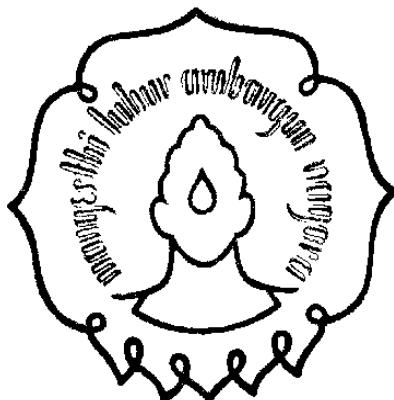


FLYPAPER EFFECT:
The Evidence of Regencies and Municipalities in Indonesia



THESIS

A thesis submitted in partial fulfillment of the
requirement for the degree of Magister Sains

by

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May this thesis is useful for the improvement of accounting in public sector and for all related sides.

Surakarta, September 2009

Dany Prihananty

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LIST OF TERM USED AND ABBREVIATIONS

| Term Used | Indonesian term | Abbreviation |
|--------------------------------------|--|---------------------|
| Aid | Sumbangan | |
| Balancing Fund | Dana Perimbangan | |
| Capital Spending | Belanja Modal | |
| Fiscal Decentralization Degree | Derajat Desentralisasi Fiskal | FDD |
| General Allocation Fund | Dana Alokasi Umum | |
| Government Accounting Standard Board | | |
| Independency of Local Government | Kemandirian Daerah | |
| Indonesia Financial Department | Departemen Keuangan Republik Indonesia | |
| Law | Undang-undang | |
| Local Government Budget | Anggaran Pendapatan dan Belanja Daerah | |
| Local Government Budget Planning | Rencana Anggaran Pendapatan Belanja Daerah | |
| Local Government Employee | Pegawai Negeri Sipil Daerah | |
| Local Government Financial Ability | Kemampuan Keuangan Daerah | LGFA |
| Local Government Spending | Belanja Daerah | LGS |
| Local Original Revenue | Pendapatan Asli Daerah | LOR |
| Local Retribution | Retribusi Daerah | |
| Local Tax | Pajak Daerah | |
| Local Total Income | Total Pendapatan Daerah | |
| Municipality | Kotamadya | |

| Term Used | Indonesian term | Abbreviation |
|---|---|---------------------|
| National Government Budget | Anggaran Pendapatan dan Belanja Negara | |
| Others Related With The Local Origin Income | Lain-lain Pendapatan Asli Daerah yang sah | |
| Production Sharing Fund | Dana Bagi Hasil | |
| Public Expenditure | Belanja Pelayanan Publik | |
| Regency | Kabupaten | |
| Role of the Internal Affair Ministry | Permendagri | |
| Separated Managed Of The Local Resources | Pengelolaan kekayaan daerah yang dipisahkan | |
| Special Allocation Fund | Dana Alokasi Khusus | |
| Spending on Duty Journey | Belanja Perjalanan Dinas | |
| Spending on Civil Servant | Belanja Pegawai/Personalia | |
| Spending on General Administration | Belanja Administrasi Umum | |
| Spending on Goods and Services | Belanja Barang dan Jasa | |
| Spending on Local Government Official | Belanja Aparatur Daerah | |
| Spending on Maintenance | Belanja Pemeliharaan | |
| Spending on Operational and Maintenance | Belanja Operasional dan Pemeliharaan | |
| Spending on others | Belanja Lain-lain | |
| Spending on Production Sharing and Financial Fund | Belanja Bagi Hasil dan Bantuan Keuangan | |
| The unconditional transfer | Bantuan tidak bersyarat | |
| Unpredicted Spending | Belanja tidak tersangka | |
| Value for Money | | VfM |

ABSTRACT

The purpose of the research is to examine the occurrence of flypaper effect in Indonesia. The research relates with the influence between local original revenue and general allocation fund to the local government spending in the financial reports. The flypaper effect is detected by the more dominant general allocation fund influencing local government spending than local original revenue.

The other objective is to examine the existence of flypaper effect in the prediction of local government spending of the next year. Local government with the different financial ability has a tendency to have different flypaper effect; it is related with their different revenue. Then it examined whether the flypaper effect different between low, medium and high financial ability area. Moreover it wants to prove that the flypaper effect has a negative influence to the independency degree of the government. The data was taken from financial report and local government budget planning.

The result of the analysis indicates that local original revenue and general allocation fund influence the local government spending and also influence the prediction of the local government spending of the next year. However, general allocation fund with the coefficient 0.245 indicates the more dominant influencing the local government spending than the local original revenue with the coefficient 0.166. It is proved that there has occurred flypaper effect.

Test resulted that the existence of flypaper effects tends to increase the amount of local government spending and the prediction of local government spending is significant. Flypaper effect is different in local governments which have different financial ability. When testing the influence of flypaper effect to the independency of local government, it is resulted that there is a negative influence between of them. The results still require confirmation through future researches.

The implication is that the regulator should encourage the local government with the limited general allocation fund in order to push the efficiency and effectiveness of the local government. In addition, local governments have to be more responsible in manage the general allocation fund and the local revenue gained.

Keywords: *flypaper effect, local original revenue, general allocation fund, local government spending, local government financial report of the realization and budget planning, financial ability category, regency/municipality, Indonesia.*

ABSTRAK

Tujuan dari penelitian ini untuk mengetahui terjadinya phenomena *flypaper effect* di Indonesia, ini meneliti hubungan antara pendapatan asli daerah, dana alokasi umum dan belanja daerah yang diambil dari laporan keuangan. *Flypaper effect* dapat dideteksi dengan melihat apakah variable dana alokasi umum lebih dominant mempengaruhi belanja daerah daripada pendapatan asli daerah sendiri.

Tujuan yang lain adalah untuk meneliti apakah *flypaper effect* juga terjadi pada penetapan perkiraan belanja daerah untuk tahun berikutnya. Pemerintah dengan kemampuan daerah yang berbeda di indikasikan mempunyai pendapatan berbeda. Maka diteliti juga apakah terjadi perbedaan antara *flypaper effect* di daerah yang mempunyai kemampuan daerah rendah, sedang dan tinggi. Dan juga pada penelitian ini ingin membuktikan bahwa terjadi hubungan negative antara *flypaper effect* dengan kemandirian pemerintah daerah. Data pada penelitian ini diambil dari laporan keuangan baik anggaran maupun realisasi.

Hasil dari analisa menunjukkan bahwa pendapatan asli daerah dan dana alokasi umum mempengaruhi belanja daerah dan juga mempengaruhi perkiraan belanja daerah untuk tahun berikutnya. Namun dana alokasi umum dengan koefisien 0,245 mengindikasikan bahwa lebih dominant daripada pendapatan asli daerah dengan koefisien 0,166 dalam mempengaruhi belanja daerah. Hal tersebut mengindikasikan terjadinya *flypaper effect*.

Penelitian menghasilkan bahwa terjadinya *flypaper effect* dalam rangka meningkatkan belanja daerah serta dalam perkiraan belanja daerah. Terdapatnya perbedaan dalam terjadinya *flypaper effect* di tiga kategori kemampuan keuangan daerah. Ketika di ujikan pada pengaruh *flypaper effect* pada kemandirian daerah, maka di hasilkan bahwa terdapat pengaruh negatif diantara keduanya.

Saran yang dihasilkan dari penelitian ini yaitu bahwa pemerintah sebaiknya mendorong pemerintah daerah dengan dana alokasi umum yang lebih terbatas untuk lebih mengefektifkan dan mengefisienkan kegiatan mereka. Selain itu pemerintah daerah juga harus lebih bertanggung jawab dalam pengelolaan pendapatan daerah dan dana alokasi umum yang didapatnya.

Kata Kunci: *flypaper effect, pendapatan asli daerah, dana alokasi umum, belanja daerah, laporan keuangan realisasi, laporan keuangan rencana anggaran, category kemampuan keuangan daerah, kabupaten/kota, Indonesia.*

CHAPTER I

INTRODUCTION

This chapter explains the background of the study that motivate the researcher in building the research, identification of the problem, purposes of study and contributions of the study.

A. Background of the Study

The implementation of political reform in Indonesia reflects significantly on the authority and responsibility of the decentralized local government. The aim of reformation is to improve political accountability and accelerate social-economic development. It is supported with the fact that all of Indonesia's public officials from the president to all of governors and district heads/mayors are now directly elected. This is intended to improve the political and economic accountability of the local public officials to their constituents (APEC, Economic Policy Report 2007).

Indonesian Local Governments in 2001 gained their own authority in running its own governmental matters. It means that the local governments have the authority to manage themselves, relating with the governmental matter and public issues. It is in line with the Act no.32 in 2004 that discussed about the local government and decentralization. Decentralization is generalized as having the right, authority and responsibility to manage and take care all of the governmental public matter by the local governments themselves (Halim 2007). Then the local governments become the key

players in service delivery. Therefore, the public demand of good governance is increasing.

Holding good governance is the requirement to all governments to realize the public aspiration in order to gain the country purposes and ideas. Good governance is a result of the legitimacy earned by those who hold the public trust to exercise an all-inclusive power over public resources. It just like what has been stated by Damayanti (2007) that it is important that such power must be applied for the public interest and the common good of the nation.

The relation between the central government and the local government is described as a principal and an agent (Levaggi 2008). The central government, as the principal, will give the authority to the local government, as an agent, to carry out the public and services commodities in the local government.

The problem arises when there is asymmetry information between the central government and the local governments. It reflects whether the central government has no control to the used of transfer / grant. In other way, it could be a tendency as a reason to get the unconditional transfer. In this condition, the local governments could decide by their consideration related to the use of transfer as efficient as possible related with the local government needed. It supported by Bae and Feiock (2004) that local government arrangements shape the incentives of local actors, which may in turn influence fiscal choices, by emphasizing the role of local government institutions in local fiscal choices.

