

FOREIGN DIRECT INVESTMENT IN JAVA ISLAND, INDONESIA

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ABSTRACT

Globalization as well as an autonomy give the opportunities and challenges for every nation, region or area in the case of attracting foreign investor so that ready to inculcate its investment especially in Java Island, Indonesia. In fact, as we know that foreign direct investment (FDI) in every province in Indonesia are different in term of monetary. The main aim of this research is to identify the critical factors affecting the success of FDI inflow into Java Island and to determine whether locality is one of the main factors that affecting the success of FDI inflow into Java Island. This research used primary data and secondary data in getting the findings. The research reveals that productivity, state minimum wage, population, inflation, and incentive are among other factors identify in attracting inflow of FDI in Java Island. It is clearly stated that through F test, the critical factors affecting the success of FDI inflow into Java Island are population, state minimum wage, productivity, inflation, incentive, and location variables. Meanwhile from the t test, it shows that population, productivity and inflation play important roles in determining the inflow of FDI to Java Island. In addition, the location's variable should be carefully considered among other things in order to facilitate foreign investors by improving or enhancing local resources or facilities, and having good network and infrastructure (logistics).

Keywords: Globalization, FDI, locality, critical factors, infrastructure

**Ropingi have passed away in June 2010 and may Allah swt place him among the syuhada. Al-Fatihah. This paper is part of his thesis for PhD at UUM.*

INTRODUCTION

In the era of globalization, economic development activities in a certain countries are closely linked with total inflow of the foreign investments. Foreign Direct Investment (FDI) is needed for the purpose of economic development especially in developing countries such as Indonesia. The inflow of foreign direct investments to Indonesia, particularly for the Island of Java is different as compared with other ASEAN member of countries. This shows several factors that affect the foreign investors in making investment through the amounts of cash allocated at different locations. Thus, the research attempts to answer the research objectives namely: (i) identify the factors that influence the entry of FDI flows to the Java Island, and (ii) investigate the locations to be among of the major pull factors to the flow of FDI entries. Therefore, the main objective of this research is to identify the key factors that influence the inflows of foreign direct investment to Java Island. Indonesia similarly with other ASEAN countries has aggressive program in the effort to attract the foreign direct investments (FDI). Table 1.1 has appropriate references for more information.

Table 1.1 The value of FDI in ASEAN (Year 2006, in Million USD)

Country	FDI Value	Percentage (%)
Singapore	24,207	48.19
Malaysia	6,060	12.06
Thailand	9,751	19.41
Vietnam	2,315	4.61
Indonesia	5,556	11.06
Philippines	2,345	4.67
Total	50,234	100.00

Source: UNCTAD, World Investment Report, 2007 in Sapuptro, 2008

There were different levels of development between the urban, rural, state, country, regions and districts. This is because of the economic actors at the lower levels are discovered to have limited knowledge in terms of economy, bargaining power, market

estimations and so forth. According Widayanto (1996), strategy development with the integration of growth and equalization should have three directions: (1) the privilege and community empowerments, (2) the grant of autonomy and delegation agreed in the management of development areas and, (3) modernization through the sharpening and strengthening the exchange of the existence in social structure of the regional autonomy in economic. They have a larger opportunity to every district towards adopting the development, finding the necessary funds or investment in regional development, including Java Island. Investments are available locally and externally in Java, so that each district is competing in obtaining such investments. The question is why it was happened?

Table 1.2 The value of FDI in Java Island for the year 2007

Province	FDI (Million USD)
DKI Jakarta	6,081.90
West Java	2,551.11
Central Java	82.40
East Java	1,067.80
Special Province of Yogyakarta	49.80

Source: Bank Indonesia

The ability of Indonesia to attract the FDI flows is determined by several factors. The foreign investments' entry programs and connected with problem of competitiveness of the location selection are the factors need to be reviewed. This has been seen from the number of foreign investment in each state or province in Indonesia is varied at several districts. The values of FDI for several regions in Indonesia for the Year 2007 were shown in Tables 1.2 and 1.3.

