

CHAPTER I

INTRODUCTION

1.1 Background

Indonesia is one of the developing countries that are the focus of the national economic development and growth. Economic development can be defined as a process that led to the increase in real income per capita of a country over a long period accompanied by improvements in the institutional system. Indonesia adheres to an open economy in which the government runs the economy will not escape the interaction of the private sector or other countries. In this regard, Indonesia would require significant financing to build the equitable and prosperous economy for its people.

Indonesia is still fragile on economic stability over time. Such conditions make Indonesia not able to maintain its economic stability of internal and external influences. One of the components that were affected by the inability of the Indonesian Economy cope with economic shocks from the outside is the swelling of expenditure incurred by the government, resulting in a deficit in the State Budget (APBN). This is what spurred Indonesia to increase sources of income derived from debt, especially foreign debt. At first, as a newly developing country, Indonesia's foreign debt is mostly done by the Government, but with the rapid development and the limited ability of the government, private sector role in the economy increased. The amount of private investment while financial resources have limited domestic support private sector foreign borrowing in the form of direct investment and commercial loans and portfolio investment in the

form of securities. While the Foreign Debt carried out by the Central Bank or Bank Indonesia is more focused to support the balance of payments and foreign exchange.

High economic growth can be an indicator of success in running the state of development, which will eventually be used entirely for the improvement of people's welfare. As with other developing countries, Indonesia relied on foreign debt to finance the construction. Limitations of domestic savings to finance the construction of the reason for the use of foreign debt. At first use of foreign debt only as matching funds to cover the shortage of development funds can't be met from the domestic resource.

Economic development of a country on one side need the big fund. While on the other hand, the mobilization of funds to finance the construction faces obstacles. The main problem is the difficulty in the formation of capital both derived from government revenue derived from exports of goods to foreign countries as well as from the community through tax instruments and instruments of financial institutions. Therefore Foreign debt is required to finance development in Indonesia. As a developing country, which has similar economic, political, social, and cultural features and problems with other developing countries, Indonesia itself is inseparable from the problem of external debt.

Debt or in this context the country's debt by Act No. 1 of 2004 is an amount of money that must be paid by the central government and / or liabilities of the central government that can be valued in money based on the legislation in force, the agreement, or based on other reasons legitimate.

External debt is state revenue either in the form of foreign exchange or

foreign exchange which is in the form of goods and or in the form of services derived from the Foreign Borrower which must pay back with certain conditions. Foreign borrowings received by the government are intended to supplement development financing, in addition to domestic sources of financing in the form of foreign trade, tax revenue and savings in both community and private sectors.

Acceleration of economic development needs to be implemented by the countries of the third world to catch up economically. To finance the economic development, the government requires a budget by an amount large enough to make the government's budget is greater than demand budget. Budget deficits necessary to find alternative solutions to finance among other things the government can do it through debt, selling assets/privatization, and by printing money. From some of these financing alternatives, it's most commonly done by the government of a country that is doing good debt domestically or abroad and is done through direct loans or through the issuance of state securities (SBN). Debt that the government has to finance government expenditures can theoretically propel economic growth on the demand side [$Y = C + I + G + NX$] and in terms of the offer [$Y = F(K, L)$].

The function of the country's debt will be:

1. Cover Budget Deficit
2. The offsetting of cash on short-term cash needs in the implementation of expenditure that can not be postponed
3. The solution in the government debt portfolio management is certainly intended to reduce the burden of debt to finance spending in the budget in subsequent years.

But the government debt may also cause debt and interest burden of debt that will burden the government budget and in the end, it inhibits growth. Meanwhile, if viewed posture of central government expenditure spending, largely used to finance subsidies and personnel expenditure that is necessary to test whether both government debt and government securities for this loan can promote the growth or actually inhibits growth.

The accumulation of large debts will result in large payment obligations as well. This can force the government to raise the level taxes, as an effective source of state revenue. High taxes will certainly lower the investment passion in the country and decrease productive effort. As a result, economic growth will be lower and the ability to pay off debt will also be lower. At certain levels of debt in a long period of time will be able to result in the name of **Debt Overhang**. Based on Krugman (1988) a country has a debt overhang problem when the expected present value of potential future resource transfers is less than its debt. If there is a debt overhang is a condition where the state does not has the ability to repay the debt in full and the actual payment depends on the implementation of economic policy.