In managing and rolling its governmental, the local government is funded by balancing fund. Balancing fund consists of general allocation fund, special allocation fund, and production sharing fund. Those are allocated as part of the national government

budget and in the local original revenue (Kawedar, Rohman and Handayani 2008). Local government is responsible for the provision of all public goods and services, except for matters related to foreign affairs, defense, justice, religion, which are the responsibility of central government. The central government is responsible for implementing general policies and setting standards for public goods and service delivery of local government.

The problem that exists in this moment is that the local government depends more on the general allocation fund allocation to finance the local government spending without optimizing more on the local resources. When the local governments in the present time gains the big portion of general allocation fund, then in the next period they would try if the general allocation fund gained will also be big. Adi (2006) stated that the proportion of general allocation fund is still the highest income compared with other income of the local government. Aldarete (2004) also mentions that original revenues of municipalities in Mexico are just only finance 20% of the local expenditure. This fact is far from the purpose of decentralization, creating the local government independency with its own resources.

Ndadari and Adi (2008) mention that increasing transfer allocation always followed by the increasing of the higher expenditure. This shows an indication that the increasing of expenditure related with the inefficiency spending of local government as mentioned by Maimunah (2008). Moreover when the central government transfer decreased, therefore it is followed by the decreasing on local government spending. It can be seen here that decreasing of local government spending is more significant compared with the declining of local origin revenue. This tendency shows that the dependency of the local government to the central one is still high. In the long term this dependency

must be eliminated, because it will give a bad effect to the independency of the local government.

The prediction of grant receipt will increase in local original revenue and it should identically affect the local government spending. Empirical research (Alderete 2004; Davey and Peteri 1988), by contrast, has found that general allocation fund is disproportionately on local government spending. Moreover many studies have found that grants received increase local government spending. This anomaly has come to be known as the *flypaper effect* since money sticks where it hits (Aragon 2008). Private income is disproportionately spent on private consumption while a federal grant, income received by the public sector, is primarily spent on public services. Aragon (2008) also defined that flypaper effect refers to the observed greater stimulatory effect of unconditional grants on local government spending than increases of the community income.

Detecting the flypaper effect, it delivers to value for money. Whether value for money (VfM) is the term used to assess whether or not an organization has obtained the maximum benefit from the goods and services it acquires or provides, within the resources available. The Budgeting reformation presently wants to apply the concept of VfM or the 'three Es', economy, efficiency and effectiveness (Halim and Damayanti, 2007). Therefore, detected flypaper effect it can be seen whether the local government has done the satisfactory arrangement to promote economy, efficiency and effectiveness across the local government related with the decentralization. Then it can be said, that if the flypaper effect detected means that the local government has not done the budget efficiently and effectively (Fielding, McGillivray and Torres 2006). Thus the economy of

the local government has not increase reflected with the total amount of local original revenue.

The relation between income and local expenditure has been discussed in many studies and many hypotheses such as by the research by Aragon (2008), Bae and Feiock (2004), Chang and Ho (2002), Maimunah (2008). The result is not so different. The result of those researches related with the grant transferring that the local governments still depend much on the transferring better than improving their own capability or resources. Then the tendency of central government to give the transfer is used by the local government more in their spending.

The influence of local original revenue and general allocation fund to the local government spending in Sumatera has been analyzed by Maimunah (2008), it resulted that the local original revenue and general allocation fund influence significantly through the local government spending. Moreover the influence of general allocation fund is more significant compared with the influence of the local original revenue to the. It means that the flypaper effect occurs in this research.

Previous researches on the budgeting (Aragon 2008; Bae and Feiock 2004; Chang and Ho 2002; Maimunah 2008) found that many dependencies exist on the grant of central government than on its own regional income. It is defined as flypaper effect. It gives the reflection of the facts happened for the realization of decentralization in creating the local independency.

Each of the area or country has its own specific things, which could be related with the geographic, economic, politic, and social culture. Local government with the different financial ability has a tendency to have a different flypaper effect, it related with

their different income. Then it also want to examine whether the flypaper effect different between low, medium and high financial ability area. Therefore, the researcher wants to analyze how is the influence of general allocation fund and local original revenue to the local government spending in Indonesia. Whether the flypaper really exists after Indonesia in the five year period of decentralization, reflected in the local government of regencies and municipalities that spread out in 33 provinces. Those descriptions motivate the researcher in analyzing a research entitled; **“Flypaper Effect: The Evidence of Regencies and Municipalities in Indonesia”**

B. Identification of the Problems

This study wants to know about the occurring of flypaper effect in the municipalities and regencies of Indonesia in the year of 2006. Based on the background of the study, then the problem statement that purposed in this study are;

- a. Whether the flypaper effect occurs in 2006 of the local government of regencies and municipalities.
- b. Whether the flypaper effect occurs in the influence of local original revenue 2006 and general allocation fund 2006 in the prediction of local government spending of the next year, in 2007, of the regencies and municipalities in Indonesia.
- c. In case the flypaper effect does exist, the researcher wonders whether there are any differences between the flypaper effect that occurs between the local government with the high, medium and low financial ability.

- d. Whether the flypaper effect, reflected by the fiscal decentralization degree, has a negative significant influence to the financial performance related with the independency degree of the local government.

C. The Purposes of the Study

The purposes of the study are stated below;

- 1. to identify the occurring of flypaper effect to the local government spending of regencies and municipalities in Indonesia.
- 2. to gain the empirical evidence of the influence of local original revenue and general allocation fund to the prediction of local government spending in the regencies and municipalities in Indonesia.
- 3. to analyze the difference of flypaper effect between the area which has the low, medium and high financial ability.
- 4. to know the dependency of the local government in line with the flypaper effect phenomenon.

D. The Contributions of the Study

The research study may give contributions for many concerning sides.

- 1. The research may implication for the central government and also the local government in order with the proper policy related the evidences based on research.

2. It enriches the researcher knowledge related with the public sector accounting and effect of the policy.
3. It shows to the public that the transparency and accountability can be used to measure the condition and reality faced by the government; it is in order to realize the public to be more conscious with the financial performance of the government.
4. The result of the research could be a reference for the academic related to the flypaper effect, local original revenue, general allocation fund, and local government spending.

It also could be the references for any other related research in the future.

E. Writing Systematic

CHAPTER I : INTRODUCTION

This chapter describes the research background, research problems, research objectives, and research contributions.

CHAPTER II : LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

This chapter describes literature review and hypothesis development.

CHAPTER III : RESEARCH METHODOLOGY

This chapter describes the population, sample, variable measurement, operational definition and data analysis method.

CHAPTER IV : RESEARCH RESULT AND ANALYSIS

This chapter describes descriptive analysis of data, classic assumption analysis, research result and hypothesis testing.

CHAPTER IV : CONCLUSION AND SUGGESTION

This chapter describes conclusion, limitation and recommendation of the study

CHAPTER II**LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT**

This chapter explains about the literature review, the previous researches in developing the research hypothesis and Conceptual Schema.

A. Literature Review

The literature review section discusses and defines about good governance, agency theory, flypaper effect, value for money, local government spending, general allocation fund, local original revenue, financial performance measurement, fiscal decentralization and dependency, and local government financial ability.

1. Good governance

Holding the good governance is the requirement to all government to realizing the aspiration of the public in order to gain the purpose and idea of the country. Good

governance refers to government agencies' conduct in implementing innovative policies and programs to increase the quality of public service with the ultimate aim of increasing economic growth (Mardiasmo 2008). It is a result of the legitimacy earned by those who hold the public trust to exercise an all-inclusive power over public resources (Damayanti 2007). Therefore it is important that such power must be applied for the public interest and the common good of the nation.

Tremendous political and institutional changes have marked Indonesia's transition to a more open and competitive society. Constitutional reforms securing direct election have created a new accountability framework at all levels of the political system. The decentralization process that started in 2001 is bringing control over resources closer to the clients/end users, providing new opportunities for participation and monitoring of service delivery.

Regions have become the key players in service delivery. As a result, users say that quality of services has improved sharply over the past two years. According to a survey, around 70% of users think that the quality of health and education service has improved, reported by APEC - Economic Policy Report in 2007. The quality of administrative matters and policy is likewise improved. The basic points of delivering good governance are as follow:

1. Public Participation; each of the citizenship has a right in making the decision. It could be proposed personally or using the mediation of the representative institution.
2. Rule of law; the framework of Law must stand the justice and done fairly especially the law for the human right.

3. Transparency; it built based on the freedom of information current. The process, institution and information directly could be accepted by the users.
4. Responsiveness; the institutions and the processes must try to serve each of the stakeholders.
5. Consensus orientation good governance; good governance becomes the mediator of different necessities to gain the best choices to the larger necessity especially in the policy and procedural matters.
6. Equity; all of the citizens have the right and opportunity to improve or to keep their prosperousness.
7. Effectiveness and efficiency; process and institutional earn the public goods and services as what have been defined. The products of good and services defined use the resources that available as best as possible.
8. Accountability; the decision makers in the governmental have the responsibility to the user institutions and stakeholders. The accountability is depended on the organization and the decision characteristics that have been made. It related weather the decision for the internal or external necessity.
9. Strategic vision; the leaders of the public institution must have the good governance perspective and have the perspective in developing the human resources in the future

The all nine characteristics above are strengthened each other and they could not stand alone (Idirwan 2007). Based on the all above description we can make a conclusion that the good governance formed in the rolling the governmental with solid and responsible, and also efficient and effective in keeping the constructive interaction between the country's domains, private sectors and public.

This research aims at identifying the flypaper effect, it is also reflected how good the local governments govern their governmental matters. Flypaper effect is much related to how the local government governs and to how they have a tendency in the anomaly. From all of the points of good governance above, we can say that if the flypaper effect exists in the local government then the local government is no good govern.

2. Agency theory

Autonomy gives different responds between each local government. They do not have the same preparation on it. This could be because of their different fiscal ability. Therefore the central government gives transfer. But sometimes the transfer itself may give the disincentive for the local government independency. The local government depends on the transfer better than optimizing their local revenue. It indicates that there is asymmetric behavior in responding the transfer (Aldarete 2004; Ndadari and Adi 2008)

The relation between the central government and the local government is described as a principal and the agent, Levaggi (2008). The central government, as the principal, will give the authority to the local government, as an agent, to carry out the public and services commodities in the local ones. The success of fiscal ability in local government depends on the information the agent posses about (Levaggi 2003).

