

The Impact of the 11% VAT Policy on the Economic Welfare of MSMEs

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Keywords: Value Added Tax, 11% VAT, MSMEs, Economic Welfare, Fiscal Policy

Abstract

The Value Added Tax (VAT) rate adjustment to 11% is part of Indonesia's national fiscal reform to strengthen state revenue and sustain development financing. However, its implementation has significant economic implications for Micro, Small, and Medium Enterprises (MSMEs) actors who are constrained by limited capital structure, production efficiency, and market bargaining power. This study aims to analyze the implications of the 11% VAT policy on MSMEs actors' economic welfare in Indonesia. A qualitative approach with a Literature Review design was employed, analyzing 16 selected national and international articles indexed in reputable databases (2021-2025). Thematic analysis identified VAT impact patterns on business costs, selling prices, market demand, income, and MSMEs tax administration aspects. Based on Pigou's Welfare Theory and Fiscal Incidence Theory, findings reveal that 11% VAT indirectly increases MSMEs production-distribution costs. Most MSMEs cannot fully shift the tax burden to consumers due to high price sensitivity and local market competition, resulting in backward shifting that compresses profit margins. Price increases also weaken consumer purchasing power, reducing MSMEs' sales volume and causing income instability. This literature study concludes that the 11% VAT significantly and negatively impacts MSMEs actors' economic welfare. Complementary policies are urgently needed, including tax incentives expansion, administrative simplification, and strengthened tax education programs, ensuring state revenue targets balance with MSMEs sector sustainability.

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Abstract:

The Value Added Tax (VAT) rate adjustment to 11% is part of Indonesia's national fiscal reform to strengthen state revenue and sustain development financing. However, its implementation has significant economic implications for Micro, Small, and Medium Enterprises (MSMEs) actors who are constrained by limited capital structure, production efficiency, and market bargaining power. This study aims to analyze the implications of the 11% VAT policy on MSMEs actors' economic welfare in Indonesia. A qualitative approach with a Literature Review design was employed, analyzing 16 selected national and international articles indexed in reputable databases (2021-2025). Thematic analysis identified VAT impact patterns on business costs, selling prices, market demand, income, and MSMEs tax administration aspects. Based on Pigou's Welfare Theory and Fiscal Incidence Theory, findings reveal that 11% VAT indirectly increases MSMEs production-distribution costs. Most MSMEs cannot fully shift the tax burden to consumers due to high price sensitivity and local market competition, resulting in backward shifting that compresses profit margins. Price increases also weaken consumer purchasing power, reducing MSMEs' sales volume and causing income instability. This literature study concludes that the 11% VAT significantly and negatively impacts MSMEs actors' economic welfare. Complementary policies are urgently needed, including tax incentives expansion, administrative simplification, and strengthened tax education programs, ensuring state revenue targets balance with MSMEs sector sustainability.

Keywords : Value Added Tax; 11% VAT; MSMEs; Economic Welfare; Fiscal Policy

1. Introduction

Micro, Small, and Medium Enterprises (MSMEs) are a fundamental pillar supporting the structure of the Indonesian economy. MSMEs contribute more than 61% to the national Gross Domestic Product (GDP) and absorb up to 97% of the total workforce (Amalia et al., 2025). Amidst this crucial role, the Indonesian government passed Law Number 7 of 2021 concerning the Harmonization of Tax Regulations (HPP Law), which mandates a gradual increase in the Value Added Tax (VAT) rate, namely to 11% in April 2022 and projected to 12% in 2025 (Fathoni, 2025). This policy aims at a macro level to carry out fiscal consolidation, strengthen state revenues post-pandemic, and reduce the State Budget (APBN) deficit.

