CHAPTER 1

INTRODUCTION

A. PROBLEM BACKGROUND

Local governments have wide authority to manage and maintain the development in the region as released in Act No. 22 of 1999, which has replaced by Act No. 32 of 2004 about regional autonomy. It is expected that the local government will carry out the development activities according to its local potential and condition. The development of a region is a central theme in economic life of the countries in the world nowadays, including Indonesia. One of the factors causing the low-rate of Indonesian economic development is the scarcity of capital. So that, in gaining the capital, Indonesia has to arrange the effective strategies to attract the investors concerning the capital in Indonesia.

As a country with a high population growth, Indonesia becomes one of preferred country in South-East Asia as the massive market of the investment. With a large internal market, a growing middle class, a consumptive lifestyle, abundant natural resources and a strategic location within Southeast Asia, Indonesia has natural appeal to foreign investors. In addition, the supporting factors such competitive and productive labour force, and market-oriented economic policy, amongst other factors, that attract Foreign Direct Investment (FDI) flows to Indonesia.

Foreign Direct Investment (FDI) has been widely recognized as an essential key to accelerate economic growth as well as contributing to both national and regional government in providing public goods and services. Many scholars argue that the flows of FDI to the region may help the host region to break out the threat of underdevelopment. The presence of FDI may favour the region in many important points that refers to accelerate the economic growth. These point such acquisition of new technology, employment creation, human capital development, contribution to international trade integration, enhancing domestic investment, and increasing tax revenue (Jenkins and Thomas, 2002; World Bank, 2000).

In this recent century, when the global market is opened, the regional government has responsibility to sustain their development and to catch up as much as possible the opportunities to accelerate the regional economic growth. Globalisation and decentralization(regional autonomy) are not only offering new opportunities for regional development but at the same time it also testing and challenging the regional governments to adapt and maintain their competitive tone. Globalisation is demanding the regional government to be responsive toward the extended markets, the rapid technological change and the greater exchange of knowledge. Moreover, the presence of Act No. 32 of 2004 about regional autonomy is requiring the regional government to be hundred times more pro-active in organizing and developing their human capital and natural resources.

Nowadays, the provinces of Indonesia are competing to attract Foreign Direct Investment (FDI) to support the development in the region in many prestigious sectors (primary, secondary and tertiary sectors). Each Province has its own potential that might not owned by other Province. For instance, Riau province with its richness of natural resources, Jakarta Province as the capital city with its strategic position and Special Region of Yogyakarta with its culture richness and so on. In this context, the nature and extent of regional mechanism in attracting foreign direct investment varies among regions regarding to the economic situation, social and institutional conditions, the natural resources potential, and ultimately the affordability of the region.

The investment climate in Yogyakarta was growing up significantly in this year (2013). It is proven by many investors especially Foreign Direct Investments were looking forward to concerning the investment to this region. According to World Bank Report and International Financial Corporation (2012), Yogyakarta assumed as the most welcome cities on accepting foreign direct investment comparing to other cities in Indonesia. The characteristics of the people that were likely to work hard, the regional minimum wage, and the profitable potentials in some prestigious sectors such as tourism, industrial, culture, infrastructure, education, and health were believed as the factors that influence the investors would rather to concerning the investment in

Yogyakarta. Those all signing that Yogyakarta has opportunities to attract more foreign direct investment with its competitive advantages. In the opening ceremony of the 18th APEC Automotive Dialogue in Yogyakarta 2012, the Vice Governor of Yogyakarta Special Region, Sri PakuAlam IX emphasized that Yogyakarta is one of 70 cities in the world that is most responsive in giving service to the foreign investors (AntaraNews.com/Jogja, 2013).

Many universities are located in the administrative area of the Special Region of Yogyakarta. It makes the Special Region of Yogyakarta become a "melting-pot" of Indonesia where the people with different culture come together and live in harmony. Yogyakarta is also known as a famous tourist destination with its magnetic power in tourism sector. The uniqueness of the culture and the existences of some cultural heritage site (temple, Sultan Palace etc.) differentiate this city with other region.

