***FLYPAPER EFFECT* OF REGIONAL EXPENDITURES AND IT’S IMPACT TO THE LEVEL OF REGIONAL FINANCIAL INDEPENDENCE**

**(EMPIRICAL STUDY AT COUNTRY/CITY IN INDONESIA)**

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***ABSTRACT***

*The objective of this research is to identify the flypaper effect of regional expenditures of country and city governments in Indonesia and it impacts on the level of regional financial independence.*

*The population used in this study is country/city of Indonesia for the period of 2014-2016. Samples were obtained are as much 252 country/city in Indonesia. Analysis of data used in this research is to test the classical assumption and hypothesis testing with multiple linear regression methods.*

*The results found that own-source revenue and unconditional grants have the positive effect on regional expenditures. The Coefficient value of unconditional grants much bigger than the own-source revenue and both of them showing a significant result, this thing shows flypaper effect has already happened on the regional expenditures in Indonesia. The regional expenditures also effect on the level of regional financial independence in Indonesia.*

***Keywords:*** *Flypaper Effect, Regional Expenditures, The Level of Regional Financial Independence.*

**INTRODUCTION**

The implementation of regional autonomy in Indonesia began with the implementation of Law No. 22 of 1999 (later revised into Law - Law No. 32 of 2004) on local government and Law No. 25 of 1999 (later revised into Law - Law Number 33 of 2004) regarding the financial balance between central and local government.

Through regional autonomy, the regions not only implement the instruction given by the central government but also demand the development of creativity and innovation of potential areas that are less than optimal before the implementation of autonomy.

In the current era of autonomy, it is expected that the regions become self-sufficient in the management of their authority, which is marked by the strengthening of fiscal capacity or regional PAD and reducing transfer funds from the center. Hines and Thaler (1995) in GoeminneStijn*et al*. (2017) says:

*"Grants to be equivalent to an increase in income that inhabitants should spend analogously to an increase in income. "*

In other words, transfers should encourage governments to increase public spending in line with increased regional revenues. However, transfers are confronted with a common phenomenon in supporting the success of regional development in that there is an increase in regional expenditure in line with increased transfer funds from the government, so the granting of such transfers results in ineffectiveness in financing regional expenditures where the greater expenditure response to transfers, hence the phenomenon called *flypaper effects* (Hamilton, 1983; Hines and Thaler, 1995; Melo, 2002).

Starting from the background, this research is to analyze whether the phenomenon of *flypaper effect* on Regional Expenditure in the implementation of regional autonomy. Ladner *et al*. (2016) say that *"Local autonomy is a highly valued feature of good governance"*. Regional financial independence can be seen from the ratio of PAD to total revenue. Based on the criteria of independence level according to Halim, the level of independence of regency / city government in Indonesia is still very low.

**Table 1 Level of Financial Independence of Local Government**

|  |  |  |
| --- | --- | --- |
| **Independence** | **Financial Capability** | **Relationship Pattern** |
| 0-25 | Very Low | Instructive |
| 25-50 | Low | Consultative |
| 50-75 | Intermediate | Participatory |
| 75-100 | High | Delegate |

 **Source: Halim, 2004**

Achievement of independence of a region will improve the welfare of the community. Based on the description above, this research is entitled,

***"Flypaper Effect On Regional Expenditure and It’s Impact To The Level Of Regional Financial Independence".***

**REVIEW OF LITERATURE**

**The *Agency Theory***

According to Lane (2003) *agency theory* can be applied in public organizations, it states that modern democracy is based on a series of principal-agent relations. In relation to this research issue is that the central government is seen as a principal and local government as agents, and legislation is implicitly a form of contract between principal-agent.

The regulation states all the obligations and rights of the parties involved in the government. One of the rules that are explicitly a manifestation of agency theory is Law no. 33/2004 which affirms that for the exercise of the authority of the Regional Government, the Central Government shall transfer the balancing funds, comprising the General Allocation Fund (DAU), the Special Allocation Fund (DAK), and the Regional Section of tax and non-tax Revenue to the Regional Government (as an agent).

The purpose of the establishment of these regulations is the implication of the existence of the era of regional autonomy, namely for equitable development. In practice, however, most areas get the transfer from the principal as the main source of funds for agents to finance their day-to-day activities.

***Flypaper Effect***

The term *flypaper effect* was first introduced by Courant, Gramlich, and Rubinfeld (1979) to articulate Arthur Okun's (1930) thinking that "*money sticks where it hits*". So far, there is no equivalent of the word "*flypaper effect*" in Indonesian so the word is written as it is without being translated. Vegh and Vuletin (2015) in Inayati (2017) argue that the *flypaper effect* is widely documented as a regulation in public finance that holds the tendency of local governments to spend higher transfers than on spending their own.

