CHAPTER II

LITERATURE REVIEW

A. Theoretical Basics

1. Military Spending

The cost of defense for security is one of the important things that must be managed by the state. In the modern security system, the sovereign state is believed to be the best "protector" for its people. The state has the primary responsibility to provide security and defend it from various threats (Bellamy, 2008). To fulfill this responsibility, military power is a necessity for a country.

This military power is needed to maintain sovereignty, support domestic orders, and avoid various threats. Budget defense expenditure is separated by countries from their national income to provide security against internal and external threats. Defense expenditures consist of production (or imports from other countries) tools and vehicles used as defense, as well as repair and maintenance costs for equipment and vehicles used in national defense, costs for R and D activities for the benefit of national defense and for citizens military civilians and staff working in the defense field. The government regulates the budget for defense spending with the improvement of the welfare of the country separately, the aim is that if they feel threats from outside and inside,

they will reduce the investment budget which will increase the welfare of the country and will increase the defense spending budget.

Endogenous growth theory, shows that government spending has an important impact on long-term growth rates. The effect depends on the size of government intervention and various components of public expenditure. In addition, various types of government spending have heterogeneous effects on economic growth. For example, improving public infrastructure, research and development in terms of economic development and growth, and improving the quality of public education are often seen as public products that have a positive effect on economic growth. On the other hand, observations about increasing government growth based on non-productive spending will be accompanied by negative effects on the country's economic growth and income. From this observation it has been given up to the hypothesis that the larger the size of government intervention will have a more negative impact. Endogenous growth theory provides the basis of the relationship between total military expenditure and expenditure in the long run, Pieroni predicts the relationship between military spending and economic growth, reversed or negative (Pieroni, 2009: 327).

Classical thinking holds that increasing military spending is likely to hamper economic growth. This argumentbased on the classical conclusion, that an increase in the budget for military spending will result in a decrease from the level of personal investment and domestic savings,

and the level of consumption which will be lower, because demand is gathering lower. This can be explained as follows. An increase in the budget that is higher than military spending will cause an increase in the interest rate that will encourage private investment. Keynesians argue that increasing the military burden of stimulating demand, increasing electricity and increasing government spending, and will create a positive external (Narayan and Singh, 2007: 395).

2. Economic Growth

Economic growth is the process of changing the country's economic conditions on an ongoing basis towards better conditions for a certain period. Economic growth can also be interpreted as a process of increasing economic production capacity that is realized in the form of an increase in national income. The existence of economic growth is an indication of the success of economic development in people's lives. Economic growth shows the growth of production of goods and services in the economic region at certain time intervals. The higher the rate of economic growth, the faster the process of increasing regional output so that the prospects for regional development are better. By knowing the sources of economic growth, priority development sectors can be determined. According to Todaro and Smith (2006) there are three main factors or components that influence economic growth, namely capital accumulation, population growth, and technological progress

Improving living standards is not only in the form of increased incomes, but also includes increasing the provision of work, improving the quality of education, and increasing attention to culture and human values, all of which not only to improve material well-being, but also to increase self-esteem in individuals and nations that concerned. Third, expansion of economic and social choices for each individual and nation as a whole (Todaro and Smith, 2011).

According to Boediono, economic growth is a process of increasing output over the long term. This understanding covers three aspects, namely process, per capita output, and long term. Boediono also mentioned that economic growth was also related to an increase in "output per capita". In this sense, theories must include theories about GDP growth and theories about population growth (Boediono, 1999).

According to Sumitro Djoyohadikusumo, economic growth is the process of increasing the production of goods and services in community economic activities (Djojohadikumo, 1994).

Economic growth shows the development of economic activities that will generate additional income in the community within a certain period. Because economic activity is basically the process of using factors of production to produce output, this process will produce a stream of improvement for the factors of production owned by the community.

With economic growth, it is hoped that people's incomes as owners of factors of production will also increase. (Susanti et al; 2000).

Todaro (2006) explains that there are three main factors or components in the economic growth of each nation, namely:

a) Accumulated capital, which includes all forms or types of new investments invested on land, physical equipment and human resources.

b) Population growth, which in the following years will automatically bring labor growth in the workforce

c) Technological progress.

Capital accumulation occurs when a portion of income is saved and invested with the aim of increasing output and income. Accumulated capital will add new resources (for example, clearing land that is not used) or improve the quality of resources (for example, improving irrigation systems, Supplayer, pesticides).

Todaro (2006) explains that capital accumulation occurs when a portion of income is saved and invested with the aim of increasing output and future income. Procurement from new factories, machinery, equipment and raw materials increases the physical capital stock of a country (ie the net value of all physical productive capital assets) and this clearly allows for future output increases. Investment in human resource

development also improves quality so that in the end it will bring the same positive impact on the production of figures, even more so that given a continuing increase in the number of people.

