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Analysis of the Impact of Import Tax Increases on Business Income in Timor Leste

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Abstract: Fiscal policy, particularly import tax policy, plays a crucial role in a country's economic stability, particularly for developing countries like Timor-Leste, which still rely heavily on imported goods. Import tax increases can have significant consequences for business activities, particularly in terms of cost structure, selling prices, and corporate revenue. This study is a literature review aimed at conceptually analyzing the impact of import tax increases on business revenue. The method used is a literature review of various sources, such as scientific journals, government reports, and relevant economic publications. The results of the study indicate that increases in import tariffs generally tend to increase production input prices, reduce product competitiveness, and reduce corporate profit margins, ultimately resulting in decreased business revenue. However, in some contexts, such policies can also encourage businesses to switch to local products and improve operational efficiency. Thus, the effect of import tax increases on business revenue is highly dependent on the readiness of businesses to adapt and domestic market conditions. This study provides a theoretical basis for further empirical research and can be used as a consideration by the Timor-Leste government in formulating a more balanced tax policy between fiscal needs and business sustainability.

Keyword: Import Tax, Business Income, Fiscal Policy

INTRODUCTION

Taxes are a crucial instrument in fiscal policy used by governments to regulate economic growth and increase state revenues. In many developing countries, including Timor-Leste, import taxes are one type of tax that significantly contributes to state revenue. These taxes are levied on goods imported from abroad and serve not only as a source of revenue but also as a means of protecting domestic industry (Musgrave & Musgrave, 2014).

In recent years, Timor-Leste has begun implementing stricter import tariff policies in an effort to stabilize the state budget. According to information from the Timor-Leste Customs Authority, the basic import duty rate is currently set at 5% of the CIF (Cost, Insurance, and

Freight) value of imported goods. Furthermore, the government also imposes a 2.5% sales tax calculated on the total import value, including import duties and excise duties (Customs Authority TL, 2023). Overall, the average effective import tariff in Timor-Leste ranges from 2.5% to 10%, depending on the type of goods and HS classification (WITS-UNCTAD, 2024). This policy directly increases costs for businesses, especially those heavily reliant on imported raw materials or consumer goods.

Table 1. Import Tax Rates in Timor Leste

No	Types of Taxes	Tariff Level
1	Customs/import duty	5% of the CIF value of imported goods
2	Sales tax	2.5% of CIF value + import duty + excise duty
3	Effective average rate	± 2.52% according to UNCTAD/WITS data, with a maximum rate of up to 10%

Source: Timor Leste Customs (2025)

These tariff increases have the potential to increase the prices of raw materials and consumer goods at the distributor and end-consumer levels. For businesses, particularly SMEs, the additional burden of import tax increases can lead to reduced profit margins and weaken product competitiveness in the domestic market (Krugman et al., 2018). A study by Santos & Guterres (2021) showed that the import tax increase in the electronics sector caused a 20% decline in sales volume in the first six months in Dili, Timor-Leste. The report also stated that some businesses experienced a 15% decline in net profit due to increased operational costs. Wahyuni (2020) observed a similar trend, asserting that import tax increases in developing countries can weaken the financial structure of local businesses if not balanced with incentives or other compensatory policies.

However, not all impacts of this policy are negative. Some businesses have begun shifting their use of imported raw materials to local ones to reduce costs and increase efficiency. The World Bank (2023) noted that in the food and beverage sector, most businesses in Timor-Leste have begun strengthening local supply chains in response to the increase in import taxes. Therefore, the impact of this policy is not entirely negative, but depends on businesses' readiness to adapt and other policy support.

As a developing country, Timor-Leste remains heavily dependent on imported goods, both for consumption and industrial raw materials. In this context, government policies regarding import taxes directly impact cost structures and business continuity, particularly in the trade and manufacturing sectors. Import tax increases that are not accompanied by other policy support can reduce business profit margins, hinder business growth, and even risk reducing the private sector's contribution to the national economy.

The urgency of this research is further heightened by the lack of academic studies specifically examining how import tax increases affect business revenues in Timor-Leste. Yet, the government desperately needs such data and analysis as a basis for evaluating fiscal policy. Businesses also require scientifically based information to develop adaptive strategies for addressing changing economic policies.