**Own-Source Revenue**

Based on Law Number 33 of 2004 regarding Financial Balance, it is stated that the Own-Source Revenue, hereinafter referred to as PAD, is income obtained by the area collected by Regional Regulation in accordance with the laws and regulations.

**Unconditional Grants**

According to Rosen (1999: 497-500) and Boex (2001: 7) in Afrizawati (2012) unconditional grant is a transfer granted by the central government to local governments without any specific requirement, meaning that local governments can be using the transfer in accordance with the interests of the relevant area without any specific restrictions set by the central government. According to Brojonegoro and Vazquez (2005: 159), *unconditional grants* in Indonesia are in the form of General Allocation Funds and Revenue Sharing Funds.

**Regional Expenditure**

According to Law no. 58 of 2005, that regional expenditure is a regional government liability recognized as a deduction of net worth. Meanwhile, Minister of Home Affairs Regulation No. 13 of 2006 states that regional expenditure is an estimation of local expenditure expenses allocated fairly and equitably to be relatively enjoyed by all community groups without discrimination, especially in the provision of public services.

**Regional Financial Independence**

The definition of regional finance as contained in the elucidation of article 156 paragraph (1) of Law Number 32 the Year 2004 on Regional Government is:

*"Regional finance is all rights and duties of the region that can be assessed with money and everything in the form of money and goods may be the property of the region in connection with the exercise of such rights and obligations ".*

Regional financial independence (fiscal autonomy) demonstrates the ability of local governments to finance government activities, development, and services to communities that have paid taxes and levies as a necessary source of income.

**RESEARCH METHODS**

**Types and Data Sources**

The data used in this study is secondary data. In this study, the data used is the realization of APBD data and published on the website of Directorate General of Fiscal Balance Ministry of Finance.

**Population and Sample**

The population in this study is all local governments in districts/cities in Indonesia. While the selection of samples in this study using *cluster sampling* and *purposive sampling method.* Cluster *sampling is* done by dividing the population into several groups then randomly selected (Hartono, 2015). In this study, the samples taken were 50% of the total number of districts / cities in each province which was then chosen *randomly*. Furthermore, from several random samples will be re-selected by using *purposive sampling method* with criteria selected in the form of: a

1. Regency/City that is not a new or established region during the study period.
2. The district/municipality government has data on APBD realization and published on the website of the Directorate General of Fiscal Balance of the Ministry of Finance respectively in 2014-2016.

**Independent Variable**

The independent variables in this study are local revenue (X1), unconditional grants (X2) and local expenditure (Y) into independent variables when influencing the level of regional financial independence (Z).

1. The Original Revenue is measured as follows:

Own-source revenue = Local Tax + Local Retribution + Management

 Result Regional Property separated + Other

 Legitimate PAD

1. Unconditional Grants are measured by the amount of DAU and DBH on realized APBD.

**Dependent Variable**

1. Expenditure Area

Expenditure Spending Area can be seen from the total Expenditures for each district / city that comes from data on the Budget Realization Report in the expenditure post as follows:

Regional Expenditures = Operating Expenditures + Capital Expenditures +

 Unexpected Expenditures

1. The level of Regional Financial Independence is measured as follows:

$$\frac{Own Source Revenue}{Total Revenue}x 100\%$$

**Data Analysis Method Data**

Analysis used in this research is descriptive statistics, classical assumption test, multiple linear regression analysis, and hypothesis test consisting of coefficient of determination test, simultaneous significance test, test of individual parameter significance, and different *t-test*.

The following is the statistical model used in this study.

**BD = α + β1 PAD + β2 TTB + ε**

**TKKD = α + β1 BD + ε**

**RESULTS AND DISCUSSION**

**Descriptive Statistics**

1. The level of regional financial independence (TKKD) in 2014-2016 shows an average value of 0.1043, the lowest independence is 0,00 that is in Arfak Mountains Regency 2014, while the highest level of independence is 0,82 that is in Badung regency in 2016.
2. Own-Source Revenue (PAD) in the year 2014-2016 shows average value Rp205.027.470.828 , with the lowest original revenues of Rp449,689,240 in Arfak Mountains in 2014, while the highest local revenue of Rp9,883,776,583,275 is in Klungkung Regency in 2014.
3. Unconditional grants (TTB) in 2014-2016 shows the average Rp886.900.725.642, with the lowest unconditional transfers Rp98.994.935.094 that is in the District of Kepulauan Meranti in 2014, while the highest unconditional transfer of Rp50,501,690,286,600 is in West Seram District 2014.
4. Regional Expenditure (BD) in 2014-2016 shows the average value of Rp1.399.449.475.301, with the lowest expenditure of Rp159.358.165.145 in Arfak Mountains in 2014, while the regional spending the highest amount of Rp75.489.827.470.388 that is in Klungkung regency in 2014.