In addition, the development planning project of new International Airport in Kulonprogo Regency that projected to start in the late of the year 2014 and targeted to finish in 2016willmakes the Special Region of Yogyakarta has such greater opportunity to attract more investors to come. Unfortunately, the Investment Coordinating Board of the Special Region of Yogyakarta (BKPM DIY) as the unit of the governance that responsible on the investment flows to Yogyakarta is not taking very seriously to differentiate the strategy both to attract foreign direct investment and the domestic investment. A staff of BKPM DIY emphasized that there are no special strategies to attract foreign direct investment in DIY (interview with the head of program division of BKPM DIY, 02 December 2013)

The head of operational unit of the Investment Coordinating Board DIY (BKPM DIY), Andung Prihadi Santoso, noticed that the direction of investment policy of Yogyakarta in 2012 is focused in three main pillars, which is education, culture and tourism. He argued that these three pillars would make Yogyakarta in-line with Bali as tourist destination(Tribunjogja.com, 2012). The development core such education, business and industrial potential are so much influence the economic growth and prosperity of a region. This argument according to Russwurm in Yunus (2000), stated that the core points those influence the rapidness of development growth beyond farming sector, here are: (1) Capital city, (2) Shopping centre, (3) Industrial area, (4) the offices centre/institutions, (5) community housing centre, (6) apartment centre, (7) education centre, (8) a recreational open space area/ tourism. However, particularly, the region with those some points will be more developed.

The vision of Long-term development planning of the Special Region of Yogyakarta (RPJP DIY) noticed that the Special Region of Yogyakarta formed to be the centre of Education, culture and well-known tourism destinations in South-East Asia in the developed, independence and welfare community in 2025. This vision continuously introduced and promoted through tagline" Jogja Never Ending Asia". Definitely, its hoped that the Special Region of Yogyakarta will attract more tourist to come and explore "Never Ending Asia".

In this context, to support the realization of the long-term development objectives, Yogyakarta need adequate infrastructure like transportation facilities (road, airport, etc.), health facilities (hospitals, insurance, etc.), industrial sectors (trade, goods/services), Accommodations (Hotels, restaurant, etc.) and so on. The regional income from taxes, retribution and other source of income will not sufficient to manage and maintain the development pattern in Yogyakarta. Regarding to this, it is very common to other provinces in Indonesia, particularly, to makes interesting strategies to attract investors to support regional development. Furthermore, the conducive investment climate like rule of law, political stability and legal security, pro-investment policy, and the adequate infrastructure development, were the main factors to attract the investors.

The investment realization and growth of PMA/PMDN in DIY in the 2008 up to semester 1/2012, are as presented in the table below:

Table 1.1 Investment Realizations and Growth of PMA/PMDN DIY, 2008-2012

No.	Year	PMDN (Rp)	PMA (Rp)	PMDN+PMA (Rp)	Growth (Rp)	Growth (%)
1.	2008	1.806.426.455.845	2.415.461.744.857	4.221.888.200.702	142.187.960.933	3,49

2.	2009	1.882.514.536.845	2.508.131.163.857	4.390.645.700.702	168.757.500.000	3,99
3.	2010	1.884.923.869.797	2.696.046.957.447	4.580.972.827.244	190.327.126.542	4,33
4.	2011	2.313.141.695.784	4.110.436.324.224	6.423.578.020.008	1.842.605.192.764	40,22
5.	2012	2,805,944,605,930	4,250,121,535,829	7,056,066,141,759	632,488,121,751	9,85

Source: Regional Investment and Cooperation Board of DIY (BKPM DIY) 2013

The investment in the Special Region of Yogyakarta (DIY) had shown a significant growth in this recent 5 years as seen on the table above. The highest growth is occurring in 2011.During this year there were many companies broaden the investment in the previous year and revitalization of companies that affected investment growth. On the other side, the recovery condition after Merapi eruption also gave positive impacts to investment growth.

The secondary and tertiary sectors presumably are the most contributing sectors to the investment growth in DIY. They were hotels, restaurants, manufacture industry, trading, and transportation service. In 2012, the PMDN investment growth was more significant in the hotels and convection industry. While the PMA has shown growth in hotels, restaurants, manufacture industry, trading, and transportation service (BKPM DIY, 2013).

From the zoning aspect, the investment realization of DIY in 2012 still centralized in Sleman Regency and Yogyakarta City. The amount of 91,68% of the total investment realization of DIY in the 2012 were located in Sleman and Yogyakarta city while Gunung Kidul and Kulonprogo Regency is only hold 2,4% of the total.

