

ABSTRACT

The main purpose of this research was to find out the effect of budget deficit finance by foreign debt on the Indonesian macroeconomy. The study attempted to examine the effect of budget deficit on inflation and economic growth. Design of the research used a specification of a simultaneous macroeconomic model, consisting of twelve(12) behaviour equations and five (5) identity equations with three (3) blocks. The behaviour equations in the model were estimated by TSLS (*two stage least square*). Data used were derived from the Indonesian economic secondary, data for the periode of 1993-2007. The research also applied an econometric test to result in a BLUE estimator.

Result of analysis showed that budget deficit financed by foreign debt would improve economic growth and had an inflationary. The estimation resulted in an improvement of money supply when the budget deficit was financed by foreign debt. It had effect on increase of price rate or inflation. In addition, the deficit also affected the economic growth as it might be found by building factors of national income. The rise of taxes affected increasing of nation's input. So that it decreased the deficit. Tax instruments affected disposable income and this disposable income affected purchasing power of the people. In the other words, the would experience higher consumption rate. The effect of the budget deficit increased national income from agregate demand. Once it ocured, it could give rise to the national economic growth.

Keywords: Budget Deficit, Inflation, and Economic Growth