

## **CHAPTER II**

### **LITERATURE REVIEW**

#### **A. Theoretical Framework**

##### **1. Economic Development and Economic Growth**

The development in developing countries is emphasized more on economic development, this is due to economic backwardness. Development in the economic field can support the achievement of goals or encourage changes or renewal of other areas. Jhingan states the main purpose of economic development is to implement capital on a scale sufficient to increase productivity in agriculture, mining, plantations and industry. Capital is also needed to establish schools, hospitals, highways, railroads and so on (Jhingan, 1992).

An economy experienced growth and development if the level of economic activity increases or is higher compared to the previous year. In other words, economic development occurs if the amount of goods and services physically produced increases in the following year. Indicators of the success of a region's economic development can be demonstrated by economic growth. Economic growth is the overall growth of people's income as a reflection of the increase in all value added created in a region.

Sirojuzilam conveyed that economic development as a multidimensional process involving major changes, the changes can be in economic structure, social change, reducing or eliminating poverty,

reducing inequality and unemployment in the context of economic growth (Sirojuzilam, 2008).

Calculation of Gross Domestic Product (GDP) and Gross National Product (GNP) in a certain period of time makes a growth in the economic activities of the community, and also a growth in the number of population. Thus, a portion of the results of the growth of economic activities must be used for the economic welfare of the community. If the GDP/ GNP growth rate is equal to or lower than the population growth rate, then per capita income will remain the same or even lower.

Based on the explanation above, some economists distinguish the definition of economic development from economic growth. Economic growth is defined as an increase in GDP/GNP regardless of whether the increase is greater or smaller than the level of population growth. But in the end the economists gave the same understanding for economic development and economic growth that is as an increase in GDP/GNP. In more general use, the term economic development is used to express economic development in developing countries while the term economic growth is to express economic development in developed countries.

## 2. Economic Development and Economic Growth Theory

Arsyad states three economic development and economic growth theories, they are Classical Theory, Neo Classical Theory, and Keynesian Theory (Arsyad, 1999). The theory are as follows:

### a. Classical Theory

#### 1. Adam Smith

Smith defines two main aspects in the economic growth, as follows:

##### a) Total output growth

According to Smith, the availability of natural resources is the most basic means of production activities of a society. The amount of natural resources available is a "maximum limit" for the growth of an economy. When these resources have not been used maximum, the number of population and capital that plays a role in the growth of output. Therefore according to Smith the main element of a country's production system is three, namely the available natural resources, the number of population, and the existing capital stock.

##### b) Population Growth

The number of population increases if the prevailing wage rate is higher than the subsistence wage rate for life, if the wage rate is above the subsistence level then people will

marry at a young age, the mortality rate decreases and the number of births increases. According to Smith the prevailing wage rate is determined by the tug-of-war between the forces of demand and labor supply. A high level of wages will increase if labor demand grows faster than labor supply.

## 2. David Ricardo

According to Ricardo, the role of capital accumulation and technological progress tends to increase labor productivity which can slow down the work of the law of diminishing returns which will slow down the decline in the level of life towards a minimum level of living. The process of economic growth according to Ricardo is a process of attraction between two dynamic forces, namely between the law of diminishing return and technological progress.

The characteristics of David Ricardo's economy are:

- a. The amount of land is limited
- b. Labor (population) increases or decreases depending on whether the wage level is above or below the minimum wage level.
- c. Capital accumulation occurs if the level of profit obtained by the capital owner is above the minimum level of profit needed to attract them to invest

d. Technological progress occurs all the time

e. Dominant agricultural sector

b. Neo Classical Theory

Neo Classical economic growth theory develops based on an analysis of economic growth according to classical economic views. This theory was pioneered by two economists, Robert Solow and Trevor Swan. According to this theory, economic growth depends on increasing the supply of factors of production (population, labor, and capital accumulation) and the level of technological progress. Solow said that the role of technological progress in economic growth was very high.