The agency theory offers unique insight into information systems, outcome uncertainty, incentives, and risk. It is an empirical valid perspective, particularly when coupled with complementary perspective. The principal recommendation is to incorporate an agency perspective in studies of the many problems having a cooperative structure (Eisenhardt 1989; Moldoveanu and Martin 2001; Sloof and Praag 2006).

The problem that arise when there is asymmetry information between the central government and the local government then it will reflected whether the central government has no control to the used of transfer. In other way, it could be a tendency as a reason to get the unconditional transfer (Ndadari and Adi 2008). Where in this condition, the local government could decide by their own consideration related with the using of transfer as efficient as possible related with the local government needed.

Bae and Feiock (2004) state that local governance arrangements shape the incentives of local actors, which may in turn influence fiscal choices, emphasizing the role of local government institutions in local fiscal choices. Therefore the detecting flypaper effect could be a tendency of the asymmetry behavior by the agent of the principal trust in directing the budget.

3. Flypaper effect

In managing and rolling its governmental, the local government is funded by balancing fund. It consists of general allocation fund, special allocation fund, and production sharing grant. It is allocated as part of the national government budget and local original revenue as stated in law No.33/2004. Local government is responsible for the provision of all public goods and services, except for matters related to foreign affairs, defense, justice, religion, which are the responsibility of central government Kawedar, Rohman, and Handayani (2008). Central government is responsible for implementing general policies and setting standards for public goods and service delivery of local government.

The existing problem presently is that the local governments depending much on the general allocation fund to finance the local government spending without optimize more on the local original revenue (Ndadari and Adi 2008). When in the present time the general allocation fund allocation is big, then in the next period the local government would try to gain the big general allocation Fund. The proportion of general allocation fund is still the highest compared with other income of the local government, even compared with local original revenue (Adi 2006; Maimunah 2008).

Aldarete (2004) also mentioned that the own revenues of municipalities in Mexican just only finance the local expenditure 20% from its totally. This facts is far from the purpose of decentralization that in creating the local government independency with its own resources. When the central government gives grant transfer to the local government to increase the local spending, there is a speculation that the spending of the local government responding the transfer changing asymmetrically (Ndadari and Adi, 2008; Alderete, 2004). This asymmetry behavior can be seen with the spending from the grant which give a personal profit; meanwhile from the grant side is decreasing. In her research Maimunah (2008) also proved that the asymmetry behavior that shows by the influence of general allocation fund and local original revenue to the local government spending. The local government spending is increased far more by grant receipts than by equivalent increases in constituent private income (Knight 2000). The big proportion of general allocation fund has a positive significant to the Local Government Spending. This result shows that the government grant especially general allocation fund is so dominant in financing the local government spending.

Ndadari and Adi (2008) also mention that increasing transfer allocation always followed by the increasing the spending which is higher. This tendency shows if there is an indication that the increasing of expenditure in relation the inefficiency of local government spending. Moreover when the grant transferring from the central government decreased then it will followed by the decreasing the local government spending. The decreasing is more significant compared with the decreasing of local original revenue. This tendency shows that the dependency of the local government to the central one is still high. In the long term this dependency must be released, because it will give a bad effect to the independency of the local government.

There is a model expects that fund or grant receipt increases the local government income then it should identically affect local public spending (Purwoko 1999). Empirical research, by contrast, has found that general allocation fund is disproportionately on local government spending. Moreover many studies have found that grants received increase public spending (Brian 2000; Bae and Feiock 2004; Aragon 2008; Maimunah 2008; Ndadari and Adi 2008; Levaggi and Zanolla 2009). This anomaly is known as the ‘flypaper effect’ since money sticks where it hits (Aragon 2008). Private income is disproportionately spent on private consumption while grant, income received by the public sector, is primarily spent on public services.

Knight (2000) describes about the flypaper effect that state government public spending is increased far more, often dollar-for-dollar, by grant receipts than by equivalent increases in constituent private income. This anomaly has come to be known as the flypaper effect. The other definition about Flypaper effect, it refers to the observed

greater stimulatory effect of unconditional grants on local government spending than increases of the community income as stated by Aragon (2008).

4. Value for money

Value for Money (VfM) is the term used to assess whether or not an organization within the available resources has obtained the maximum benefit from the goods and services that it acquires or provides. It does not only measures the cost of goods and services, but also takes account of the mix of quality, cost, resource used, fitness for purposes, timeliness and convenience to judge whether or not, when taken together, they constitute good value. Achieving VfM may be described in terms of the 'three Es' - *economy, efficiency and effectiveness*. Nowadays the budgeting reformation wants to apply the concept of VfM or the '*three Es*'. Consequently, the local government demanded to be better in managing the transfer which always held on the '*three Es*' achievement. This supports the local government to always keep in monitoring each Rupiah that gained and used. The consideration from the VfM concept stressed on the input and output outcome (Halim and Damayanti 2007).

Value for money in this context may be defined as the means by which the local government ensures the efficiency, effectiveness and economy of all its activities where: 'efficiency' means doing the same as before, but with fewer resources (money, staff, and space). 'Effectiveness' means doing more than before with the same resources as now (or less). 'Economy' means doing less with fewer resources, *i.e.* do savings (Bastian 2001).

Therefore in detecting the flypaper effect, it can be seen whether the local government has done the satisfactory arrangement to promote economy, efficiency and effectiveness related with the decentralization. While talking about the value of money,

then the strategic planning, financial strategy and budget setting process, key performance indicator system, costing and pricing policies, procurement activity and capital projects also have to be considered about (Bastian 2001). Therefore, it can be concluded that if we can detect the flypaper effect that occurred means that the local government has not done the budget efficiently and effectively. Thus the economy of the local government has not increase reflected with the total amount of Local Original Revenue.

5. Local original revenue

In financing the local government spending, beside use transfer from the central government the local governments also use their own fund from their own income, local original revenue. Based on the law No.33/2004, local original revenue defines as the income that sourced from the local tax, local retribution, separated managed of the local resources and others related with the local origin income which has a purpose to give freedom in the local government action to search the financial matter from their own resources relating the decentralization (Kawedar et. al 2008).

Local original revenue has an important role relating with the ability of the local economic. The local governments which have positive Local Original Revenue growth, they have a possibility in having a better income per capita (Adi 2006). This improvement will give a beneficial to the local government.

6. General allocation fund

General allocation fund is the grant transfer from the central government as reflected in the national government budget; this is the biggest component from the balancing fund which formed as block grant. General allocation fund is formulated based

on the fiscal formulation gap, the difference between the fiscal needed and the fiscal capacity. The formula considers the needs and the capability local government. The allocation is purposed to distribute the ability of each local government. The general allocation fund itself also has a purpose to finance the expenditure needed relating with the decentralization. (Kawedar et al. 2008)

7. Local government spending

Based on the role of internal affair minister No.13/2006, it states that local government spending is all of the spending from the local public cash accounts that decreasing the equity of cash flow. This is the local government responsibility in the one year budgeting period that will not get the return payment by the local government. Local government spending is used in order to implement the local governmental matter which become the authority of the local government that become obligatory and choice matter (Kawedar et. al 2008)

Local government spending consists of spending on local government official, public expenditure, spending on production sharing and financial Fund, unpredicted spending, and spending on other.

Spending on local government official consists of spending on general administration and spending on operational and maintenance. Each of them consists of spending on employee, spending on goods and services, spending on duty journey, and spending on maintenance. And also in spending on operational and maintenance, there is capital spending.

Public expenditure consists of spending on general administration and spending on operational and maintenance. Each of them consists of spending on employee,

spending on goods and services, spending on duty journey, and spending on maintenance.

And also in spending on operational and maintenance, there is capital spending.

8. Financial performance measurement

Accountability is one of the main focuses in achieving the good governance in Indonesia recently (Mardiasmo, Paul and Sakurai 2008). The local government will be asked to submit the report about the results of many programs which had been undertaken. Then, the citizen and legislative committee can assess the government's performance whether the government operates their job in an economic, efficient and effective ways. Techniques such as management by objectives, performance budget, and operations research have provided tools for enhancing performance measurement. Performance measurement consists of three broad categories of indicators, those that measure service efforts, those that measure service accomplishment and those that relate efforts and accomplishment, and certain explanatory information (Sadjianto 2000).

Governmental financial reporting basically only stress on the responsibility whether the resources gained have been used as the budgeting or as the roles. Therefore financial reporting just inform anything related with the government income resources, how the spent made and the present government financial position, or compliance.

Relating with government accounting standard board as cited on Sadjianto (2000), in the concept statements no.2 which divided the performance measurement in three categories; service effort measurement indicator, service accomplishment measurement indicator, related with effort and accomplishes measurement indicator (GASB 1994).

Measure of Effort is the amount of the financial and non financial resources that reflected in the form of money or any other unit, which used in running the program or

service. The measurement of service effort covers of the using ratio that compared the resource of financial and or non financial with other measurement.

There are two kind measurements of accomplishment; output and outcomes. Outputs measure the service quality that available. Outcomes measure the result of the availability of the output.

Measurement that relates effort to accomplishment, the first comparison is the comparison between the efforts and the outputs which measures the efficiency. The information given is relating with how far the result relating with the total resources used.

User is also given the explanatory information. Explanatory explanation related with the relevant information of the services and the explanatory of the factors which influence the government performance. The explanatory of the factors which influence the government performance are grouped in the two elements. They are government exceeding control element and government under control element. Beyond the control of government are such as demographic and environment element. The under control by government example are such us the employee pattern and employee composition (Sadjiarto 2000).