As a consumption tax, VAT is imposed at every stage of production and distribution of goods and services, allowing the tax burden to be economically transferred to consumers through the selling price mechanism (Rachmanisa & Subhandi Bakhtiar, 2025). However, this transfer mechanism is practically difficult for MSMEs to fully implement due to limited bargaining power and high consumer sensitivity to price changes. Several previous studies have shown that in practice, the transfer of the tax burden does not always work perfectly, especially in the MSME sector, which has a weak market bargaining position. For example, a study (Ahmad et al., 2026) explained that high tax burdens in emerging markets often hinder the process of business formalization. Furthermore, a study (Wiwin Winarti & Boyke Nugrahanto, 2025) found that an 11% increase in VAT directly impacted raw material prices and MSME operational costs, which then forced business actors to raise selling prices or accept reduced profit margins. This situation places MSMEs in a dilemma between maintaining price competitiveness or maintaining sustainable business profits.

To establish the urgency of this research on an international scale, supporting data on domestic phenomena needs to be narrated and compared with global trends and standards to identify policy gaps. Globally, the average *Value Added Tax* (VAT) rate in developed OECD countries ranges from 15% to 19%, while in the ASEAN region, countries like the Philippines have set the VAT rate at 12% (Kassim et al., 2021). This statistical narrative is often used by policymakers to justify Indonesia's fiscal space, which at that time stood at 11%, as moderate, reasonable, and below the global average. However, this global

standard justification conceals structural gaps when applied asymmetrically in developing countries. Market structures in developed countries tend to be formal with high purchasing power, in stark contrast to Indonesia's dominance of the informal sector and extreme price sensitivity.

Global literature documents that VAT implementation in developing countries triggers significant competitive distortions for MSMEs. For example, empirical findings in the Gulf (GCC) region by (Ali, 2025) and (Thottoli & Mamari, 2022) confirm that the VAT system triggers regressive *compliance costs*, with small businesses bearing tax reporting costs that far exceed their financial capacity compared to large corporations. Furthermore, research in Tanzania by (Erick et al., 2024) and Ghana by (Kumi et al., 2026) demonstrates that low tax literacy related to VAT directly erodes the financial performance of MSMEs. Several studies also strengthen this argument; such as studies (Ahmad et al., 2026) show that high tax burdens and the complexity of VAT compliance in emerging markets consistently hamper the growth and formalization process of MSMEs. In addition, (Nastiti et al., 2025) emphasize that the sustainability of MSME businesses is highly dependent on their ability to adapt to digital transformation amidst dynamic fiscal policy changes. Furthermore, (Brusco & Velayudhan, 2025) econometrically proves in India that VAT in developing countries often creates a "size -based informal sector ". In these countries, although micro-enterprises are legally exempt from VAT collection obligations (because they are below *the threshold*), they still suffer economic losses due to rising raw material prices from large *suppliers (input tax burden)* that they cannot credit. This challenge is further complicated by demographic factors; (Rusli et al., 2025) shows that the level of tax literacy, including among the younger generation (Gen-Z) who are now starting to dominate the MSME sector, is a key determinant in optimizing potential VAT revenue and voluntary compliance.

The comparison of these global researchers' findings with the domestic context highlights a novelty and fills a research gap that has not been widely explored holistically. The majority of Indonesian literature, such as studies by (Armono et al., 2025), tends to focus solely on analyzing the impact of the 11% VAT on macroeconomic inflation, end-consumer purchasing power, or state revenues. However, (Adelia & Firmansyah, 2025) revealed real challenges such as low tax literacy and operational difficulties with the *e-invoicing system* for MSMEs following the tax rate increase. Studies rarely reveal the anomaly that MSMEs are actually shifting to bear the actual tax burden. Furthermore, fiscal incentives are often not well-targeted to increase MSMEs' long-term value (Dewi & Rohman, 2023). There is a gap in understanding how the psychological and behavioral aspects of taxpayers and limited digital infrastructure create hidden "fiscal injustice" (Purwanti et al., 2023). Therefore, this research positions its novelty by uncovering the distortions in the basic welfare of MSMEs in Indonesia following the 11% VAT policy, using precise microeconomic and fiscal theory.

