CHAPTER II

LITERATURE REVIEW, FRAMEWORK AND HYPOTHESIS

2.1 Theory of Economic Development

2.1.1 Definition Economic Development

Economic growth is a change in economic conditions in developing countries explained by growth theory which states that such changes are mutually beneficial to improve economic conditions in that country. Meanwhile, according to Sukirno, economic growth is economic development that results in an increase in goods and services in the community and people's welfare. (R. Lestari, 2018)

In line with Todaro (1997), economic growth is part of development. While development itself can be interpreted as a multi-dimensional process involving major changes in social structure, familiar mental attitudes, and national institutions including accelerated economic growth, reduction or eradication of absolute poverty (Hasan & Muhammad, 2018).

It can be concluded that economic growth is a change in economic conditions that aims to improve people's welfare. Economic growth has a positive impact in the form of increased production of goods and services and public welfare.

2.1.2 Classical Growth Theory

In the late 18th and early 19th centuries, a group of economists known as the classical group developed a growth theory referred to as classical mobility. There are two types of classical schools in economic history: the classical group and the neoclassical group. Examples of classical economists include Adam Smith, Robert Malthus, David Ricardo, and John Stewart Mill, who put forward theories before the 1870s. Many microeconomic issues were addressed by this classical school, which was later passed on by neoclassical economists. Various issues of economic development are also debated in the classical school. According to Adam Smith's principle of "laissez-faire", economic policy should give priority to individual freedom and give them the freedom to carry out their own activities. Classical economic development theory began to develop during the Industrial Revolution in England, where this period was marked by rapid economic growth in developed countries. The classical group studies the causes of long-term economic growth, as well as the process of economic growth. The views of classical economics vary in this regard, so any theory from the classical group will be carefully examined (Amalia et al., 2022).

2.1.3 Neo-Classical Growth Theory

The neoclassical school of economics, which began advocating this theory after 1870, involved figures such as Alfred Marshall and Walt Whitman Rostow. Neoclassical growth theory is a new approach in economics that replaces classical economic theory because of its more effective capabilities. These changes occurred along with significant improvements in new technologies and production methods. Neoclassical theory emphasizes capital accumulation as an important factor in economic development, which is considered a gradual, harmonious, and cumulative process. Neoclassical economists also expressed optimism about economic development. They emphasize that factors such as interest rates and income can affect savings and investments. Investment tends to increase when interest rates are low and vice versa. Technological advances also drive investment demand, but this can lead to rising capital goods prices and interest rates. Therefore, neoclassical economists argue that investment restrictions may be necessary for projects that are considered more profitable (Amalia et al., 2022).

2.1.4 Factors Affecting Economic Growth

The factors that affect economic growth are (Amalia et al., 2022):

2.1.4.1 Human Resources

The importance of human capital for economic growth is enormous. Factors such as the quality and number of human resources have a direct impact on the economic development of a country. Evaluation of the quality of human resources can be done by taking into account the level of expertise, knowledge, creativity, and originality, as well as the level of education and training possessed.

2.1.4.2 Natural Resources

The economic progress of a country can be influenced by the abundance of natural resources it has, such as land, sea, and other natural resources that exist in nature. Such natural resources correspond to the climatic and environmental conditions of the country. Thus, countries that have abundant natural resources tend to have greater growth opportunities compared to countries that have limited natural resources.

2.1.4.3 Capital Formation

Capital formation can increase the availability of capital in the labor force and can increase the ratio of capital or labor in a given labor force. Therefore, it has the potential to increase output and economic growth in a country.

2.1.4.4 Technology Development

Workers use a variety of technological tools as a result of technological advances. With limited resources, technological advancements can help increase productivity. Due to the use of technology, countries that have developed rapidly can outperform countries that have not. Making the right technology development decisions can have a significant impact on economic development.

