

ABSTRACT

This research understands the role of agglomeration economies in the Indonesian furniture industry. This research views the agglomeration contribute to the knowledge accumulation process within the area through the spillover effect. The source of agglomeration economies from another related industry that has direct backward linkages relationship with the furniture industry is also considered. This research hypothesizes that there is a size of firm productivity caused by the agglomeration of firms within the same industry and backward related industry firms. The medium-large manufacturing establishment survey data from the Indonesian Statistical Agency and input-output table are employed to answer the research questions. The estimation of the role of agglomeration economies were modelled based on Cobb-Douglas production function and carried out by two-step estimation (1) production function is estimated to estimate establishment-level productivity and (2) the role of agglomeration alongside firms characteristics to firms productivity is estimated using the productivity estimated in step (1). The input-output analysis shows that Indonesia furniture industry is mainly related to chemical and wood industry. The results of this research show the role of agglomeration economies in Indonesian furniture firms' productivity which is from within industry agglomeration and related industry agglomeration. This study shows a positive relationship between the number of firms within the furniture industry and the weighted average size of related industry with firm's productivity, while there is also a negative relationship between the average size of firms within the furniture industry and the weighted sum of related industry firms with firm's productivity.

Keywords: Knowledge Spillover, Agglomeration Economies, Productivity, Furniture Industry