Table 1.3 The value of FDI in Indonesia for the year 2007

Province	FDI (Million USD)	Percentage (%)
North Sumatera	1,516.60	10.92
South Sumatera	423.70	3.05
West Java	2,551.11	18.37
Central Java	82.40	0.59
East Java	1,067.80	7.69
Special Province of Yogyakarta	49.80	0.34
Bali	227.60	1.64
East Kalimantan	692.20	4.98
South Sulawesi	95.00	0.68
West Nusa Tenggara	27.30	0.20
Indonesia	13,889.27	100.00

Source: Bank Indonesia (Edited)

According to Griffin and Pustay (2005), Mahoney, Trigg and Pustay (1998) raise this issue that the companies involved in FDI are facing several factors which are categorized into: (i) offers factors / preparation include costs of production, logistics, availability resources and accessibility to technology, (ii) demand factors include: access to the customers, marketing excellence, leveraging the competitive excellence and customer mobility, (iii) political factors include: avoidance of business constraints and economic development incentives.

- i. Ownership of excellence: The FDI companies should have a unique competitive excellence that covers the deficiencies of the competition with other companies or foreign companies at their own countries. The excellence may be the ownership's trademarks of their own technology and excellence in economy of scale.
- ii. Excellence location: Location is one of the factors to be considered in carrying out FDI. In carrying out the business activities, there should be more profitable at overseas' sites rather than local counterparts.
- iii. Internalization of excellence: Internalization of companies is made in order to gain profits and more partnerships with local companies. In practicing internalization, the company should obtain a larger profit by conducting business activities at overseas level rather than engage them with the local independent companies. Internalization will be profitable if the monitoring and implementation of local companies had proven to be costly due to the misuse of company's technology or brand and reputation become threatened danger of bad behavior of local companies.

The FDI inflows are varied at each region on the Island of Java. These raise several questions: Why the FDI inflows to Java are different?; What factors affect the flow of foreign investors to the Island of Java?; and, is the position of Java Island is really strategic as a pull factor of FDI inflows? In addition, is there a correlation between the variables that influencing the FDI inflows into the Island of Java?

In order to answer all the above questions, the references are needed to prove the hypotheses through its reviews from previous researches as well as library search. Among others are research by Kuncoro (2002) and Zhou, Li & Tse (2002) entitled *The Effects of Foreign Direct Investment on the productivity of local companies in China*; and *Results of study on the effects of wage labor of FDI* by Gopinath & Chen, (2003). On the other hand, the library search were also used as a moderator from several main

topic such as the International Business Studies, Globalization, MNEs or MNCs, investment theories, FDI factors, culture, locations and economic activities in several countries.

DEVELOPMENT OF FDI IN INDONESIA BASED ON COUNTRY OF ORIGIN

Table 2.1 shows the FDI inflows to Indonesia for the period 1997-2007 which proves that the countries from America and Asia had dominated the FDI into Indonesia.

Table 2.1 Value of FDI flow admission to Indonesia (1997–2007, in USD Million) Based on continent

Year	Continent				
	America	Europe	Asia	Australia	Africa
1997	1,067.8	9,142.9	11,564.5	167.6	42.5
1998	473.9	3,593.3	2,633.1	72.1	72.5
1999	50.9	727.7	6,485.6	2,458.4	65.7
2000	236.1	5,835.4	3,719.8	51.8	532.2
2001	56.3	779.4	10,174.8	241.2	560.4
2002	140.6	1,200.8	5,783.9	230.6	875.5
2003	380.0	1,263.2	2,663.5	125.6	4,462.2
2004	206.6	1,955.2	6,431.2	588.4	360.9
2005	634.7	591.2	6,649.8	523.4	151.9
2006	394.8	1,181.9	6,819.9	50.1	1,487.2
2007	13,454.6	1,233.3	5,960.7	425.1	1,716.8

Source: Bank Indonesia

Among the European countries found out that England, Germany and Holland among the biggest contributors for direct investment to Indonesia which was recorded from the period 1997-2007. The Table 2.2 refers for further information.

