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The Effect Of Fiscal Policy And Foreign Direct Investment On The Economic Growth Of Member Countries Of The Organization Of Islamic Cooperation (Oic)

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Abstract

Good economic growth is the main goal of all countries in the world. Economic growth will always be the center of attention and is one of the issues that attracts a lot of world attention. To increase the economic growth of a country, the government can reflect and evaluate making the right policies to carry out national economic recovery, one of which is through fiscal policy. Every country needs capital to finance its development projects.This study aims to analyze the effect of fiscal policy and FDI on the economic growth of member countries of the OIC.The focus of this study is the group of nations known as the D-8 countries. The analysis technique used in this study is panel data regression, which was processed using Eviews 12 software.As a result, The probability value of government expenditure, which is used as a proxy for fiscal policy in this study, is 0.0001. Therefore fiscal policy affects economic growth. The probability result for FDI is 0.0014, which is less than 0.05. This means that FDI has a positive effect on economic growth.

Abstrak

Pertumbuhan ekonomi yang baik adalah tujuan utama semua negara di dunia. Pertumbuhan ekonomi akan selalu menjadi pusat perhatian dan merupakan salah satu isu yang menarik banyak perhatian dunia. Untuk meningkatkan pertumbuhan ekonomi suatu negara, pemerintah dapat merefleksikan dan mengevaluasi pembuatan kebijakan yang tepat untuk melaksanakan pemulihan ekonomi nasional, salah satunya melalui kebijakan fiskal. Setiap negara membutuhkan modal untuk membiayai proyek-proyek pembangunannya. Studi ini bertujuan untuk menganalisis pengaruh kebijakan fiskal dan FDI terhadap pertumbuhan ekonomi negara-negara anggota OKI. Fokus studi ini adalah kelompok negara yang dikenal sebagai negara-negara D-8. Teknik analisis yang digunakan dalam studi ini adalah regresi data panel, yang diolah menggunakan perangkat lunak Eviews 12. Hasilnya, nilai probabilitas pengeluaran pemerintah, yang digunakan sebagai proksi untuk kebijakan fiskal dalam studi ini, adalah 0,0001. Oleh karena itu, kebijakan fiskal memengaruhi pertumbuhan ekonomi. Hasil probabilitas untuk FDI adalah 0,0014, yang kurang dari 0,05. Ini berarti bahwa FDI memiliki pengaruh positif terhadap pertumbuhan ekonomi.

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1. INTRODUCTION

Good economic growth is the main goal of all countries in the world. Economic growth will always be the center of attention and is one of the issues that attracts a lot of world attention (Rantebua et al., 2020). Economic growth does not develop linearly. Sometimes it moves slowly, and backward because the level of economic activity in producing a product (goods or services) is not the same each year. For this reason, it is necessary to accelerate economic growth through the form of policies carried out by the government so that both long-term and short-term economic problems can be overcome such as: reducing unemployment, overcoming inflation, and accelerating economic growth (Azimi, 2021).

These macroeconomic problems can be influenced by the government, one of which is through fiscal policy (Rantebua et al., 2020). The government implements fiscal policy as a tool for encouraging economic growth. Fiscal policy is a key element of the economic policy of developing countries. This policy is a vehicle to influence macroeconomic stability and accelerate economic growth. Fiscal policy is often used to influence the level of economic activity and the quality of life of the population. Comprehensive policymaking in the fiscal sector is expected to be able to boost the economy faster in times of weak economic conditions characterized by low economic growth rates (Ma'ruf & Andriansyah, 2022).

Table 1
Real GDP Per Capita Growth OIC and World (%)

Year	OIC	World
2017	1.7	2.2
2018	1.3	2.1
2019	0.6	1.4
2020	-3.8	-4.1
2021	3.5	5.1

Source: Statistical Yearbook On OIC Member Countries, 2022.