Parker (1996) as cited on Sadjiarto (2000) states that there are five benefits in measuring the government performance entity;

1. Performance measurement in improving the decision quality
2. Performance measurement in improving the internal accountability
3. Performance measurement in improving the public accountably
4. Performance measurement in supporting strategic planning and deciding the goal
5. Performance measurement to enable the entity in deciding the resources effectively.

With the government performance data measurement, data analysis and data evaluation then the regulator will be easier to decide the way how to defend or improve the efficiency and effectiveness of the activities. Moreover it also gives objective information to public related with the result achieved.

Based on Mardiasmo as cited on Zulfikar (2007), the measurement of financial performance report based on the budgeting, this made and analyzed the variance (the different) between actual performance and the budgeting.

9. Fiscal decentralization and independency degree

The main characteristic that the local area could done the autonomy very well if seeing (1) the financial ability of the local government, it means that the local government has the ability and authority to explore the financial resources, manage and use its own financial to spend to its governmental process; (2) the dependency for the central grant or help must be minimized as possible. Therefore local original revenue must be the biggest source of financial that supported by the policy of balancing financial for the central and local government (Halim 2007).

The two characteristics mentioned will affect the relationship pattern between central government and local ones. Conceptually, the financial relation pattern between the central and local government must appropriate with the ability of the district in order to finance the governmental process. In line with Musgrave and Musgrave as cited on Halim (2007), to measure the local financial performance we can use fiscal decentralization degree between the central and local government. Moreover, in seeing the local financial performance, we can use the local government independency degree. It measures how far the local incomes fulfill the local needed (Halim 2007).

The formulation used to measure the fiscal decentralization degree is to divide the aid or fund from the central government, general allocation fund, with the local total income. Then the researcher uses this formula to reflect the flypaper effect seems the definition of the two is alike.

$$\text{FiscalDecentralizationDegree} = \frac{\text{Fund}}{\text{LocalTotalIncome}}$$

The formulation used in measuring the independency of local government independency degree (LGID) is dividing the local original revenue (LOR) with local government spending (LGS).

$$\text{LGID} = \frac{\text{LOR}}{\text{LocalGovernmentSpending}}$$

10. Local government financial ability

Local government financial ability (LGFA) is one of the indicators of the local government ability in performing the decentralization.

The category of local government financial ability is a classification to decide the group related with financial ability of certain local government, and it is formulated. The data used as the base of grouping the local government financial ability is the data in the local government budget of the related year.

The category of local government financial ability (LGFA) is formulated with the local total revenue minus spending on civil servant, local government employee.

$$\text{LGFA} = \text{Local Total Revenue} - \text{Spending on Civil Servant}$$

Local government financial ability categorized in the three groups; high, medium and low just like what roles of the internal affair ministry No.21 2007. The grouping categories of local government financial ability in regencies or municipalities are following;

1. The local government which grouped in the “high” category if the financial ability beyond Rp. 400,000,000,000. 00 (four hundred million rupiahs)
2. The local government which grouped in the “medium” category if the financial ability beyond Rp. 200,000,000,000.00(two hundred million rupiahs) but under Rp. 400,000,000,000. 00 (four hundred million rupiahs)
3. The local government which grouped in the “low” category if the financial ability under than Rp. 200,000,000,000. 00 (two hundred million rupiahs)

B. Hypothesis Development

The relation between income and local expenditure has been discussed in many studies and many hypotheses (Knight 2000; Chang and Ho 2002; Bae and Feiock 2004; Adi 2006; Aragon 2008; Maimunah 2008). The empirical evidence of the researches results is not so different.

Based on the previous researches of the budgeting, found that much dependency on the grant of central government better than on its own regional income or it is defined as flypaper effect.

The influence of local original revenue and general allocation fund to the local government spending in Sumatera has been analyzed, and the result that local original revenue and general allocation fund influence significantly through the local government

spending. Moreover the influence of general allocation fund is more dominant compared with the influence of the local original revenue to the local government spending (Maimunah 2008) it means that the flypaper effect occurs in this research. Other researches (Knight 2000; Bae and Feiock 2004; Aragon 2008; Levaggi and Zanola 2009) are in line with Maimunah's finding that there flypaper effect also occurs. Based on the findings, the first hypothesis is;

H1= the influence of general allocation fund on local government spending is more dominant compared with the local original revenue.

Flypaper effect can predict the behavior tendency of the local government in predicting the local government spending allocation for the next year (Ndadari and Adi 2008). Or it can be said that general allocation fund influences more significant in predicting the next local government spending compared with local original revenue.

Therefore the researcher wonders weather the budgeting or the allocation of the next year local government spending will much affected by the general allocation fund given by the central government better than the Local Original Revenue that gained for the previous year. That will imply the dependency of local government is more to the grant given by the central government than its own local income related with the exploring its own resources.

Ndadari and Adi (2008) also state that local governments have done the asymmetry behavior. It is stated clearly that when the local governments gain the smaller general allocation fund from the previous year then the local government spending will decrease. The decreasing of the local government spending is not in line with if the last year local original revenue decline. The local government spending decline is not much

affected by the decreasing of previous local original revenue. Thus when the local government gained the bigger general allocation fund then the next year local government spending will increase but without following by the increasing in local original revenue significantly.

Occurring of the asymmetry behavior that due to the local government desire to gain grant in the same amount of even bigger in the next year (Alderete 2004), it means that the local government has limited original revenue but in once the local government allocate the spending beyond the revenue. It is with the reason that the local governments are pushed with the needed. Therefore the second hypothesis is as following;

H2= Flypaper effect occurs in the influence of local original revenue and general allocation fund in the predicting of local government spending.

In this study the researcher also curious to know the differentiation between the flypaper effects that occurs in the area with the low, medium and high financial ability of the local government. It is related with the previous research by Maimunah (2008). She did not find the differentiation between of the flypaper effect that occurs in the areas which have low allocation of local original revenue and areas which have high allocation of local original revenue area. But seeing from the theoretical framework by Halim (2002) as cited in Maimunah (2008), there is a significant difference local original income between areas which have low and high ratio of fiscal decentralization degree. Therefore, in this research the researcher tends to know about the different of flypaper effect between the three categories of financial ability. They are low, medium and high financial ability local government.

H3 = there are differences between the flypaper effect that occurs between the local region with high, medium and low financial ability.

Thus it is guessed whether the flypaper effect has a tendency related with the dependency of local governments due to the grant or help which given by the central government. So that, in here the researcher wants to check the independency degree of the local government. Higher local government independency degree, it means if the local government having more capability in financing its own spending without help from the central government (Zulfikar 2007). Fiscal decentralization degree shows the effect of the fund of the central government contribution to the whole local total revenue; therefore we can see all of the financial performance completely. In here the fiscal decentralization ration also reflected the flypaper effect.

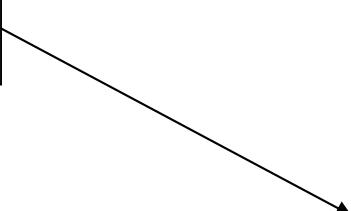
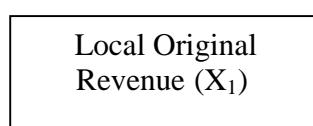
The researcher assumes that the higher contribution of general allocation fund seeing in the fiscal decentralization degree will give the reflection of the low ability of the local government in financing with its own capability and it has a negative significant influence to the financial performance of the local government. The local government should have a positive financial performance which means as the independency of the local government in financing all of the needed and support the autonomy in the local government. Then come to the fourth hypothesis;

H4 = the flypaper effect has a negative significant influence to the independency degree of the local government

C. Conceptual Schema

The conceptual scheme formed in the three frameworks below. It is described in the three different schemes related with the different variables used.

1. Step one



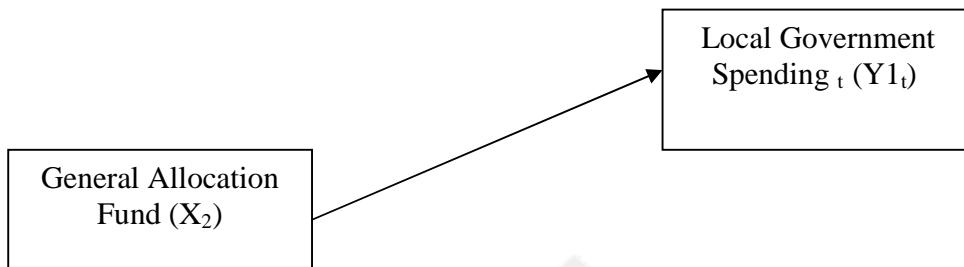


Figure 1
Step one theoretical schema

2. Step two

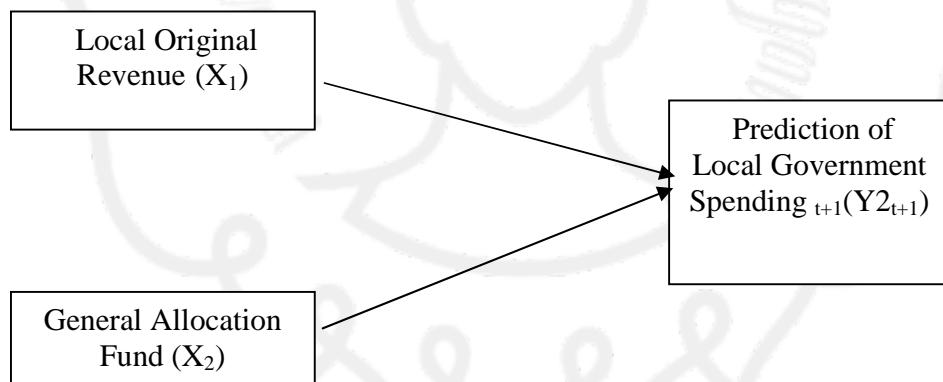


Figure 2
Step two theoretical schema

3. Step three

There is no specific schema for the third hypothesis related with the hypothesis built. The step three, the researcher wants to differentiate flypaper effect that occurs in the three different areas.