Table 2.2 Development trends value entry of FDI from Europe to Indonesia (1997–2007, in Million USD)

Year	Belgium	Holland	Italy	France	England	German	Switzerland	Others
1997	14.8	155.8	23.9	456.1	3,775.7	3,747.4	68.4	900.8
1998	8.5	296.5	6.1	3.2	3,160.6	68.7	33.0	16.7
1999	9.6	48.8	3.2	22.8	506.8	87.1	42.2	7.2
2000	5.2	1,155.5	6.3	64.0	3,560.6	950.8	42.2	508
2001	0.2	72.8	1.8	13.7	603.8	39.1	11.7	36.3
2002	7.1	104.2	1.6	250.1	718.8	33.5	74.3	11.2
2003	5.9	99.4	1.8	5.7	966.1	170.8	0.3	13.2
2004	10.2	258.8	7.8	9.2	1,317.2	29.9	299.0	23.1
2005	16.4	472.3	10.4	8.8	1,529.1	40.1	27.5	15.7
2006	3.2	78.6	22.4	356.0	1,038.1	20.0	477.7	224.0
2007	1.2	178.0	5.2	90.8	639.3	13.2	234.4	71.2

Source: Bank Indonesia

In the meantime, among the Asian countries such as South Korea, Japan, China and Taiwan among the largest contributors and also known as the "Asian Tigers" which are relatively more developed as compared with other Asian countries. Refer to Table 2.3

Table 2.3 The development trend value of FDI from non-ASEAN to Indonesia (1997–2007, in Million USD)

Year	S. Korea	Japan	Taiwan	China	Hongkong	India
1997	1,251.7	3,139.1	3,354.8	15.6	244.8	5.9
1998	162.5	830.6	78.1	7.3	326.9	14.6
1999	262.4	644.2	1,489.5	57.9	76.9	12.4
2000	662.3	1,901.6	131.0	129.5	105.8	58.0
2001	308.5	526.9	72.3	6,044.7	39.3	5.4
2002	336.4	325.9	37.7	31.8	1,712.0	4.4
2003	122.1	1,252.2	138.7	247.6	169.5	6.4
2004	402.3	1,683.5	68.5	19.1	20.1	66.6
2005	617.5	916.0	129.5	204.7	101.9	52.3
2006	877.0	443.6	218.5	126.9	398.6	113.2
2007	559.3	395.0	51.4	220.4	250.3	95.1

Source: Bank Indonesia

Table 2.4 shows that the ASEAN countries are also the main generous foreign direct investment, particularly Malaysia and Singapore. This may be caused by common geographical, cultures and language which belongs to the same group in Malay clusters. Relatively the matter is simpler in setting up in any business because of many similarities between these three countries.

Table 2.4 The development trend value inflow of FDI from ASEAN to Indonesia (1997–2007, in Million USD)

Year	Singapura	Malaysia	Thailand	Philippines
1997	1,528.5	1,979.4	19.1	0.0
1998	480.8	659.0	0.1	62.5
1999	731.1	186.3	8.4	4.9
2000	561.3	148.5	6.8	7.4
2001	969.7	2,198.9	2.9	1.9
2002	3,258.5	69.5	4.7	0.7
2003	518.9	155.3	9.8	39.7
2004	576.5	461.4	98.9	13.2
2005	1,267.0	485.5	122.0	12.5
2006	1,993.5	2,231.9	125.0	6.0
2007	2,117.6	1,977.6	268.2	3.7

Source: Bank Indonesia

RESEARCH METHOD

This study uses the secondary data to explain the factors that encourage foreign investment to Indonesia. Data used in this study is in the form of time series data as a result of foreign investment in the Region of West Java, Central Java, East Java and in general from the total foreign investments in Indonesia.

In addition, the data were also obtained from related institutions such as the Investment Coordinating that exists in Jakarta; and the Capital Investment Coordinating Board Province of West Java, Central Java and East Java. The websites such as Bank Indonesia, the Central Statistical Agency of West Java, Central Java and East Java are also used. However, some data obtained through interviews with the chairman related institutions, especially from the investment board in their efforts of attracting foreign investors on their willingness to invest in their province.

Descriptive findings of the study are based on available data (secondary data) and the inference made on the data. In addition, the analyses using ANOVA, MANOVA and correlation analyses between the factors that influence successful inflow of FDI to the Island of Java is also used to prove the hypotheses. Correlation Test was also used to identify whether there is or not exist the relationship (correlation) between variables that influence the successful inflows FDI to Java Island either positive or negative relationships. This study was performed in Java Island that includes three major regions namely West Java, Central Java and East Java.

There are three main reasons why Java Island had been chosen for this research, namely:

- (i) All three provinces are relatively large in term of areas as compared to other provinces in Indonesia.
- (ii) The three provinces have relatively the most densely population relatively when compared to other provinces in Indonesia.
- (iii) The development of economic, political and social in these three provinces acted as indicator to other provinces in Indonesia.

