CHAPTER II
LITERATURE REVIEW

A. Economic Growth Theory

Understanding of Growth

Economic growth theory is usually applied for explaining the steady-state or long-run growth measured by the percentage increase in national income or some measure of the standard of living such as HDI (*human development index*) (Sengupta, 2011). According to Supriyanto (2016) economic growth is one illustration of the state or economic activity in a country. Than Paulo Brito (2011) concludes, that theories of growth boil down to which variables explain the growth in GDP and to their dynamic behavior and which parameters are relevant. Then, economic growth is the most powerful instrument for reducing poverty and improving the quality of life in developing countries (Brown, 2007). Than, Acemoglu (2009) clarifies that economic growth sometimes increases pollution or may raise individual aspirations so that the same bundle of consumption may no longer satisfy an individual and on the other side, economic growth shows striking differences in the quality of life, standards of living, and health. On the other side Piętak (2015) explain that the level and rate of growth does not always reflect the real level of a population's living standards, it remains the primary measure of prosperity. Then he continued economic growth as a measure describing the dynamics of economic processes in the country it has some drawbacks (Piętak, 2015). Economic growth is an improvement in the economic situation in a country compared to the previous period by including several indicators related to the economic problems of its citizens. On the other side, economic growth according to (Sukirno, 2017) is an increase in GDP (*Gross Domestic Product*), without regard to population growth. Sukirno continued that usually the term economic growth is used by developed countries to explain the increase in GDP, while economic development is a term for developing countries to explain an increase in GDP. Many indicators serve as a benchmark for economic growth in a country such as a state income, income per capita, the number of workers and the unemployment rate, and the reduction in poverty levels in that country (Fair, 2007).

The way to measure economic growth in a country is generally seen from Gross National Product (GNP) and Gross Domestic Product (GDP). The GNP has the function of measuring the total national economic production expenditure of all citizens both working domestically and abroad. While GDP has a function as a benchmark of the rate of economic growth based on income derived from domestic or the results of all products produced in the country regardless of nationality (Fair, 2007).The way to calculate it is simple, Supriyanto (2016) explains that economic growth in countries can be measured by comparing, for example in a national measure, the Gross National Product (GNP), the current year with the previous year.

There are three problems in economic growth according to Supriyanto (2016) in the short term: 1) inflation which, inflation can cause the redistribution of income among the people, a decrease in economic efficiency, changes in output and employment opportunities in society. 2) unemployment, which causes a decrease in the level of output in the aggregate. unemployment itself is caused by a decrease in expenditure made by the public and the use of high technology in the industry. 3) the balance of payments deficit, this occurs when the value of imports is greater than the value of exports, the stability of the balance of payments reflects the stability of the foreign exchange rate. The problem that arises from the balance of payments deficit is the declining value of the currency and inflation. On the other hand, Jati Sengupta (2011) expresses economic growth involves two sides, one is the output side with consumption as the end-use and the other is the cost side, which is the cost implications of various resources used in the production and distribution processes of the economy.

There are various models of economic activity in society according to Supriayanto (2016):

1) The model of two sectors of economic activity, which shows the relationship between two sectors between the household sector and the company sector and also the bank sector.
2) Three-sector economic activity model, this model shows the relationship between the household sector, banks, companies, and government through taxes.
3) Open economic activity model, showing the relationship by four interrelated sectors namely, the household sector, banks, companies, government, and also the foreign sector.

Sengupta (2011) explains that some factors are affecting economic growth there are:

1) Human resources determining the very important thing in economic growth in a country by calculating the quality and quantity of human resources that have been available directly in influencing economic growth. The quality of human resources can be seen with the skills, creative abilities, training, and education that they already have. If a country has very good, skilled and trained human resources, the output will be of high quality. But the lack of skilled human resources can hamper economic growth, while the surplus to human resources will be less significant in economic growth. For this reason, human resources in a country must be proportional to the number of skills and abilities that are needed, to produce the achievement of economic growth.

2) Natural Resources can affect economic growth in a country. Natural resources are resources that are already available in nature, both on land or under the sea. Natural resources that have been owned in a country following climatic and environmental conditions within the country. Countries that have a lot of natural resources can enjoy good growth compared to countries with few natural resources.
3) The capital formation consists of land, buildings, machinery, electricity, transportation, and other communication media. Capital formation is the process of producing all products derived from man-made. The capital formation can increase the availability of capital in the workforce, it can increase the ratio of capital or labor. As a result, it can increase labor productivity, which can result in increased output and economic growth in a country.
4) Technology development, technology has the nature and type of technical instruments used with several workers. Technological development has contributed to increased productivity with a very limited amount of resources. Countries that have used technology development can grow rapidly compared to countries that do not use it. The selection of appropriate technology development can play an important role in economic growth.
5) Social and political factors consist based on customs, traditions, values , and beliefs in each country, it can contribute to economic growth. Political conditions of a country can affect economic growth in a country. If the current political conditions in a stable country will run well and can provide comfort to the community can also support increased performance in production. That way the free community will innovate and develop the potential it already has so that it will form achievements in economic growth.

Economic Growth Theory

There are many theories put forward regarding economic growth in countries. This theory becomes the basis and reference in understanding the meaning and purpose of the country's economic growth. Of course, this theory has been tested and evaluated in advance so that it can get the right answer to interpret economic growth in each of the different countries.

1. The Classical Approach

The theory of economic growth was first coined by Adam Smith and David Ricardo in the 18th and 19th centuries, later this theory became known as classical economic theory. The interest of the classical economists in economic growth derived also from a philosophical concern with the possibilities of 'progress' an essential condition of which was seen to be the development of the material basis of society. Accordingly, it was felt that the purpose of the analysis was to identify the forces in society that promoted or hindered this development, and hence progress, and consequently to provide a basis for policy and action to influence those forces. Ricardo's campaign against the *Corn Laws* must be seen in this light, as also Malthus's concern with the problem of population growth and Smith's attacks against the monopoly privileges associated with mercantilism (Harris, 2007). Then Harris continue, Of course, for these economists, Smith especially, progress was seen for the growth of national wealth. Hence, the principle of national advantage was regarded as an essential criterion of economic policy. Progress was conceived also within the framework of a need to preserve private property and hence the interests of the property-owning class. From this perspective, they endeavored to show that the exercise of an individual initiative under freely competitive conditions to promote individual ends would produce results beneficial to society as a whole. Conflicting economic interests of different groups could be reconciled by the operation of competitive market forces and by the limited activity of 'responsible' government.