Furthermore, according to this theory that capital-output ratio is dynamic. This means that to create a certain amount of output can use a different amount of capital with the help of workers whose numbers are different as needed. If more capital is used, less labor is needed, vice versa. Thus an economy has unlimited freedom in determining the combination of labor and capital used to produce a certain level of output.

c. Keynesian Theory

Keynesian growth theory was developed by Evsey Domar and Sir Roy F. Harrod, so this theory is better known as the Harrod-Domar theory. Here are some assumptions from Harrod-Domar's theory:

1. The economy is in full employment and capital goods which are made up in society are used in full.
2. The economy consists of 2 sectors, namely the household sector and the firm sector.
3. The amount of public savings is proportional to the amount of national income.
4. The amount of Marginal Propensity to Save (MPS) is fixed, as well as Capital-Output Ratio (COR) and Incremental Capital-Output Ratio (ICOR).

According to Harrod-Domar each economy can set aside a certain proportion of its national income if only to replace damaged capital goods. However, to grow the economy, new investments are needed as additional capital stock, meaning that every net addition to new investments results in an increase in total output in accordance with the capital output ratio.

### **3. Regional Economic Development**

Regional economic development is a process whereby local governments and communities manage existing resources and form a partnership pattern between the government and the private sector to create new jobs and stimulate the development of economic activities in the region (Arsyad, 1999).

The main problem in regional development lies in the emphasis on development policies based on the peculiarities of the area concerned

by using the potential of human resources, institutions, and physical resources in the regions. The orientation leads to initiatives originating from the region in the development process to create new employment opportunities and stimulate activities.

In essence, the economic development of a region is the implementation of national development in certain regions that are adjusted to the regional physical, socio-economic capabilities and comply with certain regulations.

Arsyad states economic development viewed in terms of economic activities and the angle of distribution into three (Arsyad, 1999), namely:

1. Homogeneous Area

Areas that are considered as spaces where economic activities occur and in the corners of the room are of the same nature. The similarities of these characteristics include in terms of income per capita, social culture, geography, and so on.

2. Nodal Region

Areas considered as a space economy controlled by one or several centres of economic activity so that the border is determined by places where the influence of one region or several centres of economic activities is replaced by influence from other centres.

### 3. Regional Planning

Administrative area in which the area concerned is also a space economy which is under a certain administrative area (such as provinces, districts, cities, etc.). So the understanding of the area here is more shown in the administrative division of the area.

### 4. Regional Economic Development Theory

At present there is no single theory that can explain regional economic development comprehensively. However, there are several theories that can partially help how to understand the importance of regional economic development. In essence, the core of these theories revolves around two things, namely the discussion of methods in analysing the economy of a region and theories that discuss the factors that determine the economic growth of a particular region. Arsyad conveyed some theories in regional development related to this research (Arsyad, 1999), namely:

#### 1. Economic Base Theory

This theory states that the main determinant of economic growth in a region is directly related to the demand for goods and services from outside the region. The growth of industries that use local resources, including labor and raw materials for export will produce regional wealth and job creation. This assumption provides an understanding that an area will have a leading sector if



the area can win competition in the same sector as other regions so that it can produce exports.

The essence of this economic base theory is that because the base industry produces goods and services for the market in the area concerned, the sale out of the region will generate income for the area. There was an income stream from outside the region that caused an increase in consumption and investment in the area, in their turn it would increase income and create new employment opportunities.

#### 1. Neo Classical Economic Theory

This theory provides two main concepts in regional economic development namely equilibrium and mobility of production factors. This means that the economic system will achieve its natural balance if capital flows without restrictions, therefore capital will flow from regions that have high wages to areas that have low wages.

#### 2. Cumulative Causation Theory

The condition of the areas around the city which are getting worse shows the basic concept of the cumulative causation thesis. This means that market forces tend to exacerbate the gap between these regions (developed area

versus developing area). The developed regions have accumulated competitive advantage compared to other regions.