This literature review is expected to provide a comprehensive conceptual understanding of the impact of import tax increases on business revenues. The results will be useful not only for academics but also for policymakers and economic actors in Timor-Leste. This research can serve as a basis for further, more empirical research and provide input for formulating fiscal policies that are more responsive to the needs of the business world.

The objective contains the question of the article that must be explained in the discussion and answered in the conclusion.

METHOD

This research uses a descriptive qualitative approach with a literature review method. This approach was chosen because it aimed to explore and analyze various scientific literature and official documents discussing the impact of import tax increases on business revenues, both globally and in the context of developing countries like Timor-Leste. The literature review enabled researchers to develop a comprehensive conceptual understanding based on previous findings (Snyder, 2019).

The data sources in this study come from secondary literature, such as national and international scientific journals, official reports of Timor Leste government agencies (e.g., the Directorate General of Customs and Excise), and publications from international organizations such as the World Bank, UNCTAD, and WITS. Literature selection focused on sources published between 2014 and 2024, to ensure the relevance and currency of the information. Selection criteria include: (1) direct relevance to the topic of import taxes and business income, (2) quality of sources that have undergone a peer-review process, and (3) study contexts that are appropriate to the conditions of developing countries.

The study procedure was carried out through several stages: first, identifying keywords such as import tax, business income, fiscal policy, and Timor Leste; second, searching for articles and documents through online databases such as Google Scholar, Scopus, JSTOR, and the World Bank Open Knowledge Repository; third, selecting literature based on the relevance and quality of the sources; and fourth, content analysis to identify patterns, trends, and important findings from each source (Boell & Cecez-Kecmanovic, 2015).

Data were analyzed using descriptive-qualitative analysis techniques, focusing on narrative synthesis and theoretical interpretation of previous studies. This approach helped researchers develop a conceptual understanding of how import tax increases impact business revenues and the factors influencing them. The study's findings are expected to contribute to the development of further research and more adaptive fiscal policies in Timor-Leste.

RESULT AND DISCUSSION

Import Tax

Import taxes are a type of tax imposed by the government on goods entering a country from abroad. These taxes serve not only as a source of state revenue but also as a tool to regulate international trade and protect domestic industries (Musgrave & Musgrave, 2014). In an open economy, import taxes can impact the price of goods, consumer demand, and the cost structure of domestic businesses.

According to Krugman, Obstfeld, and Melitz (2018), import taxes are a type of tariff policy that directly impacts the prices of imported goods in the domestic market. Imposing tariffs will increase the selling price of imported goods, ultimately reducing the competitiveness of foreign products compared to domestic ones. However, in the short term, high tariffs can increase costs for local companies that rely on foreign raw materials or components, thus reducing business efficiency and profitability.

In developing countries, import tax policies are often used as a strategy to increase state revenue due to weak domestic tax structures. However, this has the potential to cause distortions in business activities, particularly in the trade and manufacturing sectors (Tanzi &

Zee, 2000). For example, increasing import tariffs can encourage companies to raise their product prices, reduce production volumes, or even reduce their workforce.

In practice, import tariffs can be classified into several types, such as ad valorem (a percentage of the value of the goods), specific (a fixed rate per unit of goods), or a combination of both (Blonigen & Prusa, 2016). In Timor Leste, the government imposes an ad valorem tariff of 5% on most imported goods, plus a 2.5% sales tax, as regulated by the Customs Authority (Customs Authority TL, 2023).

Import taxes in Timor-Leste are part of the tax system regulated by national law and implemented by the Timor-Leste Directorate General of Customs and Excise. Import taxes serve as a fiscal tool to support state revenue and regulate the flow of goods from abroad into the domestic market.

According to East Timor Tax Law No. 8/2008 concerning Customs Tariff and Tax Code, goods imported into the territory of Timor Leste are subject to various types of levies, namely:

1. Import Duty (Import Duty) – a tariff imposed on all imported goods, except those exempted by law.
2. Sales Tax on Imports (STI) – a sales tax on imported goods similar to VAT/PPN.
3. Excise Tax on Imports – excise tax on certain goods such as alcohol, cigarettes, luxury vehicles, etc.

