CHAPTER 1

INTRODUCTION

1.1.1 Background

Economic development is an absolute phase that should be done by every nation to improve prosperity. The implementation of economic development is never apart from the increase in income or we called economic growth. Economic growth and economic development are almost same but they are fundamentally different. Economic growth is increase in average income of an economy, while economic development is the increase in welfare of people of that economy.

Economic Growth is an increase in a country's real level of national output which can be caused by an increase in the quality and quantity of resources, an improvement in technology or in another way an increase in the value of goods and services produced by every sector of the economy.

Economic Growth can be measured by an increase in a country's GDP (gross domestic product). “Economic growth is a process, not an economic picture in a given period, there are development or changes and use of time” (Boediono, 1992).

Indonesia’s economic growth has been up and down in over recent decades, in accordance with the conditions of the world economy. National income is a measure of economic growth, which is showed by fluctuating growth. The economic condition of Indonesia as a developing country has not reached steady state conditions in which an economy is already in a stable and less susceptible to shocks.

Indonesia’s economic growth is influenced by the various shocks. Shocks that make Indonesian’s economy is disrupted economic crisis of 1998, namely inflation 78 % and GDP decreased by approximately 11 percent. In 2008 the world economy was in recession or global economic recession, triggered by financial turmoil in the united states. This financial crisis hit countries around the world includes Indonesia. The impact of this crisis in Indonesia was marked by the side of state pending, state spending on state budget allocation in 2009 was estimated to increase by Rp 51,8 trillion, compare to the realization of the state budget of 2008 with total expenditures set at Rp 1,037.1 trillion (19.5 percent of GDP), driven by an increase in central government spending for Rp 23.74 trillion and the allocation of expenditure to the region of 28.06 trillion when compared with the realization of the 2008 budget the government has been able to anticipate the situation, so that economic growth in Indonesia is relatively safe, around 6,38% (Data BPS, 2008).

Indonesia is better equipped to survive in this time of crisis because of the experience learned from previous crisis. A country must has a government that serves as a economic dampening and political turmoil both from domestic and abroad. Dampers are able to stabilize the turmoil in the sense of a more conducive situation through various policies. Government is a very important actor in the economy of a country. An economic activity will be optimal if there is a government activity there in.

Economic growth in Indonesia is still at the development stage. Government spending on Government activities that include spending in the political sphere as well as in the field of economy where everything has planned in the budget revenue and expenditure of the state budget. Managing sources of revenue and government spending, government can make a policy to increase economic growth such as Fiscal Policy.

Fiscal Policy is the government policy which included government expenditure and taxes in collaboration with the monetary policy whose objective was to accelerate economic growth. Government expenditure consists of recurrent expenditure and development expenditure.

Recurrent expenditure is expenditure that used for maintenance and operation of a government that includes spending on personnel, goods expenditures, interest payments, subsidies and other routine expenses. Through routine expenses, the government can carry out its mission in order to maintain the smooth implementation of the government, the operations and maintenance of state assets, Government's responsibility to third parties, protection of the poor and underprivileged and maintain economic stability (Mangkoesoebroto, 1994).

Development expenditure is expenditure incurred to finance development in the economic, social, and public and that is to raise capital in the form of community development both physical and non-physical infrastructure is implemented in a given period. Budget physical and non-physical development is always adjusted to the funds mobilized.

The funds are allocated to the various fields in accordance with the priorities that have been planned. The role of the development budget is more emphasis on efforts to create a stable and conducive conditions for the continuity of the process of economic recovery by providing a stimulus to the growth of the national economy. In connection with the management of the overall state budget with limited financial resources available, the achievement of development goals should be as optimal as possible (Nota Keuangan dan APBN, 2004).

Taxes have a very important role in the life of the state. Particularly in the implementation of development because the taxes a source of state revenue to fund all expenses including the expenses of government. Whether it's for recurrent expenditures and development expenditures.

According to Waluyo (2006), high economic growth will increase the revenue of the government of taxes (VAT and income tax) as well as providing employment and earnings or saving foreign exchange.

Since the purpose of taxation and government expenditure, both recurrent and development are to support national economic activity in maintaining the momentum of high economic growth, and improve the welfare of the whole people of Indonesia. There fore the role of government in the field offiscal policy to accelerate economic growth, the authors tried to examine how the effect of fiscal policy on economic growth, in Indonesia.In this case the government fiscal policy are government expenditure and taxes.

Based on the above assumptions, Fiscal policy is a government policy can impact of activities against the government in running in the field of the economy in indonesia. to the authors are interested in doing research to take the title of

"***The Effect Of Fiscal Policy On Economic Growth : Case Study In Indonesia".***

1.2 Research Question

Based on the above explanation, the issues to be analyzed in this study are:

1. How does government recurrent expenditure influence economic growth in Indonesia?
2. How does government development expenditure influence economic growth in Indonesia?
3. How does taxes influence economic growth in Indonesia?

1.3 Research objectives

In accordance with the above problems the purpose of this study were to:

1. To examine the effect of government recurrent expenditure on economic growth in Indonesia;
2. To examine the effect of government development expenditure on economic growth in Indonesia;
3. To examine the effect of taxes on economic growth in Indonesia.

1.4 Research Advantage

The advantage**s** of this research are:

1. For I and myself, to improve my ability in writing report and doing research, especially in monetary economics, particularly fiscal policy.
2. For government as input for fiscal policy.
3. As a reference for other researcher who are interested to study in the same field with the approach ad scope are different.