### 3. Attraction Model

The theory of industrial attractiveness is the most widely used model of economic development. The underlying economic theory is that a society can improve its market position against industrialization by subsidies and incentives.

## 5. Regional Economic Growth

Regional theories of economic growth analyse a region as an open economic system that deals with other regions through the flow of factors of production and commodity exchange. Development in an area will affect the growth of other regions in the form of sector demand for other regions that will encourage the development of the region on an economic development from other regions will reduce the level of economic activity in an area and interrelation.

Economic growth can be assessed as the impact of government policy, especially in the economic field. Economic growth is a growth rate that is formed from various types of economic sectors that indirectly illustrate the level of growth that occurs and as an important indicator for the region to evaluate the success of development.

Regional growth occurs as a result of endogenous or exogenous determinants, namely the factors contained within the area concerned

or factors outside the region, or a combination of the two. Endogenous determinants include the distribution of production factors such as land, labor, and capital while the exogenous determinant is the level of demand from other regions of the commodity produced by the region in (Glasson, 1977).

## **6. Regional Economic Development Planning**

Arsyad divided the functions of development planning in general into five (Arsyad, 1999), namely:

1. With planning, it is expected that there will be a briefing of activities, guidelines for implementing activities.
2. With planning, we can estimate the potential, development prospects, barriers, and risks that may be faced in the future.
3. Planning provides an opportunity to make the best choice.
4. With planning, prioritization is made in terms of the importance of objectives.
5. Planning as a tool to measure or standard for evaluating.

Regional development planning is an economic entity with various elements of interaction. Regional economic activities are identified based on regional economic analysis, namely comparatively and collectively evaluated on regional scale economic conditions and opportunities.

Local governments have different interests with central agencies in looking at aspects of space in an area. This means that with the difference in growth and disparity between regions, the partial planning approach is very important to note. In regional development planning it is necessary to seek alternative choices of planning approaches so that the potential of existing resources will be optimized for their utilization.

Regional development policy is a decision or action by an authorized government official to formulate a development condition. The ultimate goal of the development policy is to be able to encourage and enhance overall economic growth and social welfare in accordance with the desires and aspirations that develop in the community.

## **7. The Role of the Government in Regional Development**

Local governments have an important role in the progress and welfare of economic development in the region. There are four roles that local governments can take in the process of regional economic development, namely as entrepreneurs, coordinators, facilitators, and stimulators for the incipience of regional development initiatives (Arsyad, 1999).

### **a. Entrepreneurs**

Local governments are responsible for running a business, such as developing a business (Regional-Owned Enterprises). The

result is local government assets can be managed better and economically can generate profits.

b. Coordinators

The local government acts as the coordinator in setting policies or proposing strategies for development in the region. Local governments can also involve other government agencies, businesses and communities in the preparation of economic goals, plans and strategies.

c. Facilitators

The government can accelerate development through improving the attitudinal environment (behaviour or culture of the community) in its area. This will accelerate the development process and better planning and zoning procedures.

d. Stimulators

The role of the local government stimulates business creation and development through special actions that will influence companies to enter the area and keep existing companies in the area and keep existing companies in the area that. This stimulation can be done in a way; making brochures, building industrial estates, making outlets for small industries, and helping small industries to do equalization.

## **8. Regional Autonomy**

Regional autonomy has the understanding that the authority to regulate and administer regional households is inherent in both unitary and federal states. The authority of the regional government in regulating its household in all fields except for a few things, namely foreign relations, court, monetary and finance and defence and security.

In law no. 32 of 2004 concerning regional government and law No.33 of 2004 concerning the financial balance between the central government and regional governments there is a new thing in the administration of local government. Secondly, the law has signalled a greater delegation of authority from the central government to regional governments.

Definition of autonomous regions according to law No. 32 of 2004, which is a legal community unit that has regional boundaries that are authorized and administer government affairs and the interests of local communities according to their own initiative based on the aspirations of the people in the system of the Unitary State of the Republic of Indonesia.