4. Step four

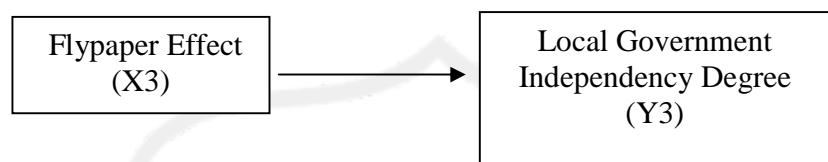


Figure 3
Step four theoretical Schema

CHAPTER III

RESEARCH METHODOLOGY

The previous chapter has been discussed related with theoretical review and hypothesis development. The chapter III explains about the research design, data, tools and hypothesis testing.

A. Research Design

The type of research is empirical research to test the influence of local original revenue and general allocation fund toward local government spending. Moreover this study wants to detect whether flypaper effect anomaly occurs in the local government in Indonesia. The independent variables in this research are local original revenue, general

allocation fund, and flypaper effect. The dependent variables tested in the research are local government spending t , the prediction of local government spending of $t+1$, and independency degree of the local government.

B. Population and Sample

Sekaran (2003) states that, population refers to the entire group of people, events, or things of interest that the researcher wishes to investigate. Then population can be explained as collection or numbers of people or events that are interesting to be analyzed. The research population is all Indonesian local government financial statement of regencies and municipalities. The total population is 455 local governments; they are formed in 369 regencies and 86 municipalities.

This data included as the cross section data. According to the time dimension, this research is included into cross section because in this research only take one period of data. This is in line with Jogiyanto (2005) that the cross section is the time dimension of research that involve only one certain time with a lot of samples. Moreover this research has a lot of data as samples to be analyzed.

Sample is part of population; it consists of elements having similar characteristics with population (Sekaran 2003). Sampling method used is purposive sampling. It is related with the desired information availability (Sekaran 2003). In this study the researcher collects all of information from the populations which have the complete available information as wanted to be analyzed.

Based on the statements of Rosche (1975), Krejcie and Morgan (1970) as well as Cohen (1969) that cited by Sekaran (2003) the sample in multiple regression analysis minimally should be ten times of the independent variables. Then as also cited on

Sekaran (2003), Krejcie and Morgan (1970) as well as Cohen (1969) suggest that if the population 455 therefore the sample should be around 210.

C. Data Source and Data Collection

This study uses secondary data which is taken from the official website of the Indonesia Financial Department through www.sikd.djapk.go.id. Gujarati (2004) defines secondary data as data collected by someone else, such as the government and private organizations. The data is the financial report of the regencies and municipalities in Indonesia in 2006 and local government budget planning of 2007. The financial annual report chosen related with the high credibility, moreover the financial report used for any other related sides to gain the information (Deegan and Rakin 1997). As cited on Unerman (1999), Woodward (1998) stated that with annual reports usually more accessible to researchers than other corporate reports.

The data are local original revenue, general allocation fund, local government spending of the realization financial statement in 2006, prediction of local government spending taken from the local government budget planning of 2007, local total income and spending on employee. The reason why the researcher takes the data from the 2006 is because the researcher found that this is the most possible way to find the real condition of Indonesia as a whole, related with the data availability. Moreover, seeing Indonesia after the 5 years decentralization period can reflected the condition of the local government in Indonesia. The budget related with transfer from central government for local government in 2006 increased significantly, than it motivates the researcher in taking the 2006 data (APEC, Economic Policy Report 2007).

Local government that used as the data must fulfill these criteria;

1. The local governments are formed as regencies and municipalities.
2. The financial report covered the data needed in the research. The data must fulfilled data are local original revenue 2006, general allocation fund 2006, local government spending 2006, prediction local government spending of 2007, local total income 2006, and spending on civil servant 2006.

D. Research Variable and Measurement

The definition of the independent and dependent variables of the research is as followed;

1. Independent variables

The Independent variable is that the influences the dependent variable in either a positive or negative way (Sekaran 2003). The independent variables of the research are local original revenue, general allocation fund, and flypaper effect.

a. Local original revenue

Based on the law No.33/2004, local original revenue defines as the income that sourced from the local tax, local retribution, separated managed of the local resources and others revenue. Those related with the local original revenue which has a purpose to give freedom in the local government action to search the financial matter from their own resources relating the decentralization (Kawedar et. al 2008).

b. General allocation fund

General allocation fund is the fund transferred from the central government sourced from national government budget , this is the biggest component sourced the balancing fund, which formed as block grant. General allocation fund formulated based on the fiscal formulation gap (the different between the fiscal needed and the

fiscal capacity) where the formula considers the needs and the local capability. It is allocated for the purpose to distribute the ability of the each local government. The general allocation fund itself also has a purpose to finance the expenditure needed relating with the decentralization. (Kawedar et. al 2008)

c. Flypaper effect

Davey and Peteri (1988) state that each of the transfer from the central government basically just a help or fund for the local government, it based on their study on Europe. They state that the fund actually does not necessary if the local government not to extravagant in spending and working harder the tax collection.

The formulation used to measure the flypaper effect is using the fiscal decentralization degree. The researcher uses this formula to reflect the flypaper effect seems the definition of the two is alike. The formula is to divide the fund from the central government, general allocation fund with the local total income. As the model of ratio in counting flypaper effect has been used by Aragon (2008) then the researcher uses this formula of ratio also to reflect the flypaper effect.

$$\text{FiscalDecentralizationDegree} = \frac{\text{Fund}}{\text{LocalTotalIncome}}$$

2. Dependent variables

Dependent variable is variable having primary focus in research, or primary variable that makes the investigation can be proved (Sekaran 2003). The dependent variables of this research are local government spending 2006, the prediction of local government spending of 2007, and local government independency.

a. The realization of the local government spending t

Local government spending consists of spending on local government official, public expenditure, spending on production sharing and financial fund, unpredicted spending, and spending on other.

Spending on local government official consists of spending on general administration and spending on operational and maintenance. Each of them consists of spending on employee, spending on goods and services, spending on duty journey, and spending on maintenance. And also in spending on operational and maintenance, there is capital spending.

Public expenditure consists of spending on general administration and spending on operational and maintenance. Each of them consists of spending on employee, spending on goods and services, spending on duty journey, and spending on maintenance. And also in spending on operational and maintenance, there is capital spending.

b. The prediction of the local government spending $t+1$

Local government spending of the prediction of 2007 also consist the same material as realization the local government spending of 2006. Local government spending consists of spending on local government official, public expenditure, spending on production sharing and financial fund, unpredicted spending, and spending on other.

c. Local government independency degree

The formulation used in measuring the local government independency degree (LGID) is dividing the local original revenue (LOR), with local government spending.

$$LGID = \frac{LOR}{LocalGovernmentSpending}$$

E. Data Analysis Method

The analysis of the research used descriptive analysis and hypothesis analysis. The data analysis used SPSS program version 16.

1. Descriptive analysis

The descriptive analysis consists of counting mean, median, standard deviation, maximum and minimum from each sample data. This analysis purposed to give the description related with the distribution and data sample behavior.

2. Hypothesis testing

Analysis tools used are multiple regression; ANOVA – One way analysis of variance and simple regression.

a. Multiple regression

The multiple regressions used to see the influence of the independent variables (local original revenue and general allocation fund) at once, than the researcher can see the flypaper effect that occurs.

The first hypothesis test (H_1) used to analyze the influence of the independents variables, local original revenue 2006 (X_{1t}) and general allocation fund 2006 (X_2), to

the local government spending 2006 (Y_{1t}). Moreover the researcher wants to see the flypaper effect that occurs which reflected by the different significance of the dependence variables to the independent variables. If the general allocation fund 2006 (X_2) has more significant influence to the local government spending 2006 (Y_{1t}) compared with local original revenue 2006 (X_1), it can be concluded that there is flypaper effect anomaly in this influence. The multiple regression of the first hypothesis is as following;

$$Y_{1t} = \alpha + b_1 X_1 + b_2 X_2 + e$$

The second hypothesis test (H_2) used to analyze the influence of the independents variables, local original revenue 2006 (X_1) and general allocation fund 2006 (X_2), to the prediction of local government spending 2006 (Y_2). The researcher wants to see whether the Flypaper effect occurs in the influence of local original revenue 2006 (X_1) and General allocation fund 2006 (X_2) in the predicting of local government spending 2007 (Y_2) of the next year of the regencies and municipalities in Indonesia. The formula of multiple regression in H_2 is stated below;

$$Y_{2t+1} = \alpha + b_1 X_1 + b_2 X_2 + e$$

Where;

| Variables | Measurement |
|--|--|
| Local Original Revenue 2006 (X_1) | Total local original revenue in the realization 2006 |
| General Allocation Fund 2006 (X_2) | Total general allocation fund in 2006 |

Local Government Spending
2006 (Y_{1t})

Total spending on local government 2006 that covers spending on local government official, public expenditure, spending on production sharing and financial fund, unpredicted spending, and spending on other

Prediction on Local
Government Spending 2007
(Y_{2t+1})

Total prediction on local government spending 2007 that covers spending on local government official, public expenditure, spending on production sharing and financial fund, unpredicted spending, and spending on other

b. The ANOVA – One way analysis of variance

The ANOVA – One way analysis of variance used to see the difference flypaper effect in three different groups of local government financial ability (LGFA).

Analysis of variance is a method to test the relation between one dependent variable with one or more independent variable (Ghozali 2005). Using the one way analysis of variance, the researcher seeks the difference that might occur. In this test category of local government financial ability as the independent variable and flypaper effect reflected as fiscal decentralization degree as dependent variable.

The third hypothesis test (H_3) used to know the difference of flypaper effect occur between in the three group categories of local government financial ability, based on the role of the internal affair ministry No21/2007. First the

researcher groups the category of local government financial ability based on the formula;

$$LGFA = Local\ Total\ Income - Spending\ Employee$$

- a. First group category is “Low”, this reflected by the local government with low financial ability. This categorized with the local governments that have the financial ability under Rp.200,000,000,000.00 (two hundred million rupiahs).
- b. Second group category is “Medium”, it is reflected by the local governments with medium financial ability. This categorized with the local government that have the financial ability beyond Rp.200,000,000,000.00 (two hundred million rupiahs) but under Rp.400,000,000,000.00 (four hundred million rupiahs).
- c. Third group category is “High”, it is reflected by the local governments with high financial ability. The local government that have the financial ability beyond Rp. 400,000,000,000. 00 (four hundred million rupiahs).