Table 1.2 Investment Realization based on Regency/City in DIY

No.	Regency/city	The investment Realization up to 2012	
		PMDN (Domestic Direct Investment)	PMA (Foreign Direct Investment)

1.	Yogyakarta City	1,303,134,160,910	1,648,551,898,790
2.	**Sleman**	**1,242,033,289,418**	**2,276,146,234,364**
3.	Bantul	191,257,086,711	226,005,372,675
4.	**Kulonprogo**	**34,017,508,942**	**3,078,450,000**
5.	GunungKidul	35,502,559,948	96,339,580,000
Total		2,805,944,605,929	4,250,121,535,829

Source: Regional Investment and Cooperation Board of DIY (BKPM DIY), 2013

The effort of promoting potential investment has been done through involvement in the investment exhibitions both at regional and national level. At the regional level such as potential investment events, Trade and Tourism Investment (TTI) Expo, One on One meeting, business forum/business gathering with the potential investors and relevant stakeholders. There was also promotion of investment through information management such as official website of BKPM DIY named "Jogja Invest". Furthermore, the effort to increase the investment climate also has been done through formation of Centralized Licensing service board so called as "GeraiP2T". It is operated for arrangement of service license to the investors companies. It also arranged in the regional investment planning (RUPMD) and managed in the local regulation draft (RAPERDA) about incentives and easiness service to the investors companies in DIY.

Local Integrated Licenses Service Agency of DIY has been giving awards by Indonesia Investment Coordinating Board (BKPM RI) among of the 130 PTSP in the provincial, regency and city level in Indonesia in 2010. The award was One star. In 2011, DIY got Two Stars Award. At the event of Promotion Regional Potential Exhibition PRJ (Jakarta week) 2012, DIY was winning an award as Brand Manage Champion 2012 in government stand category.

Other policy was Single Window Policy in investment. DIY established Regional Representative Office (KAPERDA) DIY in Jakarta. One of the activities that has been done and will be continuously run is companies gathering.Those events werethe strategy to keep-in-touch intensively with the companies and stakeholders so that they would keep and even broaden their investment in DIY (BKPM DIY, 2013).

One of the crucial problems, identified by the BKPM DIY is the equilibrium of investment realization among regencies. Regionally, the investment in DIY was still concentrated in Sleman Regency and Yogyakarta City with amount of 90% of the PMDN and PMA realization. Meanwhile, other three regencies are only hold 11% for PMDN and less than 10% for PMA (BKPM DIY,2012). This problem brought impact of economic disintegration among regency. Theoretically, the investment agglomeration is very possible to happen. There are some points that causing agglomeration, such as infrastructure, human resources and other factors that influence the production efficiency. Based on RPJMD, it is that investment realization growing significantly in DIY on the period of 2013-2017 especially in Kulonprogo and GunungKidul Regency.

The dynamic of economic activity in DIY are concentrated in Sleman Regency and Yogyakarta City. The agglomeration economies in both regions were growing faster. It is reflected from the economic growth of both regions. The economic growth of Sleman and Yogyakarta City were growing more than the average of economic growth in DIY. The domination of Sleman Regency toward economic activity in DIY started since the 2000-2007 periods. PDRB of DIY in 2007 was reached RP. 18,31 trillion and amount of 30,3% of a whole was contributed by Sleman Regency.

Yogyakarta has many challenges and opportunities to become "attraction point" of Foreign Direct Investment (FDI). This region needs to initiate such effective strategy to compete with other provinces in Java Island and Indonesia in general. National Government in RPJM 2004-2009 reported the problems that particularly occur about FDI in region were:

1. The strict competitiveness of strategies on attracting FDI among region through new innovation and uniqueness that owned by each region.
2. The lack of law certainty, caused by uncertainty of regulations and planning of investment.
3. The low incentive of investment

4. Low quality of human resources and lacking of infrastructure.
5. There is no clear regulation on technology exchange of Foreign Direct Investment.
6. High cost of economy, because of corruption cases, security, and power manipulation.
7. Un-optimal incentives and facility services to the investors.

Many local governments was still engaged with the paradigm of lean on the national allocation funds (DAU) and the pragmatic activity oriented on the income from Local Genuine Income (PAD). The concept of local development that concern on involving the investment and (or Foreign Direct Investment) as the success key to create what so called as "multiplier effect". It helps a region to cut the chain of poverty and the ineffective in some regency, including in DIY.

Meanwhile, there is some regency in Indonesia taking into consideration the investment role of their development project, such as the Sragen and Purbalingga Regencies. The limitation of natural resources in both regencies was not being an obstacle in developing and minimalizing their potentials. The transparency, easiness and effectiveness in giving the public service (especially the investment service licence)are the main initiative to create the prosperity to the citizens.

Furthermore, the agglomeration economies and investment flows of each region in DIY were causing the inequality of economic growth. The local economic development strategy should taking into account the spatial dimension. The cluster approach in local business development has become a trend and considered in many countries (Kuncoro,2002; Porter, 1998). As the implications, local governments need to formulate the sectorial approach base in certain location. In addition, Kulonprogo and GunungKidul were classified as rural area. The importance of this research is drawn from the fact that investment in Sleman Regency growing faster rather than investment in Kulonprogo Regency.