**Table 2 Descriptive Statistical Test Results**

| **Descriptive Statistics** |
| --- |
|  | N | Minimum | Maximum | Mean | Std. Deviation |
| PAD | 756 |  449.689.240 |  9.883.776.583.275 |  205.027.470.828 | 520.778.131.139 |
| TTB | 756 | 98.994.935.094 |  50.501.690.286.600 |  886.900.725.642 | 2.545.880.659.598 |
| BD | 756 | 159.358.165.145 |  75.489.827.470.388 |  1.399.449.475.301 | 3.466.814.108.862 |
| TKKD | 756 | .00 | .82 | .1043 | .09707 |
| Valid N (listwise) | 756 |  |  |  |  |

**Discussion of Research Results**

This study has passed the classical assumption test that is normality test, multicollinearity, heteroscedasticity, and autocorrelation. Furthermore for the first regression model is known to test results coefficient of determination shows the value of adjusted R² of 0.902 means, for 90.2% regional expenditure influenced independent variables, while the rest of 9.8% influenced by other variables not included in this regression model. Then for the second regression model is known to test the coefficient of determination shows the value of adjusted R² of 0.275 means 27.5% the level of regional financial independence influenced independent variables, while the remaining 72.5% influenced by other variables not included in this regression model. Based on F-statistic test results in the first regression model shows the F calculated value of 2793,092 shows a larger value of F table of 3.011 with a significance level of 0.000 below 0.05. This shows the regression model in this study can be used because all independent variables significantly influence the dependent variable. Likewise in the second regression model, F-statistical test results showed the value of F arithmetic amounted to 232,098 shows a larger value of F table of 3.857 with a significance level of 0.000 below 0.05. It shows the regression model in this research can be used because the independent variable has a significant effect on the dependent variable.

**Hypothesis**

1. Test Individual Parameter Significance Test (Test Statistic t)

Statistical test t conducted to determine the level of significance of influence between each independent variable to the dependent variable. This test is performed at a 95% confidence level or α = 5%. If the significance value t<0.05 then the independent variables individually affect the dependent variable, otherwise if the significant value t > 0.05 then the independent variable individually does not affect the dependent variable.

**Table 3 Hypothesis Test Results Regression Model 1**

| **Coefficientsa** |
| --- |
| Model | Unstandardized Coefficients | Standardized Coefficients | t | Sig. |
| B | Std. Error | Beta |
| 1 | (Constant) | 1.525 | .446 |  | 3.416 | .001 |
| PAD | .133 | .006 | .347 | 21.655 | .000 |
| TTB | .837 | .019 | .697 | 43.528 | .000 |
| a. Dependent Variable: BD |

**Table 4 Hypothesis Test Results Regression Model 2**

| **Coefficientsa** |
| --- |
| Model | Unstandardized Coefficients | Standardized Coefficients | t | Sig. |
| B | Std. Error | Beta |
| 1 | (Constant) | -31.527 | 1.897 |  | -16.617 | .000 |
| BD | 1.046 | .069 | .525 | 15.235 | .000 |
| a. Dependent Variable: TKKD |

1. Differences T-Test

Differences T-Test in this study compares the average value of local revenue derived from the region itself (PAD) with local revenue derived from the transfer of unconditional (TTB).

**Table 5 Test Results of Different T-Test**

| **Independent Samples Test** |
| --- |
|  | Levene’s Test for Equality of Variances | t-test for Equality of Means |
| F | Sig. | t | df | Sig. (2-tailed) |
|
| PendapatanDaerah | Equal variances assumed | 474.316 | .000 | -51.789 | 1220 | .000 |
| Equal variances not assumed |  |  | -51.789 | 732.769 | .000 |

**The Influence of Own-Source Revenue to Regional Expenditures**

Based on the results of the variable testing of own-source revenue (PAD) has a beta value of *Unstandardized Coefficients* B of 0.133 indicating that the own-source revenue (PAD) has a positive effect on Regional Expenditure and a significant value of 0.000 is smaller than 0.05. The results of the hypothesis show that the own-source revenue of the region has a positive effect on regional expenditure. The results of this study support the research conducted by Erlina and Nur (2017), Iskandar (2012) which proves that the Own-Source Revenue has a positive and significant impact on the Regional Expenditures.