With the regional autonomy policy, each region is required to be more independent in carrying out its regional development process in the planning, implementation, supervision, control and evaluation of development policies. Because it needs to be independent, each region

must be able to create innovative creations and optimize its output to improve regional progress and independence and improve the welfare of the people in the region. With the policy of regional autonomy, it is expected to encourage the achievement of Indonesia's development that is more advanced, fair and equitable.

Machfud Sidik states the benefits of regional autonomy into two (Sri, 2009), they are:

a. Spreading decision-making centres

If all problems are put in the hands of a person or group of decision-making, there will be a build-up of authority at one decision-making centre.

b. The quickness in decision making

Not all problems need to be decided by a single decision-making center, of course decision making can be carried out more quickly. Especially in developing countries where transportation and communication are not always smooth, the distribution of authority to more than one decision-making centre will accelerate decision-making itself.

## **9. The Purpose of Regional Autonomy**

Through the regional autonomy policy, it is expected that the regional government is able to play its role in opening up opportunities to advance the region by identifying potential sources of income and

being able to determine regional expenditures that are economically reasonable, efficient, effective, including the ability of regional apparatuses to improve performance, and be responsible to the government and society. The goals to be achieved in the implementation of regional autonomy are:

- a. Developing regions in various fields
- b. Improve service to the community
- c. Grow regional independence
- d. Increase regional competitiveness in the growth process

In addition, the objective of regional autonomy is to improve the ability of the regions in the administration of government based on local potential, with the aim of:

- a. The realization of regional independence based on local potential.
- b. Increased regional financial capacity.
- c. Increased synergistic performance between policy determinants.

## **B. Previous Research**

Below is a section that contains a summary of several studies which is the research background used by the researcher. Below are the previous research that is used:



1. The similarity of this study with the journal below is the using of analysis method, namely Growth Ratio Model, Shift-Share Analysis, Location Quotient Analysis, Overlay Analysis, and Klassen Typologi Analysis. The purpose is also similar, to find out the leading sector of the chosen region.

**Table 2.1 Previous Study**

Authors, Year, Title	Analysis Methods	Results
Agus Tri Basuki and Utari Gayatri, 2009, <i>Penentu Sektor Unggulan dalam Pembangunan Daerah: Studi Kasus di Kabupaten Ogan Komering Ilir (OKI)</i>	<ul style="list-style-type: none"> <li>- Growth Ratio Model (MRP)</li> <li>- Shift Share Analysis</li> <li>- Location Quotient Analysis (LQ)</li> <li>- Overlay Analysis</li> <li>- Klassen Typology Analysis</li> </ul>	<p>Due to the great growth and contribution to the GRDP, agricultural sector is the leading sector in OKI Regency. Processing industry sector has the dominant growth but lack contribution to the GRDP. Building sector, trade, restaurant and hotel sector and services sector, those three sectors has less growth but great contribution to the GRDP. The last, mining and quarrying sector; electricity, gas and clean water sector; the transportation and communication sector and the financial, leasing and business services sector those four sectors are not potential both in their growth and contribution to the GRDP of OKI Regency.</p>

2. The similarity of this study with the journal below is the using of analysis method, namely Shift-Share Analysis.

**Table 2.2 Previous Study**

Authors, Year, Title	Analysis Methods	Results
Setyani Irmawati, 2015, <i>The Analysis on Leading Industries in Central Java Province</i>	<ul style="list-style-type: none"> <li>- Static Location Quotient (SLQ)</li> <li>- Dynamic Location Quotient (DLQ)</li> <li>- Shift-Share Analysis</li> </ul>	<p>According to the result of those three analyses, there are eight (8) industries among twenty four (24) industries that act as a leading industry in Central Java. Namely, beverage industry, tobacco manufacturing industry, textile industry, apparel industry, wood industry, printing industry, furniture industry, as well as other manufacturing industries.</p>

3. The similarity of this study with the journal below is the using of analysis method, namely Location Quotient Analysis and Shift-Share Analysis. The purpose is also similar, to find out the leading sector of the chosen region.

