



Abstract

The continuous decline of oil and gas prices in the early 1980s was often suggested as one of the reasons Indonesia should focus more on tax revenues to finance its government. While income tax has great potential to be the main source of funding for the government, changes in income tax could also affect Indonesian workers' wage income. These changes in income, which are usually explained to have income and substitution effects, could affect Indonesia's labor supply in terms of employees' working hours and labor participation rate. Hence, this paper examines the effect of taxation on labor supply in Indonesia by using econometric and statistical analysis. This paper's aim is to establish a better understanding of the effects of the implementation of tax reforms on changes in Indonesia's supply of labor, so proper measures can be taken. The analysis will then focus on Indonesia's 1994 tax reforms, because their main characteristic was a significant reduction in taxes. The result shows that different sex and age groups of Indonesian workers respond in different ways to taxation changes. The Indonesian Government should make an effort to determine the best policies that can stabilize labor supply in the Indonesian labor market. At the same time, the government should also maintain stability in its tax revenue.