LOCAL GOVERNANCE AND DIRECT INVESTMENT: EVIDENCE FROM PROVINCE IN INDONESIA[1]

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Acknowledgement: Special thanks to Dr. Telisa A. Falianty (Faculty of Economics, Universitas Indonesia) for giving us meaningful feedback.

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ABSTRACT

After releasing Act No. 22 of 1999 about local autonomy, Indonesia has entered decentralisation era which implicated in decision making process as well as managing development activities in each region. Local government has a wider authority in directing and determining development's direction in its own area although has to be aligned with central government's development corridors. Investments also became an area in which each region is expected to be managed by. Unfortunately, a gap is still occurred among regions regarding their capacity in attracting direct investment in their jurisdiction. This paper tried to extent prior researches by investigating roles of governance in each region including corruption, quality of human resources, transparency of local government, and ruling party toward realisation of direct investment in local government in Indonesia. The paper utilised all Indonesia's province-level data during 2008-2010. The results were strongly associated with domestic direct investment for supporting political party, corruption perception, and disclosure of financial statement. In other hand, this research has only proven that FDI highly associated to disclosure of financial statement.

Keywords: local government, direct investment, corruption, ruling party, financial dislosure

INTRODUCTION

After releasing Act No. 22 of 1999 about local autonomy, Indonesia has entered decentralisation era which implicated in decision making process as well as managing development activities in each local region. Local government has a wider authority in directing and determining development's direction in its own area although still has to be aligned with central government's development corridors. By such wide authority, it is hoped that each local government can run a better development activities according to both its local potential and its specific faced condition, while the final outcome should effectively reach development main's objectives, people's welfare.

In align with autonomy, local government has also obligation to prepare financial statement as accountability of state finance utilisation. Many regulations has been released as a financial reform package after local autonomy act, including Act No. 28 of 1999 about free corruption governance, Act No. 17 of 2003 about state finance, Act No. 1 of 2004 about state treasury, and Act No. 15 of 2004 about audit management and accountability of state finance. Such financial reform package is expected to be effectively become a supporting mechanism in order to realise good government governance in the country. Although quite extensive regulation has been released, local government financial statement is not sufficiently provided. Audit report of Supreme Audit Body (*Badan Pemeriksa Keuangan*-BPK) indicated that in 2011 only 67 local government that gotten unqualified opinion or only 13% from total financial statement audited by the body. Although the number has increased since 2006 (with only 3 financial statement gotten unqualified), but the figure is far away from the autonomy and reformation spirit.

An area in which to be influenced by decentralisation is investment both foreign direct investment and domestic investment. Investment is believed can become leverage for economic growth in a region. As booster of a region, it provides several roles including providing job opportunities, elevating region's income, at the end delivering people's wealth as a whole. Moreover United Nations (2004) also stated that investment triggers technology transfers, assists human capital formation, enhances international trade integration and commonly creates a more competitive business environment. As an implication of

decentralisation process, each local government is expected to attract as many as investment in their own regions in order to support local development which cannot be fully supported by government's budget.

Prior researches have already considered the important of governance on investment including Quazi (2007) found that countries can attract more FDI by improving their domestic investment climate through tax and tariff reform, reducing government ownership of business, and liberalising the banking and financial sector. Drabek and Payne (2002) commented that a nation that takes steps to increase its transparency in its policy and institutions could expect significant increases in FDI inflow to their country. Similar result was found by Zhao et al (2003) which summarised that low public transparency is likely to have a negative effect on FDI inflow. Habib and Zurawicki (2002) also argued that bureaucracy and corruption in the country are important factors in determining FDI inflows. Such researches are strengthened by Seyoum and Manyak (2009) who tried to specifically investigated role of private and public transparency toward FDI in developing countries. They argued that both transparencies have positive and significant impacts on inward FDI although private transparency has a greater influence. In Indonesian context, Lipsey and Sjöholm (2010) which argued that low inflows of Foreign Direct Investment (FDI) to Indonesia is caused by weak business environment and inefficient institutions.