**Table 2.3 Previous Study**

Authors, Year, Title	Analysis Methods	Results
Fitri Amalia, 2012, <i>Penentuan Sektor Unggulan Perekonomian Wilayah Kabupaten Bone Bolango dengan Pendekatan Sektor Pembentuk PDRB</i>	- Location Quotient Analysis (LQ) - Shift-Share Analysis	According to LQ analysis, processing industry sector is the base sector that has the greatest value of other base sectors. Based on SS analysis, shows that the sector which is a competitive sector, namely the financial, leasing and business services sector because besides being a base sector, this sector has a positive shift value.

4. The similarity of this study with the journal below is the using of analysis method, namely Location Quotient Analysis. The purpose is also similar, to find out the leading sector of the chosen region.

**Table 2.4 Previous Study**

Authors, Year, Title	Analysis Methods	Results
Anna Yulianita, 2009, <i>Analisis Sektor Unggulan dan Pengeluaran Pemerintah di Kabupaten Ogan Komering Ilir</i>	- Location Quotient Analysis (LQ) - Correlation and Determination Analysis (R, R <sup>2</sup> , T-test)	According to the result of LQ analysis, during the period of 2004-2008 OKI Regency has three leading sectors namely agriculture sector, building sector, and trade, hotels and restaurants sector. While the result of t-test, R <sup>2</sup> is 0.6589 means 66% development of leading economic sectors (agriculture, buildings and trade, hotels and restaurants) in OKI Regency are influenced by government spending, while 34% are influenced by other variables.

5. The similarity of this study with the journal below is the using of analysis method, namely *Klassen Typologi Analysis*.

**Table 2.5 Previous Study**

Authors, Year, Title	Analysis Methods	Results
Bambang Suprayitno and Tejo Nurseto, 2011, <i>Pergeseran Sektor Ekonomi Unggulan Kabupaten Bantul Pasca Gempa Melalui Analisa Tipologi Klassen</i>	- <i>Klassen Typology Analysis</i>	The composition of each classification is basically the same as the original position as before the 2006 earthquake, there were only 2 sectors that experienced a shift, namely the Building Sector and the Manufacturing Industry Sector. The Building Sector shifts its position towards a better position, namely from the position of the fast-growing but unproductive sector to the leading sector, the sector that grows fast and productively. The shift also occurred in the Manufacturing Industry sector towards a worse position, namely from the productive sector but growing slowly.

6. The similarity of this study with the journal below is the using of analysis method, namely *Location Quotient Analysis* and *Shift-Share Analysis*. The purpose is also similar, to find out the leading sector of the chosen region.

**Table 2.6 Previous Study**

Authors, Year, Title	Analysis Methods	Results
Zuhairan Yunmi Yunan, 2011, <i>Analisis Sektor Unggulan Kota Bandar Lampung (Sebuah Pendekatan Sektor Pembentuk PDRB)</i>	- <i>Location Quotient Analysis (LQ)</i> - <i>Shift-Share Analysis</i> - <i>Sectoral Typology</i>	Bandar Lampung City has 7 base sectors. The Regional Government of Bandar Lampung City needs to pay special attention to these sectors, especially for sectors that are still slow to grow. So, the competitiveness of Bandar Lampung City can be increased.

7. The similarity of this study with the journal below is the using of analysis method, namely Location Quotient Analysis, Shift-Share Analysis. The purpose is also similar, to find out the leading sector of the chosen region.

**Table 2.7 Previous Study**

Authors, Year, Title	Analysis Methods	Results
Rika Hariani, Sri Rum Giyarsih, and Sri Rahayu Budiani, 2005, <i>Analisis Sektor Unggulan dalam Penyerapan Tenaga Kerja di Daerah Istimewa Yogyakarta</i>	- Location Quotient Analysis (LQ) - Shift-Share Analysis	According to LQ analysis, the leading sector in Kulon Progo Regency are agriculture and services sector, while in Bantul Regency are agriculture, mining and quarrying, processing industry, building, and trade, hotels and restaurants sector. In Gunung Kidul Regency the leading sector are agriculture, mining and quarrying, and building sector, while in Sleman Regency are processing industry, building, trade, hotels and restaurants, finance, leasing and company services sector. In Yogyakarta City, the leading sector are electricity, gas and water, trade, hotels and restaurants, transportation and communication, finance, leasing and company services, and services sector.