2.2 Theory of Structural Change

2.2.1 Definition Structural Change

Structural change is defined as a change in economic structure from traditional sectors with low productivity to economic sectors with higher productivity. Meanwhile, according to Chenery, structural transformation itself is a transition process from the traditional economic system to the modern economic system where each economic sector will undergo different transformations (Rinaldi et al., 2022)

Structural change or can also be referred to as structural transformation is defined as a fundamental change in the economic structure characterized by changes in sectoral contributions in the national economy both in terms of products produced and employment. In theory, structural changes that occur are marked by the increasing role of the non-agricultural sector, namely industry or services and the decreasing dominance of the agricultural sector in the economy, both in terms of gross domestic product (GDP) and in labor absorption (Putri & Monika, 2022). Structural transformation is a process that occurs during the transition from the traditional economic system to the modern economic system. In this process, rising incomes can result in increased accumulation of physical capital and human quality, and shifts in the composition of demand, trade, production and utilization of labor (Daryanto et al., 2015)

The conclusion of an understanding of structural change is a change in economic structure from traditional sectors with low productivity to sectors of the economy with higher productivity.

2.2.2 Development of Structural Transformation Theory

The development of structural transformation theory can be seen from various perspectives. One of them is the concept of shifting labor and investment from the primary sector to the secondary sector, then to the tertiary sector described by Fisher (1935) and Clark (1940). Subsequently, Rostow (1960) and Lewis (1954) considered structural transformations from the

point of view of increasing capital accumulation. Meanwhile, Kuznets (1960), Syrquin, and Chenery (1988) considered the aspect of increasing income.

The theory of structural transformation proposed by Fisher (1935) is similar to the theory of stages of economic growth proposed by List. The list states that there are five stages of economic growth based on the shift in the distribution of labor from primitive society to manufacturing-trade society. However, Fisher highlights the structural transformation from the standpoint of permanently shifting labor and investment from the agricultural sector to the industrial sector, and finally to the service sector. Clark (1951) proposed that transformational economic growth could be achieved by increasing productivity in each sector and shifting labor from low-productivity sectors to high-productivity sectors.

Rostow focuses more on the rate of capital accumulation as the key to changes in the structure of the economy. According to him, there are five stages of economic growth starting from traditional society to reaching a period of high consumption. In line with Rostow, Lewis in his dualistic economic theory emphasized the shift of resources from the traditional sector to the modern sector.

Kuznets (1960) and Chenery (1960) conducted empirical evidence and statistical approaches to structural transformations. They argue that in addition to increasing capital accumulation, including the quality of human resources, changes in economic structure are also important for a transition from a traditional economy to a modern economy (Daryanto et al., 2015).

2.3 Theory of Poverty Reduction

2.3.1 Theory

In this section, we will explore various levels of theoretical frameworks that underpin the study of structural change and poverty reduction in Tajikistan and Indonesia.

a. Grand Theory

Grand theories are broad, abstract, and offer comprehensive frameworks for understanding complex social phenomena. For this study, the relevant grand theory is Modernization Theory. This theory posits that economic development and social progress are linear processes whereby societies transition from traditional to modern states. Modernization Theory suggests that structural changes, such as industrialization and urbanization, are essential for reducing poverty and achieving economic development.

b. Middle Theory

Middle-range theories provide more focused frameworks that can be empirically tested and are less abstract than grand theories. In the context of this research, Structural Change Theory serves as a middle theory. This theory, notably developed by Arthur Lewis and expanded by others, emphasizes the shift of labor from low-productivity agriculture to high-productivity industrial and service sectors as a key mechanism for economic growth and poverty reduction. Structural Change Theory helps explain how changes in the economic structure can lead to improved income distribution and reduced poverty levels.

c. Applied Theory

Applied theories are practical applications of broader theoretical frameworks to specific contexts or problems. For this research, Policy Implementation Theory is an appropriate applied theory. This theory focuses on how government policies and interventions are formulated, implemented, and their impacts assessed. It provides a basis for examining the effectiveness of government policies aimed at reducing poverty in Indonesia and Tajikistan, such as expenditures on health and education, and the establishment of social safety nets.

