stronger tax administration experienced significantly higher uptake of fiscal incentives and a more robust local economic recovery. This finding is highly relevant for Indonesia, where administrative capacity varies widely among regional authorities. Provinces with well-developed tax offices, digital infrastructure, and training programs for MSMEs tend to disseminate incentive information more effectively, facilitate digital onboarding, and provide accurate compliance guidance. These strengths translate into higher MSME participation in tax programs and more substantial economic impacts. Conversely, regions with limited administrative capability are less able to manage incentive programs effectively, which leads to lower uptake rates and weaker economic stimulation. In the long term, these disparities may exacerbate regional inequalities as stronger regions recover more rapidly while weaker areas lag behind.

Regulatory clarity is another structural factor influencing the sustainability of MSME tax incentive outcomes. Regulatory uncertainty creates barriers for MSMEs by increasing perceived risks and compliance complexity. Research by Janský and Palanský (2021) notes that in developing countries, unclear tax regulations discourage participation in tax systems and reduce the effectiveness of fiscal incentives. In Indonesia, MSMEs frequently cite confusion regarding eligibility criteria, calculation methods, and reporting obligations associated with tax incentives. Even when incentives are financially beneficial, regulatory opacity may reduce uptake, especially among micro-enterprises with limited accounting capacity. Regions where local authorities provide clearer guidance, outreach programs, and simplified administrative procedures tend to observe stronger policy impacts. Regulatory clarity therefore enhances the long-term sustainability of incentive effects by reducing compliance costs and strengthening MSME trust in tax institutions.

Access to finance constitutes another structural determinant of long-term incentive effectiveness. Tax incentives alone rarely provide sufficient resources for meaningful capital investment, particularly in capital-intensive sectors such as manufacturing and agribusiness. Research by Kim (2021) shows that tax incentives become significantly more effective when combined with credit guarantees, subsidized loans, or microfinance support. For Indonesian MSMEs, access to finance varies substantially across regions. Urban regions with strong banking infrastructures and fintech adoption offer more financing opportunities, enabling MSMEs to leverage tax savings for expansion, innovation, or workforce stabilization. In contrast, rural regions face credit rationing, higher borrowing costs, and limited availability of financial institutions, which curb the potential of tax incentives to support long-term growth. Enhancing financial inclusion is therefore essential for optimizing the long-term

benefits of MSME tax incentives and ensuring that small enterprises can convert fiscal relief into productive investments.

Another structural dimension pertains to market access and supply chain integration. MSMEs embedded within strong regional supply chains benefit more from tax incentives because they can reinvest profits into scaling operations, improving quality, or accessing new markets. Jenkins et al., (2025) highlight that MSMEs operating in well-integrated markets exhibit higher productivity gains and stronger contributions to local economic resilience. In Indonesia, supply chain integration varies considerably. Regions with strong industrial clusters such as West Java and Central Java provide MSMEs with greater opportunities to leverage fiscal incentives for growth. Regions lacking industrial linkages face higher transaction costs, limited access to suppliers, and reduced demand, limiting the extent to which tax incentives translate into sustained economic improvements. Strengthening regional value chains and enhancing market connectivity therefore emerges as a strategic priority for maximizing the transformative potential of tax incentives.

Local governance quality further influences the long-term outcomes of MSME incentives. Governance factors such as transparency, accountability, and coordination between local and central authorities shape the extent to which fiscal policies are implemented effectively. Research by Liu et al. (2022) indicates that local government performance significantly affects the reach and impact of MSME tax programs during crisis and recovery periods. In Indonesia, variations in governance quality across provinces influence everything from policy dissemination to compliance supervision and program monitoring. Regions with high governance effectiveness tend to demonstrate better incentive implementation and stronger local economic responses. In contrast, governance weaknesses can undermine policy impact by creating inconsistencies, delays, or bottlenecks in program administration. Enhancing local governance quality through capacity-building programs, digital transparency tools, and citizen feedback mechanisms could therefore strengthen the long-term performance of MSME tax incentives.