Article 2 of the Law states that: "The customs duty shall be levied on imported goods according to the rates specified in the Customs Tariff Schedule and shall be collected at the time of importation." According to the Ministry of Finance of Timor-Leste (2020), the main objective of this import tax system is: "To promote revenue generation, protect local industries, and ensure fair trade practices by regulating the inflow of foreign goods."

Conceptually, import taxes in Timor Leste also reflect the government's role in maintaining a balance of trade, encouraging the growth of local industries, and ensuring fair treatment for domestic and foreign businesses.

Business Income

Business revenue is the economic result a company obtains from its core operational activities, primarily the sale of goods or services to consumers (Weygandt, Kimmel, & Kieso, 2018). In the context of accounting and economics, revenue is a key indicator of company performance because it reflects the company's ability to generate value from its business processes.

According to Hansen and Mowen (2005), business revenue is influenced by various internal and external factors. Internal factors include production efficiency, marketing strategy, and product quality. External factors include macroeconomic conditions, price stability, government regulations, and fiscal policies such as import taxes.

Revenue is also closely linked to the concept of Revenue Recognition in financial reporting standards, which states that revenue is recognized when it is probable that economic benefits will flow to the entity, and the amount of revenue can be measured reliably (IASB, 2020). Therefore, changes in the cost structure due to an increase in import taxes can affect sales volume, selling prices, and profit margins, which overall impact the company's net income.

In the trade and manufacturing sectors, import taxes can be an additional burden, reducing profit margins or leading to higher selling prices, which can further reduce market demand. This, in turn, reduces total business revenue (Parkin, 2012).

In general, business income is often measured through quantitative indicators such as total sales, net revenue, gross income, and net profit, all of which can be affected by changes in tax policy (Garrison, Noreen, & Brewer, 2015).

Fiscal Policy

Fiscal policy is one of the main instruments in a country's macroeconomic management, involving the use of the state budget to influence the level of economic activity. This policy is implemented by the government through the regulation of state revenues (such as taxes) and state expenditures to achieve economic stability, equitable income distribution, and sustainable economic growth (Mankiw, 2016).

According to Samuelson and Nordhaus (2010), fiscal policy has two main forms, namely:

1. Expansionary fiscal policy aims to increase economic growth through tax cuts or increased spending.
2. Contractionary fiscal policy, used to control inflation or budget deficits by increasing taxes or reducing spending.

Import taxes are a contractionary component of fiscal policy because they increase state revenue while limiting consumption of imported goods (Musgrave & Musgrave, 2014). In the context of international trade, these taxes also serve as a means of protecting domestic industries from losing out to cheaper foreign products.

In developing countries like Timor-Leste, fiscal policy through import levies is often the primary source of state revenue due to the limited domestic tax base. However, this type of fiscal policy can also have adverse effects on the business sector, particularly those dependent on raw materials or products imported from abroad. Increased import taxes can increase input prices, reduce production efficiency, and ultimately negatively impact business revenues (Tanzi & Zee, 2000).

Discussion

Timor-Leste is a country that relies heavily on imported goods to meet its consumption and production needs. Data from 2022 shows that Timor-Leste's imports reached approximately USD 934 million, while its exports were only around USD 473 million. This imbalance reflects a significant trade deficit, indicating that most domestic goods are still imported. The main import commodities entering Timor-Leste include mineral fuels, motor vehicles, machinery and mechanical equipment, and foodstuffs such as rice and cereals. This dependence indicates that nearly all business sectors in Timor-Leste are significantly affected by the government's import tariff and tax policies.

Timor-Leste's high dependence on imported goods undoubtedly has significant implications for economic activity, particularly for business sectors that rely on imported goods. As Parkin (2012) emphasized, increasing import tariffs will increase the prices of goods entering the country, both consumer goods and industrial raw materials. In this context, businesses that rely on imported materials will experience significant increases in production costs.

This increase in costs directly reduces the profit margins businesses can achieve, thus impacting their net income. This aligns with findings from Weygandt et al. (2018), which explain that when costs increase but consumer purchasing power does not experience a commensurate increase, companies tend to be unable to pass on the full cost burden to consumers through selling prices. Consequently, profitability declines and business sustainability is compromised.

On the other hand, an indirect impact of import tax increases is a decrease in consumer demand. When the price of imported goods or products derived from imported raw materials rises, consumers become more selective in their purchases. This results in decreased sales volume, particularly in sectors such as retail trade, food and beverages, and light manufacturing (Musgrave & Musgrave, 2014). In the long term, this situation can lead to slow business growth and job losses.

