ABSTRACT

Most countries in the world, including Indonesia, rely upon debt as an important part of their development financial source. Financing through foreign debt is conducted as a result of the domestic fund source scarcity. In this relation, it is important to pay a close attention to the absorption ability of a country, as an economics argument that is proposed to support the foreign debt existence.

The parameter of the foreign debt absorption ability can be seen from the ratio of the foreign debt to GDP with the standard limit of 30 %. However, some facts show that until this time being, Indonesia's foreign debt ratio to GDP is still higher than the standard limit given. It indicates that the level of Indonesia's foreign debt is too high. It becomes the focus of the problem in this research.

This research is aimed to examine the variables influencing Indonesia's foreign debt as well as the empiric model of the foreign debt. To analyze it, Error Correction Model (ECM) is used as an approach to examine the existing short run and long run equilibrium relationship between dependent variable and independent variables.

The results of analysis show that all independent variables : budget deficit, investment, exchange rate (rupiah to dollar), net export, and domestic savings are strongly significant influence the foreign debt, both in the short and long term in the period of 1970 – 2005. This level significant also supported by the ECt coefficient which means that the ECM specification model applied in this research is valid.

Budget deficit and exchange rate (rupiah to dollar) variables are positively and significantly influence the foreign debt both in the long and short terms. Investment contributes positive and significant results in long terms, while domestic saving contributes negative and significant results in long terms. Meanwhile, net export variable gives significant and negative results to foreign debt both in the short and long terms.

This result finding that foreign debt is a structural and long term economical problem. In this relation, the government needs to focus on increasing the net export and domestic saving to reduce foreign debt.

Keywords : foreign debt, budget deficit, investment, domestic saving, net export, exchange rate (rupiah to dollar), ECM.