2.3.2 Poverty Indicators

There are provisions issued by the government that regulate standard poverty indicators in PERMENSOS No. 146 of 2013, namely (Pratiwi et al., 2022):

1. Don't have a job or have a job but don't generate enough income to meet basic needs.
2. Income is only enough to meet basic food needs that are very simple.
3. Do not have access to health services except through puskesmas or with the help of subsidies from the government.
4. Not being able to afford clothes at least once a year for each family member.
5. Only able to send children to junior secondary education (SMP).
6. The house has walls made of bamboo, wood, or walls that are in poor condition, such as cracked or unplastered walls.
7. The floor of the house is made of soil, wood, cement, or ceramics with poor condition.
8. The roof of the house is made of fiber, weed, tile, zinc, or asbestos which is not in good condition.
9. Do not have access to electricity or use unmetered electricity for lighting at home.
10. The floor area of the house is less than 8 square meters per person.

11. The source of drinking water used comes from unprotected wells or springs, such as rivers or rainwater.

2.3.3 Causes of Poverty

Effendi (1995), later developed by Wirasakti (2020), outlines four types of poverty as follows:

1. Absolute poverty refers to a condition in which a person's income is insufficient to meet basic needs such as food, clothing, and shelter. This group is below the poverty line and is often referred to as the absolute poor

2. Relative poverty occurs when basic human needs are not met according to the standards available at that time. This is because human needs include not only material aspects such as food and clothing, but also education and health

3. Cultural poverty arises from the isolation of society, inability to interact with the outside world, and lack of access to information. It usually occurs in conflict-ridden areas

4. Structural poverty is caused by external barriers beyond a person's control, thus preventing them from taking advantage of opportunities. These barriers can be bureaucracy or official regulations that hinder individuals from reaching their potential (Wirasakti, 2020).

2.4 Poverty reduction planning in Indonesia

Amartya Sen (Indiarti, 2017) explains poverty as a form of deprivation of an individual's basic abilities and is not seen as a lack of income so that efforts that need to be made to eradicate poverty are to provide guarantees of freedom and make individuals agents of change through forms of development in the form of expanding human capabilities. and evaluate existing capabilities. Therefore, poverty does not only focus on income, but also on an individual's ability to obtain aspects other than income such as health, education, access to clean water and sanitation.

The concept of capability proposed by Amartya Sen has three main aspects, namely: first is the existence of adequacy which includes a feeling of being sufficient for basic needs. Second, there is self-esteem which includes one's desire to progress and respect oneself as well as one's identity as part of society and the country. Third, there is freedom from servitude. The components of human freedom include many components, including political freedom, personal security, legal certainty, freedom of expression, political participation and equality of opportunity (Indiarti, 2017). This is where human freedom is an important aspect in the development process as an embodiment of the basic human right to participate in the development process.

Table 2. 1 Implementation of Policies and Programs Poverty Reduction

Policy/program	Kind
State/regional expenditure allocation policy	1. Central and regional financial balance (fiscal decentralization: balancing funds and transfer funds) 2. Village fund allocation (add) 3. Expenditure-based support on poverty alleviation 4. Expenditure on infrastructure development and social spending
Economic development policy	1. Green and blue economy 2. Protection and empowerment of fishermen 3. MSME development
Social security program	1. Conditional cash transfer program, 2. Social assistance programs 3. Social assistance programs (cash transfer, oil subsidies, prosperous family card [KKS], smart indonesia card [KIP], healthy indonesia card [KIS])
Tourism industry programs	1. International tourism industry 2. Rural community-based tourism programs 3. Development of tourism villages.
Agriculture and forestry development programs	1. Agricultural development 2. Village forest 3. Palm oil development
Health improvement programs	Meal supplement program to support early childhood
Public service improvement programs	Poverty alleviation services based on education, health, socio-economic and data integrity
Equitable policies	Gender mainstreaming policy
Islamic philanthropy management policy	Policies on the management of zakat, infaq, alms and waqaf

Source: (Saribulan, 2020)

2.5 Poverty reduction planning in Tajikistan

Efforts made to overcome poverty are:

2.5.1　Cooperation with IFAD

IFAD has been investing in the rural poor in Tajikistan since 2008, strengthening local institutions and grassroots organizations, and expanding their access to land, productive technologies and resources.