a. Adam Smith

Adam Smith describes his opinion on how to analyze economic growth with two factors they are, the total output factor and the population growth factor. Calculation of total output can be used on three variables they are: First, natural resources; Second, human resources; Third, and capital stock. Whereas if the second factor is population growth, it is carried out in determining market area and economic growth (Sengupta, 2011).

b. David Ricardo

David Ricardo is thinking about the well-known economic growth, which is about *the law of diminishing return*s. David Ricardo's thinking about how population growth can affect the decline in marginal products due to the limited amount of land. According to David Ricardo, increasing productivity in the workforce requires more technological advances and considerable capital accumulation. That way, economic growth will be achieved (Sengupta, 2011). The essence of David Ricardo's theory is he believed that for every increase in population there must be increased land and employment. On the other hand, (Brito, 2011) explains that the modern economic growth process has been contemporaneous with a demographic revolution; except this, it seems to be independent of the rate of growth of the population.

According to Smith and Ricardo, the macroeconomic problem of the 'laws of motion' of capitalism appeared as the primary problem on the agenda, and it seemed necessary that the whole of economic analysis – including the basic theories of value and distribution – should be deliberately oriented towards its solution (Harris, 2007).

Based on these basic thoughts, it is concluded that classical economic theory, has the assumption, that the market can achieve its balance through market mechanisms, where supply will always create its demand. Supriayanto (2016) explains that classical economic theory believes that economic activity will develop efficiently, economic growth will increase, and full employment, in the long run, will be achieved.

In 1929 - 1939 there was a Great Depression in the United States of America, this crisis occurred due to falling buyer demand while the high level of production, high debt levels, overly high speculation at the stock market, unemployment due to high levels of dismissal, and the absence of government interference (Komalasari, 2015). This crisis creates a new thought on the theory of growth called the theory of Keynesian in 1939.

2. Keynesian Approach

John Maynard Keynes wrote a book called *The General Theory of Employment of Interest and Money,* 1936. This book was written as a reaction to the great depression that occurred in the 1930s which was unsuccessful with Classical and Neo-Classical thinking. Keynesian growth theory explains that consumption by one person in the economy can help increase the income of others. at the time of the great depression crisis, people refrained from consuming and instead hoarded money. this is what causes the cycles of money circulation to stop and causes the economy to paralyze. The solution to this problem according to Keynes is by government intervention. Principles in Keynesian Economic theory according to (Komalasari, 2015) :

- The market is unstable and cannot self-regulate
- The economy cannot achieve full employment
- The supply of production will adjust demand
- Wages and prices are relatively fixed
- The existence of government interference in the economy

Short-term models refer to the scientific achievements of Keynes. Their main purpose is to identify the possibility of having the level of actual production approach the level of potential output (Piętak, 2015).

3. Neo-Keynesian Approach

In the Neokeynes theory, 2 figures are well known, namely Roy F. Harrod and Evsey D Domar. This approach is also often referred to as the modern growth theories in economics or the Harrod – Domar model. Roy Harrod and Evsey Domar developed a model that sought the possibility for sustainable growth. They extended the short-term Keynesian model, that assumes the instability of the capitalist economy (Piętak, 2015). This approach explains that capital investment is the key to economic growth measured in terms of real income. This theory explains the positive relationship between investment and growth, this theory is assumed to increase production, with increasing capital. If it is assumed there is a direct relationship between capital capacity (K) and economic growth (Y), then every addition of one unit of capital stock will increase the level of output (Y) (Sengupta, 2011). In other words, the effect of investment in aggregate demand and growth on production capacity can increase economic growth. In the model of Harrod-Domar growth is sustainable if three growth rates are equal: the actual growth rate, guaranteed growth rate, and natural growth rate. Harrod called such a situation the "*golden age*", whereby the achieved macroeconomic balance ensures the full use of capital and labor. However, equilibrium requires equalization of savings, which are dependent on households and investments that are in the hands of the capitalists (Piętak, 2015). Principles in the Harrod – Domar model according to (Sukirno, 2017) :

1) At the initial stage, the economy has reached full employment
2) The economy itself consists of two sectors namely the household sector and the corporate sector
3) The amount of community savings is proportional to the amount of national savings
4) The inclination to save is fixed, wherein, the ratio of production capital and the ratio of production allowances are fixed or unchanged

According to Sukirno (2017) Harrold-Dommar model, explaining the factors causing slow economic growth or stagnation are:

1) The technological development that is saving capital. Then the development of technology of this nature leads to a reduction in the ratio of production capital and pushes down prices, which in turn reduces the occurrence of capital investment.
2) Population growth is very slow. Different from the classical theory which considers that population growth is an economic hindrance. Harrold - Dommar believes that a large number of productive population is an expansion of the market, which in turn can increase public demand. public demand for goods and services reduces the drive for capital investment.
3) Reduced *Frontier Spirit*, or the desire to develop new regions and natural resources. this is due to reduced area and natural resources that can be developed. this can reduce the urge for capital investment.

4. Neo Classic Approach

a. Robert Solow and Trevor Swan

The two problems identified by the Harrod – Domar model, instability of the economy and the impossibility of full use of the labor, were solved in the Solow – Swan model by introducing the assumption of substitution of factors of production, which in turn removed the assumption of a constant ratio of capital or production (Piętak, 2015). Solow-Swan used the neoclassical growth model as the basis for decomposing the growth in output per capita into portions accounted for by increased inputs and the portion attributable to increases in productivity (Masoud, 2013). Slow-Swan growth model has the following assumptions, they are: First, assuming a permanent workforce and technology; Second, assuming only fixed technology; Third, workforce and technology are changing.

Solow-Swan growth model explains that interest rate and income affect the level of savings and investment. If the interest rate is low then the investment rate will be high, so is the reverse. As a result of increased investment, the interest rate rises thereby increasing the amount of savings (Acemoglu, 2009). In other words, economic growth is a series of activities originating from four main factors namely human, capital accumulation, modern technology, and output.

b. Joseph A Schumpeter

Schumpeter in the book "The Theory of Economic Development" explains, that the main factor causing economic development is the process of innovation. In this theory, economic growth is defined as an increase in the total output of society (Acemoglu, 2009). Other aspects involve three main mechanisms that guide the process of industrial evolution according to Schumpeter model:

1) Mechanisms for creating diversity in the fields of goods and services and technology,
2) A mechanism for transmitting diversity to other sectors through backward and forward linkages. For example, "More use of inputs and more demand for output,
3) The selection mechanism with which to succeeding terms of innovation emerged as a leader.