FINDINGS OF THE RESEARCH

The FDI to the Island of Java in general is different in terms of total cash. This situation is believed to occur because of the location, infrastructure and facilities owned by each district are different, such as airports, seaports and other basic amenities (infrastructure and logistics facilities). Table 4.1 shows the number of the FDI inflows into the three provinces for further reference.

Table 4.1 The value of FDI from the West, Central and East Java (1992-2006, in Million USD)

Year	PROVINCE		
	West Java	Central Java	East Java
1992	2,674.6	42.5	274.4
1993	2,494.2	49.5	2,281.3
1994	4,465.5	67.5	6,252.5
1995	12,445.3	726.7	10,207.5
1996	7,761.8	3,273.7	2,401.7
1997	7,965.8	5,469.8	4,215.8
1998	5,504.2	3,066.5	563.3
1999	1,499.4	69.6	273.7
2000	3,138.0	3,013.9	1,113.6
2001	2,780.0	117.1	1,679
2002	1,053.6	71.6	262.5
2003	1,294.2	89.7	417.7
2004	2,671.6	3,371.4	325.1
2005	4,212.4	627.3	526.9
2006	2,551.11	82.4	1,067.8

Source: www.bi.go.id

Table 4.1 shows the FDI flows for the year 1992 to 1995 into West and East Java which relatively improved quite drastically. The Central Java province was experiencing the same increases as compared to West and East Java. However, for the year 1997 - 1999 the statistic indicated that some decreases due to political instability and economic interferences as well as world financial crises. After the year 2000, with the result of improved political stability and security which invites further inflows of FDI in all three provinces. Fluctuation in FDI inflows to West and East Java for the period 2000 - 2006 has declined tremendously, while the fluctuation of FDI flows in the Central Java province was stable. These results suggest that the foreign investors were attracted from the present situation in Java Island and to continue their investment for the longer period of times.

The FDI flows to West Java province recorded to the highest number in 1995 with the total of 12,445.3 million USD. The highest number of Central Java province was recorded in the year 1997 to the amount of 5,469.80 million USD and East Java province to the highest number of FDI flows recorded to 10,207.50 million USD in the year of 1995. The magnitude of The Gross Regional Domestic Product (GRDP) can be used as an indicator on the ability of a district adopts a particular product or services. More and more of prosperity of the GRDP showed also the higher as recorded in the districts. The development of three regional in term of GRDP is shown by Table 4.2 for further reference.

Table 4.2 Gross Regional Domestic Product of Java Island (1996–2006 in Million USD)

Year	PROVINCE		
	West Java	Central Java	East Java
1996	7,761.8	3,273.70	2,401.70
1997	7,965.8	5,469.80	4,215.80
1998	5,504.2	3,066.50	563.30
1999	1,499.4	69.60	273.70
2000	3,138.0	3,013.90	1,113.60
2001	2,780.0	117.1	1,679.0
2002	1,053.6	71.6	262.50
2003	1,294.2	89.7	417.70
2004	2,671.6	3,371.40	325.10
2005	4,212.4	627.3	526.90
2006	2,551.1	82.4	1,067.80

Source: BPS Varieties Publishing, 1996 – 2007

Exacerbation of the economic structural changes, particularly changes in the structure of production also occurred in East Java province with a declining role of agriculture and the increases role of other economic sectors such as services sectors. The population as a proxy for demand factors which reflects many potential customers from their respective research areas. The more populations in the areas, the higher will be potential markets and customers are shall attract more investors for investment that particular province. In addition, being a proxy of potential customers, people can also be used as offer potential employees. Population growth from these three provinces can be seen from Table 4.3.

Table 4.3 The population of Java Island, 1997 – 2007

Year	PROVINCE		
	West Java	Central Java	East Java
1997	40828400	30364300	33257524
1998	41578300	30703300	34550008
1999	42332200	31043700	34536210
2000	35500611	31223000	34766000
2001	36070065	31063818	34703595
2002	36914883	31691866	35148579
2003	37980422	32052840	36199078
2004	38472185	32397431	36396345
2005	39960869	33121200	37067700
2006	40737594	33482221	37739055
2007	41529416	33847177	38422569

Source: BPS For Period of 1997–2007

The regional minimum wage rates can also be used as a proxy in the form of offer factor which considered as the cost's component. Differences in minimum wage rates for each province can be seen in Table 4.4. This indirectly explains the ability of a province to serve on beneficial factors of worker's production were also varied.