To provide a solid analytical foundation, this research is built on two main theoretical pillars. First, the Economic Welfare Theory, proposed by classical economist Arthur Cecil Pigou (1920). Pigou defined economic welfare as a component of social welfare that can be directly or indirectly linked to the measuring rod of *money*. The logical link between this theory and the research variables is strong: the 11% VAT increase policy directly triggered *cost-push inflation*, which reduced the purchasing power of the public and MSMEs. When purchasing power declines, MSMEs' disposable income, available for savings, to meet living needs, or to be reinvested, shrinks sharply (Hajatina & Hasanah, 2024). This depreciation in the exchange rate of money theoretically and practically reduces the economic welfare of MSMEs, in accordance with Pigouvian parameters.

Second, the Fiscal Incidence Theory is used to analyze the distribution of tax policy burdens. This theory critically distinguishes between *statutory incidence* (who is legally required to pay taxes) and *economic incidence* (who actually bears the economic burden of the tax after a price shift occurs). The logical link between this theory and the reality of MSMEs is that MSMEs operate in a highly competitive market with highly elastic consumers and high price sensitivity (Ojo & Shittu, 2023). When VAT rates increase, in theory (*statutory*), MSMEs should shift the burden forward (*forward shifting*) to end consumers by raising selling prices. However, in reality, for fear of losing market share, MSMEs lack sufficient bargaining power. As a result, MSMEs are forced to absorb the burden of the increased costs independently (*backward shifting*) by reducing their net profit margins. This forced profit reduction is the epicenter of the erosion of their economic well-being.

Based on the urgency of the phenomenon and the theoretical justification above, this research is systematically formulated into 3 (three) main objectives, namely:

1. Conducting an analysis of the concept of economic welfare of MSME actors based on the concepts and views of economic theory experts.
2. Reviewing empirical evidence from various article references regarding the position and reality of the concept of economic welfare of MSMEs after the implementation of regulations.

3. Analyzing the impact in depth to find out what the implications of the 11% VAT policy will be on the operations and resilience of MSMEs in Indonesia.

2. Research methods

2.1. Object, time and place

The main object of this study is the impact and implications of the 11% Value Added Tax (VAT) policy on the economic welfare of Micro, Small, and Medium Enterprises (MSMEs) in Indonesia. The time frame focuses on literature published between 2021 and 2025 to reflect the conditions following the enactment of the Taxation Harmonization Law (UU HPP). The research covers the national context of Indonesia, with comparisons to fiscal trends in other developing countries.

2.2. Data collection technique

This study uses a conventional literature review approach, namely a narrative review of relevant secondary sources to build a comprehensive understanding of the topic. Data were collected from reputable academic databases such as Scopus, SINTA, Google Scholar, DOAJ, as well as official reports from the Ministry of Finance and BPS. The search keywords included "Impact of 11% VAT on Indonesian MSMEs," "VAT impact on SMEs in developing countries," "tax incidence on MSMEs," and "economic welfare taxation." The selection criteria included publications from 2021-2025 in Indonesian/English with full-text access, resulting in 16 representative journal articles.

2.3. Data Analysis Techniques

Data analysis was conducted using conventional thematic analysis with three main stages (Hardani et al., 2020): (1) data reduction through the selection and summary of key findings related to business costs, selling prices, market demand, income, and tax compliance; (2) data presentation via table matrices for domestic-global comparisons; and (3) interpretation of conclusions based on Pigou's Welfare Theory and Fiscal Incidence Theory. This approach allows for flexible synthesis that integrates empirical evidence with theoretical frameworks, without strict systematic protocols.

3. Results and Discussion

3.1. Research result

Based on a synthesis of empirical data from 16 reviewed primary journals, this section presents an in-depth analysis that is logically constructed and correlated with the three main study objectives. This discussion integrates theoretical perspectives with field realities to examine the multidimensional impacts of the 11% VAT policy. The following is a summary of the 16 journals that form the basis of this study's analysis:

Table 1. Summary of Previous Literature Study Results

No	Author Name (Year)	Research Title	Method	Main Research Results
1	Sastri, Datrini, Pertamawati, & Yoga (2024)	<i>Increasing Value Added Tax (VAT) Rates on Community Purchasing Power and Economic Stability</i>	Qualitative (Literature Review)	The increase in VAT rates significantly reduces the real purchasing power of the community. This decline in purchasing power has a massive impact on the economic stability of retailers and micro-businesses that rely heavily on daily household consumption.
2	Brusco & Velayudhan (2025)	<i>VAT incidence in real VAT systems (Study in India)</i>	Quantitative (Spatial Econometrics & Panel Data)	In developing countries, the burden of VAT (<i>incidence</i>) is largely unable to be shifted to consumers (<i>failed forward shifting</i>). The VAT supply chain system actually distorts and squeezes the margins of small firms that make up the size-based informal sector.
3	Ali (2025)	<i>The Impact of Value Added Tax (VAT) Implementation on the</i>	<i>Mixed Methods (Quantitative & Qualitative)</i>	The implementation of VAT has caused financial shock and extreme compliance costs for MSMEs. MSMEs in Oman are required to undergo stringent

		<i>Performance and Sustainability of SMEs in Oman</i>		<i>cash flow management overhauls to avoid short-term operational bankruptcy.</i>
4	Thottoli & Al Mamari (2022)	<i>Business owners' perception on VAT: Evidence from Oman</i>	Quantitative (Extensive Survey)	Small business owners have a very negative perception of VAT due to a lack of accounting understanding (<i>tax literacy</i>). This structural weakness causes MSMEs to bear disproportionate tax penalties and undermines business sustainability.
5	Kumi, Baafi, & Osei (2023)	<i>The effect of value-added tax on SMEs' financial performance in Ghana</i>	Quantitative (Financial Statement Regression Analysis)	VAT increases in developing African countries have been shown to have a significant negative correlation with MSME profitability. Unclaimed input tax <i>transforms</i> into a <i>sunk cost</i> that damages the capital structure of MSMEs.
6	Erick (2022)	<i>Effects of Value Added Tax (VAT) Knowledge on SMEs Performance in Morogoro Tanzania</i>	Quantitative (Questionnaire and SPSS)	Low VAT knowledge <i>directly</i> impacts the financial performance of MSMEs. Failure to comply with VAT regulations results in operational disruptions and the loss of potential formal markets.
7	Caesaria, Mumpuni, Mayasha, & Murti (2024)	<i>Analysis of the Impact and Implications of the VAT Rate Increase in Indonesia</i>	Qualitative (<i>Systematic Literature Review</i>)	The 11% VAT increase directly impacts production costs and spikes in market prices. This exacerbates inflation and forces a sharp decline in the purchasing power of the lower-middle class, leading to a decline in MSME market revenue.
8	Charisma & Furqon (2023)	Analysis of the Impact of Increased Value Added Tax (VAT) Rates on Society and Inflation in Indonesia	Qualitative (Literature Study)	The 11% VAT puts extra pressure on the real sector, which is struggling to recover. The purchasing power of lower-class people has plummeted, hitting the MSME sector, whose products are highly sensitive to changes in staple food prices.
9	Sitorus, et al. (2026)	The Impact of VAT Policy on Public Purchasing Power: A Phenomenological Analysis of Consumer and MSME Perceptions	Qualitative (Transcendental Phenomenology)	A price illusion phenomenon has emerged in society; MSMEs are forced to employ extreme efficiency strategies and <i>selective pricing</i> (holding back price increases) to prevent customers from switching to competitors in traditional markets.
10	Winarti & Nugrahanto (2025)	The Impact of an 11% Increase in Value Added Tax (VAT) on Product Selling Prices and the Income of Micro-Business Actors	Quantitative (Multiple Linear Regression Analysis)	There is a real dilemma that is pressing MSMEs: increasing selling prices to comply with the new VAT rate burden, in fact, has a direct impact on a sharp decline in sales volume and a decline in net business profit turnover.