New technology and innovation create a very competitive world, where Schumpeterian competition plays a dynamic role (Jati Sengupta, 2011). The essence of Schumpeter's theory shows the importance of innovation and the role of entrepreneurs in economic growth. The neo-classical theory emphasized the competitiveness of markets as central to economic growth and ignored the roles of governance and the legal framework.

Developing countries have fuelled the world output growth rate since 2011, but the growth rates in these countries are steadily declining. While major developed economies remained sluggish, their overall growth performance started to improve. On the other hand, D-8 is a prominent economic organization that collectively accounts for 5 percent of the global GDP and 15 percent of the population with an expected upward trend soon (TEPAV, 2018).

From Table 2.1 we can find the rate of economic growth in countries D-8 countries from 2011 to 2013 are quite diverse between one another. Bangladesh leads with the highest growth (6.16%), followed by Turkey (5.80%), Malaysia (4.43%) and Indonesia (3.92%) in 2017. Then the lowest growth of D-8 countries is Nigeria (-1.77) in 2017.

Table 2.1. Growth Rate of Real GDP per Capita (%) in D-8 Countries

Countries	**Growth Rate of Real GDP per Capita (%)**				
	2013	**2014**	**2015**	**2016**	**2017**
Malaysia	2.80	4.18	3.40	2.67	4.43
Turkey	6.75	3.47	4.40	1.57	5.80
Egypt	-0.08	0.67	2.18	2.26	2.19
Iran	-1.46	3.30	-2.50	12.10	2.62
Pakistan	2.21	2.51	2.61	3.38	3.63
Nigeria	2.61	3.52	-0.02	-4.16	-1.77
Bangladesh	4.77	4.84	5.37	5.96	6.16
Indonesia	4.24	3.73	3.65	3.85	3.92

Source: World Bank (2018)

Unfortunately, D-8 has not moved at the envisaged pace to achieve its objectives. This is even though the member states have complementary economies and can do a lot to intensify intra-group trade and economic cooperation. It is because of the lack of commitment on the part of its member states. Except for Bangladesh, all members signed the PTA on May 14, 2006, at the fifth D-8 Summit at Bali, Indonesia. So far, six members have ratified the agreement. Bangladesh and Egypt are reluctant to ratify the treaty. Egypt is demanding a 50 percent value addition; while the "Bangladesh Tariff Commission" has advised the country not to ratify the treaty saying that it will not help boost the country‟s exports. During the eighth Summit in Islamabad, Chairman of the D-8 Federation of Chambers and Commerce and Industries, Dr. Herbert Ademola of Nigeria, expressed his concern that "implementation of PTA is still pending." Despite the constraints that be, the D-8 governments have taken many practical steps to facilitate the promotion of trade. Besides the PTA, other important frameworks such as Agreement on Visa Facilitation, Cooperation on Customs and Memorandum of Understanding (MoU) on Civil Aviation have been concluded. Forums have also been created to promote institutional linkages among the business communities of member states (Iqbal K. , 2013).

According to Iqbal (2013) strategy for future growth for D-8 countries are as follows:

1) D-8 Strategy towards achieving its long-term ideals and objectives should be based on an objective assessment of the potential of the community and analysis of the commonalities, particular characteristics and challenges faced by the member states, and their resolve to overcome such challenges through cooperation and collective effort.
2) D-8 should collaborate with other compatible entities following its charter.

3) D-8 should explore, in consultation with national investment and trade promotion agencies, the strategies and plans of action for increasing D-8 trade and investment with special emphasis on the energy sector through public-private partnerships.
4) D-8 should broaden and deepen cooperation in critical areas and stress the importance of collaborative efforts on capacity-building.

On the other hand, the results of Insani's research (2013) on OIC countries, to improve economic growth the government paid more attention to the agriculture and trade sector as a sector that could sustain the economy of the OIC country, in addition to that efforts were also made to increase economic growth in each country relies on its potentials and can overcome the problem of unemployment by facilitating business establishment permits so that greater employment opportunities and open up potential employment opportunities so that it can absorb a large workforce. Furthermore, FDI flows flowing into the OIC to be controlled and not concentrated in several developed countries. Finally, for the government to make effective policies in controlling inflation. It is hoped that the growth rate in OIC countries can continue to increase (Insani, 2013).

According to Khan (2012), factors that can increase economic growth, in the long run, are trade liberalization and capital account liberalization. Developing countries must meet prerequisites such as basic infrastructure and institutional development before embarking on a broad liberalization program. In particular, the development of the real sector must precede the development of the financial sector.

According to Sengupta (2011) four factors are a challenge and at the same time encouraged for developing countries in their economic growth they are:

1) Information technology

An economy characterized by this new technology is often called "the new knowledge economy," and it has four fundamental characteristics: accumulating knowledge capital, improving competitive efficiency, expanding export markets through global trade, and increasing collaboration and mergers in the creation and diffusion of new knowledge capital, which has significant spillover effects. Some countries such as Korea and Japan have successfully utilized the development of information technology to increase their economic growth and succeed in increasing the wealth and welfare of their countries. developing countries have limited information and knowledge technology, until now developing countries only utilize large and vast countries by developed countries.

The effects of technology can be different in each country where countries that have many young populations are worried about having difficulty in getting jobs because of technological change that replaces routine work. In fact, according to a World Bank report, Technological change that replaces routine work is estimated to have created more than 23 million jobs across Europe from 1999 to 2016, or almost half of the total increase in employment over the same period. Recent evidence for European countries suggests that despite technology may be replacing workers in some jobs, overall it raises the demand for labor. Technological progress leads to the direct creation of jobs in the technology sector.

People are increasingly using smartphones, tablets, and other portable electronic devices to work, organize their functions, secure and heat their homes, and have fun. Workers create online interfaces that drive this growth. With consumer interests changing fast, there are more opportunities for people to pursue careers in mobile and virtual app development reality design (World Development Report, 2019).