Although quite extensive researches in investigating association of direct investment and governance, most of them focus on country-level analysis. Such condition causing question about why some regions in a country tend to attract more investment while other regions failed to pull investments. In a decentralised era, a local region should have different approach as well as strategy in determining their own development path including attracting inward investment. Decentralisation implied in increasing authority of local government to issue localised regulation, utilising its own uniqueness, and choosing its specialities in order to optimise their region development. Thus, specific effect of region should have some effects in attracting direct investment as an explanation why some region in a country can attract more investment than others which cannot be explained by country-level characteristics. Too aggregation on country-level characteristic has blurred local characteristics which important in recognising investment decision making process. Moreover current direction shows that increasing role of local government need to be captured by capital owners in order to assess an investment opportunities.

This research tries to extent prior research related to association of governance and direct investment by utilising local government-level data. It tries to find evidences some specific factors of a region that influence direct investment in Indonesia's province context. Past researches have limited availability in depicting association of governance and direct investment in narrow level of government.

This study is expected to have some benefits including for local government which can utilise the results to make appropriate policy especially to provide a sound investment friendly policy. For related science development, it is expected to be a base for further governance-related researches, purposively in local government level analysis. Society as a whole also becomes the benefited party by using its result to assess and to watch whether local government's policies and performance are appropriate to deliver net benefit to the region.

This paper is arranged into five parts. The following section outlines the theoretical framework and prior literatures that employed in this study. In the part III, empirical specification including data and methodology are discussed. Then, the part IV presents the results of the analysis. The last part resorts conclusion for overall discussion as well as summarises policy implications for local government and investment policy.

LITERATURE REVIEW

Investment is always believed as a driver for economic acceleration in a region. In private sector's view, investment becomes tool for achieving fast growth of its business. In other hand, public sector views that investment assist government in providing public services and development which cannot sufficiently be financed by government budgets. Abundant researches and theories in classical economics literatures have been released which indicating several factor that causing investment decision. Jorgenson (1967) comprehensively explaines how interest rate influences investment level. Tax policy that promotes liberalisation is indicated has substantial influences toward investment expenditure (Hall and Jorgenson, 1967). Buckley et al (2007) state that inflation rates is negatively associated with direct investment, in other hand, many researchers have proven that economic growth positively associated. Benhabib and Spiegel (2000) also find that financial development positively influences rates of investment.

Besides such hard factors that known to influence investment, current researches have tried to recognise soft influencing factors to investment. Socioeconomic and political factors are also indicated to impact on investment. One of main component of such factors is governance. Several measurements were employed by prior researchers to prove the association. La Porta, et al (1998) find that countries with better legal protection for investors tend to have more active stock market. Globerman and Shapiro (2003) find that countries with transparent legal system and better protection of property rights tend to attract more foreign direct investments. Busse and Hefeker (2007) indicate that government stability attracts FDI while Guerin and Manzocchi (2009) show whether parliamentary democracies are more likely to attract FDI than presidential one. In other hand, Li and Filer (2007) try to identify impact of governance environment towards choice of investment mode. They conclude that investors tend to choose direct investment than portfolio investment in countries with public rules. They also argue that direct investment gives investors more direct and effective control over their investment, thus better protection to their interest especially in a governance environment where laws are ineffective and lack of accounting standard.

Despite of various measurements, transparency becomes a favourite topic to be proven its association to investment both in private and public sector. It aligns with basic theory where transparency is highly related with commitment to reduce asymmetric information. A greater commitment to increase transparency will lower cost imposed to and from investors. Gordon (2003) comments on its report:

> From a business point of view, transparency reduces risks and uncertainties, promotes patient investment, reduces opportunities for bribery and corruption, helps unveil hidden investment barriers and draws the line between genuine and less genuine policy objectives, assists investors dealing with 'thin' rules, discourages 'conflicting requirements' situations between home country and host country, contributes to the playing field among firms and facilitates sustainable development.

In accounting literature, the real manifestation of transparency is formed by financial statement disclosure. Information disclosure is believed to give an opportunity to stakeholders to get information that they need to know about. In private sector researches, abundant studies have proven how increasing commitment to transparency by adequate disclosure is priced by users. Such as, Leuz and Verrecchia (2000) based on study toward Germany firms, find that firms who commit to provide better disclosure by switching to accounting standard which promote higher disclosure requirement (US GAAP or IFRS) have lower bid-ask spread and higher stock turnover. In other hand, despite of its limited research availability, accountability and governance (including transparency) become research topic with the most attention in public sector research (Goddard, 2010).