Economic growth is something that is often associated with human development. High economic growth is a target in development. For developing countries According to UNDP (Ginting, 2008) states that until the end of 1999 human development is determined by economic growth. Economic growth is closely related to the increase in goods and services produced in the community, so that the more goods and services produced, the welfare of the community will increase so that it will changing the national income better which give positive effect on Military Expenditure

3. Unemployment

Unemployment is one of the social factors variables that can affect economic growth in a region. Unemployment that continues to increase will have a direct impact on social and economic problems that will affect economic growth.

According to Sukirno (2004), unemployment is the number of workers in the economy who are actively looking for work but have not found one. Whereas unemployment rate according to BPS is the percentage of the number of people entering the workforce (aged 15 years and over) who are looking for work and not getting it.

One of the causes of unemployment is increasing in new labor that occurs every year, while employment does not increase. In addition, the time needed for workers to find jobs that are in accordance with their desires and expertise is another factor that causes unemployment (Mankiw, 2006).

One important factor that determines the prosperity of the community is the level of income. Community income reaches a maximum if full employment levels are realized. Unemployment will reduce people's income, and this will reduce the level of prosperity they achieve (Sukirno, 2004).

Unemployment causes the level of prosperity of the community is not optimal while the ultimate goal of development is to create prosperity and welfare of the community. If the unemployment rate in a region is high, it will hamper the achievement of economic development goals. The income of the community is reduced so that the purchasing power of the people decreases, education and health which are basic needs to improve the quality of human beings also cannot be fulfilled, when it happen the country will decrease the allocation for Military Spending to help citizen that's why Unemployment has negative effect on Military Spending (Sukirno, 2004).

4. Investment

Investment is defined as expenditures or expenditures from capital investors or companies to buy capital goods and also equipment to improve capabilities producing goods and services available in the economy (Sukirno,2004).

Investment is the current expenditure to buy tangible assets (land, houses, cars, etc.) or also financial assets that aim to generate greater income in the future, the following also says that investment is an activity related to business sources withdrawals (funds) are used to obtain current capital goods, and with this capital new product flows will be generated in the future (Huagen,2001).

In economics, investment can be categorized as follows:

a) There are purchases of types of capital products such as production equipment and machinery to build various types of companies and industries.

b) There are costs to be able to build houses, factories, and also office buildings and other supporting buildings. Investment is to build a factory,so that the factory can operate and generate more capital.

c) There is an increase in value in the inventory of goods that have not been sold, which then at the end of the year there is a calculation of national income on raw materials and also goods that are still in the production process.

Benoit (1973) theorized that the negative impact of the military budget would increase the resources used for military purposes, meaning that they would reduce the resources available for investment and production in the civilian sector. This is especially so in developing African countries which are usually short-lived. This effect, if significant, will be very important especially where the military budget has high contents and this will reduce the share of imported capital goods and products needed or not for civil investment (Egwaikhide and Ohwofasa, 2009).

Military spending can have a positive or negative effect on savings and investment. It can be said that if an increase in military spending is funded by taxes and, if this expenditure decreases in the future, the saving trend can increase. But in developing countries, increasing new income, for example from increasing taxes, is very difficult, so military spending can be funded by increasing inflation and reducing savings (Dunne and Uye, 2010).

Investment activities make it possible the community continues to increase economic activities and opportunities work, increase national income and increase the level of prosperity Public. This role comes from three important functions of the activity investment, namely

a. investment is one component of expenditure aggregate, so an increase in investment will increase aggregate demand, national income and employment opportunities;

b. increase in capital goods as a result of investment will increase production capacity;

c. investment always followed by technological developments. (Sukirno, 2000)

B. Previous Study

To find out more clearly about this research, it is very important to explore prior research with problems that are close to the focus of the discussion in the title of this thesis.

Table 2.1
Previous Study

Author (Year)	Tittle	Analysis	Results
(Korkmaz, 2015)	"The Effect of Military Spending on Economic Growth and Unemployment in Mediterranean Countries "	Panel data regression Dependent Variable: Military Spending Independent Variable: Economic Growth Unemployment	The results of this study found that the GDP growth variable has a negative relationship with military spending, while the unemployment variable has a positive relationship with military spending. F rom the results of the model it was also found that all independent variables have a significant effect on the variable it depends.

Author (Year)	Tittle	Analysis	Results
Aiyedogbon, John Olu- Coris (2011)	"Military Expenditure and Gross Capital Formation in Nigeria, 1980 – 2010	*ARCH Model* GARCH Model Dependent Variable : Recurrent Military Expenditure Independent Variable : Exchange Rate Interest Rate Money Supply Inflation	The results of this study found that 90% of the value of the dependent variable can be explained by the independent variable, and there is no autocorelasion bias seen from the Durbin Watson value of 1.8. Lending levels and military expenditure variables that are negatively related to GCF variables, LR variables are significant for GCF but GDP growth variables have a positive and significant relationship
(Dunne, 2010)	"Military Spending and Economic Growth in Sub Saharan Africa"	Fixed Effects Model Dependent Variable : Military Spending Indipendent Variable: GDP Gross Investment Labour force growth rate	the results of this study found that the military budget is a separate budget from the expenditure budget. Therefore considerable attention is paid to countries in the Sub Saharan Africa region which have an impact on economic growth. Empirical evidence shows little or no evidence for positive effects on economic growth and is likely to have negative effects on economic growth.
Papanikos, G. T. (2015).	Military spending, International trade and Economic growth in the Mediterranean Basin. *Athens Journal of Mediterranean Studies*	Panel Granger Causality Test Dependent Variable: Military Spending Independent Variable: International Trade GDP	the evidence of the descriptive simple shows that there is a negative relationship between increased international trade and military spending, and tests show that the causality most likely originates from trade to military spending
Chairil (2013)	Relationship between Military Expenditure and Economic Growth in ASEAN	Augmented Solow growth model 3SLS Dependent Variable : Military Spending Independent Variable : Economic Growth Investment	The results of this research show that economic growth in Indonesia has a negative effect on military spending This negative relationship occurs due to the development of human capital as part of defense spending