1. The projects carried out are:
2. Livestock and Pasture development projects
3. Community-based farm support projects plus
4. Community-based agricultural support projects

2.5.2　Cooperation with the World Bank

The World Bank provides assistance in the form of:

1. Technical for designing the financing framework of the Rogun hydropower project in Tajikistan. The aim is to assist the Tajikistan government in strengthening the financial and commercial structure of the project, as well as improving technical, environmental, and social aspects to ensure its sustainability. The Rogun hydropower project, which is under construction, has the potential to deliver significant economic, social, and environmental benefits to Tajikistan and other countries in Central Asia if developed sustainably financially, environmentally, and socially.

2. The new human development project will specifically focus on the "Human Resources and Resilience" area in the Joint Work Plan (CPF): First, the learning environment project aims to support Tajikistan's national strategy in education development by improving the quality of the learning environment in selected public secondary schools. Second, the social protection and economic inclusion modernization project aims to protect poor and vulnerable households from shocks, promote economic inclusion, and strengthen social protection systems.

3. Tajikistan's financial and private sector development project, approved in July 2023, aims to support the Tajikistan government in strengthening the country's financial sector as well as developing the private sector, especially in high value-added sectors such as agribusiness, textiles, and tourism, to stimulate economic growth.

Table 2. 2 Possible Knowledge Support for Tajikistan, 2021–2025

Knowledge Support Area	Description of Knowledge Support
Enhancing economic efficiency and resource mobilization in transition to a market economy	1. Policy dialogue on and advisory support for finance sector reforms, financial market development, and strengthening fiscal management 2. Knowledge support for and policy advice on enhancing competition among enterprises in the market 3. E-governance initiatives 4. Binding constraints on private investment and reform priorities 5. Foreign direct investment 6. Integration with global value chains 7. Public–private partnership support 8. Strengthening of the insurance sector 9. Cross-border mobility of labor and remittance inflow 10. Anti-money laundering 11. Promotion of technology-enabled processes or technology-based solutions
Improving labor productivity through human capital development	1. Education: analytical and capacity building support for developing and modernizing technical and vocational education and training; knowledge support for improving natural science education; distance learning; secondary school resilience; and assessment system reforms, including for secondary schools 2. Health: integrated maternal and child health care, health sector reforms, and vaccine program support 3. Gender mainstreaming in all sectors

Fostering better livelihoods through investment in a landlinked economy	1. Livable cities: analytical and capacity building support for improving the technical and financial management of DVK, the Dushanbe water supply and sanitation utility; the national urban assessment; and climate-resilient urban water supply and sanitation systems
	2. Food security: climate-resilient livestock production and marketing, sustainable irrigation schemes, integrated water resources management, and research and extension services for enhanced agricultural productivity
	3. Disaster resilience: institutional capacity building, an integrated disaster management information system, national hazard and disaster risk maps, and an inventory of assets at risk
	4. Tourism: institutional capacity building, a tourism development plan, a tourism satellite account, and pipeline and feasibility designs of investment projects
	5. Energy: ongoing sector reforms, improvement of governance and financial sustainability, management contract, advanced retail metering, and diversification of power generation
	6. Transport: road maintenance, road safety, and road asset management
	7. National urban assessment

Source: Asian Development Bank

Table 2.2 Previous Studies

No.	Study	Title	Method	Variable	Result
1.	Lestari (2018)	Analysis of Structural Changes to Poverty	Panel data analysis with Error Correction Model (ECM)	**Dependent Variables:** Poverty **Independent Variable:** Economic Growth, Education, Agricultural Share and Industrial Share Of Poverty	The result show that economic growth has no significant effect on poverty in the short term but in the long term have a significant positive effect. Education has a significant negative effect on poverty in the short term and long term. Agricultural share has a significant positive effect on poverty in the short and long term, while industrial share has no significant effect on poverty in the short and long term
2.	Megasari et al. (2015)	Economic Analysis and Poverty in Indonesia	Simultaneous equations model with Two Stages Least Squared (TSLS)	**Dependent Variables:** Poverty **Independent Variable:** Consumption, Investment, Government Spending, Net Exports, Unemployment, Inflation, and Taxes	The study concluded that (1) consumption, investment, government spending, net exports significantly affect poverty in the Indonesian economy. While inflation and taxes are not a significant effect on the economy in Indonesia (2) The economy, government spending and unemployment significantly influence poverty in Indonesia
3.	Ardiansyah et al. (2020)	Structural Transformation of Agriculture	Vector Error Correction Model	**Dependent Variables:** Poverty	in the long run, the agricultural sector has a negative and significant relationship to