8. The similarity of this study with the journal below is the using of analysis method, namely Klassen Typologi Analysis, Location Quotient Analysis, Growth Ratio Model, and Overlay Analysis.

**Table 2.8 Previous Study**

Authors, Year, Title	Analysis Methods	Results
Azis Pratomo, 2014, <i>Analisis Pengembangan Pusat Pertumbuhan Ekonomi di Kabupaten Cilacap</i>	<ul style="list-style-type: none"> <li>- Klassen Typology Analysis</li> <li>- Location Quotient Analysis (LQ)</li> <li>- Growth Ratio Model (MRP)</li> <li>- Overlay Analysis</li> <li>- Scalogram Analysis</li> </ul>	<p>According to Klassen Typology Analysis, sub-districts in Cilacap Regency are divided into 4 categories namely rapid growth region, retarded region, growing region, and relatively backward region. And the result shows that there is no single sub-district in Cilacap included in relatively backward region. While based on LQ, MRP, and Overlay Analysis the number of sub-districts that has no leading sector is the highest than sub-districts that has one, two, or even three leading sector. And according to scalogram analysis there are three sub-districts that become the growth center in Cilacap namely Majenang, Gandrungmangu, and Kesugihan.</p>

9. The similarity of this study with the journal below is the using of analysis method, namely Klassen Typologi Analysis.

**Table 2.9 Previous Study**

Authors, Year, Title	Analysis Methods	Results
Sutarno and Mudrajat Kuncoro, 2003, <i>Pertumbuhan Ekonomi dan Ketimpangan antar Kecamatan di Kabupaten Banyumas, 1993-2000</i>	<ul style="list-style-type: none"> <li>- Klassen Typology Analysis</li> <li>- Williamson Index and Entropy Theil Index</li> <li>- Pearson Correlation</li> </ul>	<p>According to Klassen Typology Analysis, sub-districts in Banyumas Regency are divided into 4 categories namely rapid growth region, retarded region, growing region, and relatively backward region. And from the result of both Williamson index and entropy theil index during the observation period of 1993–2000 there was a tendency to increase inequality, one of which was due to the spatial concentration of economic activity.</p>