Seyoum and Manyak (2009) were the first one who tried to simultaneously identify the role of private and public transparency on 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 inflow. Despite of their results which indicated more influence from private sector side, but some other studies found significant association of public sector transparency on direct investment. Empirically, Drabek and Payne (2002) summarise that a nation that try to increase its transparency in its policies and institutions could expect significant increases in inward direct investment. They also outlined why transparency is 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.

Unfortunately, most of researches were done for country-level analysis. Limited studies were found which touching the impact of governance to direct investment local-level analysis. In current trend which decentralisation has been high on the policy agenda, consideration toward its broad effect also be needed. Kessing et al (2006) argue the local government are closer to their constituency, in other hand, potential competition and benchmarking between regions becomes feasible which is not feasible under a unified central government. They also concluded that decentralisation has horizontal and vertical dimension. Horizontal dimension caused by competition between regional governments which resulting improved investment condition and reduced possibilities for local governments to appropriate parts of investment's return through taxation. In other hand, vertical dimension is caused by the inevitable multiplicity of government levels that are created in the process of decentralisation.

In context of Indonesia, the country has entered financial management reform since releasing three packages regulation during 2003 and 2004 including Act No. 17 of 2003 about state finance, Act No. 1 of 2004 about state treasury, and Act No. 15 of 2004 about audit management and accountability of state finance. Financial reform is started by planning and budgeting process, budget implementation and accountability process and auditing. Before such regulations were released, Indonesia had employed a set of regulation from colonisation period which recognised incapable to meet current development of state organisation and state finance management systems. The old systems were also blamed as the cause of dispersion in state finance management.

The Act No. 15 of 2004 is the basis for reforming state finance accountability and its audit process. This act defines state finance accountability as responsibility of government to perform sound finance management, comply into regulations, efficiently, economically, effective, and transparently perform with attention in fairness and appropriateness. Supreme Audit Body (BPK) performs auditing process into state finance management and its accountability. Auditing process which performed by the body including financial audit, performance audit, and special purposes audit. Financial audit is audit process into financial statement provided by central and local government. Central and local government financial statement is form of accountability of budget implementation according to the Act No.1 of 2004. Performance audit is audit process to state finance management including any aspects of economy; efficiency; effectiveness of activities. In other hand special purposes audit is audit process outside financial audit and performance audit.

Given the state of the literature, the following hypotheses are developed:

H1: The disclosure of financial statement positively associated to investment realisation in provinces in Indonesia.

Moreover, Morrisey and Udomkerdmongkol (2011) also identify that lower control of corruption and lower political stability have direct effects toward direct investment although with insignificant and significant effect respectively. Thus:

H2: The clean corruption perception positively associated to investment realisation in provinces in Indonesia.

H3: The higher political stability in a region positively associated to investment realisation in provinces in Indonesia.

In other hand, as specified by Kessing et al (2006), possibility of vertical component influencing investment due to higher level government intervene the authority of local government because of any relationship existed. Thus

H4: The dependence in a region negatively associated to investment realisation in provinces in Indonesia.

DATA AND MEASUREMENT

This study used purposive sampling toward all provinces in Indonesia for period of observation 2008-2010 which resulting 99 sample years. Then following model was employed:

$$FDI_{it} \text{ or } DDI_{it} = \beta_0 + \beta_1 DISC_{it} + \beta_2 CORRUPT_{it} + \beta_3 POLITIC_{it} + \beta_4 DEPEND_{it} + \beta_5 INFLATION_{it} + \beta_6 GROWTH_{it} + \beta_7 POP_{it} \varepsilon \quad \text{(eq. 1)}$$

The model will be used both for identifying explanatory variables toward foreign direct investment and the effect to domestic direct investment.

Explanation of each variables and its measurement is provided in table 1.