		and Poverty in Indonesia	(VECM) with time series data	**Independent Variable**: Agricultural sector, Industrial sector, Service sector, and Per capita income	poverty, while the industrial and service sectors do not have a significant effect on poverty in Indonesia. Per capita income has a positive relationship with poverty in Indonesia. Based on the explanation, it concludes that the policy that must be implemented to overcome the problem of poverty is to develop the agricultural sector
4.	Murdiyana & Mulyana (2017)	Policy Analysis of Poverty Alleviation in Indonesia	Descriptive method with library studies design	**Dependent Variables:** Poverty **Independent Variable:** Government Policies	The results showed that government policies related to poverty alleviation strategies in Indonesia are working quite well. This is marked by the government's efforts to issue several policies that are outlined in laws and regulations which then formulate poverty alleviation programs. Starting from the old order period to the reign of President Joko Widodo and Jusuf Kalla continued to try to reduce the number of Indonesians living below the poverty line.
5.	Fitria et al. (2020)	Structural Transformation of Agriculture and Poverty in Indonesia" by	Vector Error Correction Model (VECM) with time series data	**Dependent Variables:** Poverty **Independent Variable:**	In the long run, the agricultural sector has a negative and significant relationship to poverty, while the industrial and service sectors do not have a significant effect. The study

				Agricultural sector, Industrial sector, Service sector, and Per capita income	concludes that policies to develop the agricultural sector must be implemented to overcome the problem of poverty in indonesia
6.	Roufaye et. Al (2023)	Structural Transformation and Poverty in the WAEMU	Simultaneous Equation Model	**Dependent Variables:** Index of the structural transformation of the economy and poverty level **Independent Variable:** The vector of structural transformation and The vector of poverty level	Structural transformation does not contribute to poverty reduction in the WEAMU. However, its effect becomes favourable when combined structural transformation with human capital development. In order to fight poverty, the study recommends that the structural transformation process must be accompanied by an improvement in human capital
7.	Aizenman et al. (2012)	The Relationship between Structural Change and Inequality: A Conceptual Overview with Special Reference to Developing Asia	Conceptual overview	**Dependent Variables:** Inequality **Independent Variable:** Structural Change	Structural change exposes the population to both challenges and opportunities, with foreign trade and technological progress being key drivers of inequality. The experiences of advanced economies in managing the inequality effects of structural change provide valuable lessons for developing asia.

8.	Kamal & Fatima (2023)	Structural Transformation And Political Economy: A New Approach To Inclusive Growth	Sectoral employment elasticity technique	**Dependent Variables:** GDP Growth **Independent Variable:** Employment Elasticity	Using the sectoral employment elasticity technique, it finds that the economy functions better under military regimes than democratic periods. As an agriculture-based economy, the decline of the agriculture sector in Pakistan highlights the need for reforms to prevent loss of employment
9.	Atta-Ankomah (2021)	Structural Change and Welfare: A Micro Panel Data Evidence from Ghana	Probit and Ordinary Least Square (OLS) regression	**Dependent Variables:** Welfare **Independent Variable:** Structural change	structural change, in the form of a shift of labor from agriculture to services and industry, is associated with improvements in household consumption expenditure and poverty reduction.
10.	Aggarwal (2016)	Growth, Structural Transformation and Poverty Reduction: Issues and Challenges with special reference to India	Descriptive analysis	**Dependent Variables:** Poverty **Independent Variable:**	The study finds that the relationship between growth, structural transformation and poverty reduction in India is complex and characterized by various issues and challenges influenced by the government's broader growth strategy and implementation.