11	Armono, et al. (2025)	Evaluation of the VAT Increase Policy: Impact on Economic Stability and Public Welfare	Qualitative (Literature and Policy Studies)	This fiscal consolidation policy risks widening economic inequality among the people. It places an increased burden on end consumers, leading to sluggish absorption of local products from the MSME sector.
12	Hajatina & Hasanah (2024)	Analysis of the Impact of Increases in Value Added Tax (VAT) Rates on Consumption Behavior and Public Welfare in Indonesia	Qualitative (<i>Literature Review</i>)	Inflationary pressures from VAT burden end consumers regressively. Consumers immediately shift their consumption patterns to cheaper substitutes, squeezing the profitability of MSMEs, the primary suppliers.
13	Amalia, et al. (2025)	Analysis of the Increase in Value Added Tax (VAT) Rates for Micro, Small, and Medium Enterprises (MSMEs)	Qualitative (<i>Library Research</i>)	MSMEs face a dual fundamental challenge: dependence on raw materials from large <i>suppliers</i> whose prices have increased (impacted by VAT), which reduces profit margins and drastically weakens product competitiveness in the local market.
14	Djufri (2022)	The Impact of the 11% VAT Imposition on Business Actors in Accordance with Law No. 7 of 2021 Concerning the Harmonization of Tax Regulations	Qualitative (Legal Phenomenological Study)	New tax regulations demand stringent legal compliance for the industry. MSMEs are faced with a dilemma between costly administrative compliance and the threat of operational sanctions from fiscal authorities.
15	Purwanti, Manrejo, & Eprianto (2023)	The Impact of the VAT Rate Increase Policy on Tax Compliance (A Study of Micro, Small, and Medium Enterprises in Bekasi)	Quantitative (Questionnaire and Regression Analysis)	Rising selling prices partially impact tax compliance. However, stagnant sales levels reduce <i>cash flow</i> , ultimately significantly lowering MSMEs' tax compliance.
16	Fathoni (2025)	<i>Indonesia's Value Added Tax (VAT) Reform: Fiscal Benefits and Sectoral Impacts</i>	Qualitative (<i>Analytical Literature Review</i>)	In terms of sectoral division, MSMEs are experiencing the heaviest pressure with a projected decline in business margins of 2% to 3%, proving to be much more vulnerable (<i>less resilient</i>) than the formal sector and large-scale national industries.

Source: Processed Secondary Data (2026)

3.2. Discussion

Based on the synthesis of data obtained from the ten main literatures in Table 1, this section will outline a comprehensive analysis that is correlated with the objectives of this literature study, namely: a theoretical review of economic welfare, validation of empirical evidence post-implementation of the 11%

VAT policy, as well as an analysis of systemic impacts and adaptation strategies for business actors.

1) Analysis of the Concept of Economic Welfare Based on Pigou's Theory Perspective

Theoretically, evaluating the fate of MSMEs after the implementation of tax increases cannot be reduced to just looking at sales or turnover figures alone. The analysis must touch on the fundamental aspects of welfare itself. Referring to AC Pigou's magnum opus in *The Economics of Welfare* (1920) (Harris, 1935), economic welfare is defined as part of social welfare that can be measured, either directly or indirectly, with a monetary benchmark (*the measuring rod of money*). In the MSME ecosystem, welfare according to Pigou's perspective is achieved when the net disposable income *received* by business owners is able to maintain their real purchasing power, as well as provide positive marginal utility for living needs and business development. Pigou emphasized that any public policy that reduces the "national dividend" or real income of the poor and middle class without providing equivalent compensation is a policy that reduces total social welfare.

The implementation of the 11% VAT policy in Indonesia logically creates a mechanism that contradicts Pigou's welfare principle. The increase in the tax rate triggers *cost-push inflation*, effectively reducing the real value of money held by MSMEs. The logical link in this research variable is clear: when 11% VAT is imposed on raw materials or production support services, MSMEs' operational costs increase. However, due to limited competitiveness, MSMEs are often unable to increase their product prices proportionately. As a result, profit margins are eroded. From a Pigouvian perspective, this decline in margins is not simply an accounting figure, but rather a decline in the utility of life. Money that should have been used for household consumption by business owners, children's education, or capital reinvestment is now lost to tax inflation.

