FACULTY OF ECONOMICS
ANDALAS UNIVERSITY

Thesis

The Effect of Government Consumption, Government Investment, and Government Transfer on Economic Growth in Indonesia (1979-2008)

BY

NINA SEPTIANA
05 151 054

The student of Bachelor Degree of Economic Department

Thesis is submitted in partial fulfillment of the requirements for the Bachelor Degree from Andalas University.

PADANG
2009

FACULTY OF ECONOMICS

ANDALAS UNIVERSITY

	University Alumnus Registration No:	**Nina Septiana**	Faculty Alumnus Registration No:
	Personal Identity a). Place/Date Birth: Padang / 15 September 1987 b). Parents Name: Bustam and Indrawati c).Faculty: Economy d). Department: Economy e). Student Id Number 05 151 054 f). Examination Date: July 13, 2009 g) Graduation standard: with honor h) GPA: 3.20 i) Length of Study: three years ten months j) Parents Addres: Komp. Indovilla I Block CC/10 Parak Laweh, Padang		

The Effect of Government Consumption, Government Investment, and Government Transfer on Economic Growth in Indonesia (1979-2008)

Thesis by: Nina Septiana   Thesis Advisor: Prof. Dr. Nurzaman Bachtiar

ABSTRACT

The objective of this research is to analyze if there is a significant positive relationship between the size of government consumption, government investment, and government transfer and the growth rate in national output in Indonesia years 1979-2008. This research using secondary and annually data that researcher got from Central Bureau of Statistic (BPS), annually report from Indonesian Central Bank, and International Financial Statistic from IMF. The variable used in this research divided into two, they were dependent variable consist of economic growth and independent variable consist of government consumption, government investment, and government transfer. For the hypothesis, I used regression model by doing F-statistic and t-statistic test by using *eviews* program. The result of this research show that all independent variables consist of: government consumption, government investment, and government transfer have positive significantly effect on economic growth. It means that all independent variable in this research is needed to improve economic growth in Indonesia.

The Abstract has been approved by the advisor and the examiner:

Signature			
Full name	Prof. Dr. Nurzaman Bachtiar	Drs. M. Nazer, MA	Yessy Andriani, SE,M.IDEC

Approved by :
Head of Depertment : Prof.Dr.H.Firwan Tan,SE,M.Ec.DEA.Ing
NIP.130812952

Signature

The Alumnus has registered to the Faculty of Economics/ Andalas University and has obtained the Alumnus Registration Number:

	The officer in charge of Faculty /Andalas University	
Faculty Alumnus Registration No :	Name	Signature
University Alumnus Registration No :	Name	Signature

CHAPTER 1

INTRODUCTION

1.1 Background

Government expenditure or more generally called as public sector spending is an important subject of analysis and debate. It is classified into three main types.[1] First, government purchases of goods and services for current use that are classified as government consumption. Second, government purchases of goods and services intended to create future benefits, such as infrastructure investment or research spending, are classified as government investment. Third, government expenditures that are not purchases of goods and services, and just represent transfers of money, such as social security payments, are called government transfer payments. Most of developing countries have experienced in increasing levels of public expenditure over time.[2] Indonesia is one of these where the government expenditures have increased.

Some empirical findings suggest that government expenditure beyond a certain limit of its core function would have an adverse impact on economic growth.[3] In a cross – sectional study of over 100 countries in the period 1961-1976, the evidence was a negative relationship between the growth rate of real per capita and

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[1] Robert Barro and Vittorio Grilli (1994). *European Macroeconomics*, Ch. 15-16. Macmillan, ISBN 0333577647

[2] Lindauer, D. and A. Valenchik, (1992). 'Government Spending in Developing Countries: Trends, Causes and Determinants', *World Bank Research Observer*, 7(1) 59-78.

[3] Dar, A. AmirKhalkhali, S.(2002). "Government Size, factor accumulation, and economic growth: evidence from OECD Countries" *Journal of Policy Modeling*.

the share of government consumption expenditure in GDP.[4] Further notes, that for a broad group of 98 countries that growth in real per capita GDP was positively related to initial human capital and negatively related to share of government consumption in GDP.[5] Studied in 115 countries and found the evidence of a negative relationship between the growth rate of real GDP and the growth rate of government share in real GDP.[6]

The impact of public expenditure on growth will depend on its form. The expenditure on investment and production activities (in principle including State-owned production) should contribute positively to growth, whereas government consumption spending is anticipated to be growth-retarding.[7] While numerous studies have been conducted, there is no consistent evidence that exists for a significant relationship between public spending and growth in a positive or negative direction. Results and evidence differ by country, analytical method employed, and categorization of public expenditures. The actual relationship between public spending and growth is not well understood and there is a need for more empirical research.[8]

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[4] Landau, D. (1983), 'Government Expenditure and Economic Growth: A Cross-Country Study', *Southern Economic Journal*, 49(3), 783-92.
[5] Barro, Robert J. (1990). 'Government Spending in a Simple Model of Endogenous Growth', *Journal of Political Economy*, Vol. 98, S103–S125
[6] Grier, K.B and Tullock G. (1987) An empirical analysis of cross national economic growth, 1950-1980, Working Paper, California Institute of Technology.
[7] Barro, Robert J. (1990). 'Government Spending in a Simple Model of Endogenous Growth', *Journal of Political Economy*, Vol. 98, S103–S125
[8] Grier, K. and G. Tullock (1989), 'An Empirical Analysis of cross-National Economic *Journal of Monetary Economics*, 24, 259-276.

CHAPTER VI

CONCLUSION AND SUGGESTION

6.1 Conclusion

According to research question and hypothesis, the objective of this research is to prove if there is a significant positive relationship between the size of government consumptions, investments, and transfers and the economic growth in Indonesia. To execute the research, it required a secondary data obtained from Annual Report of Economics from Statistical Body Center (BPS) in Padang. In conducting the research, the writer uses quantitative analysis method which was proceeded by using Eviews.

This research found that government consumptions have a significant effect on economic growth. It is caused by government consumption in general was to increase growth of national economy, like the payment for the personnel's salaries, pensions, and also to buy various materials which are importance for societies. Fulfilling the government's consumption needs made the economic activities increased which had been in the increase of Gross Domestic Product (GDP). These matters proved that high government distribution fund in investments assisting project activities of national development has given positive impact to increased GDP.

Government investments also have a significant effect on economic growth. Government investments have been able to increased national economic sector, such as the opening a new work field that is able to decrease the number of unemployment, height in education orientation, and existence of poorness eradication have created generalization of earnings and reduction in the number of poorness. This matter show

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