Table 1. Variables, definition and measurements

Variable	Definition	Source
FDI	Foreign direct investment realisation per year	Indonesian Investment Coordinating Board (BKPM)
DDI	Domestic direct investment realisation per year	Indonesian Investment Coordinating Board (BKPM)
DISC	Percentage of disclosure of financial statement made by local government to requirement from Government Accounting Standard (scale to 0-100%). Numerator is respective government's fulfillment to GAS, denumerator is mandatory disclosure required by Indonesia GAS.	Checklist items based on Indonesia Government Accounting Standard (PSAP)
CORRUPT	Perception of corruption in a province (index: 0-100)	Transparency International
POLITIC	Percentage of members of supporting party to current head of local government	Indonesia's Election Commission (KPU)
DEPEND	Percentage of total budget transfer from central government to total revenue of local government	Province's financial statement
INFLATION	Rate of inflation in the province for a year	Central Statistical Bureau (BPS)
GROWTH	Percentage of regional's economic growth for a year	Central Statistical Bureau (BPS)
POP	Population of the province in a year	Central Statistical Bureau (BPS)

In this study, main dependent variables are FDI and DDI. Explanatory variables are governance related variables including percentage of disclosure of financial statement which measured by developed checklist item from Indonesia's Governmental Accounting Standard, corruption perception, supporting party to head of local government and dependence to

budget transfer. Additional control variables is included namely inflation, regional economic growth, number of population, and local government spending which widely proven to have influence to investment realisation.

RESULTS AND ANALYSES

1. Descriptive Analysis: Investment and Governance in Indonesia's Province

This study analyses is started by describing samples taken to know characteristic of data. Table 2 shows descriptive statistics of foreign and domestic direct investment, as well as governance related variables in provinces during 2008-2010.

Table 2. Descriptive statistic for dependent and explanatory variables

	FDI	DDI	CORRUPT	POLITICAL	DEPEND	DISC
OBSERV	99	99	99	99	99	99
Mean	423,266,667	3,051,084,848,485	4.6668	0.2847	0.5952	0.4738
Median	37,200,000	272,300,000,000	4.6700	0.2530	0.6100	0.4800
Max	9,927,600,000	42,895,000,000,000	6.7100	0.8090	0.9740	0.7900
Min	-	-	2.9700	-	0.2600	0.1680
STDDEV	1,342,238,051	6,485,101,547,289	0.6896	0.1504	0.1969	0.1162
Skewness	5.185801	3.5784447	0.2720	1.2202	0.0282	(0.0877)

From the table, we can conclude that during the observation period, direct investment in Indonesia As a whole for the sample year, province in Indonesia had attracted on average US$ 432,266,667 of FDI and Rp 3,051,084,848,485 of domestic investment. The highest foreign investment was in DKI Jakarta in 2008 amounting US$ 9,927,600,000, in other hand, some provinces did not attract any foreign investment during the observation including Maluku, Gorontalo and Sulawesi Barat in 2008-2009. Jawa Barat became the provinces which can attract highest domestic investment especially in 2008 it absorbed around Rp 42,895,000,000,000 around 21,065% of domestic investment during 2008. In other hand, no domestic investments were made in Gorontalo, Sulawesi Barat, Sulawesi Tenggara, Sulawesi Tengah, NTB, NTT during 2008-2009, and unfortunately no investment in Maluku and Maluku Utara during observation periods. From the investment data, it can be concluded that FDI was fluctuated during observation periods, while domestic investment consistently and significantly increased during the period.

Current progress of financial disclosure has been proven by this research. Disclosure level in municipalities were increased which been shown from larger number of average disclosure level amounting 58.55% for 2010 compared to 47.91% for 2009 and 44.99% for 2008. The minimum level of disclosure also increased from 21.3% in 2008 to 32.64% in 100. It indicates that the awareness of local government in providing better, reliable as well as valuable information for the users shows a favourable progress. Although several limitations are still existed, development of accountability and transparent government are needed to be rewarded. Specifically, Java still superior compared to other area in Indonesia. On average, city in Java discloses around 54.07% disclosure items during 2008-2010. Current progress shows Sumatera and East Indonesia do a fast growing in providing better disclosure of financial statement, especially Sumatera's provinces had on average 42.27% for 2008 perform to 57.81% for 2010. In other word, it can be concluded that the gap between the Western and the Eastern part of the country is occurred in municipal's financial reporting issue.

On average the perception on corruption of region in Indonesia was 4.67 in scale of 10. The higher score means the region is recognised as relatively clean city. The highest perception on corruption was in Bali in 2010 with 6.71 index score, in contrary, Nusa Tenggara Timur in 2008 was the most corrupt region with 2.97 index score. The index

depicted that varied trend of each region, some regions did a good perform by an increasing index, while some others did in an opposite direction. As a whole, based on public perception, region in Indonesia still suffers a relatively high corruption.