After grouped the financial ability, than the researcher calculate the value of flypaper effect that reflected as fiscal decentralization degree. The formula is as follow;

$$FiscalDecentralizationDegree = \frac{Fund}{LocalTotalIncome}$$

c. The simple regression

The simple regression used to see answer the forth hypothesis. The forth hypothesis test (H_4) used to analyze whether the flypaper effect (X_3), reflected by the fiscal decentralization degree, has a negative significant influence to financial performance related with the independency degree of the local government (Y_3). The formula of simple regression in H_4 is following;

$$Y_3 = \alpha + b X_3 + e$$

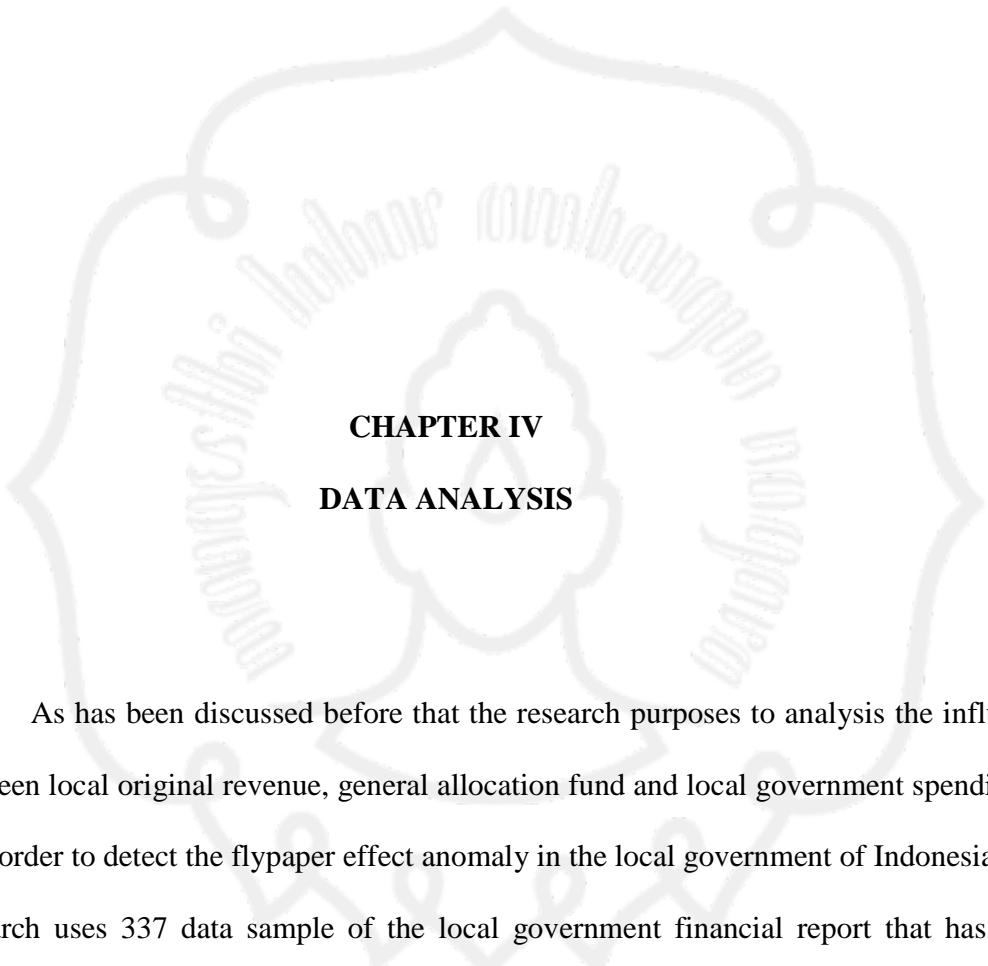
Where,

| Variables | Measurement |
|---|---|
| Flypaper Effect (X_3) | Fiscal decentralization degree = general allocation fund/local total income |
| Independency Degree of the Local Government (Y_3) | Independency degree = local original revenue / local government spending |

In order to ensure that the data analyzed is valid, consistent and efficient on the regression coefficient interpretation there should be handle a classic assumption. It becomes the qualification to multiple regression analysis and hypothesis test (Gujarati 2004). The classic assumption test in the research covered Normality test, Multicollinearity test and Heteroscedasticity test.

The Normality test functions to test whether in the regression model, disturbance variables or residual has a normal distribution. The Multicollinearity test has a purpose to test whether the regression model

independent variables has correlation. Then the Heteroscedasticity test aims to test existence of different variance from the one observation residue to the other observation in the regression model (Ghozali 2005).



CHAPTER IV

DATA ANALYSIS

As has been discussed before that the research purposes to analysis the influence between local original revenue, general allocation fund and local government spending; it is in order to detect the flypaper effect anomaly in the local government of Indonesia. The research uses 337 data sample of the local government financial report that has been published by Indonesia Financial Department. This chapter reveals about the data description, research result, discussion and comparison related with the previous researches. The analysis used in the research are multiple regression, one way Anova and single regression using the SPSS version 16 as the tool of operation.

A. Data Description

Data description explains about the data of population and sample taking in the research.

1. Sample selection

The samples of the research taken from the realization and budget planning of local government financial statement that published by Indonesia Financial Department. Actually the researcher has intention to use all of the 455 population data of financial reports. Unfortunately related to the data availability in informing all of the points related to analyzed, there are only 400 financial statements that covered all of the information.

Finding some data with extreme value, the researcher did outlier data, and then finally the researcher took 337 Log data from 400 to gain the normal distributed data and pass the classic assumption test. Finally, the researcher examined the data and tests the data within SPSS for windows 16.00 program. The sample was taken from 337 local governments in Indonesia.

The variables used in this research are local original revenue 2006, general allocation fund 2006, realization of local government spending 2006, the prediction of local government spending 2007, flypaper effect (as reflected as fiscal decentralization degree) and local government independency degree.

Seeing the dimension of time, that only takes in one period of financial statement report and abundant data, this data of the research included as the cross section data. The cross section is the time dimension of research that involve only one certain time with a lot of samples (Jogiyanto 2005)

The choice of using financial statement report in 2006 is based on the availability of the data Indonesia Financial Department that covered almost all of the population as

the first intention of the researcher gaining all of the population as data. In here the researcher wants to see the real condition of all of the local government of regencies and municipalities in Indonesia. Therefore the researcher expects that the result of the analysis reflected the real condition of the decentralization in Indonesia after the five year period.

2. Descriptive statistic

The table stated below explains about the result of the descriptive statistic analysis from the each research variable. The information covered the mean, standard deviation, minimum value, and maximum value.

Table 1
Descriptive Statistic

| Variables | Minimum | Maximum | Mean | Standard Deviation |
|---|----------------|----------------|-------------|---------------------------|
| Local original revenue 2006 (X_1) | 1263.71 | 178026.17 | 28884.63 | 27750.37 |
| General allocation fund (X_2) | 72991.00 | 830714.90 | 314889.97 | 137296.44 |
| Local government spending 2006 (Y_{1t}) | 115254.49 | 1271536.32 | 424715.14 | 185432.89 |
| Prediction on local government spending 2007 (Y_{2t+1}) | 242378.71 | 1577315.63 | 600268.08 | 258421.48 |
| Flypaper effect (X_3) | 0.04 | 0.83 | 0.63 | 0.12 |
| Independency Degree of the Local Government (Y_3) | 0.01 | 0.39 | 0.12 | 0.05 |

Based on the statistical descriptive from the table, the mean of the local original revenue 2006 (X_1) value after 28884.63 where Sidoarjo regency received the biggest amount of local original revenue in 2006, Rp.178,026,170,000.00. Mamasa regency received the smallest number Local Original Revenue in 2006, Rp. 1,263,710,000.00. There are 114 (34%) local government financial statement having local original revenue above the mean value. There are 223 (66%) local government financial statement having the local original revenue below the mean.

The mean value of the general allocation fund in 2006 (X_2) is 314889.97. It is detected that Garut regency received the most general allocation fund in 2006, Rp.830,714,900,000.00. Tarakan municipality got the fewest general allocation fund, Rp.72,991,000,000. 00. There are 144 (43%) local government financial statements that general allocation fund in 2006 are above the mean. There are 193 (57%) financial statements which general allocation funds in 2006 are below the mean value.

The highest local government spending in the realization of 2006 (Y_{1t}) of local government in Indonesia is Tangerang regency, Rp.1,271,536,320,000.00. The lowest local government spending realization in 2006 of local government financial report is Nias Selatan regency with the local government spending in the realization of 2006, Rp.115,254,490,000.00. The mean point in the local government spending realization of 2006 is 424715.14. There are 148 (44%) local government financial statements which have realization of local government spending in 2006 beyond the mean. Therefore there are 189 (56%) local government financial statements which have local government spending realization in 2006 below the mean.

In the prediction of local government spending of 2007 (Y_{2t+1}) Mamasa regency has the lowest amount of prediction on Local Government Spending 2007 of Rp.242,378,710,000.00. Then Tangerang regency has the highest prediction of local government spending in 2007, Rp.1,577,315,630,000.00. The mean value in the prediction of local government spending 2007 as showed in the table is 600268.08. And there are 116 (34%) local government financial statements which the predictions of local government spending 2007 are above the mean point and there are 221 (66%) local government financial statements that have prediction the local government spending 2007 under the mean.