Author (Year)	Tittle	Analysis	Results
d'Agostino (2013)	Military Expenditure, Endogeneity and Economic Growth	IV estimation OLS estimator Dependent Variable: Military Expenditure Independent Variable: Economic Growth Civil conflict onset	In this research shows that economic growth has a negative effect on military spending When some countries has an conflict the GDP of the country will reduction of nearly 4%
Hirnissa (2009)	Military Expenditure and Economic Growth in Asean-5 Countries	Auto Regressive Distributed Lag (ARDL) and Dynamic Ordinary Least Square (DOLS). Dependent Variable : Military Expenditure Independent Variable: RGDP	The results of this research that the cointegration analysis show that 3 out of 5 cointegration countries, namely Singapore, Indonesia and Thailand have a long-term negative causality relationship between military spending and economic growth that goes from RGDP to MILEX
Tian 2017	Military expenditure and economic growth, 1960–2014	Augmented slow growth model Dependent Variable: Military Spending Independent Variable: Economic Growth Unemployment	Economic growth has a negative effect on Military Expenditure, while the unemployment variable has a positive relationship with military spending
Qiong (2015)	Military expenditure and unemployment in China	Time-series properties ARDL (Autoregressive Distributed Lag) Dependent Variable: Military Expenditure Independent Variable: Unemployment GDP	The results of this research show that when military spending increases, the level of unemployment will increase as well, when non-military partners increase it will reduce almost 10 times lower than military expenditure

22

Author (Year)	Tittle	Analysis	Results
Azam (2015)	Military Expenditures and Unemployment Nexus for Selected South Asian Countries	Multivariate framework DOLS Dependent Variable: Military Expenditure Independent Variable: Unemployment GDP Foreign Direct Investment (FDI) net inflows population growth rate	The relationship between military spending and unemployment in the SAARC region has a more elastic relationship where there are supporters of the level of employment in the region, While energy consumers and the unemployment rate have a negative relationship

C. Analysis Hypotheses and Models

1. Research Framework

The defense budget has been separated by states from their national income to provide security against internal and external threats. Defense spends consisting of production (or imports from other countries) tools and vehicles used as defense, repair and maintenance costs for equipment and vehicles, costs for R&D and military activities and civilian staff working in the defense sector. The government sets their share separately for defense spending by taking their country's welfare into consideration. If they feel threatened, they reduce investments that will improve the welfare of the country and increase defense spending. The effect of defense spending on the economy is one of the topics discussed today.

Many countries prioritize defense spending compared to education, health and infrastructure spent.

Military costs are needed in Southeast Asia, because in the Southeast Asian region there are cases of Spratly Island, which is a problem related to South China Sea waters. In this case there were six countries fighting over the ownership of Spratly Island, namely China, Taiwan, Malaysia, Vietnam, Brunei Darussalam and the Philippines. In this case it is explained that this relationship is related to the progress of military modernization from Southeast Asia related to the desire of each country contained in the Southeast Asian region which is the basis for saving in protecting his own country. (Simatupang, 2013).

Military costs are influenced by various variables, one of which is the variable of economic growth. Economic growth has a significant positive impact on military costs. In addition to variable growth that can affect military costs. For variable unemployment has a significant negative relationship for military costs. In addition to the variable of economic growth, unemployment, there are also investment variables. Investment is very influential on economic growth. But investment has positive relationship with military costs.
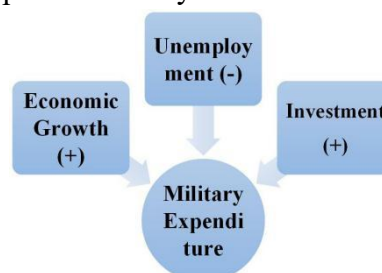

Figure 0-1
Schematic Framework

2. Hypothesis

Based on the theoretical foundation, the hypothesis in this study is formulated as follows:

H1 : *Economic Growth* have positive and significant effect on Military Expenditure in 5 ASIAN Countries 2009-2018 period.

H2 : Unemployment has negative and significant effect on Military Expenditure in 5 ASIAN Countries 2009-2018 period.

H3 : Investment has positive on Military Expenditure in 5 ASIAN Countries 2009-2018 period.