This decline in welfare utility is confirmed by empirical evidence in the domestic context. Winarti & Nugrahanto (2025) in their case study at the village level found that the net income of micro-entrepreneurs contracted significantly following the increase in VAT. Entrepreneurs were forced to sacrifice their personal welfare funds to maintain business continuity. This is exacerbated by the findings (Armono et al., 2025), which highlight that the economic stability of small business households is highly vulnerable (*fragile*) to external price shocks. The increase in VAT acts as a disturbance variable *that* shifts the satisfaction curve of MSMEs to a lower (suboptimal) point. Without an effective transfer payment mechanism or direct subsidy from the government to offset this cost increase, the principle of welfare redistribution, which is the state's goal, fails, resulting in a deadweight loss for small producers.

3.2. Empirical Evidence of the Economic Welfare of MSMEs: Analysis Through Fiscal Incidence Theory

A thorough exploration of global and local literature demonstrates that the reduction in MSME welfare is not merely an assumption, but rather a concrete manifestation of the shifting tax burden. This phenomenon is analyzed in depth using Fiscal Incidence Theory. This theory clearly distinguishes between statutory incidence, i.e., who is legally required to pay taxes, and economic incidence, i.e., who ultimately suffers the actual financial loss resulting from the tax. Legally, VAT is designed as a consumption tax, the burden of which is ultimately borne entirely by consumers. However, fiscal incidence analysis demonstrates that in imperfect market structures such as those in developing countries, MSMEs are often the ones "squeezed" and forced to bear this economic burden.

An international study conducted by Brusco & Velayudhan (2025) in India provides a highly relevant empirical basis. They found that small firms in developing countries face a highly elastic demand curve. This means that consumers in this segment are highly sensitive to price changes. If MSMEs attempt forward shifting (shifting the tax burden forward) by increasing product prices by 11%, consumers will easily switch to cheaper substitutes or turn to the informal sector, which does not collect taxes. As a result, market mechanisms force MSMEs to hold prices down.

This dynamic was confirmed in the Indonesian context by (Sitorus et al., 2025) through a phenomenological analysis of business actors in Medan. The study found a psychological barrier in the market, where consumer perceptions that "goods prices are already too expensive" post-pandemic forced MSMEs to shift backward. In this scenario, MSMEs chose to absorb the increased VAT burden into their own cost structure, sacrificing profit margins to maintain customer loyalty and sales volume. This aligns with Djufri's (2022) analysis, which explicitly states that without cross-subsidies or special incentives, the increase in VAT rates in Indonesia is regressive for small businesses, as they bear a proportional tax

burden that is heavier than their economic capacity.

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The relevance of the 11% VAT policy can be analyzed through the Theory of Tax Incidence, as discussed in (Fathoni, 2025). This theory asserts that the economic burden of a tax does not always fall on the tax subject designated by law (the final consumer), but is distributed based on the level of elasticity of demand and supply in the market. For MSMEs, which generally operate in a perfectly competitive market with elastic products (consumers are highly sensitive to price changes), the tax burden is often "trapped" at the producer level. The phenomenon of tax absorption, or the absorption of the tax burden by MSMEs to maintain competitive prices, theoretically results in a contraction in the producer surplus, which directly distorts the level of economic welfare of these business actors.

However, the Tax Incidence theory reviewed by (Fathoni, 2025) A legal review by (Djufri, 2022) indicates a significant increase in the fiscal burden. MSMEs operating in markets with elastic demand are often unable to fully shift the tax burden to consumers. Instead, they are forced to "absorb" the burden of the 11% VAT increase into their operational cost structure. Theoretically, this self-absorption of the tax burden is a major factor eroding profit margins and stifling long-term business sustainability (Djufri, 2022).