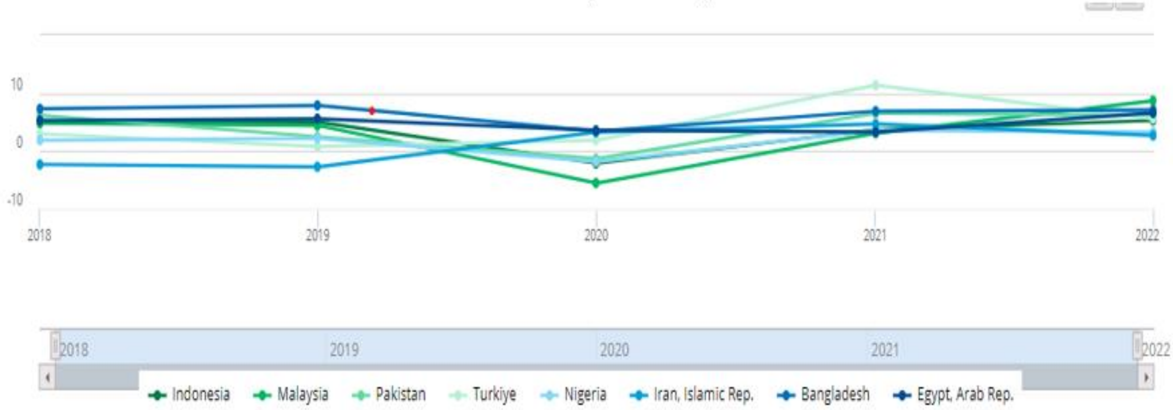
When viewed from the percentage growth of GDP per capita of OIC countries each year in Table 1, it appears that there is no significant growth. There is often a decrease in GDP, especially from 2018 to 2020. This may be due to Covid-19, which has caused a contraction in economic growth in various countries. In addition, if you pay attention to GDP growth from the last 5 years, namely from 2018 to 2020, it has only increased slightly.

The focus of this study is the group of nations known as the D-8 countries. The D-8 countries are a group of developing nations that are members of the Organization of Islamic Cooperation (OIC). Their goal is to achieve sustainable economic development by focusing on the growth of the financial sector and implementing strategies to promote international trade (Abadiyah et al., 2023). In 1997, eight Muslim countries, known as the D-8 or Developing 8, signed a multilateral agreement aimed at promoting economic cooperation. These member countries, which include Bangladesh, Egypt, Indonesia, Iran, Malaysia, Nigeria, Pakistan, and Turkey, are some of the world's fastest-growing economies with enormous potential for further development (Mahjabeen et al., 2020).

Figure 1 Indonesian Coffee Production in 2017-2022

Based on Figure 1, it appears that the GDP growth (annual %) in D-8 countries did not increase from 2018 to 2019. In the subsequent year, 2020, there was a significant decline in GDP growth as a result of the COVID-19 pandemic which negatively impacted every country. In 2021, the D-8 countries were able to increase their economic growth and recover from the previous year's economic downturn. However, in 2022, the growth rate is projected to remain stagnant or only slightly increase. Therefore, it seems that there is no significant economic growth in comparison to the previous year. To increase the economic growth of a country, the government can reflect and evaluate making the right policies to carry out national economic recovery, one of which is through fiscal policy (Aqmarina & Furqon, 2020).

Figure 1.
GDP Growth (annual %)



Source: World Bank, 2023

Fiscal policy is an essential tool used by fiscal authorities in conjunction with monetary interventions to achieve specific macroeconomic objectives. This policy empowers the government to monitor and influence economic activities through its control over public finances, making it a key macroeconomic stabilization tool at its disposal (Burger & Calitz, 2021). Fiscal policy is an integral component of the government's socio-economic policy, and its significance becomes apparent when addressing crucial macroeconomic objectives such as creating jobs, improving the standard of living, promoting equal distribution of income, and fostering sustainable economic growth. By utilizing fiscal policy tools, the government can encourage the growth of certain sectors, regulate spending, and stimulate economic activity. Through this approach, fiscal policy can help drive the economy towards long-term prosperity and stability (Makhoba & Kaseeram, 2022).

According to the Keynesian Cross theory, government spending has a significant impact on economic growth as it directly affects income and output levels. The government plays a crucial role in boosting economic growth and if the allocation of government spending is not appropriate, it can negatively impact economic growth. Low government spending can be detrimental to economic growth. However, when the government spends in accordance with its portion, it can lead to an increase in economic growth (Putri, 2022).

Government expenditure refers to the consumption of goods and services by the government, as well as the financing of government administration and development activities. Although it is the smallest component of expenditure, its impact is significant in terms of allocation, distribution, and stabilization. The government's budget is determined by the expected tax revenue, political considerations, and the challenges faced. Government spending reflects government policy, and if the government has set a policy to purchase goods and services, government spending reflects the costs incurred to implement the policy. The theoretical basis for government spending can be seen from the identity of the balance of national income, which is $Y = C + I + G + (X-M)$. This equation provides legitimacy for the Keynesian view of the relevance of government intervention in the economy. It is worth noting that an increase or decrease in government spending will have a corresponding effect on national income (Silalahi & Ginting, 2020).