B. RESEARCH QUESTION

Foreign Direct Investment (FDI)assumed as the important matter in accelerating the economic growth. Ironically, the realization of PMDN and PMA in DIY if compared to other provinces in Java Island categorized very low(BKPM RI Report 2012,2013). Moreover, the economic growth in DIY is also unequal among regencies. The agglomeration of investment makes the imbalances of economic growth and human resources development. As the result, some regencies have been developed and some others left behind. According to investment report, it can be seen that the Sleman Regency is the most developed while Kulonprogo Regency is the most left behind.

Based on the problem background above, this research will explore on:

1. How do the strategy on attracting FDI and its leverage toward Economic Growth of Sleman and Kulonprogo Regency in 2013?
2. How do the Agglomeration Economies and its leverage toward Investment (or FDI) and Economic Growth of Sleman and Kulonprogo Regency in 2013?

C. PURPOSE AND BENEFITS OF THE RESEARCH

1. Purpose of the Research

The purposes of this research are:

1.1 To analyse the strategy on attracting FDI and its leverage toward economic growth of Sleman and Kulonprogo Regency.

1.2 To analyse the agglomeration economies and its leverage toward Investment in Sleman and Kulonprogo Regency.

1.3 To analyse the agglomeration economies and its leverage toward economic growth of Sleman and Kulonprogo Regency.

2. Benefits of the Research

This research expected to brings benefits as the basic research to understand the nature fundamentals of the social phenomenon. The results and findings of this research are hoped to be generalized into the decision making process and as the measurement to analyse the problems in the investment sector. Based on the purposes and objectives of the research, the benefits expected from this research are:

a. Theoretical Benefits

In relation to development concept, this research expected to be a base for further governance-related researches, purposively in local government level analysis. It is hoped to be a base to develop the strategic management knowledge especially in the relation of local governance and investment as general and foreign direct investment.

b. Practical Benefits

This research is expected to bring some benefits including for local government which can utilise the results to make an appropriate policy for FDI. Society as a whole also becomes the benefited party by using the result to assess and to watch whether local government's policies and performance are appropriate to deliver net benefit to the region.

D. THEORETICAL FRAMEWORK

1. Strategy on Attracting FDI

1.1 The concept of strategy

According to Chandler (Rangkuti, 2000, p3), strategy is the tool to reach the company's objectives in relation to the long-term goals, indirect program, and resources allocation.

Moreover, the strategy is the united plans, broad and integrated. It is connecting the government/company's strategies with the environment threats to ensure that the main objective of the government/company could be reached through appropriate implementation by the organization (Glueck and Jauch, p.9, 1989).

In addition, Argyris, Mintzberg, Steiner and Miner (Rangkuti, 2000, p4) defined strategy as the simultaneous and adaptive responses toward the opportunities and external threat as well as internal strength and weakness that might influence the organization. As general, the strategy can be defined as the incremental and simultaneous action. The velocity of new market innovation and the changes of consumer pattern need the core competencies by the companies/governments to maintain its capacity and competencies to afford their organization sustainability.

According to Porter (in Rangkuti, 2000) there are three strategies to a company/ government to gain the competitive advantages as follow:

a. *Leadership Cost*, the government/company can initiate the cost competitiveness. It can be done through offering the lower cost to the costumer for the same product or services with same quality compares to the competitors. The lower cost initiates by utilizing the economic scale, production efficiency, technology usage and so on.
b. *Differentiation*, the company can create the perception toward certain value to its costumer.
c. *Focus*, the focus strategy applied to gain the competitive advantages through targeted market segmentation.

1.2 Concept and Definition of Investment and (or FDI)

Investment is always believed as a driver for acceleration economic growth in a region. In private sector's view, investment becomes tool for achieving fast growth of its business. On the other hand, public sector assumes that investment assist government in providing public services and development which cannot sufficiently be financed by government budgets. Buckley et al (2007) stated that an inflation rate is negatively associated with Foreign Direct Investment. Many researchers have proven that economic growth positively associated with it. Benhabib and Spiegel (2000) also found that financial development positively influences rates of investment.

Seyoum and Manyak (2009) were the first one who tried to simultaneously identify the role of private and public transparency on Foreign Direct Investments. With sample of 58 developing countries, they concluded that both private and public sector transparency have a significant and positive effect on inward FDI flows to developing countries. Moreover, private sector transparency has a greater influence on the flow. Despite of their results which indicated more influence from private sector side, some other studies found significant findings on public sector transparency on direct investment.