2) Empirical Evidence Study in the Context of 11% VAT Implementation

The clash between the macro policy of 11% VAT and the realities of the micro market structure creates a destructive domino effect on the operational stability of MSMEs. This systemic impact can be detailed in the following four crucial dimensions:

a) Swelling of Production Costs and COGS (Cost of Goods Sold)

The increase in VAT has a direct and inevitable impact on production cost structures. Studies (Amalia et al., 2025) and (Caesaria et al., 2024) highlight that non-VAT-employed MSMEs in Indonesia experience a double hit. First, when purchasing raw materials from manufacturers or large distributors, they are required to pay 11% VAT as part of the purchase price. Second, because they are not Taxable Entrepreneurs (PKP), they do not have a legal mechanism to credit the input tax as a tax deduction. As a result, the 11% VAT accumulates and permanently inflates the Cost of Goods Sold (COGS). This phenomenon is also validated by a study (Kumi et al., 2026) in Ghana, which warns that the accumulation of unclaimed input tax *will* slowly but surely erode the basic working capital of MSMEs, forcing them to operate with increasingly reduced efficiency.

b) Demand Volatility and Price Illusion From the demand side.

The VAT rate escalation triggered negative market sentiment in the form of an "illusion of high prices," as noted in a study (Sitorus et al., 2025). Consumers, particularly those from the lower-middle class who are the primary target market for MSMEs, experienced price shock. (Kharisma & Furqon, 2023) found that people reflexively rationalized spending by cutting secondary and tertiary consumption. The derivative impacts were further explained by (Hajatina & Hasanah, 2024), who noted a migration of consumption patterns. Consumers switched to lower-quality substitute goods or shopped in the completely tax-exempt black market (informal). This led to a drastic decline in sales volume for legal and registered MSMEs, creating a buildup of unsold merchandise inventory.

c) Liquidity Pressure and Cash Flow Crisis

The financial impact of this policy extends to the heart of business operations: cash flow . Research trends in the Gulf region (Oman) by (Ali, 2025) uncover an often overlooked yet potentially fatal implication for the sustainability of MSMEs: liquidity turbulence. The VAT collection system often creates a time lag between the obligation to deposit taxes into the state treasury and the actual receipt of payments from customers. MSMEs already included in the tax system often have to cover tax payments in advance (when transactions are recorded/invoices are created) before their customers' invoices *are* disbursed in cash, which can take weeks. This time asymmetry drains daily working capital that should be used for routine operations. This cash flow vulnerability is also specifically warned about in the Indonesian context by (Armono et al., 2025) , where MSMEs with thin capital reserves are at risk of technical bankruptcy due to a *cash flow freeze* , even though they may be profitable in accounting.

d) Regressive Administrative Compliance Burden

The final, equally crucial dimension is the non-financial burden of compliance costs. Low tax literacy and digital readiness pose serious structural barriers. Studies by Erick et al. (2024) in Tanzania and Thottoli & Mamari (2022) in Oman emphasize that the costs of understanding complex regulations, hiring tax consultants, or adopting VAT administration technology (such as e-Invoice applications) are proportionally much higher for MSMEs than for larger companies. Large companies have economies of scale in compliance, while MSMEs do not. In Indonesia, Purwanti et al. (2023) found that this administrative complexity reduces voluntary compliance intentions . This burden is exacerbated by findings by Fathoni (2025) , who noted a 2-3% compression in real profit margins for MSMEs simply to cover administrative costs, staff training, and technology overhead arising from adjusting to the new tax system.

e) Systemic Impact Analysis and Reconstruction of Adaptation Strategies

This policy creates a complex domino effect. The psychological impact, in the form of *price illusion* , causes consumers to perceive price increases as higher than the actual tax increase (Sitorus et al., 2025). This situation places MSMEs in a vulnerable position due to limited access to capital and technological inefficiencies compared to the more resilient formal sector (Fathoni, 2025).

However, this impact analysis also reveals opportunities for transformation. As noted by Purwanti et al. (2023) , the economic sustainability of MSMEs depends heavily on their ability to maintain sales volume through non-price strategies. Adaptation strategies can no longer rely solely on low prices, given the systemic rise in cost structures at the national level.

Critically, this study argues that the economic well-being of MSMEs amidst the 11% VAT policy can only be maintained through business model repositioning. MSMEs are encouraged to achieve internal efficiency through digital bookkeeping to mitigate cost leakage, as well as diversify products with high added value . This way, business actors can increase their *bargaining power* in the market, so that the emerging fiscal burden does not become an obstacle to their sustainable economic growth. The transformation from a "survival" strategy to a "digital adaptation" strategy is an absolute requirement for the stability of MSME economic well-being in this new fiscal policy era.