Various studies have demonstrated the positive impact that government spending can have on achieving inclusive growth. For instance, Ambya (2020) found that investing in education, health, and infrastructure had a significant positive effect on economic growth in Indonesia between 2001 and 2010. Similarly, Johansson (2016) discovered that investing in infrastructure and education can contribute to economic growth. Johansson (2016) also concluded that social protection spending can help in reducing inequality.

Makhoba & Kaseeram (2022)The study provides strong empirical evidence of the impact of fiscal policy and public debt on economic growth in SADC economies. The empirical results were found to be robust and theoretically plausible, even when using benchmarking techniques. The study estimated the PVAR model with accompanying IRF to analyze the response of GDP due to the innovative shocks of endogenous variables in the system. The results indicate a significant positive influence of fiscal policy on economic growth in SADC. Moreover, the results validate the Keynesian hypothesis in the SADC region, indicating that fiscal policy should be at the center of prudent policy formulation aimed at promoting stable public finances consistent with balanced and sustainable economic growth. However, Arjona et al (2003)highlighted that a lack of motivation among workers was one of the factors that had a negative impact on inclusive growth due to spending on social protection in 21 OECD countries between 1970 and 1998.

Every country needs capital to finance its development projects. If it turns out that the supply of savings in the country is not sufficient, then one way to get an injection of capital is to attract foreign direct investment (FDI). National policy is the key to attracting foreign direct investment (Kholis, 2012). FDI is considered one of the most appropriate sources for investment development as can it create jobs, transfer and develop new technologies and production capabilities, and help local businesses gain access to new international markets (Zardoub & Sboui, 2023). Improvements to investment ecosystems around the world have undergone dramatic changes in the past 20 years. The financial and economic crisis has affected bilateral FDI relationships and international capital movements. Many studies explain the relationship between FDI and economic growth. In the production function, FDI directly impacts a country's production of goods and services and therefore its economic growth (Rahmandani et al., 2023).

Foreign Direct Investment (FDI) is defined by the World Trade Organization (WTO) as the acquisition of an asset in another country by an investor based in a different country, with the intention of managing the asset. FDI includes various forms of management, such as bonds, and portfolio investments in foreign stocks, and is considered an important aspect of economic growth and financial globalization. It brings in additional foreign capital, advanced technology, and better managerial skills, which can have a positive impact on the macroeconomic and microeconomic levels, and promote economic growth, measured by increases in gross domestic product and quality of life standards. FDI inflows have increased rapidly worldwide since the 1980s and 1990s, and are crucial for less developed countries to support their economic development and growth. It is essential to study the relationship between foreign direct investment and economic growth (FDI-EG) (Cicea & Marinescu, 2020).

Foreign direct investment plays an important role in the growth and development of a country. It brings in capital for infrastructure development, creates job opportunities, and facilitates technology transfer. Multinational corporations often use FDI as a means to invest in various countries. This investment mechanism is particularly valuable for newly developing and developing economies as it helps attract more investors and increase the inflow of FDI (Rahmadani et.al, 2023)

The theory assumes that FDI stimulates economic growth through new practices and technology transfer, increased knowledge and capital stock, productivity, and total factor consumption. These assumptions, which are sometimes controversial based on empirical results. Some studies have found that FDI alone doesn't affect economic growth (Artus & Cartapanis, 2008; Rogoff, 2003). However other studies have found that FDI affects economic growth (Obwona, 2001; Tiwari & Mutascu, 2011). The empirical controversy has prompted some developing countries to express their concerns regarding the economic, social, and political consequences of foreign investment. They are afraid to cede important sectors of their economies to foreign interests, which seek only maximum profits. Thus, they impose restrictions on the entry of private capital including the tightening of laws governing the requirements for the establishment and operation of foreign-owned companies, screening and supervision of investors, restrictions on foreign ownership and control in certain sectors, and investment-related requirements (Iritié & Tiémélé, 2023).

The study aims to investigate the impact of fiscal policy and foreign direct investment (FDI) on the economic growth of countries in the Organization of Islamic Cooperation (OIC) over the years. Despite the interest in exploring the extent to which fiscal policy and FDI encourage economic growth, it remains unclear. Therefore, the researchers are interested in examining the effect of fiscal policy and FDI on the economic growth of member countries of the OIC.