Degree of dependence on transfer budget in the municipalities in Indonesia is still high. With average 59.52% of revenue in provinces is derived from budget transfer from central government. Papua Barat was the most dependence province with more than 97% of its revenue derived from budget transfer in 2010. In opposite, Jawa Timur became the least dependence province with 26% of its revenue during 2010 was derived from budget transfer. It indicated that the ability of province in Indonesia to generate own income is still differed.

Ratio of member of ruling parties which become supporters toward major of the city on average was 28.47%. Governor of Jakarta in 2008-2010 was city's leader with the highest backing up from political party amounted 80.9% seats in the local representative. Head of Aceh province had no backing up from political parties, since they were appointed civil servant for replacing former major who stepped down for several reasons, or their backing up political parties did not get any seats in local representative when the 2009's legislative election.

Those data were subject to be examined whether any outlier existed. Outlier was determined when a data less (more) than mean value minus (plus) three times standard deviation. Testing on outlier indicated that FDI, domestic investment (DDI), political party, growth, inflation, spending, and population had outlier data. To eliminate outlier, winsorise technique was employed by modifying the outlier into 1/3 of its original value or the maximum (minimum) amount that recognised as not outlier whichever higher. The descriptive statistic after outlier were as follow

Table 3 Descriptive Statistic for Independent Variables after Winsorisation

	FDI	DDI	DISC	CORRUPT	POLITICAL	DEPEND
Mean	263,000,000	2,340,000,000,000	0.474141	4.666768	0.261212	0.595556
Median	36,100,000	240,000,000,000	0.48	4.67	0.24	0.61
Maximum	3,210,000,000	19,900,000,000,000	0.79	6.71	0.57	0.97
Minimum	-	-	0.17	2.97	0	0.26
Std. Dev.	599,000,000	4,390,000,000,000	0.115688	0.689643	0.129475	0.196589
Skewness	3	3	-0.089474	0.271959	0.292365	0.026863

GROWTH	INFLATION	POP
6.020505	7.476768	6899785
5.93	7	3498125
17.75	19.32	37657651
-5.42	1.78	729962
3.2332	3.920977	9660158
0.07704	0.478768	2.457721

2. Hypotheses Testing

This study utilised panel data from 2008-2010. Firstly, we did multicollinearity test by employing correlation matrix. Table 4 provides correlation information among variables. Multicollienarity is indicated when a correlation is more than 0.8. Based on the matrix, there was no inter variables correlation with more than 0.8. thus no multicollinearity existed. Autocorrelation test were conducted by identifying Durbin-Watson value. No autocorrelation is indicated when the value is around 2. The former regression test indicated that the Durbin-Watson value was 1.391518 for FDI model, and 2.286798 for domestic investment model which indicated no autocorrelation was expected to be existed.

Tabel 4 Correlation Matrix

	FDI	DDI	DISC	CORP	DEPD	POLT	INFL	GROW	POP
FDI	1.00								
DDI	0.34	1.00							
DISC	0.16	0.09	1.00						
CORRUPT	0.03	0.10	0.13	1.00					
DEPEND	(0.42)	(0.37)	(0.42)	(0.09)	1.00				
POLITICAL	(0.19)	0.01	(0.01)	(0.06)	0.19	1.00			
INFLATION	(0.13)	0.17	(0.23)	(0.15)	0.08	(0.00)	1.00		
GROWTH	(0.05)	(0.03)	0.04	(0.02)	0.06	0.01	0.04	1.00	
POP	0.50	0.33	0.25	0.12	(0.61)	(0.08)	(0.07)	(0.08)	1.00

Heteroscedasticity test were examined by Breusch-Pagan-Godfrey test. Based on the test, the value of Prob > chi^2 was 0.0000 or less than 5% for FDI model. In conclusion, the data contained any heteroscedasticity problem. In other hand, the value of Prob > chi^2 was 0.0672 or slightly more than 5% for domestic investment model. In conclusion, the data marginally contained any heteroscedasticity problem. For FDI model, to fix heteroscedasticity problem, testing by generalised least square were employed. While for domestic investment model, cross section weight is employed.