The tangible impact of import tax increases can also be seen through case studies of distribution companies like East Timor Trading (ETT), which has a distribution network of over 2,000 outlets. This company relies on imported supplies, particularly for daily necessities like beverages, processed foods, and other consumer goods. When import taxes increase, procurement costs automatically increase. If the company does not significantly increase its selling price, its profit margin will decrease. However, if the selling price is raised too high, purchasing power will decrease, directly impacting sales volume and business revenue.

In general, the import tax structure in Timor-Leste consists of an import duty of approximately 5% of the CIF (cost, insurance, and freight) value plus a 2.5% sales tax. This tariff increase results in increased operational costs for businesses dependent on imported goods. For example, businesses importing vehicles or heavy equipment for construction or distribution purposes experience cost pressures of more than 7% per unit. This has led some businesses to delay expansion, reduce imports, or seek alternative suppliers with lower prices, although these may not always be consistently available.

Import tax increases also put pressure on the domestic trade sector, especially those unable to produce substitute goods locally. In this situation, most businesses must bear the burden of additional costs without the option to switch to local sourcing. This aligns with Weygandt et al.'s (2018) finding that increased production costs due to tax changes tend to reduce business revenues if not accompanied by increased efficiency or market demand. Similarly, Musgrave and Musgrave (2014) emphasize that tax changes must consider their impact on the real sector and businesses' adaptability.

Some businesses in Timor-Leste have attempted to address these cost pressures by adjusting operational strategies, such as implementing distribution efficiencies, reducing workforces, or exploring local production partnerships. However, as noted by the World Bank (2023), such adaptations are unlikely to occur in the short term due to the continued weakness of domestic economic infrastructure and production capacity. Consequently, the majority of businesses remain negatively impacted by the import tax increase, both in terms of revenue and business growth.

From a fiscal policy perspective, the decision to raise import tax rates is indeed intended to increase state revenue. However, Tanzi & Zee (2000) caution that fiscal policy in developing countries must balance fiscal interests with microeconomic impacts. If such policies are not balanced with incentives for local businesses, the risk of economic slowdown and income inequality will increase.

Therefore, it is crucial for Timor-Leste to re-evaluate its sectoral import tariff structure. Products that are key industrial inputs or essential for the community should be subject to lower tariffs or even receive tax breaks. This approach can help maintain the competitiveness of national businesses while ensuring that business revenues do not continue to decline due to high fiscal burdens.

CONCLUSION

Based on the results of a literature review and descriptive analysis of fiscal policy, particularly import taxes, in Timor-Leste, it can be concluded that the increase in import tax rates has a significant impact on local business revenues. The tariff increases, intended to boost state revenues, instead create new challenges for businesses, particularly those reliant on imported goods for raw materials and merchandise.

As production and distribution costs increase due to higher import tariffs, many businesses are experiencing declining profit margins, directly impacting net income. This is exacerbated by limited domestic production capacity, resulting in a high dependence on foreign products. In this context, fiscal policies such as import taxes need to be carefully designed to avoid weakening the still-developing domestic business sector.

Thus, the Timor-Leste government needs to balance fiscal interests with the sustainability of micro, small, and medium enterprises (MSMEs). Mitigation measures such as subsidies, local production incentives, and support for import substitution are crucial in addressing the negative impact of the import tariff increase on business revenues.

This study has several limitations that should be considered when interpreting the results and conclusions. First, the approach used was a literature review, which did not include primary data in the form of direct interviews or surveys of business actors in Timor-Leste. This limits an in-depth understanding of the real conditions faced by local businesses in responding to the import tax increase policy.

Second, the limited availability of up-to-date economic and statistical data from official sources in Timor-Leste, particularly regarding detailed import tariffs and business income reports, presents a challenge in quantitatively analyzing the impact. Much of the data is macro and general in nature, thus failing to capture the specific impacts on the small and medium enterprise (SME) sector.

Third, this study also failed to explore the long-term impact or multiplicative effects of import tax increases on the investment climate and domestic supply chains. Therefore, further studies combining quantitative and qualitative approaches, and directly involving business actors, are essential to obtain a more comprehensive picture.

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