Table 4.4 : The minimum wage in Java Island, 1997-2007 (In Indonesia Rupiah)

Year	PROVINCE			
	West Java	Central Java	East Java	
1997	172,500	113,000	132,500	
1998	198,500	130,000	52,500	
1999	230,000	153,000	182,000	
2000	270,000	185,000	236,000	
2001	245,000	245,000	220,000	
2002	280,800	314,500	245,000	
2003	320,000	340,400	274,000	
1	Agriculture	Rice, Maize, Soya, Peas, Casava	1,705.096 Ton/year	Wonosobo, Banjarnegara, Grobogan, Temanggung, Purbalingga, Blora
2004		366,500	365,000	310,000
2005		408,300	390,000	340,000
2006		447,600	450,000	390,000
2007		516,300	500,000	448,500
<i>Average</i>		<i>314,100</i>	<i>289,600</i>	<i>266,400</i>

Source : BPS For Period of 1997 – 2007

Inflation factor of this research is also used as a proxy on the offer side of the production costs' components. High inflation rate explains that the general price occurs in a certain province is also high whereby this inflation rate can be used as an indicator on how the production factor price condition started from each province. Refer to Table 4.5 for further information.

Table 4.5: Inflation rate for Java Island (1997-2006, in Percentage)

Year	PROVINCE		
	West Java	Central Java	East Java
1997	9.95	10.88	9.11
1998	72.59	67.19	95.21
1999	4.29	1.51	0.24
2000	8.52	8.73	10.46
2001	11.91	13.98	14.13
2002	11.97	13.56	9.15
2003	5.69	6.07	4.79
2004	7.56	5.98	6.06
2005	19.56	16.46	14.12
2006	5.33	6.08	6.71
<i>Average</i>	<i>15.7</i>	<i>15.0</i>	<i>17.0</i>

Source : BPS for Period of 1997–2006

In addition, the economic potential of an area can be seen from Tables 4.6, 4.7 and 4.8 below.

Table 4.6: Economic Potential East Java Province

No	Sector	Commodity	Potential	Location
1	Industry	Engine and basic metal, train industry		Madium
		Agriculture engine & equipment		Malang
		Shipping industry		Surabaya
		Basic chemistry industry and cement		Pasuruan, Lamongan, Mojokerto, Gersik
		Food industry, textile, home furnishing		Pasuruan, Malang, sidoharjo, Surabaya
2	Mining	Oil and Gas		North Beach Gresik, Madura, Tuban
		Brick, Coalite, Marble, Black Tin Ore		Pacitan, Tulung Agung, Ponorogo
		Silver, Copper, Gold, sulphur		Malang, Trenggalek, Jember, Pacitan, Banyuwangi, Pasuruan, Mojokerto, Jombang
3	Fishery	Deep Sea Fishery		
		Sea Fishery	251,336 ton	ZEE, East Java Beach
4	Tourism	Eco Tourism		Bromo, Tengger, Alas Purwo

Source: Research Team of Center Political Studies Soegeng Sarjadi Sidicated, 2001

		Horticultural		
		- Red Onions	2,293.150 Ton/year	Brebes, Tegal, Pati, Pemalang,
		- Potato	990,280 Ton/year	Wonosobo, Banjarnegara, Brebes,
		- Durian	380,580 Ton/year	Magelang, Semarang regency
		- Zalacca Palm	2,642.660 Ton/year	Pekalongan, Jepara, Kendal, Semarang, Purworejo
2	Farming	Tea, Carrot, Cinnamon		Magelang, Banjarnegara Karanganyar, Boyolali, Pekalongan
3	Peternakan	Buffalo and Cow	1,331.100 animal	Sragen, Sukoharjo, Banyumas, Pati, Blora, Boyolali, Rembang, Grobogan
		Cow for Milk		Boyolali
		Goat/Sheep	2,974.917 animal	Wonogiri, Purworejo, Brebes
4	Industry	Animal Food, Processing Food, Packaging, Furniture, Textile and Clothing , Electric, Engine Component		Boyolali, Brebes, Jepara, Batang, Kudus, Blora, Rembang, Pekalongan, Cilacap, Tegal, Kendal, Sragen
5	Fishery	Deep Sea Fishing	37.476 Ton/year	Purworejo, Magelang, Rembang, Banyumas, Wonogiri
		Prawn		Along Jepara Beach
		Sea Fishery	287.395 Ton/year	Tegal, Pati, Cilacap, Batang, Rembang, Pemalang, Pekalongan
6	Mining	Marble		Purworejo, Rembang, Grobogan
		Gem/Tin Ore		Rembang
		Phosphate		Wonogiri, Banjarnegara
7	Tourism	Garden and Nature of Forest Beach and Sea		Ambarawa, Banyumas Nusakambangan, Karimunjawa

