

ABSTRACT

International trade theory, conventional balance of payments adjustment theory, and neoclassical supply-side growth theory are less precise in explaining the condition of the open economy in an integrated concept. Thirlwall (1979) found that the trade balance is a constraint to economic growth in the open economy, so a Keynesian demand-side growth model developed that integrates the balance of payments, known as the Balance of Payment Constrained Growth (BPCG) model. This study aims to (1) analyze the behavior pattern of Indonesia demand for import, and (2) investigate the hypothesis of Thirlwall's BPCG model which states that the balance of payments is a constraint to economic growth in cases of Indonesia. This study uses the Error Correction Model (ECM) to analyze the Indonesia demand for imports with a sample of quarterly data from 1990Q1-2019Q1. The national income elasticity coefficient obtained from the estimation of the import demand model is then used to calculate the predicted growth rate according to the BPCG model. The results showed that the behavior of Indonesian imports in accordance with the law of demand in the long-run and short-run, specifically the price level has a negative effect and national income has a positive effect on imports. Using the Wald statistical test, it was found that the actual growth rate is statistically identical with the predicted growth rate. Then it can be concluded that the trade balance is a constraint on Indonesia's economic growth. Therefore, a demand-side approach to improve economic growth while maintaining the condition of the trade balance needs to be done by means of import substitution and structural reforms to increase exports of high value-added products.

Keywords: Thirlwall, Balance of Payment Constrained Growth, Error Correction Model, Indonesia demand for imports.