Empirically, Drabek and Payne (2002) summarised that a nation which increase its transparency in policies and institutions will result in significant increasing in Foreign Direct Investment flows. They also outlined why transparency was important for direct investment especially originating from foreign sources including: (i) additional cost incurred due to non-transparency, (ii) facilitating cross-border mergers and acquisitions, (iii) protection of property rights, (iv) positively influence business attitudes, and (v) monitoring by outside organisation.

Previous studies have shown that most of researches were done for country-level analysis. Limited studies were found which touching the impact of governance to Foreign Direct Investment in local-level analysis. Current trend which decentralisation has been high on the policy agenda, consideration toward broad effect also needed. Kessing et al (2006) argued that the local government are closer to their constituency, hence, potential competition and benchmarking between regions becomes feasible. They also concluded that decentralisation has horizontal and vertical dimension. Horizontal dimension caused by competition between regional governments which result improving investment condition. It also reduced possibilities for local governments to appropriate parts of investment's return through taxation. On the other hand, vertical dimension is caused by the inevitable multiplicity of government levels that are created in the process of decentralisation.

1.3 Strategy on attracting FDI in Public sector

John Dunning Eclectic FDI Theory stated in the determinant of Foreign Direct Investment and foreign cooperation's activities. It covers the O, L, & I. OLI stands in the intersection of macroeconomic theory of international trade (L) and micro economic of the firm (O and I).This paradigm called OLI Paradigm. There is three variables including:

1. Ownership-specific (O)

   There are variables of Ownership advantage including tangible assets (natural main power, and capital endowment) and also intangible assets (technology and information, managerial, marketing and entrepreneurial skill and organizational systems).

2. Location-specific (L)

The variables of location specific (country or regional specific) refers to market structure; government legislation and policies; and the political; legal and culture environment which have been undertaken by FDI.

3. Internalization (I)

The internalization variable refers to inherent flexibility of the company, product capacity and market by the way of its own internal subsidiaries.

These five factors was developed from the Electic FDI Theory (OLI Paradigm) and going to be analysed in the relation to the government of DIY's strategy on attracting and inviting FDI to the region.

1. Political and Regulation

Asiedu and Brempong (2000) claimed that any countries with more open policies especially in terms of trade and investment would attract a large number of foreign investment flows. In addition, Tahir, R., &Larimo, J (2004) found the main factors that can attract FDI in the country is not taxes but it is a good infrastructure, economic growth and political system, market size and labour cost. Asiedu, E (2006) said that political instability has a negative influence on increasing of inward FDI.

2. Economy and Market

The economic strength in the country is the main indicator of a wealthy country. It is demonstrated as the number of GDP growth, people's living and purchasing power, new technology, and economic stability. The Heckscher-Ohlin theory predicted in term of FDI flows that if there were three factors such as labour, capital and natural resources, investors. A large domestic market and chances to exploit economies of scale is important for the timing of the decision of FDI (Dunning, J.H. ,2000).

3. Geographical Location

Geographical location is very important in decision making for foreign investors. Hollenstein, H (2005) stated that the improvement of infrastructure and the low level of government impediment in a host country have played an important role. It can increase FDI flows and make a foothold to investors in the country. Jovana Trikulja (2005) mentioned that the implication of the capital flow is geographically altering as the rural area and urban landscapes are modified to the new market systems. The quality of infrastructures is important and the availability of skilled workers will positively affects developing countries in attracting foreign capital (Bellack, C., Leibrecht, M., &Damijan, J.P, 2009).

4. Financial

FDI is an international capital flow that provides the parents firm and MNEs get control and linked with foreign affiliates. Ahn, Y.S., Adji, S.S. and Willett, T.D (1998) mentioned that different "high" and "Low" of inflation rate, which is not distinct, can be used as an indicator of the economic and political condition in the host country.Glaister, K.W. and Atanasova, H (1998) also said the effect of high inflation and unemployment in Bulgaria and high inflation can cause many problems in the country particularly to attract foreign investors. In addition, Qazi Muhammad Adnan Hye (2011) said that financial factor plays very important role of all investment and business at the same time it will increase formation and economic growth by introduction of new technologies such as managerial skill, idea, new production techniques, and varieties of capital goods.

5. Social and Culture

De Mooij, M. & Hofstede, G (2010) said that culture is the major cited words in international business and management studies. According to Gao, T (2005) likeness in culture plays an important role in forecasting FDI because foreign firms tend to go to the location where they have close culture proximity. Its indicated that MNEs are possible to launch their business in a country where they have similar culture. Another similar study by Galan, J.I. & Gonzalez-Benito, J. G (2001) about FDI found that societal and cultural factors helped clarify as FDI increase in the same region.