**The Influence of Unconditional Grants to Regional Expenditures**

Based on the results of variable testing of unconditional grants (TTB) has a beta value of *Unstandardized Coefficients* B of 0.837 indicates that Unconditional Grants have a positive effect on Regional Expenditure and a significant value of 0.000 is less than 0, 05. The results of the hypothesis show that unconditional grants have a positive effect on regional expenditure.

The results of this study support the research conducted by Maimunah (2006) and Iskandar (2012) shows unconditional grants have a positive and significant impact on the Regional Expenditures.

**Analysis of *Flypaper Effect* on Regional Expenditure**

Based on the test results in hypothesis the 1st and the 2nd hypothesis, between local revenue (PAD) and unconditional transfers (TTB) to regional expenditure in Indonesia shows that PAD and TTB have a positive effect on local expenditure, this TTB is more dominant in financing regional expenditure, it can be seen from value of coefficient of TTB (0,837) bigger than coefficient value of PAD (0,133) and value of both significant, this result indicates that happened *flypaper effect* at local expenditure in Indonesia. The occurrence of the *flypaper effect* on regional expenditures in Indonesia is reinforced by different test results of a *t-test*, which indicates there is an average difference between the number of unconditional transfers (TTB) sourced from the central government with revenues sourced from the region itself (PAD). These results provide empirical evidence that there has been a *flypaper effect* on the district/city spending in Indonesia.

The results of this study support research conducted by Inayati (2017), and Amalia (2017) which proves that most districts/cities in Indonesia experience *flypaper effect*.

**The Influence of Regional Expenditures to Regional Financial Independence**

Based on the results of the variable testing of Regional Expenditure (BD) has a beta value of *Unstandardized Coefficients* B of 1,046 indicates that the Regional Expenditure has a positive effect on the Regional Financial Independence and significant value 0.000 less than 0.05. The results of the hypothesis show that the Regional Expenditure has a positive effect on the level of Regional Financial Independence. This result study is inline with Gamayuni (2018), stated that Local Expense has significant effect on autonomy ratio. The bigger local expense, the more independent local government is, or more able to fund governmental activity, development, and service for community.

This means that despite the phenomenon of *flypaper effect* on regional expenditure, but in this study is not proven to cause independence of an increasingly declining region. This in fact proves that the overactive attitude of local governments to the importance of transfer. The increase of transfers is addressed by local governments of districts/cities in Indonesia by raising the PAD excavation. The results of this study also indicate that unconditional grant acceptance is not a substitute for the collection of revenue from the region itself (PAD).

The use of effective and efficient transfer funds to improve facilities and infrastructure required by the local government so that people feel satisfied impact on the productivity of the industrial sector increased and generate maximum local revenue (Sari, 2015). This study also reinforces Haryanto's (2014) statement that the increase in transfer budget to the regions is not a problem if it is supported by the quality of regional spending that is superior. The increase in transfer funds is in line with an increase in spending excellence such as capital expenditures that will ultimately contribute substantially to local revenue. The original income of the region increases then the area can be said to be independent.

**CONCLUSION AND SUGGESTIONS**

**Conclusion**

Based on the purpose of this study it can be concluded that the *flypaper effect* is a phenomenon when the local government in terms of financing the spending more funded from the transfer than its own income. From the result of data analysis that has been done, hence can be concluded that happened *flypaper effect* at the expenditure of regency/city in Indonesia in the year 2014-2016 which is shown from a value of a coefficient of transfer bigger than coefficient value of PAD to expenditure area and both significant. But in this case not proven to cause independence of an increasingly declining region. This is due to the fact that the provision of transfers is relatively larger and is followed by an increase in sub-national spending, but if supported by a superior quality of regional spending that will ultimately contribute substantially to local revenue. Regional acceptance increases, then the area can be said to be independent. The results of this study provide evidence that grant receipts are not unconditionally substituted for local revenue collection efforts and illustrate that local governments in Indonesia are generally quite good at managing existing transfer funds so that this large transfer can improve independence regional finance in Indonesia which in this case is still in a very low category.

**Suggestion**

Based on the results of the above research, the researcher suggests some suggestions, among others:

1. For local government, it is expected to increase the achievement of PAD to a higher level so that the provision of *unconditional grants* can improve the level of regional financial independence in Indonesia which is still in a very low category.
2. For the next researcher, it is expected to add other variables regarding the implications of the occurrence of *flypaper effect*, increase the sample to be studied and also expand the study period to be studied.

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