Table 5 was the result of regression testing based on random effect for FDI model and fixed effect with cross section weighted for domestic investment model. Complete output of regression testing was presented in Appendix 1. Determination Coefficient reflected how many variations of dependent variable that can be explained by the model. Adjusted-R^2 for FDI model was 12.51%, it means that 12.51% variations in foreign direct investment inflow to the province can be explained by corruption perception index, disclosure of financial statement, ratio of dependence to transfer budget, ratio of major supporting party's members in local house of representative, province's growth, province's inflation, and province's population. While adjusted-R^2 for domestic investment model was 58.48%, it means 58.48% variations of domestic investment in a province that can be explained by same explanatory variables. In other hand, 83.49% and 41.52% variations of FDI and domestic investment respectively are explained by other variables that not be included in the model.

The significance of model can be tested by using F-stat test. Based on Table 5, the value of Prob was 0.006967 and 0.00000 or less than 5% for both model. In conclusion, simultaneously, based on regression output, the probability of β_{hdi} / β_{ddi} = β_{disc} = $\beta_{corruption}$ = β_{depend} = $\beta_{political}$ = $\beta_{inflation}$ = β_{pop} = β_{growth} = 0 was 0.006967 and 0.00000 respectively or far below 0.05, thus accept H_1 and all parameters for independent variables (disclosure of financial statement, corruption perception index, dependence on central budget, ratio supporting political party in house of representative, population, inflation, and growth) simultaneously significant toward dependent variable with degree of confidence 95%.

Table 5 Regression Output

Variable	Prediction	FDI		Domestic	
		Coef	Prob	Coef	Prob
Constant		283,000,000	0.5453	37,400,000,000,000	0,0002*
DISC	Positive	609,000,000	0.0004*	-4,610,000,000,000	0.0514**
CORRUPT	Positive	-12,508,276	0.6911	1,320,000,000,000	0.0003*
DEPEND	Negative	-417,000,000	0.2126	-2,030,000,000,000	0.3270
POLITICAL	Positive	-404,000,000	0.3222	5,270,000,000,000	0.0100*
POP	Positive	23,94	0.0000*	-5,808,610	0.0001*
INFLATION	Negative	-7,304,307	0.4145	109,000,000,000	0.0034*
GROWTH	Positive	-1,259,975	0.7781	11,600,000,000	0.8257

Adj R-squared	0.125182	0.584782
F-stat	3.003336	4.538995
Prob (F-stat)	0.006967	0.000000

Legend:
* Significance at 1%
** Significance at 5%
*** Significance at 10%

Partial coefficient test also conducted to find out whether each independent variable had associated to dependent variable as well as hypotheses testing. T-stat test was employed to examine partial coefficient test. Disclosure of financial statement had Prob(t) value of 0.0004 and 0.0514 for FDI and domestic investment respectively. Such figure gives a strong proof that FDI strongly required high transparency and price the public sector transparency by its willingness to invest in its region. In other hand, domestic investment tends to avoid region with better transparency in public sector. Although the value is marginally significant but it informs how behaviour of local investor which tend to hidden information that may associated to its relationship with local government in which they run its business. This result is accepted H1 whether disclosure of financial statement is positively associated to investment especially for FDI, but not proven in domestic investment.

This result should become a warning since how domestic investor run and perform their business in each region. In other hand, to attract more foreign investors, province government need to improve their commitment to disclose any publicly needed information especially related to their policy, accountability and development plan.

Table 5 indicated that corruption perception toward corrupt behaviour in province in Indonesia is highly significantly associated toward domestic direct investment in provinces in Indonesia. Its positive sign of coefficient means the higher corruption perception which measured by corruption perception index released by the Transparency International positively associates toward the investment. But the perception not significantly influences the FDI. This result is supported that clean perception on province is positively associated to investment but only proven for domestic investment. Such result signed that a same direction is existed between stakeholder's believe whether a local government is perceived to be clean with its commitment to become more transparent in driving its government and in providing a good accountability. In significant result for FDI is the same with Morrissey and Udomkerdmongkol (2011) which indicated that FDI not significantly associated with corruption control. In other hand, corruption level tends to become obstacles for local investors since they burden more.