Approaching with Sengupta, Brown further says that future growth will need to be based on an increasingly globalized world that offers new opportunities but also new challenges. New technologies offer not only 'catch-up' potential but also 'leapfrogging' possibilities. New science offers better prospects across both product and service sectors (Brown, 2007).

2) Productivity

In global markets today competitive efficiency holds the key to success. Several important aspects of this efficiency have to be noted. The most important aspect of competitiveness is national productivity and especially the productivity of those sectors using information technology and software services. First, sustained productivity growth at the industry level requires that an economy continually upgrades itself. An upgrading economy is one that develops the capability of competitive success in entirely new and sophisticated industries. Doing so absorbs human resources released in the process of improving productivity in existing fields. The second aspect of competitive advantage is to compete in international trade by eliminating the need to produce all goods and services within the country itself and therefore specializing in goods and services where it is most cost-efficient.

Finally, one must note that governments cannot create competitive industries, only private firms and industries can. Efficiency-driven growth in the knowledge capital intensive industries today It has always drastically changed the market structure. there are four basic elements of core competence are as follows: learn, coordinate, integrate, and innovate. Another concept of efficiency which is important for economic growth is "adaptive efficiency." The incentives embedded in the institutional framework motivate the process of learning by doing and adopt the desired systems of economic structure. Adaptive efficiency provides the mechanism to encourage the development of decentralized decision making that allows societies to maximize their efforts required to explore alternative ways of solving inefficiency problems. Institutional change and reforms offer important strategies here. Two forces shape institutional change. One is IR and the other is imperfect markets characterized by significant transaction costs. In a world where there are no IR and markets are perfectly competitive, institutions do not matter.

3) Inequality

Kuznets (1955) examined the historical relationship between income per capita and income distribution. His analysis based on international cross-section data suggested that at low-income levels economic growth and average income tended to create more income inequality as measured by the Gini coefficient. Kuznets found in his empirical investigation that as per capita income continues to increase, a critical threshold level of income is reached and further economic growth and even higher average income tended to reduce income inequality. Another important reason for increasing inequality is the role of increasing monopoly elements due to the emergence of large and dominant firms in modern technology-intensive industries. Since these investments have high fixed costs, they generate substantial scale economies. The scale economies act as a deterrent to the new entry of smaller and medium-sized firms. Taiwan's economic policy prevented this from happening by encouraging the smaller and medium-sized firms to have easy access to the technology-intensive fields. Also, software technology and R&D activity requiring skilled human capital were strongly supported by the state policy. This helped maintain a more equalitarian distribution of income.

Than, Acemoglu (2009) defines economic growth is generally good for welfare but it often creates inequality. Joseph Schumpeter's famous notion of creative destruction emphasizes precisely this aspect of economic growth; productive relationships, firms, and sometimes individual livelihoods will be destroyed by the process of economic growth, because growth is brought about by the introduction of new technologies and creation of new firms, replacing existing firms and technologies. Growth in developing countries is generally high but this does not always represent the welfare of the country, in developing countries inequality between the highest-income people and the lowest income people has a very high distance. This process creates a natural social tension, even in a growing society. Another source of social tension related to growth (and development) is that, as emphasized by Simon Kuznets. Then institutions and policies can be arranged to resolve the problem of inequality in developing countries.

On the other side Brown, 2007 explained that growth does not necessarily lead to an increase in inequality. While some theoretical research shows a causal relationship between growth and inequality (and vice versa), the consensus of the latest empirical research is that there is no consistent relationship between inequality and changes in income.

4) Market Failure

Dynamics of industry growth, technology, and globalization have a dramatic impact on the current economic growth of nations today. In the world of innovations and the spillover of R&D effects, various forms of non-competitive market structures have evolved in recent times. This has sometimes been characterized as "market failures" associated with the deviations from the competitive market model. Four types of market failure would be discussed in this section as follows:

- Externalities and spillover effects
- Risk and uncertainty in financial markets
- Transparency in information and technology markets
- Market power and limit pricing

Many theories of economic growth that state excessive population growth will negatively affect economic growth. The population of D-8 member countries constitutes 14,6 % of the world's population (D-8 Economic Outlook 2017). the results of the research conducted by (Dao 2012) are, in a developing country the effect of population growth on per capita GDP growth is linear and everywhere negative. Governments in developing countries can influence population growth to stimulate growth. China provides a clear example by suddenly introducing a collection of highly coercive methods to reduce the total fertility rate from about 5.8 to 2.2 births per woman between 1970 and 1980.

On the other hand, a similar opinion was put forward by (Mohd Khairul Amri Kamarudin 2018) who explained, that the relationship between population growth and economic development has become a recurring theme in economic analysis. High population growth creates pressure on limited natural resources, reduces the formation of private and public capital, and shifts additions to capital resources to maintain rather than increase capital stock per worker. Positive effects, such as economies of scale and specialization, are likely to spur favorable motivations caused by increased dependence. To overcome this, the governments of developing countries issue human capital policies to enhance economic growth that will increase the level of state income.

Shaari (2019) added that developing countries incorporate less value added of services than developed countries in many sectors and are lagging in particular when it comes to exploiting the potential of services, especially in agriculture. The meeting will aim at strengthening value-added services that will nurture agriculture value chains, with a focus on small-holder farmers (Shaari, 2019). Hereinafter, Semmle (2014) explains that economic growth in developing countries depends on natural resource management which often does not pay attention to environmental welfare factors. developing countries must pay attention to sustainable economic growth, with the depletion of natural resources and the environmental impact of economic activities that need to be maintained. Policies must be developed to conserve resources and preserve the environment such as natural resources, land, air, water, climate, and biodiversity (Willi Semmle, 2014).

B. Public Policy Reform

Public Policy

Public policy is a multidisciplinary science because it involves many disciplines such as political science, social science, economics, and psychology. Public policy can be described as the overall framework within which government actions are undertaken to achieve public goals, with a good working definition of public policy, for our purposes, being the study of government decisions and actions designed to deal with a matter of public concern (Cochran & Malone, 2014). In line with Cochran & Malone (2014) (Uddin, Ali, & Masih, 2016) define public policy as a government action form government programs for the achievement of goals or objectives. Than (Hayat, 2018) explain that public policy is decisions made by someone who has authority in the government, both formal and informal or everything that is done or not done by the government is public policy. Doing by making a decision or not doing by not making a decision is a public policy.