There are three initiatives that would help the local government improving their competitiveness on attracting FDI: (1) bureaucracy reformation on investments service, (2) information system of investment potentials, and (3) physical infrastructure provisions (KPPOD,2002).

1.4 The Relationship of Government Strategy on Attracting FDI and the Economic Growth

Table 1.3 Economic Growth Rate

No.	Economic Growth Rate (Per cent/ year)	Category
1.	0-1%	Stagnant
2.	2-3%	Very Low
3.	4-5%	Low
4.	6-7%	Fit
5.	>8%	High

Source: Tarigan, 2007

According to Todaro (2000), three main factors in economic growth, they were:

1. *Capital accumulation*, which include all form or types of new investment in land, physical instruments, and human resources.
2. *Population growth*, which in the future will resulting the labour growth,

3. Development of Technology, which is the improvement of technology which is used in attract FDI.

Setyowati et.al (2007) pointed out the factors influence investment, were:

1. Labour

   The availability of labour in a region will increase the investment; in contrast, the lack of it will decrease the investment.

2. Inflation

   Generally, inflation defined as the tendency to rising of goods prices continuously. The relation of inflation and investment in a region/state is negative. It means that the rising of inflation will decrease the interest of investor to concerning investment, oppositely, if the 1inflation decrease, the investment is increased.

3. Product Domestic Regional Brutto (PDRB)

   When the income rate is increase, it will affect the demand for goods and services of consumption. The increasing of a regional income will increase the demands of investment in society. In this case, the investment is the function of income, I=f (Yd). The correlation of investment and income was positive; its means if PDRB increase it will attract investor to invest in that region/state. In addition, if the PDRB decrease it will also decrease the interest of investor.

4. Interest Rate

   The fluctuation of the interest rate is become a consideration of investors. The correlation of interest rate with the investment is negative. If the interest rate is low, then investor might attract to invest, but if the interest rate is high, then the value of investment would decrease. The economic growth occurs caused by the activity of society and labours that used their capital to producing goods and services. They were adopting efficient methods of production to result a high quality product or services (USAID, 2008).

Investment as an important component in the aggregate demand in economy is among one factor of the sustainability of economic growth. One of the indicators of succeed are signed by a high rate of national income per capita or stable growth rate of Product Domestic Brutto (PDB). The development process of a state is considering the production activities (goods and services) in all sectors of domestic economy.

As a result, it needs to build factories, machine and production equipment's. Furthermore, it is also need to prepare the employers or skilled human capital to support the development, include the facilities such as school building, library and so on. Finally, everything needs fund called investment funds (Setyowati et.al, 2007).

Factor that influences the economic growth is investment. Investment is the main machine to run the economic development that creating new job opportunities as well as labour absorber. Moreover, the skilled/educated labour would able to used technology and finally will improve the production capacity. The capacity improvement next would increase the economic growth.

The typology of FDI was developed by Jere Behrman to explain the different objectives of FDI:

a. Resource seeking FDI
b. Market seeking FDI
c. Efficiency seeking (global sourcing FDI)
d. Strategic asset/capabilities seeking FDI

Table 1.4 Factors Influencing FDI inflows to a Country

Business Climate in the Destination Country
I. Policy Frameworks to the FDI

- Autonomy: socio-politics, stability - Entry and Operating Regulations - Policy standard for foreign affiliation - Market Function and market structure (competition policy)	
II. Economic Factors	
FDI Classification by the destination country and TNC motivation	Principal determinant in the destination country
a. Resource seeking FDI	- Raw material - Low-skilled labour cost - Labour skill - Technological and other assets innovation (such as brand creation embodied in individuals, firms, and clusters). - Physical infrastructures (Portland, roads, energy, and telecommunication).
b. Market seeking	- Market size and per capita income - Market growth - Local consumer preference - Market structure
c. Efficiency seeking (global sourcing FDI)	- Resource and asset costs (as in A), and labour productivity - Other input costs, such as transportation and communication

	• Economic costs from and to the destination country and intermediate product costs • Membership in regional cooperation (support to regional cooperation inter-firm).
d. Strategic asset/capabilities seeking FDI -	• Acquisition of key established local firms • Acquisition of local capabilities including R&D, knowledge and human capital • Acquisition of market knowledge • Pre-empting market entrance by competitors • Pre-empting the acquisition by local firms by competitors
III. Business Facilities	
• Investment promotion (including image creation and investment facilities services). • Investment incentives • Unidentified costs (in relations to corruptions and administration efficiency etc.). • Social amenities (bilingual schools, quality of life etc.) • Post investment services	

Source: Modified from World investment Report, Trends and Determinants, 1998.

