ABSTRACT

The aim of this study is for analyzing the effect of government expenditure and budget deficits on investment in Indonesia during 1986-2008. While Keynesian assumes that government expenditure will be able to crowd in investment, the Monetarist-Classical assumes the other way. Increase of government expenditure may also lead to increase on the budget defisit and crowd out investment by higher interest rate. Therefore, this study tried to demonstrate the effect of both variables by building two models (The Keynesian and Monetarist-Classical) that was previously developed by Kustepeli (2005). This study applied Cointegration and ECM (Error Correction Mechanism). The results show that both government expenditure and budget deficits has a negative effect on investment, but budget deficits statistically insignificant.

Keywords : investment, government expenditure, budget deficits, crowd out, cointegration, ECM (Error Correction Mechanism).