CHAPTER I

INTRODUCTION

1.1 Background

One of the problems macroeconomic is about growth of economy and the objective is to make it more better. Indicator of economic growth are the main problem in the analysis of the economic development that occurs in a state, because it can provide a macro overview of the policies that have been implemented or already exist, specially in the economic field. Economic growth is determined by Gross Domestic Product (GDP). GDP is the sum of four categories of expenditures which is: consumption, investment, government purchase and net exports. GDP has functional relationship with price, quantity of commodity and level production in domestic market including the income that is received or come by foreigners who are working in domestic market.

According to classical extremists, government expenditure has no effect on GDP due to complete crowding out between government expenditure and investment. This is vehemently rejected by radical keynesians that assert a fiscal expansion policy affects GDP in full. Totally it expects an increase in government expenditure raises aggregate demand. When demand is more than supply in economy, prices will increase and it makes a force for decreasing demand until economy stand on equilibrium point. In addition, there is an other viewpoint about government expenditure effects. If government expenditure acts as a complementary effect for private investment, can be expected an increase in government expenditure will make a growth in production and employment. Investment affected by interest rate, wheter its decreasing or increasing.

Economics is a reflection of human behavior, referred to as "rational self-interest" (McConnell, 2008). Rational self-interest can be interpreted as an increase in income, rents, interest, and profit that makes a person able to meet their needs. Every individual tries to reach a standard of satisfaction by the consumption of goods or services, by allocating power, money, or time to achieve satisfaction. The problem lies in the limitedness of resources. Scarcity and availability of goods and services within a country will reflect the level of economic growth. High or low economic growth can be measured by calculating the gross domestic product (GDP) of the country concerned.

The growth of Gross Domestic Product (GDP) in Indonesia since 1995 to 2015 tend to be static. In 1995, the growth of GDP in Indonesia is 8.22%. After that in 2015, the growth of GDP in Indonesia is 4.79%. However in 1998, the growth of GDP in indonesia has reach the lowest level at -13.12%, it because in 1997-1998 Indonesia having a monetary crisis. The average growth of GDP in Indonesia since 1995-2015 is 3.9%.

The government expenditure in Indonesia tend to increase every year since 1995 to 2015. In 1995, the government expenditure in Indonesia is 51 billion rupiah, and increase to 1.984 billion rupiah in 2015. The average of government expenditure in Indonesia since 1995 to 2015 is 752 billion rupiah.

Based on the data changes in the government expenditure in Indonesia, the government expenditure probably have impact to GDP.

The exchange rate in Indonesia tend to fluctuate. In 1995, the exchange rate in Indonesia is 2.342 Rupiah per 1 US Dollar, After that in 2015, the exchange rate in Indonesia is 13.389 Rupiah per 1 US Dollar. The average growth of exchange rate in Indonesia from 1995 to 2015 is 4.14% or rupiah depreciate 4.14% every year. In 1998, the exchange rate in Indonesia reach the lowest level at 10.013 Rupiah per 1 US Dollar because the monetary crisis. Since 1995 to 2015, Indonesia's exchange rate averaged 8663 Rupiah to 1 US Dollar. From the fluctuating exchange rate in Indonesia since 1995 to 2015, it probably have influence to GDP in Indonesia.

The interest rate in Indonesia tend to fluctuate, in this studies using Real Interest Rate from 1995 to 2015. In 1995, Real Interest Rate in Indonesia is 8.33%. In 2015, Real Interest Rate in Indonesia is 8.08%. During monetary crisis in 1998, Real Interest Rate in Indonesia reach the lowest level at -24.60%. The average Real Interest rate in Indonesia since 1995 to 2015 is 3.86%. From the changing data of Real Interest Rate in Indonesia probably have impact or affect the GDP in Indonesia.

In macroeconomic analysis of economic growth rate reached a measured state of development of a country's national income which is the sum of consumption, investment, government spending and net exports. The investment is the use of money as an activity for the supply of capital goods used in an activity to generate profits in the future (Mankiw, 2008).

Government Expenditure divided into 2, reccurent (goods, services and infrastructure) and capital expenditure. Capital expenditure refers to invenstment outlets that increase the assets of the state, recurrent expenditure refers to financial outlays necessary for daily running of government and business (Lacey, 1989). Rodrik (2009), proves that GDP is affected by currency exchanges rates of a particular country. Udoka (2012), states that the interest rate is one of determeninants of economic growth. The statements made by researchers above can prove that the interest rate and the exchange rate can influence economic growth.

Based on the explanation above, some economist argue that government expenditure, exchange rate and interest rate probably have no Impact or have Impact to GDP, we want to analyzing and examine the relationship of government expenditure, exchange rate and interest rate on economic growth, so the title is: **"The Impact of Government Expenditure, Exchange Rate and Interest Rate on Economic Growth in Indonesia".**

1.2 Research Questions

The main problems of the study are:

1. How the economic growth be influenced by government expenditure, exchange rate and interest rate in Indonesia.
2. What is the relationship between economic growth with government expenditure, exchange rate and interest rate in Indonesia

1.3 Research Objective

The main objective of the study are:

1. To analyze the main economic variable which influences gross domestic product of Indonesia those variables consist of government expenditure, exchange rate and interest rate.

2. To analyze the relationship between economic growth with government expenditure, exchange rate and interest rate in Indonesia.

1.4 Research Advantages

This study's benefits are:

1. As the subject of term to graduate of bachelor of economics in Economic Faculty, Andalas University.
2. For the writer, it improves the ability on writing reports and doing research, exactly in the monetary sector.
3. For the reader, it is expected to add the understanding regarding the economic analysis about the context of impact from government expenditure, exchange rate and interest rate on economic growth.
4. For a researcher in the field of economics and finance is expected this study can be a reference for the next research.
5. For government will have a reference for taking a policy in interest rate, exchange rate and government expenditure.
6. For society will give new knowledge about the impact of interest rate, exchange rate and government expenditure on economic growth in Indonesia.

1.5 Research Scope

This research is focusing on hypothesis test about the impact and relationship between, government expenditure, exchange rate and economic growth in Indonesia. Coverage used in this analysis is year time series data during 1995-2015.

1.6 Writing Systematic

Systematic writing of study is separate into six chapters. As for each chapter are briefly described as follows:

Chapter I: Introduction

This chapter contains a description of the background of the economic growth. Theoretically economic growth influenced variables such as government expenditure, exchange rate, and interest rate. This chapter also describes about problem identification, research advantage, the scope research, and writing systems.

Chapter II: Literature Review and Theoritical Framework

This chapter will provide the poverty theory and the relationship between economic variables such government expenditure and exchange rate. To support the literature review some explanation from empirical studies in the past, as proven. Hypothesis is writen in this chapter.

Chapter III: Research Method and Theoritical Framework

This chapter elaborates about study method of problem, containing research data such as research variables, data characteristics that, accompanied by clarification about data collecting procedure, and also technique data analysis.

Chapter IV: General Overview.

Chapter IV explains about the outlook and recent development of variables in Indonesia related to research data from 1995 until 2015.

Chapter V: Empirical Result and Analysis

This chapter explains about the output of the research and the analysis from the processed of data.

Chapter VI: Conclusion and Recommendation

In this chapter consist of conclusion of the analysis carried out, suggestion, and implication arising from the conclusion of the problem.