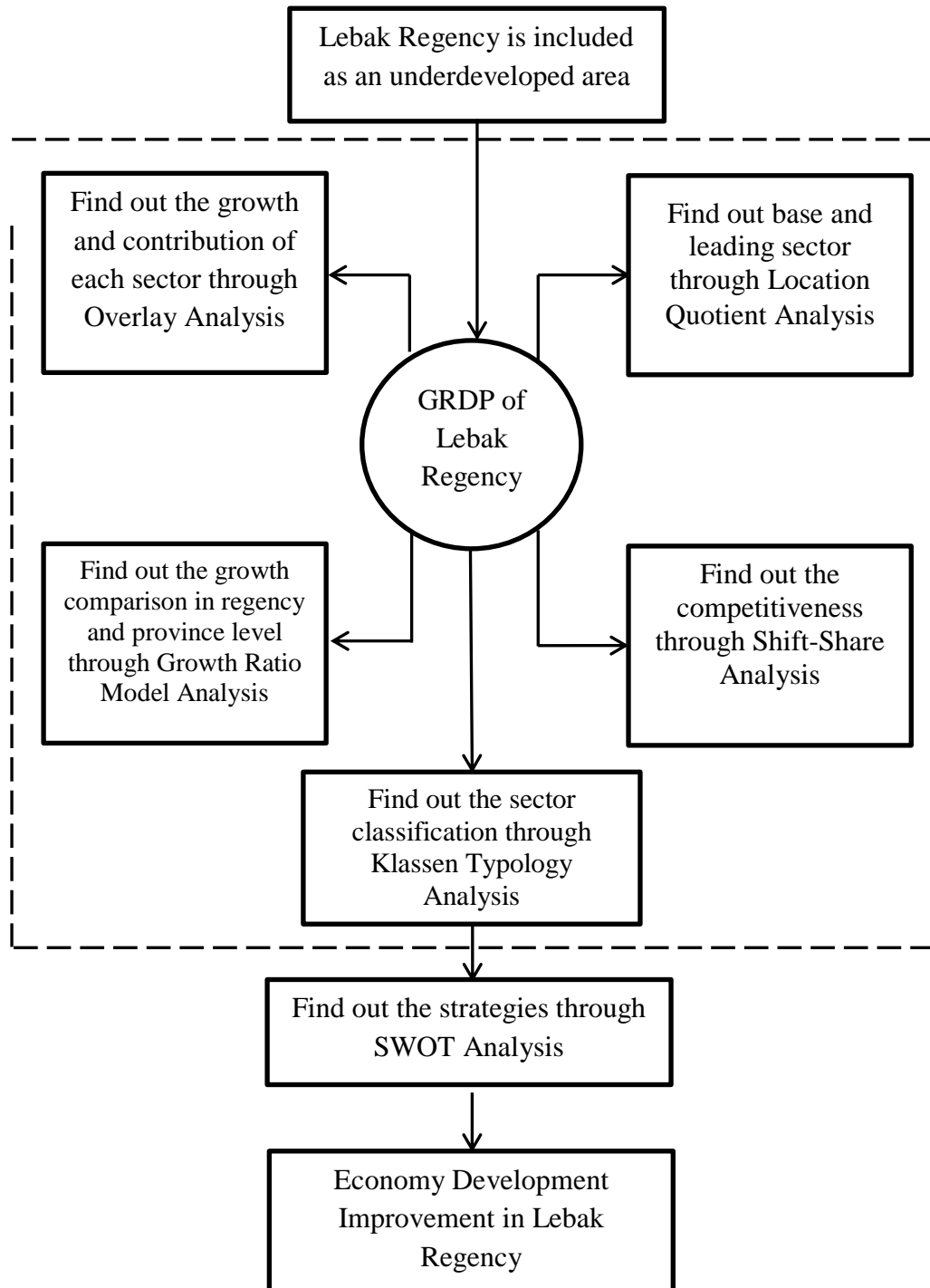
10. The similarity of this study with the journal below is the using of analysis method, namely Location Quotient Analysis and Shift-Share Analysis.

**Table 2.10 Previous Study**

Authors, Year, Title	Analysis Methods	Results
Anggraeny Puspaningtyas, 2013, Analysis of Local Economic Potential and Competitiveness Economic Sector in Improving Local Economic Development (Study in Batu City)	- Location Quotient Analysis (LQ) - Shift-Share Analysis	There are three sectors included in main local economy potential in Batu City namely services sector; trade, hotel and restaurant sector; and agriculture sector. While three main local economy potentials in Batu City that have competitive in East Java Province are trade, hotel and restaurant sector; services sector; and construction sector.

The difference of this study with the previous studies above are the object of this study is located in Lebak Regency and focused on economic sectors which are the components of Gross Regional Domestic Product (GRDP). The data is obtained from Central Bureau of Statistic (BPS) of Lebak Regency and Banten Province in the period 2013-2017. Analysis tools that are used in this research are Growth Ratio Model (MRP) Analysis, Shift-Share Analysis, Location Quotient Analysis, Overlay Analysis, and the last is Klassen Typology Analysis. The result of this research can give the contribution to the local government in order to develop and plan economic development in the Lebak Regency by using reliable economic sectors for regional development.

### C. Research Framework



**Figure 2.1**

Research Framework