Furthermore, Maulana and Nugroho define public policy as the impact of government activity or in other words defines it as a series of actions proposed by someone, a group, or the government in a particular environment, with existing threats and opportunities (Maulana & Nugroho, 2019). Whereas, according to (Munro, 2009) determine public policy is not just a governing tool to raise or lower taxes as a tool for price manipulation and revenue terms in the general demand function. On the other hand, public policy as a series of actions/activities proposed by a person, group, or government in a particular environment where there are obstacles and opportunities for implementing the proposed policy to achieve certain goals (Leo Agustino 2008; Taufqurakhman, 2014). Then, public policy can be seen as the preferences and values of the government elite. Although public policy often reflects the needs of the community. This can happen through:

1) Public policy is made incrementally and accommodates the values of the interests of the elite. The values of the elite will greatly affect the public. However, elitism does not mean that the public policy is anti-community (welfare) but the existing public policy responds to the people's welfare

prioritizing the interests of the elites rather than the interests of the community in general,

2) The lite sees that most of the people are passive, there is an information situation, people's sentiments are manipulated by the elite (Taufiqurokhman, 2014).

According to Cochran & Malone (2014), there are different models can identify important aspects of policy problems and provide explanations for public policy and even predict consequences. The following is a selection of some of the models frequently used by policy analysts to highlight certain aspects of policy behaviors :

1) Institutional Model

   The institutional model focuses on policy as the output of government as the ultimate decisionmaking authority. The model emphasizes constitutional provisions, judicial decisions, and common law obligations. Strictly speaking, a policy process does not become a public policy until it is adopted, implemented, and enforced by some government institution. Government institutions are crucial in that once a policy is officially adopted, the government provides legitimacy to that policy by enforcing it through government institutions. Government policies provide reciprocal-Public Policycal legal rights and duties that must be recognized by involved citizens. Governmental policies also extend universally to all members of society. Finally, governments alone have a monopoly on the legitimate use of coercive force in society and on sanction violators. Some very successful interest groups focus their efforts on influencing critical institutions of government rather than winning popular support. phenomenal success closely tracks the institutional model as it demonstrates how policy output can be influenced by agents' putting pressure on government institutions. Its efforts recognize that both the national and state governments receive independent legal authority from their citizens.

2) Incremental Model

   This model focuses on how public policy decisions are made. Those who support this model suggest that public policy is primarily a continuation of past government activities with only incremental changes. Incrementalism, a conservative ideal, holds that current policy and programs possess a certain legitimacy as they already exist. Groups who are beneficiaries support the continuation of the status quo, and politicians generally accept the legitimacy of established programs and are inclined to continue them because the consequences of adopting and implementing completely new or different programs are not easy to predict. In short, concentrating on increases, decreases, or modifications of current programs is simpler and less risky for policymakers than embarking on totally new programs. The model is often criticized because it does not require the establishment of clear goals. It tinkers with current programs with the hope that goals and alternatives will become clearer over time. However, this model is defended as the way that policymakers make decisions. Some argue that breaking down the implementation of major changes into smaller steps is necessary to make the changes more acceptable. For example, an administration proposal to raise the minimum wage by a significant amount is broken down into smaller increments over several years.

3) Group Theory

This model, also called pluralism, holds that politics represents the struggle among groups to influence public policy. Public policy at any given time repre-public Policysents the equilibrium reached in the group struggles. The role of government is primarily to establish the legal and regulatory rules in the group struggle. Politicians engage in bargaining and negotiating with groups to form a majority coalition of groups. The political parties are viewed as coalitions of interest groups. The model holds that individuals and groups have overlapping memberships, which prevents anyone from the group from moving too far from moderate values and any single interest from consistently dominating other groups. Pluralists claim that the power of each group is checked by the power of competing groups, resulting in a marketplace of policymaking in almost perfect competition. Critics of pluralism claim that in fact, different groups have vastly different resources. Some interests, such as those representing businesses or affluent professions, are very well organized and financed, while others, such as those representing poor or immigrant groups, have fewer financial resources and are more poorly organized, undermining any claim of group equilibrium. Some critics of the theory claim that the model ignores the role public officials play in public policymaking.

4) Model Elite

The elite model views public policy as reflecting the preferences and values of the power elite. This theory claims that society is divided between elites who have power and those who are not. Every society has more nonelites than elites. Democracy is often considered good for the poor because the poor far outnumber the elite. Conventional wisdom shows that democracy will lead to policy choices that reflect the preferences of the poor. In a democratic society, elites are worried about the dangers posed by nonelites who can unite and overwhelm them in the ballot box and redistribute wealth to the bottom. The elite is united in values protecting limited private and government property. They tend to have higher incomes, education, and status, which more than makeup for their lack of numbers compared to nonelites. They use their money and organization to maintain the status quo. Elites form mass opinions while mass opinions have little influence on elites. In general, government officials tend to adopt and implement policies decided by the elite, which flow toward the masses.

5) Scope of the Conflict Model

A competitive political system in which competing leaders and organizations define the alternatives of public policy in such a way that the public can participate in the decision-making process. To understand the meaning of democracy, one must be aware of how conflict determines the role people play in the political system. All conflicts contain the elements that give rise to a riot. A conflict between two individuals always attracts bystanders who want to know what the fight is about. If the spectators do not get involved, the outcome of a quarrel or a fight will depend on the skill of the two participants. Because the bystanders outnumber the original participants, their role is crucial. If they get involved in the conflict, they will determine the outcome. The outcome of every conflict is determined by the extent to which the audience becomes involved. Those who are winning in a conflict will try to limit the scope of the conflict to those already involved, to ensure their preferred outcome. Those who fear that

> they will lose will try to enlarge the scope by drawing in bystanders sympathetic to their cause. Politics is the socialization of conflict. When bystanders join the conflict, they change the nature of the original quarrel so much that the original participants may lose control of the conflict altogether.