From the Table above, it could be concludes that FDI is a complex cooperation. It included many aspects of country's life. Amongst other, there was such crucial interrelation between FDI and government or policy maker in a country/region in the era of autonomy. Unlike to the international trade, license, and other portfolio of investment, the FDI needs long term commitments of the business environment in the destination countries or region.

FDI frequently involves number of assets and other resources which are necessary to be coordinated and managed across country. Hence, attracting FDI into business environment in public sector in Indonesia is not a straight forward. It needs various strategies in investment project. The different FDI (companies, sectors, etc.), the different objectives they brought, so that the different strategy or ways needed to attract them.

2. Agglomeration Economies

2.1 Concept and Definition of Agglomeration

There are many definitions about agglomeration. Before it is explored further, its need to comprehend the concept. The term of agglomeration first known from Marshall Idea about *agglomeration economies* or in Marshall Term called *localized industries*. Marshall pointed out that *Agglomeration economies or localized industries* occur when a firm picked up the location of the production activity that runs for long-term periods.

As the impact, the people could gain some advantages if following them to build a business over that location (Mc Donald, 1997:37). Furthermore, Montgomery defined the agglomeration economies as the economies of proximity that associated by segmentation of firms, labours, consumers spatially to minimalize the transportation, information and communication costs (Montgomery,1988:693).

In addition, Markusen stated that agglomeration is a location that is "not easy to change" as the impacts of external proximity that opened for every firms that located side –by-side with other firms and the service providers (Kuncoro, 2002:24). Moreover, based on some definition above, it can be concluded that agglomeration is the concentration of economic activities and the people causing by the preference of location proximity. Some of the benefits of agglomeration were, particularly, in that location there has been groups of skilled-labour, good and low cost facilities, for instances electric power, machine shops, clean water facility, housing, supermarket and so on (Robinson Tarigan, 2004).

The benefits of the spatial concentration as the effects of scale economies named agglomerations economies (Mills and Hamilton, 1989). The concept of agglomeration economies also related to externalities of geographic proximity of any economic activities (Bradley and Gams, 1996). The agglomeration economies defined as the decreasing of production cost because of the economic activity located in certain places. Hoover classified the agglomeration economies into 3 types (Isard, 1979), which are:

1. Large scale economies

   The benefits collected by the firms from the enlargement of the firms production scale in a location.
2. Location economies

   The benefits collected by any firms in the same industry as well as the location.
3. Urbanization economies

   The benefits collected by any industry in same location as the consequences of enlargement the economic scale (citizens, income, output or prosperity) of that location.

Different view from O 'Sullivan (1996) divided agglomeration economies into two types: (1) localization economies, and (2) urbanization economies. The formation of agglomeration signed by several points as follow:

a. The industrial competition increasingly severe and huge

b. The practice of any forms of efficiency in industrial accomplishment.
c. The enhancement of industrial activity and production quality.
d. Awarding of simplicity to the industries activity.
e. The control simplicity and labour networks
f. The equity of industries location with corrects number, usefulness and environmentally sounds.

Agglomeration can be measured through various ways. First is the proportion number of habitants in urban area over number of citizens of that province. Second is using the production agglomeration concept (Bonet in Atur J. Sigalingging, 2008). This research is using production agglomeration concept that measured by the proportion of PDRB of the regencies over the province PDRB. This measurement aimed to identify the leverage and impacts of agglomeration toward economic growth and investment.

2.2 The Relationship of Agglomeration Economies and the Investment

The investment and (or FDI) determinants in a region based on the types of FDI such as the location seeking, efficiency seeking and other motives. The formation of agglomeration needed the technology, capital and infrastructure availability. The endogenous growth theory persisted that the development of a region need the advancement of technology and capital. The centripetal or prevalence of centrifugal power in long-term periods would forming the Agglomeration (Orlando Gomes, 2007).

The agglomeration will raise the disparities of rural and urban areas. The concentration of economic activity in certain location might cause the mobility of citizen to that location. This condition also would make the rural areas were left by the habitants and will cause the economy run more slowly. The public policy makers could set the strategy to make the equilibrium of investment distribution in rural and urban areas with rural-urban linkages action.