Human capital readiness represents an additional structural factor influencing long-term economic outcomes. MSMEs with better managerial skills, financial literacy, and technological capability are more capable of utilizing tax incentives strategically and converting relief into sustainable business improvements. Studies across Asia consistently show that human capital investments play a crucial role in enabling MSMEs to respond effectively to fiscal interventions and expand their economic contributions (Kim , 2021). In Indonesia, disparities in human capital across regions significantly affect MSME competitiveness. Regions with higher educational attainment and training opportunities tend to exhibit stronger and more durable economic recovery. Expanding training initiatives that target MSME owners and workers could therefore strengthen the effectiveness of tax incentives by enhancing managerial decision-making and operational resilience.

Long-term policy effectiveness is also influenced by infrastructure quality. Reliable transportation, logistics networks, digital connectivity, and energy supply play central roles in enabling MSMEs to scale operations and participate in broader markets. Regions with strong infrastructure can generate significant long-term gains from tax incentives by supporting expanded production, distribution, and market access. Research by UNCTAD (2022) highlights that small enterprises in infrastructure-rich regions demonstrate higher productivity and survival rates following economic shocks. In Indonesia, infrastructure development remains uneven, with significant gaps between urban and rural regions. These gaps influence the extent to which MSMEs can

reinvest tax savings into productive activities and contribute to local economic performance. Long-term reforms that prioritize infrastructure expansion and modernization can therefore magnify the structural benefits of MSME tax incentives.

Institutional coordination between central and local governments represents another key determinant of policy success. The decentralized governance structure of Indonesia means that local administrations hold significant autonomy in managing economic policies, including MSME development programs. However, misalignment between national tax policies and local implementation strategies often reduces policy effectiveness. Studies in public finance show that coordinated policy implementation enhances the ability of fiscal incentives to produce sustained regional economic benefits (Simmler and Wardell-Burrus, 2022). Improved coordination mechanisms, including harmonized policy guidelines and joint monitoring systems, can enhance the consistency and reach of MSME tax incentive programs.

Taken together, these structural and institutional factors demonstrate that the long-term success of MSME tax incentives depends on much more than the fiscal measure itself. A conducive institutional environment, strong governance capacity, supportive financial systems, human capital development, and adequate infrastructure are essential to ensuring that tax incentives translate into durable improvements in local economic performance. Without these structural supports, the gains produced by tax incentives may be short-lived or uneven across regions, perpetuating disparities rather than fostering inclusive recovery.

CONCLUSIONS

This study demonstrates that the effectiveness of post-pandemic MSME tax incentives in Indonesia is shaped by behavioural, structural, and institutional dynamics that collectively influence local economic recovery. MSME responses to tax relief are mediated by formality levels, liquidity conditions, digital readiness, sectoral composition, and local market environments. These behavioural variations interact with regional determinants such as administrative capacity, local purchasing power, and governance quality, contributing to uneven outcomes across Indonesia's diverse local economies. Structural factors including regulatory clarity, financial access, supply chain integration, human capital readiness, and infrastructure quality further determine the sustainability of incentive-driven improvements. Taken together, these findings indicate that tax incentives play an important but partial role in stimulating local economic performance, and their long-term effectiveness depends on the surrounding ecosystem that supports MSME operations.

To enhance the structural impact of MSME tax incentives, Indonesia should pursue coordinated policy reforms that strengthen administrative capacity, expand digital access, improve financial inclusion, and promote market integration. Local governments need to improve governance quality and align regional development strategies with national tax frameworks to ensure consistent and effective implementation. Investments in infrastructure and human capital are also essential to enable MSMEs to convert fiscal relief into sustainable productivity gains. These structural improvements will increase the long-term effectiveness of tax incentives and support a more resilient and inclusive local economic recovery.

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