Public Policy Reform

Public policies Reform pursue the public interest by attempting to correct for market imperfections, lower transaction costs, effectively regulate externalities or enhance productivity (Rausser, 2012). According to (Just, Hueth, & Schmitz, 2004) argues that public economic policy can be issued only with a quote analysis of economic welfare, policymakers can make decisions based on information with an understanding of the level and magnitude of the consequences from their economic policies. Than policies, reform is purposive courses of action devised in response to a perceived problem. Public policies are filtered through a specific policy process, adopted, implemented through laws, regulatory measures, courses of government action, and funding priorities, and enforced by a public agency. Individuals and groups attempt to shape public policy through the mobilization of interest groups, advocacy education, and political lobbying (Cochran & Malone, 2014). Than Hayat (2018) explains that policy reform is a policy formulation, policy implementation, and policy evaluation are public policy actions that are based on the interests of the public. Also, to form an achievement of the objectives of the policy to be achieved as expected. Of course, the policy formulation is based on an evaluation of the previous policy. Each policy does not stand alone and is a continuation of the policy that ever existed. As a series that can not be separated to find patterns that are relevant and good for the interests of the community. Policies must be based on improvements to previous policies based on the results of policy evaluations. In other words, policy reform becomes the transmission between evaluation and policy formulation. Various inputs in policy evaluation serve as guidelines for making changes in policies. This includes whether replacing existing policies with new ones or continuing existing policies with better patterns and methods. Meanwhile, economic reforms according to (Adams, 2010) are usually political because by changing the distribution of benefits in society, economic reforms benefit some social groups and others are detrimental.

While according to (Rausser, 2012) in the policymaking process endogenization of the instrument arrangement as a function of government bureaucracy and the actions of stakeholders. Still, another public policy reform is the result of manipulation by powerful groups actively engaged in the pursuit of their self-interest. On the other side, (Lofits, 2017) explains that public policy can change over time, policy reform is a picture of the weight of decision-makers from evaluating important things for the welfare of society, Lofits continued the determinants of policy reform can change over time. Meanwhile, according to (Adams, 2010) policy reform is often delayed and affected in developing countries. apart from positive contributions from policy reforms such as currency devaluation, privatization of state enterprises and the elimination of consumer subsidies might create trade and budget deficits and general economic prosperity, a recent study by the International Monetary Fund (IMF) found that "*economic reforms remain incomplete and external eligibility difficult to understand* "in many developing countries.

Public policy reforms can be done by selecting country-specific policy priorities, such as differences in income levels, institutional capacity and macro policy attitudes and can be seen through learning from previous public policy reforms about failure and success (OECD, 2017). Furthermore, a change in public policy cannot occur just because the government issued a policy, but the policy must have the support of the community so that the policy change can go well (Moran, Rein, & Goodin, 2006). Then, according to Taufqurakhman (2014), several new problems arise as a result of new policies or a public policy reform :

1) **Rule,** understanding of the rules here all the public problems or also problems caused by the public. Public problems can arise if: (a) the ambiguity or confusion of the language used in regulations, such as not explaining things that are prohibited and which must be done by the community, (b) some regulations have the potential to cause problematic behavior, (c) regulations often expand the division of problem behaviors, not even eliminate them, (d) regulations open opportunities for non-transparent behavior. Fifth, regulations give excess authority to implementing regulations to act repressively.

2) **Chance**, an individual can perform problematic behavior if the opportunity is wide open. The meaning is that if the opportunity is open then it can influence an individual to deviate behavior.
3) **Capacity**, it is related to the exchange that is caused by not being able to order individuals to do things beyond their ability. For that, there needs to be an understanding of the conditions of each individual in a country.
4) **Communication**, the emergence of problematic behavior can be caused by people's ignorance of a regulation. Ignorance is triggered by communication that is not going well. The issue of communication is a classic problem in a country that is rich in culture and very plural.
5) **Interest**, this category can be used to explain an individual's views about the consequences and benefits of each behavior. The consequences and benefits that can arise can be in the form of material (economic benefits) and also non-material (recognition and appreciation).
6) **The process** is an instrument used in finding problematic behavior caused in or by an organization. Some of the processes used to formulate problems in organizations include: First, the process of gathering input. Second, the process of input processing becomes a decision. Third, the output process, and the fourth, the feedback process.
7) **Ideology**, a set of values held by society to feel, think, and act. A value that applies in society is usually the result of mutual agreement in a group. The possibility of conflict is very large given the value of living in a pluralistic and heterogeneous society (a value that is held is often not following the views of each group).

The seven factors above are intended to narrow and systematize the scope or views of policymakers or policy analysts in making new policies or reforming public policies in society.

Policy reforms in parliamentary democracies result from the activity of politicians who belong to government and opposition parties (Konig, Tsebelis, & Debus, 2010). inline with Koning, Tesibels, and Debus, (Case & Fair, 2007) explain that actors from policymakers are the government. Furthermore, the role of government as social planners according to Semmler (2006) is including raising taxes optimally without distortion and choosing four types of public expenditure: (a) public investment to improve education and health services that increase the stock of human capital, (b) investment in public infrastructure assets (transportation and communication systems as well as energy, water supply, and sanitation), to support market production and the creation of human capital, (c) transfers and public consumption represent expenditures with characteristics of public goods that can fit into home preferences stairs (public parks), civic facilities and consumption transfers, and (d) public administration required for the functioning of the government (including justice, security, and tax collection). On the other hand, the role of government in the economy: to overcome market failures such as price rigidity, monopoly, and adverse externalities, the role of government is needed in a country's economy. This role can be done in the form of interventions directly or indirectly. The following are direct and indirect government interventions in determining market prices to protect consumers or producers through a floor price policy and a ceiling price policy (Case & Fair, 2007).

To overcome economic problems, the government uses certain policies. There are three government policies in the macroeconomic field. The policy is as follows:

1) Fiscal policy is closely related to government activities as a public sector actor. Fiscal policy in government revenue is considered as a way to regulate the mobilization of domestic funds, with its main instrument being taxation. In developing countries such as Indonesia, monetary policy and foreign policy have not proceeded as expected. Thus, the role of fiscal policy in the economic field becomes increasingly important. Fiscal Policy is an economic policy used by the government to control or direct the economy when conditions are better. The method is to regulate government revenues and expenditures. the use of fiscal policy not only for economic stabilization but also to promote growth and the increase of per capita income (Semmler, 2006).
2) The main instruments of fiscal policy are tax (T) and government expenditure (G). Government fiscal policy can be expansive or contractive. Expansive policies are carried out when the economy is facing a problem of high unemployment. The action taken by the government is to increase government spending or reducing the tax rate. The contractive fiscal policy is

a form of fiscal policy that is carried out when the economy reaches full employment or faces inflation. The action taken is to reduce government spending or increase tax levels (Case & Fair, 2007).