Based on conducted regression analysis, DEPEND had Prob(t) value of 0.2126 and 0.3270 respectively for FDI and domestic investment. It indicated that dependence toward budget transfer from central government which measured by ratio of total transfer to total revenue is insignificantly associated toward investment both FDI and domestic investment. Negative sign means that the higher level of budget transfer from central government will decrease investment in the provinces. This result shows whether H3, dependence on budget transfer is negatively associated to investment in province, hard to be proven. The sign actually support what Kessing et al (2006) previously concluded whether intervention from central government tends to crowd out investment especially FDI.

Finally, portion of supporting political party in local house of representative is significantly associated toward domestic direct investment in a province. Its positive sign of coefficient is consistent with our hypothesis which means the higher portion of political party in the house representative tend to become an incentive toward domestic investor to invest their fund in the region. Such result is consistent with prior researches including Morrissey and Udomkerdmongkol (2011) which indicated that better stability of a region tend to attract

more direct investment from domestic, in other hand less stable region is favour for FDI. High support from legislative means lower possibility of political conflict with executive body which minimise instability in the province This evidence also reminds people and all local government's stakeholder to guide and to watch bargaining process in their local government. Political deals are commonly happen in bureaucratic and governmental life, which determine investment and development direction of a province. Social control toward legislative and executive body in local government need to be built especially when leader of the region is highly supported by majority of political parties in local house of representative.

Additionally, appendix 1 part c shows the fixed effect of each province toward value of investment. For example Aceh, the figure show as follow

CROSSID	FDI	Domestic Inv
Aceh	40,868,001	(18,100,000,000,000)

It means that the value of FDI is higher by US$ 40,868,001 from average in all provinces when all explanatory variables are equal to 0. In other hand, for domestic investment in Aceh is lower by Rp 18,100,000,000,000 from average value of domestic in all provinces when all explanatory variables are equal to 0.

CONCLUSION AND SUGGESTIONS

This study gives some evidences about association of some governance indicators toward direct investment in Indonesia's provinces. The results are strongly associated with domestic direct investment for supporting political party, corruption perception, and disclosure of financial statement. Supporting political party is indicated as stability indicator in a region as well as higher corruption perception which means lower potential cost burden to the investor are among of governance indicators that favour for domestic investors. In other hand, unexpectedly, disclosure of financial statement tends to become negative incentive to the investment which become a warning for society whether any deals happen between local governments and local investment during investment process. In other hand, this model cannot prove association of almost explanatory variables toward foreign direct investment. It only proves that disclosure of financial statement highly associated to FDI. This indicated that foreign investors require high commitment on transparency of local government to be recognised as their investment target.

This research not free from limitations, limited number of samples and scopes of observation are among the limitations. This study only employed data from 2008-2010 for province level government. Further research is better to utilise longer period of observation, in other hand, using city/regency level government to be analysed should be result a more representative result. Indonesia's decentralisation is heavy on city/regency level, thus investigating such unit will result more detail picture since many policies and development decisions are made in the level. Employing other variables and measurement are also suggested to get stronger association toward investment decisions. Variables such information freedom from external side (mass media), infrastructure, quality of human development, as well as regulation side have not been captured by this study.

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APPENDIXES

Appendix 1. Regression Test

a. Domestic Investment model

Dependent Variable: DDI01
Method: Panel EGLS (Cross-section weights)
Date: 12/31/12 Time: 20:54
Sample: 2008 2010
Periods included: 3
Cross-sections included: 33
Total panel (balanced) observations: 99
Linear estimation after one-step weighting matrix

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	3.74E+13	9.23E+12	4.047669	0.0002
DISC01	-4.61E+12	2.32E+12	-1.988472	0.0514
CORRUPT01	1.32E+12	3.44E+11	3.836129	0.0003
DEPEND01	-2.03E+12	2.05E+12	-0.988327	0.3270
POLITICAL01	5.27E+12	1.98E+12	2.661793	0.0100
POP01	-5808610.	1401811.	-4.143646	0.0001
INFLATION01	1.09E+11	3.56E+10	3.055680	0.0034
GROWTH01	1.16E+10	5.26E+10	0.221167	0.8257

Effects Specification

Cross-section fixed (dummy variables)

Weighted Statistics

R-squared	0.750022	Mean dependent var	2.36E+12
Adjusted R-squared	0.584782	S.D. dependent var	4.08E+12
S.E. of regression	2.89E+12	Sum squared resid	4.94E+26
F-statistic	4.538995	Durbin-Watson stat	2.286798
Prob(F-statistic)	0.000000		