The flypaper effect (X_3) value reflected by the ratio of fiscal decentralization degree, which divided the general allocation fund with local total income. The mean value of flypaper effect is 0.63. Then the local government Aceh Barat municipality is the local government which has the lowest flypaper effect value, 0.04. Kaimana regency with the flypaper effect value is 0.83 become the local government that has the biggest flypaper effect value. There are 205 (61%) local government which have the flypaper effect beyond the mean then there are 132 (39%) local governments which have the flypaper effect below the mean

The independency degree (Y_3) is formulated by local original revenue divided by local total income of 2006. From the table above, it can be stated that the mean value of independency degree is 0.12. Then the minimal value is 0.01, comes to Bangli regency. And the local government which gets the highest value of independency degree of 0.39 is Lingga regency. There are 160 (47%) local governments that have the independency

degree higher than the mean. There are 177 (53%) local governments which have the independency degree lower than mean.

B. Data Analysis

The test of hypothesis could be done after all classic assumption fulfilled. The data analysis was tested through SPSS program for Windows 16.00. Hypothesis testing was done through multiple regression, one way ANOVA, and simple regression. Regression test was done by measuring goodness of fit regression model to measure the appropriateness of sample regression function in predicting actual value. Regression model goodness of fit could be seen statistically from determination coefficient, F value, and t value.

1. Step one analysis

The first step, multiple regression analysis, is to test the influence between the independent variables (local original revenue and general allocation fund of the realization in 2006) to the dependent variable (local government spending of the realization of 2006). The purpose is to detect the occurring of flypaper effect in 2006. Following is the table of regression analysis;

Table 2
Multiple Regressions Test Result
First Hypothesis

| Variables | Value |
|-------------------------|--------|
| R ² | 0.241 |
| Adjusted R ² | 0.237 |
| F test | 53.065 |
| p-value | 0.000 |

Table 3

**Multiple Regression Test Result
First Hypothesis**

| Variables | Coefficient | t-value | significant |
|--------------------|-------------|---------|-------------|
| Constant | 3.541 | 13.764 | 0.000 |
| Log X ₁ | 0.166 | 6.926 | 0.000 |
| Log X ₂ | 0.245 | 4.916 | 0.000 |

*) significant 5%

Dependent variable = Local Government Spending 2006 ($Y_{2,t}$)

Determination Coefficient (R^2) is measured how far the independent variables can explain the dependent variable. The adjusted R^2 of the table shows 0.237. The combination of the independent variables can explain the dependent variable in the range 23.7% and the rest of 76.3% explained by other factors outside of the model.

The F value is used to decide whether the regression model could be used to predict the dependent variable. It can be said that the independent variables of the research influence the dependent variable. The result shows that the F value is 53.065 with the probability 0.000. The probability much smaller than 0.05, the regression model can be used to predict the local government spending 2006 (Y_1), or it also can be said that local original revenue (X_1) and general allocation fund (X_2) at the same time influence local government spending 2006 (Y_1).

The significance of the each independent variable to the dependent variable can be detected by the p value. When the p value smaller than the significance level, it can be said that the independent variables partially influence significantly to the dependent variable. Therefore when the p value bigger than the significant level, it can be said that the independent variables partially do not influence significantly to the dependent variable.

Local original revenue of 2006 (X_1) influences significantly to the local government spending of 2006 (Y_1). It is showed by the p value 0.000 in the significant level of 5%. Positive coefficient showed in the table reflects the positive relation between local original revenue of 2006 (X_1) and local government spending of 2006 (Y_1). It means when the local original revenue bigger, therefore the local government spending 2006 will also increase. The research result is consistent with research of Maimunah (2008); Ari (2006) that also found the positive influence relation between local original revenue and local government spending.

General allocation fund of 2006 (X_2) significantly influences to the local government spending 2006 (Y_1). The p value in this test is 0.000 in the significant level of 5%. It also means that there is a positive relation between general allocation fund of 2006 (X_2) and local government spending of 2006 (Y_1). It means that when the general allocation fund raises then the local government spending 2006 will also increase. The research result is consistent with Maimunah (2008); Alderete (2004); Ndadari and Adi (2008), they also found the positive influence relation between grant or fund from the central government (general allocation fund) and local government spending.

The all independent variables of the regression model, we can see that two of them have significant probability. The significant probability of local original revenue 2006 (X_1) is 0.000 and general allocation fund 2006 (X_2) is 0.000, < 0.05 . Then we can say then local government spending 2006 (Y_1) significantly influenced by local original revenue 2006 (X_1) and general allocation fund 2006 (X_2), with the formulation is as following.

$$\text{Log } Y_1 = 3.541 + 0.166 \text{ Log } X_1 + 0.245 \text{ Log } X_2$$

The constanta of 3.541 it means that the independent variable considered as constant. The regression coefficient of local original revenue 2006 (X_1) is 0.166. It means that every addition of local original revenue 2006 (X_1), 10 (in million rupiahs), will increase the local government spending 0.166 (in million rupiahs). The regression coefficient of general allocation fund 2006 (X_2) is 0.245. It means that every addition of general allocation fund 2006 (X_2) 10 (in million rupiahs) will increase the local government spending 2006 (Y_1) 0.245 (in million rupiahs).

From the table, it can be seen that the flypaper effect occurs. The flypaper effect detected if the grant given by the government influence more significant than the local owned income. The result is as what predicted before. The result of unstandardized beta coefficient, it can be seen that the general allocation fund 2006 (X_2) coefficient (0.245) more dominantly influence than local original revenue 2006 (X_1) coefficient (0.245), so we can conclude that there is exist flypaper effect in influencing the local government spending 2006 (Y_1). It is in line with the previous researchers (Knight 2000; Bae and Feiock 2004; Aragon 2008; Maimunah 2008; Levaggi and Zanola 2009). Therefore, from the result of analysis above we can conclude that flypaper effect occurs in the local government spending 2006 (Y_1).

2. Step two analysis

The second regression tests the influence between the independent variables, local original revenue 2006 (X_1) and general allocation fund 2006 (X_2), to the dependent variable (local government spending of the prediction of 2007). The purpose is to detect the occurring of flypaper effect in the influence of local original revenue 2006 (X_1) and

general allocation fund 2006 (X_2), in the predicting of local government spending 2007 ($Y_{2,t+1}$) of the regencies and municipalities in Indonesia. Following is the table of regression analysis;

Table 4
Multiple Regressions Test Result
Second Hypothesis

| Variables | Value |
|-------------------------|-------|
| R ² | 0.044 |
| Adjusted R ² | 0.038 |
| F test | 7.653 |
| p-value | 0.001 |

Table 5
Multiple Regression Test Result
Second Hypothesis

| Variables | Coefficient | t-value | significant |
|--------------------|-------------|---------|-------------|
| Constant | 4.831 | 17.955 | 0.000 |
| Log X ₁ | 0.053 | 2.124 | 0.034 |
| Log X ₂ | 0.125 | 2.401 | 0.017 |

*) significant 5%

Dependent variable = Prediction on Local Government Spending 2007 ($Y_{2,t+1}$)

Determination Coefficient (R²) is measured how far the independent variables can explain the dependent variable. The adjusted R² of the table shows 0.038. The combination of the independent variables can explain the dependent variable in the range 3.8% and the rest of 96.2% explained by other factors outside of the model.

The F value is used to decide whether the regression model could be used to predict the dependent variable. It can be said that the independent variables of the research influence the dependent variable. The result shows that the F value is 7.653 with

the probability 0.001. Probability smaller than 0.05, then the regression model can be used to the predicting of local government spending 2007 ($Y_{2,t+1}$), or it also can be said local original revenue 2006 (X_1) and general allocation fund 2006 (X_2) at the same time influence the predicting of local government spending 2007 ($Y_{2,t+1}$).

Local original revenue of 2006 (X_1) influences significantly to the prediction local government spending 2007 ($Y_{2,t+1}$). It is showed by the ρ value 0.034 in the significant level of 5%. Positive coefficient showed in the table reflects the positive relation between local original revenue of 2006 (X_1) and prediction of local government spending 2007 ($Y_{2,t+1}$). General allocation fund 2006 (X_2) also influences significantly to the prediction of local government spending 2007 ($Y_{2,t+1}$). The ρ value in this test is 0.017 in the significant level of 5%. It also means that there is a positive relation between general allocation fund 2006 (X_2) and prediction of local government spending 2007 ($Y_{2,t+1}$). It means when the general allocation fund 2006 (X_2) is bigger then the prediction of local government spending 2007 ($Y_{2,t+1}$) also increases.

All independent variables of the regression model, it can be seen that two of them have significant probability. The significant probability of local original revenue 2006 (X_1) is 0.034 and general allocation fund 2006 (X_2) is 0.017, < 0.05 . Then we can say the prediction of local government spending 2007 ($Y_{2,t+1}$) significantly influenced by Local Original Revenue 2006 (X_1) and general allocation fund 2006 (X_2), with the formulation is as following.

$$\log Y_{2,t+1} = 4.831 + 0.53 \log X_1 + 0.125 \log X_2$$

The constanta of 4.831 it means that the independent variable considered as constant. The regression coefficient of local original revenue 2006 (X_1) is 0.053. It means

that every addition of local original revenue 2006 (X_1) 10 (in million rupiahs) will increase the prediction of local government spending 2007 (Y_{2t+1}) 0.53 (in million rupiahs). The regression coefficient of general allocation fund 2006 (X_2) is 0.125. It means that every addition of general allocation fund 2006 (X_2) 10 (in million rupiahs) will increase the prediction of local government spending 2007 (Y_{2t+1}) 0.125 (in million rupiahs).

From the table, it can be seen that the flypaper effect occurs. The flypaper effect is detected when the grant given by the government influence more dominant than the local owned income. The result is as what predicted before. The result of unstandardized beta coefficient, it can be seen that the general allocation fund 2006 coefficient (0.053) is more dominant influencing the prediction of local government spending 2007 (Y_{2t+1}) than local original revenue 2006 coefficient (0.125), so we can conclude that there is exist flypaper effect in influencing the prediction of local government spending 2007 (Y_{2t+1}). It is in line with the previous researchers (Aldarete 2004; Ndadari and Adi 2008). Therefore, from the result of analysis above we can conclude that flypaper effect occurs in the prediction of local government spending 2007 (Y_{2t+1}) of the next year in Indonesian regencies and municipalities.