3) Monetary policy is an economic policy that is used by Central Bank as a monetary authority, to control or direct the economy in better or desired conditions by regulating the money supply and interest rates. The main objective of monetary policy is to control the amount of money in circulation. Monetary policy has the same objectives as other government economic policies. The difference lies in the policy instruments. If in fiscal policy the government controls government revenues and expenditures, in monetary policy the Central Bank controls the amount of money in circulation. Through monetary policy, Central Bank can maintain, or reduce to spur economic growth while maintaining the stability of prices. Monetary policy has three instruments there are, open market operations, discount rate policy, and the reserve requirement ratio included: 1) Open market operations, that is the government policy to control the amount of money outstanding by selling or buying government-owned securities. Open market operations are carried out by selling or buying Bank Central Certificates and Money Market Securities. 2) Discount Rate, One of the facilities is the discount rate, which means the interest rate set by the government for public banks that borrow from the central bank (Case & Fair, 2007).

Furthermore (OECD, 2017) explains that the government problems in the economic field do not only cover micro problems such as price rigidity, monopoly, and externalities that require government intervention. Economic problems also occur in the macroeconomic sphere that requires government policy. In developing countries, there are generally three major problems with economic development. These three problems are related to poverty, economic inequality, and increasing unemployment. The explanation is as follows:

1) **Poverty Problem** is a state of economic disability so that a person cannot meet basic needs because his income is low. Poverty occurs due to several factors. Because of the low income that causes low purchasing power. Also,

because of the low education of the people, people do not get a decent life (OECD, 2017).

2) **Underdevelopment Problems**, characteristics of developing countries are low levels of income and equity, low levels of progress and public / public facility services, low levels of community discipline, low levels of population skills, low levels of formal education, lack of capital, and low labor productivity, and weak levels of labor business management. To overcome the problem of underdevelopment, the government seeks to improve the quality of human resources by conducting educational programs and conducting training. Besides, exchanging experts, transferring technology from developed countries. The problem of underdevelopment is a problem that we must overcome together. Because we are the subject or object of this problem. The effort we can do is to have a passion to move forward so that we have the desire to learn and keep learning. The effort that can be done is to improve science and technology because it is the key to overcoming the problem of underdevelopment (OECD, 2017).

Then (Gray, 2007) explains that larger governments can inhibit growth in countries with weak governance, but this effect is not linear. where are the results of this study is below about one-third of GDP, the size of government is not correlated with growth, but once public spending exceeds 35 percent or so of GDP, increasing government size can harm growth. Strong governance reduces this negative impact, which is one of the reasons that big governments do not necessarily reduce economic growth in several high-income developing countries. Various reasons explain why large governments can stunt growth in countries with weak governance, with the following description:

1) large governments are more likely to run fiscal deficits during economic downturns, particularly where public spending is inflexible because of weak budgeting systems, reliance on earmarks, and high public employment.
2) The high rates of taxation needed to fund big governments can distort private activity, particularly if tax administrations are weak and thus not able to tap a broad tax base.
3) A large government presence in particular sectors may be accompanied by anti-competitive regulations on private sector participation.

4) Government spending may be misallocated as a result of corruption or poor capacity, sapping productive resources from the economy. While strong and capable governments may be able to avoid many of these problems through tight budget planning and execution and efficient tax administration, countries with weaker governance would be well advised to keep public spending and taxation to more modest levels if they want to spur rapid rates of economic growth.

According to D- 8 Economic Outlook low-income countries are particularly in need of improved education and infrastructure, good quality economic institutions, reduced barriers for better market efficiency and effective competitiveness. Low-income countries need to achieve rapid accumulation of capital, raising agricultural productivity and technology diffusion in labor-intensive industries to maintain a dynamic growth path supported by productivity growth. Some of this problem can resolve with public policies reformed. According to D-8 Economic Outlook 2017, several public policies must be reformed by D-8 countries member they are : (1) institutional equality and, (2) research and development fund, (3) financial development, which will be explained below.

a. Institutional Equality

Institutions can be defined in terms of property rights' protection and regulatory frameworks by authorities to defend their population against economic shocks and provide social protection (SESRIC, 2016). On the other hand, institutions are the core component of the institutional matrix. They set stages for other institutions to be devised and influence economic growth (Slesman, Baharumshah, & Azman-Saini, 2019). Furthermore, the institutional model focuses on policy as the output of government as the ultimate decisionmaking authority. The model emphasizes constitutional provisions, judicial decisions, and common law obligations. Strictly speaking, a policy process does not become a public policy until it is adopted, implemented, and enforced by some government institution. Government institutions are crucial in that once a policy is officially adopted, the government provides *legitimacy* to that policy by enforcing it through government institutions (Cochran & Malone, 2014).

In the literature, economists agree on at least five types of institutions that they consider vital for economic development (Rodrik & Subramanian, 2008; SESRIC, 2016). The evolution of institutions that create a hospitable environment for cooperative solutions to complex exchange provides for economic growth. On the other side, (Sengupta, 2011) explains that growth is institutional change. Both economic and extra-economic institutions must change if economic growth must continue. Economic institutions include, for example, markets and banks. Extra-economic institutions consist of governance, for example in terms of laws and regulations and the bureaucratic system. Both types of institutions are important for economic growth.

The central focus here is on the problem of human cooperation, specifically the cooperation that permits economies to capture the gains from trade that were the key to Adam Smith's Wealth of Nations. These are institutions that government property rights, regulatory institutions, institutions for macroeconomic stability, social insurance institutions, and institutions of conflict management. Rule of law and regulatory quality is one of the categories for institutional equality, D-8 country is still low (SESRIC, 2016).