Unweighted Statistics

R-squared	0.656740	Mean dependent var	2.34E+12
Sum squared resid	6.49E+26	Durbin-Watson stat	2.217653

b. FDI model

Dependent Variable: FDI01
Method: Panel EGLS (Cross-section random effects)
Date: 12/31/12 Time: 21:41
Sample: 2008 2010
Periods included: 3
Cross-sections included: 33
Total panel (balanced) observations: 99
Swamy and Arora estimator of component variances
White cross-section standard errors & covariance (no d.f. correction)
WARNING: estimated coefficient covariance matrix is of reduced rank

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	2.83E+08	4.66E+08	0.607169	0.5453
DISC01	6.09E+08	1.66E+08	3.674881	0.0004
CORRUPT01	-12508276	31377498	-0.398638	0.6911
DEPEND01	-4.17E+08	3.32E+08	-1.255366	0.2126
POLITICAL01	-4.04E+08	4.06E+08	-0.995460	0.3222
POP01	23.94186	5.108777	4.686418	0.0000
INFLATION01	-7304307.	8909457.	-0.819838	0.4145
GROWTH01	-1259975.	4458950.	-0.282572	0.7781

Effects Specification			
		S.D.	Rho
Cross-section random		3.72E+08	0.4993
Idiosyncratic random		3.73E+08	0.5007
Weighted Statistics			
R-squared	0.187669	Mean dependent var	1.31E+08
Adjusted R-squared	0.125182	S.D. dependent var	4.04E+08
S.E. of regression	3.78E+08	Sum squared resid	1.30E+19
F-statistic	3.003336	Durbin-Watson stat	1.391581
Prob(F-statistic)	0.006967		
Unweighted Statistics			
R-squared	0.277538	Mean dependent var	2.63E+08
Sum squared resid	2.54E+19	Durbin-Watson stat	0.713328

Cross section effect of each province

CROSSID	FDI	Domestic Inv
Aceh	40,868,001	(18,100,000,000,000)
Bali	(40,680,033)	(22,200,000,000,000)
Banten	527,000,000	24,700,000,000,000
Bengkulu	(110,000,000)	(33,200,000,000,000)
D.I. Yogyakarta	(253,000,000)	(22,400,000,000,000)
DKI Jakarta	1,070,000,000	24,100,000,000,000
Gorontalo	(47,610,571)	(35,600,000,000,000)
Jambi	(95,951,164)	(21,000,000,000,000)
Jawa Barat	719,000,000	182,000,000,000,000
Jawa Tengah	(785,000,000)	151,000,000,000,000
Jawa Timur	(193,000,000)	178,000,000,000,000
Kalimantan Barat	(80,332,946)	(15,700,000,000,000)
Kalimantan Selatan	(76,533,849)	(18,700,000,000,000)
Kalimantan Tengah	65,828,760	(26,000,000,000,000)
Kalimantan Timur	112,000,000	(18,800,000,000,000)
Kep. Bangka Belitung	21,147,417	(37,600,000,000,000)
Kep. Riau	45,263,731	(32,900,000,000,000)

Lampung	(265,000,000)	4,870,000,000,000
Maluku	(7,665,586)	(34,500,000,000,000)
Maluku Utara	171,000,000	(37,600,000,000,000)
Nusa Tenggara Barat	(81,654,575)	(16,300,000,000,000)
Nusa Tenggara Timur	(159,000,000)	(14,200,000,000,000)
Papua	91,317,743	(25,600,000,000,000)
Papua Barat	147,000,000	(38,600,000,000,000)
Riau	73,503,421	(7,140,000,000,000)
Sulawesi Barat	30,403,889	(36,900,000,000,000)
Sulawesi Selatan	(165,000,000)	9,280,000,000,000
Sulawesi Tengah	2,130,100	(27,900,000,000,000)
Sulawesi Tenggara	(80,433,304)	(28,900,000,000,000)
Sulawesi Utara	(37,062,027)	(29,600,000,000,000)
Sumatera Barat	(284,000,000)	(13,100,000,000,000)
Sumatera Selatan	(68,731,186)	1,920,000,000,000
Sumatera Utara	(288,000,000)	35,600,000,000,000