3. Step three analysis

The ANOVA – One way analysis of variance used to see the difference of flypaper effect in three different groups of local government financial ability.

Analysis of variance is a method to test the relation between one dependent variable with one or more independent variable. Using the one way analysis of variance, the researcher seeks the difference that might occur. In this test category of local

government financial ability as the independent variable and flypaper effect reflected as fiscal decentralization degree as dependent variable. In this test the researcher uses three categories. The result of the analysis is as following;

Levene's test of homogeneity of variance calculated with SPSS to test the Anova assumption whether each of the independent variable group has the same variance. Levene statistic significant > 0.05 it means that the groups have same variance.

From the Levene test result, we see that the F value is 11.839 and it is not significant. The $p < 0.05$, it means that the variance is different. This could be against as stated by Ghazali (2003), because he said that this is not fatal and the analysis still could be continued.

Table 6
Anova Test Result of
Between-Subjects Effects

| Source | F | Sig |
|-------------------|----------|------|
| Corrected Model | 21.527 | .000 |
| Intercept | 2053.374 | .000 |
| Category of Area | 1.991 | .000 |
| R-Square | = 0.114 | |
| Adjusted R-square | = 0.109 | |

From the table 6, the F value is 2053.374 for the Intercept and significant in 0.05, then also for the category area of financial ability is 21.527 and significant in 0.05.

Related to the category area of financial ability variable is significant in the level 0.05, so we can conclude that the category area of financial ability influence the flypaper effect or fiscal decentralization degree. It can be concluded that there is difference of flypaper effect (fiscal decentralization degree) between categories. The adjusted R

squared is 0.109 means that the variability of Flypaper effect or decentralization degree can be explained in 10.9% by the variability of financial ability category area

Table 7
Anova test result of Post Hoc Test

| | Category of Area | Category of Area | Mean Difference | Sig |
|-------------------|------------------|------------------|-----------------|--------|
| Tukey HSD | 1 | 2 | 0.0022 | 0.998 |
| | | 3 | 0.1633 | 0.001* |
| | 2 | 1 | -0.0022 | 0.998 |
| | | 3 | 0.1611 | 0.000* |
| | 3 | 1 | -0.1633 | 0.001* |
| | | 2 | -0.1611 | 0.000* |
| Bonferroni | 1 | 2 | 0.0022 | 1.000 |
| | | 3 | 0.1633 | 0.001* |
| | 2 | 1 | -0.0022 | 1.000 |
| | | 3 | 0.1611 | 0.000* |
| | 3 | 1 | -0.1633 | 0.001* |
| | | 2 | -0.1611 | 0.000* |

*Statistically significant on the level 0.05

From the Tukey HSD or Bonferoni output shows that there is difference of flypaper effect between the area 1, low financial ability area, area 2, medium financial ability area and area 3, high financial ability area. The different between area 1 and area 2 is 0.0022 and statistically is not significant ($p=0.998$ much above 0.05). The different between the area 1 and area 3 is .1633 and statistically significant with $p = 0.001$. The different between area 2 and area 3 is 0.1611 statistically significant with $p = 0.000$.

Table 8

Anova test result of Homogenous Subset Test

| Category Area | N | Subset | |
|--------------------------|----------|---------------|----------|
| | | 1 | 2 |
| 3 | 117 | 0.5892 | |
| 2 | 189 | | 0.7504 |
| 1 | 31 | | 0.7526 |
| Sig | | 1.000 | 0.998 |

Tukey test gives addition information through the subset table. This table gives the information of independent variable categories and the means. From the description given by the out put above, it can be assumed that the total number regencies / municipalities of each financial ability category. In the category area of low area, there are 31 municipalities / regencies grouped in this category. The category of medium financial ability consists of 189 municipalities / regencies. And in the high category of financial ability, there are 117 municipalities / regencies grouped.

In the first subset consist of means of flypaper effect in the category area of local government financial ability. The significance is 0.998, it can be said that the means value of flypaper effect between the area 1 and 2 (in the second subset) has no difference statistically, then in the first subset is the mean of flypaper effect in the area 3. The mean of flypaper effect between area 1 and area 2 is not too different then it gathered in the same subset, in other way because the flypaper effect means in area 3 differs that the others, then it comes in other subset.

The third hypothesis whether the researcher wants to know the different of flypaper effect, measured by fiscal decentralization degree, in the three categories area then the researcher get the answer by seeing the SPSS output. The conclusion is that first there is no different of flypaper effect between the area category 1 (low financial ability

area) and the area category 2 (medium financial ability area). Second, there is different of flypaper effect between the area category 1 (low financial ability area) and the area category 3 (high financial ability area). Third, there is different of flypaper effect between the area category 2 (medium financial ability area) and the area category 3 (high financial ability area).

4. Step four analysis

The third regression is to test the influence between the flypaper effects to the independency degree of the local government. The purpose is to detect the negative influence of flypaper effect to the independency degree of the regencies and municipalities in Indonesia. Following is the table of regression analysis;

Table 9
Simple Regression Result
Forth Hypothesis

| Variables | Value |
|-------------------------|-------|
| R ² | 0.015 |
| Adjusted R ² | 0.012 |
| F test | 5.133 |
| p-value | 0.024 |

Table 10
Simple Regression Result
Forth Hypothesis

| Variables | Coefficient | t-value | significant |
|----------------|-------------|---------|-------------|
| Constant | -1.336 | -48.900 | 0.000 |
| X ₃ | -0.235 | -2.266 | 0.024 |

*) significant 5%

Dependent variable = Independency Degree (Y_3)

Determination Coefficient (R^2) is measured how far the independent variables can explain the dependent variable. The adjusted R^2 of the table shows 0.012. The independent variable can explain the dependent variable in the range 1.2% and the rest of 98.8% explained by other factors outside of the model.

The F value is used to decide whether the regression model could be used to predict the dependent variable. It can be said that the independent variable of the research influence the dependent variable. The result of the test, it shows that the F value is 5.133 with the probability 0.024. Related that the probability much smaller than 0.05, then the regression model can be used to predict the Independency of the local government, or it also can be said that flypaper effect influences local government independency.

Flypaper effect influences significantly to the local government independency. It is showed by the p value 0.024 in the significant level of 5%. Negative coefficient showed in the table reflects the negative relation between flypaper effect and local government independency. It means that smaller the flypaper effect then the independency degree of local government increases.

The independent variable of the simple regression model, it can be seen that it has significant probability. The significant probability of flypaper effect is 0.024, < 0.05 . Therefore we can say then local government independency degree is significantly influenced by flypaper effect, with the formulation is as following.

$$\log Y_3 = -1.336 - 0.235 \log X_3$$

The constanta of -1.336 it means that the independent variable considered as constant. The regression coefficient of flypaper effect (X_3) is minus 0.235. It means that

every addition of flypaper effect of 10 will decrease the independency degree (Y_3) in 0.235.

The result of unstandardized beta coefficient, we can see that the fiscal decentralization degree, flypaper effect (X_3), has a negative significant influence to the independency degree of local government.

As the statistical result above, it proved that there is a negative significant influence between flypaper effect and independency degree of local government. This is in line with the statements by Mahmudi (2007); Zulfikar (2007) and Landiyanto (2005).

5. Classical assumption

Classical assumption is the requirement to the regression test. The classical purposed to have confidence and to ensure the data is valid. The researcher did three times classical tests in order to do three times regression tests with different variables.

The classical assumption test in the variables of the first hypothesis covered Normality test, Multicollinearity test, and Heteroscedasticity test. The variables of the first hypothesis are local original revenue 2006, general allocation fund 2006 and local government spending 2006.

The second hypothesis' variables are local original revenue 2006, general allocation fund 2006 and prediction on local government spending 2007. Then the researcher took Normality test and Heteroscedasticity test as the classical assumption.

For the forth hypothesis' variables as the simple regression are flypaper effect and independency degree. The classical assumption tests taken are Normality and Heteroscedasticity. The result of the classical assumption can be seen in the appendix 6, appendix 7 and appendix 8.

CHAPTER V

CONCLUSION, LIMMITATION AND RECOMMENDATION

A. Conclusion

With the data analysis, it is gained the result related with the flypaper effect phenomenon that exists in Indonesia. The results of the research can be concluded as follow.

It is proved that flypaper effect does exist in 2006, after the five year period of the decentralization. This is reflected with the evidence of the more dominant influencing of general allocation fund to the local government spending than the local original revenue.

There is flypaper effect exist in the influence of local original revenue and general allocation fund to predict the local government spending of the 2007. There is an indication of asymmetric behavior of local actor or the local government in predicting the Local Public Spending. The result of the research shows that the general allocation fund still has a big influence to the local government spending in regencies or municipalities.

There is different of flypaper effect between the local government financial ability area categories Then it can be said that the ability of local government in finance their own district will differ their dependency to the central government' transfer.

The dependency of the local governments to the central will make them not perform well in the financial performance and it will effect to their independency. Contrary it also can be said that the grant from the central government, general allocation

fund, can cover the gap between local spending and income of the regencies and municipalities local government.

B. Research Limitation and Recommendation

The research result could be used by other sides that interest and deal with the budgeting matter. The researcher hopes attracting the other next researchers in studying essence of information in financial report and it could also may related with any other subject disciplines.

The research has some limitations and it needs improvement dealing with the future research. The limitations that may exist in the research are;

1. The research only takes two year events of financial reports to detect the flypaper effect phenomenon; even researcher takes almost all of the population as the data. It would be better if in the next research used the time series data.
2. There is a good description about the behavior proxy in allocating resources by the principal and agents. It will need a deeper and feasible research for example by field research or experiment research with the local government executive and legislative as subject of research.
3. In this study, the researcher does not analyze the affectivity and efficiency of the using of budget. For example it doesn't consider the quantity, structure, age, and the educational background of the employee and the inhabitant. It is recommended if the future researches explore more and relate about it.

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