Table 2.2

Rule of Law and Regulatory Quality in D-8 Countries

Countries	**2015**	
	Rule of law	**Regulatory Quality**
Malaysia	0.4	0.7
Turkey	-0.1	0.3
Egypt	-0.5	-0.7
Iran	-0.9	-1.3
Pakistan	-0.8	-0.6
Nigeria	-1.1	-0.8
Bangladesh	-0.3	-0.8
Indonesia	-0.4	-0.2

Source: World Bank (2017)

In table 2.2, only Malaysia get positive scores in both of these categories and Turkey in only one category. Iran has the lowest score of regulatory quality and, Nigeria has the lowest score in the rule of law. The cost of inefficiency in governance and lack of suitable progressive economic laws favorable to sustaining competitive efficiency have acted as great deterrence to economic growth in developing countries (Sengupta, 2011). Inefficiency in governance can be analyzed in several ways. One is the transaction cost approach emphasized by the Coase theorem and North's theory. As North (1990) argued that in a world where there are no transaction costs and increasing returns, institutions do not matter. Institutional reforms, both political and economic, involve providing adaptive efficiency, which provides incentives to encourage the development of decentralized decision making. Second, organizations are subject to path dependence, where history matters. Political and legal institutions can either facilitate or hinder the process of innovations and technology transfer. The fixed cost for any change to decentralized forms is very high, and it causes significant deviations from competitive efficiency. Finally, economic laws generate significant inefficiency due to a lack of decentralization. Bureaucratic control and outdated laws of land reforms create stumbling blocks to incentive creation and dispersion. Some progressive laws are not adequately enforced (North, 1990; Sengupta, 2011).

b. R&D Fund

Then R&D expenditures may be considered as an investment in new technologies, and knowledge base, which can be then transformed into more efficient production methods for available resources Innovation requires significant investment and a long-term perspective (Tunaa, Kayacana, & Bektaúa, 2015). In other words, R&D activities are the foundation of the company's long-term sustainability in developing and developed countries. Sengupta (2011) in his book entitled "*Understanding Modern Theory and Experience*" said that the learning process involves several forms. The first is to learn by imitation. Some of these countries imitated the new up-to-date technology and improved it. The modern endogenous growth theory emphasized the dynamic role of the spillover effect by which industrial knowledge shifts from the advanced countries to the developing ones. To catch this affect the industries in the developing countries have to practice organizational learning and management, and dynamic flexibility in their decision making.

The basic driver of economic growth is R&D activities. The common prediction claims that any rise in the level of resources allocated to R&D should inevitably increase the economic growth rate (Genç and Atasoy, 2010; Tunaa, Kayacana, & Bektaúa, 2015). Then, according to (Sengupta, 2011) economic development is driven by innovation through a dynamic process in which new technologies replace the old, a process in this context, is specified that innovation consists of the following five circumstances:

- Introduction of a new good
- Introduction of a new method of production
- Opening of a new market
- Conquest of a new source of supply of raw materials or semi-manufactured goods
- Implementation of a new form of organization.

D-8 countries' innovation activities in each industry hinge on the nature of the industry. Some industries are dominated by large innovative firms while others may be dominated by smaller firms with the ability to provide specialized products. In other industries, the capability to innovate is based on only the ability to exploit economies of scale (SESRIC, 2016).

Table 2. 3

R&D Expenditure of GDP in D-8 Member Countries (%)

Countries	**2010**	**2014**
Malaysia	1.3	1.26
Turkey	-	1.01
Egypt	0.68	0.68
Iran	0.12	0.33
Pakistan	0.29	0.29
Nigeria	0.22	0.22
Bangladesh	-	-
Indonesia	0.08	0.08

Source: World Bank (2017)

R&D expenditure in D-8 countries it is still not satisfactory (Table 2.3). Only Malaysia and Turkey spend more than 1% of their GDP on research and development, in this figure is as low as 0.08% in Indonesia. This is because developing countries specifically D-8 countries allocate more funds for education than research and development funds. However, low government spending on research and innovation sector need to be allocated according to national development strategies and priorities in D-8 countries member (SESRIC, 2016). On the other hand, the government 's spending on education at all levels and also on research in new areas such as solar and renewable energy or agricultural research provides an important strategy for augmenting the learning process. Finally, management skills in organizational learning are the most essential. Hence, the state policy should support and encourage the management of education and research activities in the country. Problems of coordination and organization inefficiency are the two most basic problems that hinder economic growth (Sengupta, 2011).

c. Financial Development

Finance is defined as the management of money and includes activities such as investing, borrowing, lending, budgeting, saving, and forecasting (Kim, Yu, & Hassan, 2017). Than (İnancli, Altintas, & İnal, 2016) devine that financial development was represented by loans to the private sector. As we know the Muslim population reaches 1/4 of the world's population. In recent years, due to the emergence of Shariah-based finance products and insurance, which is following a flexible interpretation of shariah. It plays an important role in increasing the level of financial development of Islamic countries (Akin, Iqbal, & Mirakhor, 2016). A commonly used indicator for determining the degree of financial deepening is the ratio of broad money to GDP. The average of broad money relative to the GDP of D-8 countries was recorded at 54.6% and 116.2% of the world average in 2015 and the financial sector on average provided credit to the domestic economy is 65.4% of the GDP in D-8 countries in 2015 (SESRIC, 2016). Then (İnancli, Altintas, & İnal, 2016) found, that financial development for D-8 countries had a positive effect on economic growth. Then (Slavtcheva, 2015) argues when a country has a low level of financial development, a flexible exchange rate leads side to lower productivity growth than a fixed exchange rate side, while the effect is insignificant in financially developed countries.

On the other hand, (Akin, Iqbal, & Mirakhor, 2016) as a result of his study that revealed the OIC countries have not fulfilled the basic requirements of risk-sharing financial arrangements and thus the framework for the comprehensive development of Islamic finance. Unfortunately many members of the D-8 countries not getting benefit greatly from financial development. In D-8 countries except for Malaysia, financial depth, as measured by the volume of broad money relative to GDP, is still below the average world level in 2015. In Malaysia, the total size of broad money which includes, inter alia, all narrow money, and deposits, was more than 1.3 times of GDP (135.1%) (SESRIC, 2016). Further Sengupta (2011) clarifies that Financial reform is essential for economic growth. This is because of two basic reasons. One is the credit and loan facility, which helps private investment to grow. Good monetary policy is, therefore, essential for economic development. The financial crisis of 2007-2009 affects the USA and the world economy is basically due to the failure of the banking system and the economy-wide credit policies. A second reason is that the networking strategy by the domestic banking sector can set up very profitable links with banks abroad and this facilitates the expansion of the world market.

C. Hypothesis

H_1 = export will have a positive effect of economic growth in D-8 member countries

H_2 = political stability will have a positive effect of economic growth in D-8 member countries

H_3 = developing-8 will have a positive effect of economic growth for its members.