CHAPTER I

INTRODUCTION

1.1 Background

Countries experiencing a savings-investment gap is a common occurrence in various countries of the world. The phenomenon of a country experiencing a savings-investment gap is a common problem in many countries in the world. At any given time, a country might be able to meet the investment needs of domestic savings, but at other times the possibility of domestic savings can not meet to needs of investment or savings-investment gaps . If this happens, then the required capital inflows from abroad (capital inflow) to close the existing gaps. Foreign capital inflows is an important role in the economic development of a country, especially for developing countries as an additional (supplement) for their domestic savings and increase domestic investment. The emergence of these ideas, from the fact that in developing countries, where they generally face the problem of saving-investment gap.

Economic growth requires increased investment. Increased investment in turn requires the fund transfers originating from inside or outside the country. From both these financing sources, domestic sources of funds are the principal source of financing. Especially seen in the context of long-term economic growth, which a country should base their investment financing from domestic sources. Of the various sources of domestic financing, domestic savings is one of the important factors for financing. Domestic savings can be sourced from the savings of society / private sector, and government savings. In the context of domestic savings, ideally, these two components must be improved synergistically and simultaneously. Gap between domestic savings and investment is what will be studied at this time.

Investment is the first step of production activities. With this position, the investment is also the first step in economic development activities. The dynamics of investment affect the level of development and economic growth. Therefore, in effort to grow the economy, every country always trying to create a climate to attract investment. Low domestic savings do not allow adequate investment, so that the governments of developing countries must attract loans and investment from abroad. foreign debt can play a crucial role in efforts to reduce the country concerned the main obstacle in the form of foreign exchange shortages, as well as to boost economic growth

The saving-investment gap will adversely affect the economy of a country, if not covered by capital inflows from abroad. Because if the expected investment is not met, it will cause jobs would be a little bit so it is not able to accommodate the existing workforce. Subsequent impact will cause unemployment. If this constantly happens then will be higher unemployment, widening poverty can not be avoided, so that national security could be compromised. This will ultimately have a negative impact on economic growth due to the difficulty of attracting capital from outside when national security compromised. Though requiring foreign capital flows not only developing countries but also developed countries, so that competition among countries to attract capital from abroad will be more stringent. The problem will be growing again if the flow of foreign capital flows in the form of short-term capital. If the state is not careful in managing it, it can interfere with the balance of payments and foreign exchange reserves.

The saving-investment gap will adversely affect the economy of a country, if not covered by capital inflows from abroad. At the time of the economic condition of a country attractive to foreign investors, the capital will be easy to get in but when the economic situation is considered to be worse, so quickly withdrawn capital from those countries. If the amount of capital that is drawn very big, of course, will shake the country's economy, as experienced by Mexico. Not long ago, it would also tend to occur in Indonesia because Indonesia is also a policy of free foreign exchange system. As is known that, in an open economy, investment is no longer only come from domestic savings, but can be sourced from the foreign sector and the government sector. As a result, investment is not always equivalent to the savings can be higher or lower. In other words, the savings- investment gap can arise in an open economy.

Savings-investment gap is equivalent to the current account deficit [(S-I) = (X-M)]. This identity shows that the internal imbalances that shortage of savings will be overcome by the external imbalances is the current account deficit. In other words, changes in the behavior of exports and imports will be equal to the change of behavior of domestic savings and investment (Roubini, 2006). Furthermore, the current account deficit will cause capital inflows from abroad because of the deficit requires capital inflows to balance the balance of payments. This shows that the savings-investment gap is closely related to capital flows.

Development in Indonesia also create economic growth as a target. To achieve high growth targets required a substantial investment. Due to the limitations of national savings to finance investment, foreign investment is a priority in promoting growth. Total outflow of foreign capital, in addition to turning the wheels of the real sector is also expected to increase the speed of the flow of money in the financial markets, adding the market capitalization of the stock exchange / Indoneia, as well as closing the current account deficit that has always experienced by Indonesia. economic growth, income per capita, and the influx of foreign capital does not necessarily reflect the rapid advancement of the Indonesian economy. The high economic growth in Indonesia, does not describe that growth is a business unit owned by the majority of the Indonesian people. Instead, growth is a business unit owned by foreign conglomerates. Similarly, the increase in income per capita Indonesia does not show the income of every citizen of Indonesia recovered. GDP is owned by foreigners whose contribution is quite large.

Therefore, in the literature of economic development when a country experiences a savings-investment gap, the country needs net capital inflows to close the gap between savings with investment. Based on the theory of economic growth Solow, to reach a level of capital / capital guaranteed (steady-state capital) and to maintain a steady level of economic growth, the level of domestic savings should be high to justify the investment so that the production process can be sustained and the level of output can be increased (Mankiw, 1997). Meanwhile, according to Harrod-Domar growth theory, a country's economic growth will be hampered if the country's economy is experiencing a shortage of capital. Therefore, the gap between saving and investment need to be addressed, so that economic growth can take place.

Based on this background the authors are interested in examining the impact and influence of saving-investment gap, by raising the issue in a scientific paper entitled: **"Analysis the Effect of Debt, Credit and Income for Savings-Investment Gap in Indonesia (SIGap)".**

1.2 Research Question

Based on the description above, it can be formulatedin this study, some ofthe issues to be examine das follows:

1. What the impact of foreign debt to development and structure of the Indonesian economy?
2. What is the effect of national income on saving –investment gap in Indonesia?
3. What is the effect of domestic credit on saving-investment gap in Indonesia?

1.3 Research Objectives

Based on the background and the formulation of the above problems, the objectives to be achieved in this study are:

1. To analyze the effects of foreign debt on saving-Investment gap in Indonesia during the period 2000-2015
2. To analyze the effects of national income on saving-investment gap in Indonesia during the period 2000-2015
3. To analyze the effects of domestic credit on saving-investment gap in Indonesia during the period 2000-2015

1.4 Research Advantages

This study expected to provide the following benefits:

1. The results of this study are expected to contribute ideas or additional study materials, especially for the students of Department of Economic Development.

2. As input for academics and researchers who are interested to discuss the impact of saving-investment gap to national income and foreign debt.

3. The results of this study to see if there are effect of long-term and the short-term.

4. In addition, complementary and as the result of a comparison of the existing research on the topic.

1.5 Scope of Research

This research will be focus to analyze the effect of macroeconomics variables such as Gross Domestic Product (GDP), foreign debt and Domestic Credit to Saving-Investment Gap. First, the author will set the methodology and formula to solve the equation with Error Correction Model (ECM) using STATA 12 program to process the data, then the author will describe what is the effect of macroeconomics variables such as Gross Domestic Product (GDP), foreign debt and Domestic Credit to Saving-Investment Gap in short run and long run. The author will answer with descriptive approach, it will be explain with some output from data process.

1.6. Writing Systematic

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

Chapter I: Introduction

This chapter contains description of the background of the effect of macroeconomics variables to Saving- Investment Gap. This chapter also describes about problem identification, research questions, research objectives, the research advantage, the scope of research, and writing systematic.

Chapter II: Theoretical Framework and Literature Review

This chapter will provide the theory and the relationship between macroeconomics variables such as Gross Domestic Product (GDP), foreign debt and Domestic Credit to Saving-Investment Gap. To support the literature review some explanation from empirical studies in the past, as proven.

Chapter III: Research Methodology

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

Chapter IV: General Overview

This chapter describes the overview of research object, such as overview about trend of Saving-Investment Gap, Gross Domestic Product (GDP), foreign debt and Domestic Credit in Indonesia.

Chapter V: Empirical Results and Analysis

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

Chapter VI: Conclusions and Recommendations

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