2.3 The Relationship of Agglomeration and the Economic Growth

The interconnection bond between industries and its supporting factors named as cumulative causation (Toyne, in Mudrajad Kuncoro 2002). Myrdal and Pred (in Mudrajad Kuncoro, 2002) argued that the positive impacts were cumulative causation called agglomeration economies. It form such as formation of new industries, increasing job opportunity, rising the work and investment attraction, increasing the skill of the citizens in the development of related industry, expansion of local services with lower cost, and the availability of public services and entertainment.

E. DEFINITION OF CONCEPT

There are some definitions to support means of the terms used in this research. Those definitions were:

1. Strategy on Attracting Foreign Direct Investment (FDI)

   Strategy on attracting FDI is the initiatives to attract the Foreign Investment and International Cooperation which running the development project by taking incentives, taxes and other agreements with the host country/region.

2. Agglomeration Economies

   An agglomeration economy is the concentration of economic activities and the people spatially causing by the preference of location proximity.

3. Economic Growth

   Economic growth is the process of output per-capita improvement in long-term period of time.

F. OPERATIONAL DEFINITION

In this study, the definition of operational used as follows:

1. Strategy on Attracting FDI
   1.1 Policy frameworks to the FDI
      a. Autonomy: socio-politics, stability
      b. Entry and operating regulations
      c. Policy standard for foreign affiliation
      d. Market function and market structure (competition policy)

   1.2 Economic factors
      a. Resource seeking FDI
      b. Market seeking FDI
      c. Efficiency seeking FDI
      d. Strategic asset/capabilities seeking FDI
      e. Social Overhead Capital

   1.3 Business facilities
      a. Investment promotion (including image creation and investment facilities services)
      b. Investment incentives
      c. Unidentified costs (in relations to corruptions and administration efficiency, etc.)
      d. Social amenities (quality of life)
      e. Post investment services

2. Agglomeration economies leverage toward investment

   To analyse it leverage toward investment and (or FDI), the writer conduct a study analysis as follows:
   a. The proportion of PDRB from FDI realization by sectors in both regencies.
   b. The spatial/location of the investment and (or FDI) development in both regencies.

G. RESEARCH METHOD

1. TYPE OF THE RESEARCH

This research used the qualitative research method to collect the data and information. Moreover, this research used descriptive-qualitative research method. The descriptive method is the study of explanation and systematic description of the actual facts and the relation of the phenomenon observed. This type of research method used the phenomenon and problems deeply. The problems of this research were related to strategy on attracting FDI and agglomeration leverage toward economic growth of Sleman and Kulonprogo Regency during 2013.

2. DATA COLLECTION TECHIC

a. Interview

Interview is the tool of data collection through directing several oral questions to be answered orally too. The interview in this research was open ended interview. Interview expected result a more accurate and detail information related to the problem. The interview conducted in both investment offices of Sleman and Kulonprogo Regency with the relevant staffs/manager of the offices that handling the investment strategy or had well-understanding of the presence of FDI in the region. In Selman Regency, interview delivered to Mr. Sriyono (Investment Development Division) and Mr. Arjunandir (Investment Marketing Division). In Kulonprogo Regency interview conducted with Mrs. Nuryani (Cooperation and Promotion Division) and Mr. Robby Amra Y (Investment Development). Furthermore, several questions also delivered to the foreign investors/firms to ensure any factors that influencing the investor's preference toward a place/region.

b. Documentation

The documentation technique is the way of collecting data by involving archives, books and information related to the problem and theory to resolve the problem. In qualitative research method, the technic used as the main tool of data collecting because the hypothesis would be answered logically and rationally through perspective, theory, regulations, whether opposed and proposed the hypothesis.

The data from government program and reports related to FDI regulation and strategy from the relevant institutions (BKPM/BPMPT/KP3M) are chosen as the main information sources. The document of the RPJMD, Strategy on attracting FDI in both regencies and the challenges and opportunity to attract FDI, the agglomeration leverage toward economic growth and the real conditions of performance of BKPM DIY, Investment board of Sleman and Kulonprogo Regency would be the most valuable document to support author on finding the outcome and answers of the hypothesis in this research.

3. DATA CLASSIFICATION

In this research, the writer uses the secondary data classification. The secondary data is the data that quoted from main source and not directly collected from the main source of the study. The secondary data collected from various sources such as books, archives, journals, documents and so on.

Table 1.5 Data classification

No	Data	Primer	Secondary	Source
1.	Investment realization and growth in DIY		✓	Archives of BKPM/BPMPT/KP3M
2.	Strategy on attracting FDI		✓	Journal
3.	Agglomeration economies in DIY		✓	Book