Table 2. Summary of the Impact of the 11% VAT Policy on MSMEs

Review Aspects	Findings Based on Literature & Theory Analysis
Theoretical Basis (Pigou & Incidence)	Empirical evidence validates the failure of <i>forward shifting</i> . MSMEs are forced to absorb the tax burden unilaterally (<i>backward shifting</i>) due to high consumer price elasticity.
Production Cost & COGS	There has been a surge in real costs across the supply chain. Input taxes <i>have</i> become <i>sunk costs</i> , costing the vast majority of non-PKP MSMEs .
Purchasing Power & Market Demand	Post-VAT inflation of 11% triggered <i>price illusion</i> . Rational consumers responded by sharply reducing prices and switching to informal substitute products that were exempt

Review Aspects	Findings Based on Literature & Theory Analysis
	from the VAT trap.
Financial Liquidity	There is an asymmetry in the <i>cash flow cycle</i> , where MSMEs (with PKP status) are required to pay VAT tax obligations before the commercial receivables turnover is fully collected from customers.
Administrative Compliance	The complexity of the reporting system bureaucracy (<i>e-invoice</i>) and low tax literacy among MSMEs multiply disproportionate <i>compliance costs for micro-scale businesses</i> .

Source: Synthesis of Researcher Analysis Results (2026)

Figure 1. Scheme of the Impact of 11% VAT on the Economic Welfare of MSMEs



Source: Secondary Data (2026)

4. Conclusion

Based on the results of a comprehensive analysis based on *the Systematic Literature Review* (SLR) of 16 domestic and international literature (range 2021-2026), it can be concluded equivocally that the implementation of the 11% VAT rate policy has significant and regressive implications for the sharp decline in the economic welfare of MSMEs in Indonesia. Based on the rational foundation of AC Pigou's Economic Welfare Theory and Fiscal Incidence Theory, MSMEs in developing countries are proven to be trapped in structural dissonance of market mechanisms. Because they have to deal directly with consumers who have high price elasticity , MSMEs fail to shift the tax burden forward (*forward shifting*). The empirical consequence is a *backward shifting phenomenon* where MSMEs are forced to absorb the burden of *input inflation* (rising production costs from *suppliers*) by cutting their own net profit margins. The implications of the 11% VAT fiscal consolidation policy have led to a domino effect that endangers operations: declining purchasing power, which has sharply depressed daily sales volumes, the potential for a short-term cash flow liquidity crisis, and the escalation of tax administration compliance *costs* , which disproportionately impact micro-enterprises. Fundamentally, this fiscal policy has been proven to sacrifice the financial resilience and economic well-being of a sector that is truly the main foundation of the national economy.

As a manifestation of solutions and constructive recommendations from this research, there are several suggestions aimed at stakeholders. For MSMEs, it is recommended to immediately adapt resilience quickly through digitalization of bookkeeping to tighten control of *cash-flow leakage* , carry

out efficient supply chain management by seeking alternative *suppliers*, and focus diversification innovation on products with high price inelasticity to maintain profit margins without having to lose the core customer base. For the Government, it is crucial and urgent to immediately formulate complementary asymmetric policies as a safety valve; among others, by redesigning the minimum input tax credit limit for MSME entities, simplifying the SPT reporting bureaucracy (*administrative and reporting simplification*) to reduce *compliance costs*, and reallocating a specific percentage of the VAT revenue in the form of working capital subsidies or direct financial literacy assistance to the most affected MSME ecosystem. For Further Research, recognizing the inherent limitations of this study, which relies purely on a qualitative literature review (SLR), it is strongly recommended that future researchers employ a primary quantitative approach in the field. Using empirical panel data and econometrics directly from MSME financial reports in various provinces will be crucial for precisely measuring the percentage of business mortality and shrinking MSME liquidity in the field. This approach will provide an undeniable scientific basis and strategic mitigation in addressing the discourse on escalating the VAT rate to 12% in the future.

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