Source : Badan Penanam Modal of Central Java Province

Table 4.7 Economic Potential of Central Java Province

No	Sector	Commodity	Potential	Location
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Table 4.8 Economic Potential of West Java Province

West Java				
No	Sector	Commodity	Potential	Location
1	Agriculture	Rice, Maize, Soya, Peas, Casava	2,852.462 Ha	All West Java
		Horticultural	99,435 Ha	All West Java
2	Farming	Cocoa, Tea, Rubber, Cinnamon	465,708 Ha	Purwakarta, Subang, Bandung
		Jahe	2,500 Ha	Cirebon
3	Peternakan	Buffalo and cow	100 Ha	North Cirebon
		Milk Cow/Buffalo	184,445 unit	Gegesik, Babatan
		Rear cow	165,686 unit	Gegesik, Babatan
4	Industry	Animal Food, Processing Food, Packaging, Furniture, Textile and Clothing , Electric, Engine Component	> 30% PDRB Jabar	Bandung, Cilegon, Tasikmalaya, Bekasi, Cibinong, Citeurep and Cirebon

5	Fishery	Budidaya	96,000 Ha	Tasikmalaya, Bandung, Sukabumi
		Pond Prawn	25,000 Ha	
		Budidaya udang	50 Ha	West Java Beach
		Sea Fishery	173,337 Ton	
6	Forestry	Rainforest Trees	3350 Ha	Cirebon
		Bamboo Forest	1331 Ha	Cirebon
7	Mining	Oil and Gas		Cirebon, Indramayu
		Gold		Gunung Pongkor, Gunung Limbung, Purwakarta
		Marble		Tasikmalaya, Bandung, Sukabumi
		Batu Kwarsa		Bogor, Sukabumi, Bekasi, Cirebon
8	Tourism	Phosphate		Ciamis, Sukabumi
		Garden and Nature of Forest	65 Ha	Bandung

Source: 1. BKPM
2. Research Team of Center Political Studies Soegeng Sarjadi Sidicated,
2001

CONCLUSION

The FDI flows to Indonesia based on country of origin involved relatively more from developed countries such as the U.S., Germany, Britain, Japan, South Korea, Australia and Singapore. While the FDI flows to Indonesia based on economic sectors was relatively more investment in the service sectors. Nevertheless the agricultural sectors are relatively small. The major factors that affect the success of the FDI flows in Java Island are population, minimum wages, inflation rates, incentives and locations variable and also productivity of the province. Location is one of the variable factors that influence the success of the FDI flows to Java Island. That means, most foreign investors would consider an appropriate location for their future investment in Java Island. The province's productivity and minimum wages factors in each province are varied in the proportion. This indicates that the location variables have a significant impact in supporting and creating the province's productivity as well as increasing to the Minimum Wages Province (UMP) for the population.

RECOMMENDATIONS

The era of globalization and regional autonomy are the assertion of its provinces in Java Island. Accordingly, each province's capital is necessary in building up neighborhood for better internal and foreign capital investments. The Government of West, Central, and East Java need further improvement in order to attract more foreign investors to enhance their investment in their own province. The ability in preparing the necessary and basic facilities such as port's facilities (sea and air), the improvement of quality of human capital and other critical facilities are to be the important factors which are able to encourage foreign investments in the future. On the other hand, the proposal for each province should be well versed in pro-business policies, environments, transparent, responsible people and related requirements in order to create a friendly market for the future of Java Island. In other words, the government of each province should create an environment whereby it is consider as market friendly for foreign investors to invest in their province.

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