2. RESEARCH METHODS

This study is a type of research that aims to explain the cause-and-effect relationship between variables. It is also known as verification research or causal study. The main goal is to demonstrate that variable X directly causes variable Y. The objective of this particular study is to determine the impact of fiscal policy and foreign direct investment on the economic growth of OIC countries. In this study, government expenditure is a proxy for fiscal policy, while GDP represents economic growth. The population used in this research is OIC countries, and the sample is taken from the D-8 group. The D-8 group includes eight developing countries with a majority Muslim population, namely Indonesia, Malaysia, Pakistan, Turkey, Nigeria, Iran, Bangladesh, and Egypt. The group aims to strengthen development cooperation.

The type of data used in this study is secondary data, obtained from the Statistical Economic and Social Research and Training Center for Islamic Countries (SESRIC) and the World Bank. The analysis technique used in this study is panel data regression, which was processed using Eviews 12 software. Panel data is mixed data from cross-section and time series. The research model equation is as follows:

$$Yit = \propto + \beta 1X1it + \beta 2X2it + eit$$

Where:

Y= Economic Growth

$\propto$ = Constant

β1-2 = Regression Coefficient

X1it = Government Expenditure

X2it = Foreign Direct Investment

eit = Error Item

The data analysis techniques involve panel regression model estimation methods that include the common effect model, fixed effect model, and random effect model. Model selection includes the test chow test, Hausman test, and Lagrange multiplier test. Classical assumption tests include normality tests, multicollinearity tests, autocorrelation tests, and heteroscedasticity tests. Finally, hypothesis testing includes the coefficient of determination (R2), F test, and t-test.

3. RESULT AND DISCUSSION

The economic system called "circular economy" focuses on the production, distribution, and consumption processes of products with a focus on reducing, reusing, and repairing materials. These activities can be carried out at the micro (company, consumer), meso (neighborhood industrial area), and macro (city, region, country) levels. The goal is to achieve a sustainable economy, creating good environmental quality, economic prosperity and social justice. New business models and responsible consumer behavior can enable a circular economy..(Purwanti, 2021)

Table 2 presents the descriptive statistics of the research variables from 2017 to 2021. Based on Table 2, it can be observed that each variable comprises 40 data points. The economic growth (Y) has a minimum value of -5.50 and a maximum value of 11.40 with a standard deviation of 3.34. The average value of 3.48 indicates that the average economic growth of all the samples is quite low, as it is still far from the maximum value. Fiscal policy (X1) has a minimum value of 11.99 and a maximum value of 35.72 with a standard deviation of 7.18. The average value of 20.07 shows a high value. On the other hand, Foreign Direct Investment (X2) has a minimum value of 0.20 and a maximum value of 5.40 with a standard deviation of 1.05. The average value of 1.36 indicates a low value, suggesting that investment in the OKI countries is fluctuating.

The estimation results of the model are presented in Table 3. The probability value of the Chow test is 0.0001, which is smaller than the significance level of 0.05. Therefore, the Fixed Effect Model (FEM) is the best model. The Hausman Test is then conducted, and the results show a probability value of 0.0001, which is also smaller than the significance level of 0.05. Thus, the FEM is still the best model, and the LM test is no longer necessary. Based on Table 3, the FEM is the best model estimate that will be used. The normality test yielded a probability value of 0.390354, which is greater than the significance level of 0.05. This means that the null hypothesis (HO) is accepted, and it can be concluded that the data is normally distributed. The heteroscedasticity test is conducted using the Glejser test, which involves regressing the absolute residuals of the initial regression on one or more independent variables related to the variance of the dependent variable (Raza et al., 2023). As shown in Table 3, the variables X1 and X2 have a probability value greater than the 0.05 significance level, indicating that there is no heteroscedasticity problem in the residuals of the research model. For the autocorrelation test, this study uses the Breusch Godfrey method or the Lagrange Multiplier (LM). The criteria are that if the probability value on the Obs * R-squared is smaller than the significance level of 0.05, then the data may contain elements of autocorrelation.

Table 3.
Selected Panel Data Regression Estimation Results

Variable	Coefficients,Standard Errors, and Probabilities	Value
Chow Test	Probabilities	0.0001
Hausman Test	Probabilities	0.0001
Normality	Probabilities	0.390354
Autocorrelation Test	probabilities	0.0631
Multicolinearity Test	Coefficient Correlation	0.469184
Heteroscedasticity Test	Probabilities X1	0.1561
	Probabilitas X2	0.0925
X1	Coefficients	1.603452
	Standard Error	0.342214
	Probabilities	0.0001
X2	Coefficients	2.191510
	Standard Error	0.624435
	Probabilities	0.0014
Adjusted R-Squared		0.608264

source: Data Processed

The probability value of government expenditure, which is used as a proxy for fiscal policy in this study, is 0.0001. Therefore, the first hypothesis, which states that fiscal policy affects economic growth, is accepted. These findings are consistent with previous research conducted by (Phuc Canh, 2018)The results of this study support the Keynesian perspective on fiscal policy, which suggests that developing countries require fiscal policy to promote economic growth since the private sector's growth potential is still limited, and the government plays a crucial role in initiating the development of other sectors. Moreover, in developing countries, the public sector is still dominant through state-owned enterprises, and fiscal policy has a significant impact on the overall economy by influencing the public sector.

