

CHAPTER 1

INTRODUCTION

1.1 Background

In recent years, fiscal policy tends to be important in supporting economic growth in Asian countries. Generally, fiscal policy is the economic policy done by the government in terms of controlling the budget, which covers government revenue and expenditure in order to get an optimum economic growth and to stabilize the economy in a whole (Jaka Sriyana, 2002).

In the fact that fiscal policy is not a fundamental source of economic growth. The fundamental sources of economic growth are represented by economic factors like accumulation of physical capital, labor force, human capital, and technological knowledge, and by non-economic, social, cultural, political geographical factors, like the quality of institutions, the availability of natural resources or the dominant cultural paradigm in the society. From this point of view, fiscal policy represents just a tool for the government authorities, which could be used to influence these fundamental sources of economic growth (Cosmin Enache, 2009).

The variables of fiscal policy are government revenue and government expenditure. where the main sources of government revenue are tax revenue, besides of foreign debt and other domestic sources such as sales of gas and oil. Government expenditure consists of routine expenditure and development expenditure. The routine expenditure is a purchasing for a variety of goods, services purchasing, such as payment of civil servants salary, payment of foreign debt and subsidies for people. The development expenditure constitutes expenditure for financing the physical and non-physical development in each region. But since 2005, there are no separation between routine expenditure and development expenditure. Government expenditure divided into central government expenditure and region government expenditure (APBN, 2005).

Government expenditure and tax revenue are the variable of fiscal policy equally give important meaning to stability of the economy. In Keynesian macroeconomic theory has generally assumed that increased government expenditure tends to lead to high aggregate demand and in turn rapid economic growth, and if the lower of government expenditure will affect the slow economy, because government expenditure illustrate the progress of government activity. tax revenue become the major source of the largest government revenue in recent years, if compared from oil and non oil sector of revenue. Can be said that taxes are a source of domestic revenue and strategic potential that must be managed properly in order to increase the total of government revenue. In other hand, the important is the government efforts to increase the tax revenue side. An increase in tax revenue will increase the allocation for government spending, because the tax revenue used to fund the government expenditure (Mwafaq M.Dandan, 2011)

Indonesia also seems to have emphasized the importance of fiscal policy. This can be seen from various policy statements made by governments to stimulating the economic growth. The policies include the allocation, distribution, and stabilization. The government have also shown in economic condition low, government expenditure is autonomous particularly, goods and services expenditure, capital expenditure, that can give stimulation on economy to growth. And conversely, in economic condition are heating up, cause the higher aggregate demand, fiscal policy may act through a contractionary policy to balance demand and supply conditions of the sources of the economy, it is because fiscal policy has a strategic function to encourage economic growth.

Based on the explanation above, the economy of Indonesian has grown at the average rate by 4.56% in the period 1991-2010. The fiscal policy variables, government expenditure and tax revenue also grown in the period 1991-2010. Where are government expenditure grown at 14.91%, and tax revenue at the average rate by 22.45%. the proportion of fiscal policy in

gross domestic product has also increased during the period. Probably, the implication is that fiscal policy may have an important effect on the process of economic growth in Indonesia. The research on the effect of fiscal policy on economic growth in Indonesia have been done by Zaher Khan Kakar (2011). So, the main purpose of this research is to analyze **“THE EFFECT OF FISCAL POLICY ON ECONOMIC GROWTH IN INDONESIA”**

1.2 Research Question

Based on the above description of the background problem can be formulated as follows:

1. How the development of fiscal policy in variables, government expenditure and tax revenue on economic growth in Indonesia during the period 1991-2010?
2. What is the effect of fiscal policy in variables government expenditure and tax revenue on economic growth in Indonesia during the period 1991-2010?

1.3 Research Objective

Based on the formulation of the problem which have been described previously, the purpose of this study are :

1. To know and analysis the development of fiscal policy in variables government expenditure, and tax revenue on economic growth in Indonesia during the period 1991-2010.
2. To analyze the effect of fiscal policy in variables government expenditure, and tax revenue on economic growth in Indonesia during the period 1991-2010.

1.4 Benefit Of Research

The benefit of this research are:

1. As input for the government in making policies in the economy, especially in taking appropriate fiscal policy and to provide a better effect for stability and economic growth in Indonesia .
2. For additional information, literature, and comparison for future research,
3. For researchers can increase their knowledge and experience in researching the effect of government fiscal policy and tax revenue on economic growth in Indonesia
4. To fulfill requirements of bachelor of economic in economic faculty, Andalas University.

1.5 Limitation Study

This research explains about the effect of fiscal policy on economic growth, the case of Indonesia during 20 years. The writer classify the variables into two group where the economic growth as dependent variable, fiscal policy variables are government expenditure and tax revenue as independent variables. This research uses secondary data to see the effect of government expenditure, and tax revenue on economic growth during the period in 1991 – 2010. This research uses the secondary data because the research conducted at the macro level include the object. These data are reprocessed by the writer in accordance with the needs of the models used. This research uses OLS (Ordinary Least Square).

1.6 Organization Thesis

The organization of this thesis consist of 6 chapters. The following brief content of the chapters are as follow.

Chapter I : Introduction

This chapter consists of background, research question, research objective, benefit of research, and limitation study.

Chapter II : Theoretical Framework And Literature Review

In this chapter, there will be some theoretical framework and some literature reviews related to the analysis of effect of government fiscal policy on economic growth Indonesia.

Chapter III : Research Methodology

Is a chapter describing the research methods and operational definitions of research variables, types and sources of data, data collection methods, data analysis methods.

Chapter IV : Overview to Indonesia's government expenditure and tax revenue

In this chapter described some overview to Indonesia government expenditure, tax revenue, and economic growth.

Chapter V : Analysis and discussion

It is a chapter outlining the results and discussion of the research object description, data analysis, and discussion.

Chapter VI : Conclusions and Implications

It is a closing chapter that describes the conclusions of the analysis carried out and the implications that arise from the conclusion as an answer to the question of the problem.