THE MACROECONOMIC EFFECT OF FISCAL SHOCKS IN INDONESIA

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This paper examines the macroeconomic effect of fiscal shocks during the period 2000:M3–2009:M6 in Indonesia. A structural vector autoregressive (SVAR) model is estimated using three-variable and five-variable identification schemes. Our results provide the following evidences. A symmetric positive causality between tax revenues and government spending are found to be existed. Tax shock generates a negative impact on output whilst government spending produces a contrary effect in the short run periods. Government spending and tax yield a positive and negative, respectively, effect on price for all horizons. Fiscal shocks induce a positive response of interest rates. Tax shock is considerably important to explain output fluctuations. Fiscal and monetary shocks share an equal role in explaining price variability. Finally, there is a weak evidence on the interaction between fiscal and monetary policies.

Keywords: tax, government spending, fiscal policy, structural VAR, Indonesia

INTRODUCTION

In recent years, fiscal adjustments and their macroeconomic effects have received a renewed interest among policymakers and academic researchers alike, for instance, various fiscal instruments has spurred the role of fiscal policy in the midst of the global recession and financial crisis of 2007-2009. From both theoretical and empirical point of view in recent studies, the sign and magnitude of the impact of fiscal policy on key macroeconomic variables offer different conclusions.

The view of the standard Keynesian models is that government spending and deficit boosting policies have positive effects on aggregate demand and output. Fatas and Mihov (2001), Blanchard and Perotti (2002) and Gali et al. (2007), for example, have shown empirically that private consumption tends to react positively to an increase in government spending. In contrast, empirical work done by Giavazzi and Pagano (1990) and Giavazzi et al. (2000) and theoretical model proposed by Baxter and King (1993), Sutherland (1997), Perotti (1999), and Barry and Devereux (2003), reveal that many fiscal contractions have been associated with sustained economic recovery (expansionary fiscal contraction), even in the very short run. Correspondingly, several episodes of rapid fiscal expansions can be followed by economic activity downturn. This counter-prediction is the so-called non-Keynesian effects of fiscal policy.

Some studies, for instance, Perotti (2002) and De Castro and De Cos (2008)