In summary, these studies underscore the complex and context-specific relationship between structural change, growth and poverty reduction in developing countries. They highlight the importance of the agricultural sector, rural development, manufacturing growth and government policies in shaping the pace and distribution of poverty reduction during structural transformation.

2.6 Conceptual Framework

The conceptual framework of this study integrates elements from the grand, middle, and applied theories to examine how structural changes in various economic sectors influence poverty reduction in Tajikistan and Indonesia. The framework also incorporates the role of government policies as an essential factor in facilitating or hindering these structural changes.
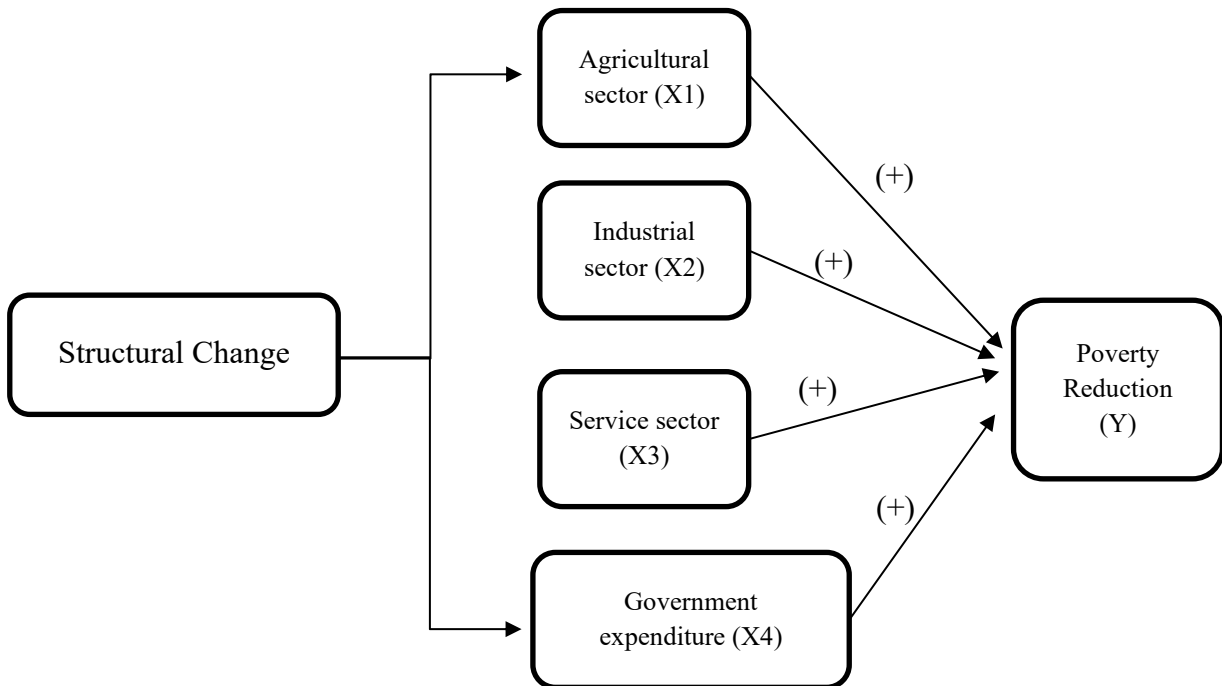

Figure 2.1 Conceptual Framework

This framework illustrates the direct relationships between structural changes in agriculture, industry, and service sectors, and poverty reduction, with government policy acting as a moderating variable.

2.7 Hypothesis

Based on the theoretical frameworks and conceptual model, the following hypotheses are proposed for this study:

H1: Structural changes in the agricultural sector are negatively associated with poverty rates in Indonesia and Tajikistan.

H2: Structural changes in the industrial sector are negatively associated with poverty rates in Indonesia and Tajikistan.

H3: Structural changes in the service sector are negatively associated with poverty rates in Indonesia and Tajikistan.

H4: Government policies, indicated by expenditures on health and education, have a significant negative effect on poverty rates in Indonesia and Tajikistan.

These hypotheses will be tested using time series regression analysis over the period from 2002 to 2021, allowing for a comprehensive understanding of the dynamics of poverty reduction in both countries.