Fiscal policy is often associated with promoting economic growth. Specifically, fiscal policy can be used to stimulate economic growth and development under certain circumstances. Those who support government involvement in the economy maintain that such intervention can help foster long-term economic growth (Tilahun Mengistu, 2022).

The probability result for FDI is 0.0014, which is less than 0.05. This means that the hypothesis H2, which states that FDI has a positive effect on economic growth, is accepted. This finding is consistent with the "Solow Residue" concept introduced by Solow in 1956. According to this concept, economic growth cannot be explained only by an increase in production factors. It also requires an increase in technological innovation. Technological innovation plays a crucial role in driving economic growth that cannot be explained by an increase in production factors alone.

Foreign direct investment (FDI) has the potential to enhance economic growth through technology transfer, job creation, new market access, and stimulation of domestic investment. However, it is critical to create an environment that is conducive to FDI. This includes having clear investment policies, legal protection, and adequate political stability. Therefore, the government should attract FDI that fosters these benefits and promotes linkages between foreign and domestic companies (Afdhal Mubarak et al., 2023).

The results of this study are also in line with the research Agyapong & Bedjabeng (2019); Kenh & Wei (2023); Wondimu (2023). Countries that are members of the Organisation of Islamic Cooperation (OIC) and receive foreign direct investment (FDI) are likely to see a rise in their Gross Domestic Product (GDP) as a result of such inflows. This increase in national income is expected to have a positive impact on all sectors of the economy, particularly the financial sector, thus facilitating its development.

Investment plays a crucial role in driving economic growth and human development, making it an effective way to boost national economies and communities. Among different types of investments, foreign direct investment (FDI) is particularly significant in fostering a country's economic growth, as it creates favorable conditions for attracting investors to develop and enhance the quality of human resources (Wang et al., 2022).

4. CONCLUSION AND SUGGESTIONS/RECOMMENDATIONS

4.1 Conclusion

The results of the analysis prove that the level of economic growth in a country is influenced by fiscal policy, in this case, government expenditure and foreign direct investment. Government expenditure especially in the form of infrastructure investments, public projects, and stimulus programs, can provide an immediate boost to economic activity. It creates jobs, increases production, and stimulates growth.

When government expenditure is not allocated appropriately, it can have a negative impact on economic growth. Inadequate government spending can hinder the growth of the economy. Conversely, when government spending is optimal, it can lead to an increase in economic growth.

Foreign direct investment (FDI) plays a crucial role in driving economic growth by facilitating technology transfer, offering access to new markets, creating jobs, and encouraging domestic investment. To attract FDI, it is necessary to establish an environment that is conducive to investment, which includes having clear investment policies, legal protection, and political stability. While political stability can amplify the positive impact of foreign aid on economic growth, it can also reduce the positive impact of FDI on economic growth. Therefore, it is essential to maintain a stable political environment to fully harness the benefits of FDI.

It is crucial to keep in mind that while government spending can play a significant role in boosting economic growth, its effectiveness depends on several factors. The efficient management of public funds, implementation of appropriate policies, and the overall economic environment are critical determinants of success. Additionally, external factors such as monetary policies, political stability, and global market conditions can also influence the impact of government spending on the economy.

4.2 Suggestions/Recommendations

Based on the results of the study, which indicate that fiscal policy and Foreign Direct Investment (FDI) have a positive and significant effect on economic growth in OIC member countries, particularly the D-8 countries, it is recommended that governments in each country further optimize the role of fiscal policy by increasing productive government expenditure, especially in strategic sectors such as infrastructure, education, and health, which can promote sustainable economic growth. In addition, governments are encouraged to create a more conducive investment climate by improving regulatory frameworks, strengthening economic and political stability, and providing attractive incentives for foreign investors in order to increase FDI inflows. For future research, it is suggested to include additional variables that may influence economic growth, such as institutional quality, macroeconomic stability, or international trade, as well as to extend the research period and expand the country coverage to obtain more comprehensive and robust results.

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