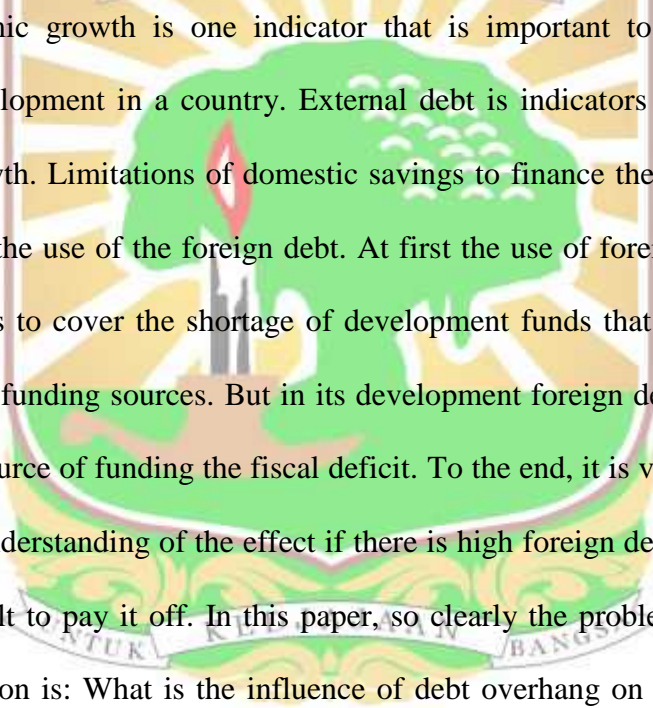
While Indonesia is due to the need for funds for development expenditures that are always large and continue to increase also every year, then to cover the shortfall the government uses foreign debt. As a result, development receipts which are the government's foreign debt also increase steadily every year.

Therefore, I am interested to analyze the effect of inflation and its effects as well as government debt and its effect on economic growth in Indonesia.

Thus, under these conditions to know what the effect of debt overhang in external debt for economic growth in Indonesia? as well as government debt and its effect on economic growth in Indonesia? So what's the best for Indonesia in the promotion of economic growth ?. Therefore, pursuant to the above problems the authors are interested in analyzing a research title:

"THE PROBLEM OF DEBT OVERHANG IN INDONESIA"

1.2 Research Problem



Economic growth is one indicator that is important to an analysis of economic development in a country. External debt is indicators that analysis of economic growth. Limitations of domestic savings to finance the construction of the reason for the use of the foreign debt. At first the use of foreign debt only as matching funds to cover the shortage of development funds that can not be met from domestic funding sources. But in its development foreign debt has been led into a major source of funding the fiscal deficit. To the end, it is very important to have a good understanding of the effect if there is high foreign debt and make the country difficult to pay it off. In this paper, so clearly the problem we conclude with the question is: What is the influence of debt overhang on external debt to economic growth in Indonesia?

1.3 Research Objective

Based on the research problem, the author wants to analyze the cause of economic growth in Indonesia, such as: To analyze the effect of debt overhang to

external debt on economic growth to Indonesia during period 2000-2015 in short run and long-run effect.

1.4 Research Advantages

This study hopefully expected to be useful for the writer and the others interest parties. And the benefits of this research include 1). The results of this study are expected to contribute ideas or additional study materials, especially for the students of Department of Economics. 2). As input for academics and researchers who are interested to discuss the effect of external debt on economic growth in Indonesia. 3). To determine the results of analysis of debt overhang in Indonesia.

Then, 4). The results of this study are expected to be useful as an input to the Central Government and Local Governments in formulating development policy planning to increase of economic growth. 5). Promote the development and knowledge, particularly subject to the external debt. 6). Usable parties concerned to use the concepts and new ideas generated development research on external debt that influences economic growth.

1.5 Systematic of Writing

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

Chapter I : Introduction

This chapter contains a description of the background of economic growth in Indonesia. Theoretically and study case economic growth influenced by

the macroeconomic variable such as external debt and debt overhang. This chapter also describes problem identification, research objectives, the research advantage, and system of writing.

Chapter II : Theoretical Framework

This chapter discuss about the theoretical framework and literature review which have a relation external debt and economic growth.

Chapter III: Research Methodology

This chapter describes the model, that is Error Correction Model, the transform of the model and also the source of data that will be used in this research.

Chapter IV: General Overview

This chapter describes the overview of research objects, such as overview about debt overhang, external debt, and economic growth in Indonesia.

Chapter V: Empirical Result and Analysis

This chapter discusses more the study description contains a description of the research object, data analysis, interpretation and discussion of the result obtained from the study.

Chapter VI: Conclusion and Recommendation

This chapter consists of the conclusion of the study and implication on the future research.

