Journal of Economics, Finance and Management Studies

ISSN (print): 2644-0490, ISSN (online): 2644-0504

Volume 06 Issue 12 December 2023

Article DOI: 10.47191/jefms/v6-i12-41, Impact Factor: 7.144

Page No: 6133-6140

Does the Flypaper Effect Phenomenon Occur on the Financial Performance of Provincial Governments in Indonesia?

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ABSTRACT: The purpose of this research is to detect the flypaper effect phenomenon on the financial performance of provincial governments in Indonesia. This research uses one dependent variable, namely regional expenditure and two independent variables, namely the General Allocation Fund (GAF) and local own-source revenue (OSR). The data used in this research is secondary data in the form of panel data consisting of time series data (2018-2022) cross section with the number of observations as many as 33 provinces. Then, this research data was collected from the Directorate General of Financial Balance, Ministry of Finance of the Republic of Indonesia and other supporting reports. This research was analyzed using panel data regression analysis. Based on the results of panel data regression, results were obtained Based on the results of panel data regression, results were obtained that partially each variable local own-source revenue (OSR), The General Allocation Fund (GAF) has a positive and significant impact on the regional level of exploration in Indonesia. Meanwhile, simultaneously local own-source revenue (OSR), General Allocation Fund (GAF) has a positive and significant impact on regional expenditure in Indonesia with an Adjusted R-squared amount of 97.07 percent. Then, if you look at the flypaper effect phenomenon, it can be concluded that there is a flypaper effect on the financial performance of provincial governments in Indonesia. Based on the results of this study, each provincial government in Indonesia should increase Local Own-Source Revenue (OSR) to be used as the main source of regional expenditure, then local governments should also prioritize the use of regional expenditure for productive things, so that the existence of central government transfer funds can increase the independence of government financial performance and ultimately can minimize dependence on the central government.

KEYWORDS: flypaper effect, local own-source revenue (OSR), General Allocation Fund (GAF)

I. INTRODUCTION

The difference in potential in each region has resulted in different levels of economic progress in each region. Equitable distribution of financial capacity between regions can be done through fiscal decentralization policy (Elmi, 2002). This is in accordance with the mandate of the Constitution of the Republic of Indonesia Year 1945, where local governments regulate and manage their own government affairs according to autonomous principles. In the implementation of regional autonomy, the central government transfers the Balancing Fund to local governments (Law No.32/2004). However, what happens is that the balancing fund from the central government is often used as the main source of funds by local governments to finance regional expenditures (Hadi, 2011). This indicates fiscal inefficiency in the utilization of central transfer funds. Therefore, to see indications of inefficiency in the transfer funds, it can be seen from the government's expenditure response better known as the flypaper effect theory. According to Oates (1999), this government response is a direct response from local governments in responding to fund transfers in the form of balanced funds, especially the General Allocation Fund (GAF) which is realized in the regional budget. When the response (shopping) area is greater to the transfer, it is called the flypaper effect.

According to Sidik et.al (2002), regional autonomy is implemented in order to carry out government affairs that are more efficient, effective and responsible. In this case, the policy of using all these funds is handed over to the local government. One of the most striking phenomena of regional autonomy in Indonesia is the high dependence of local governments on the central government. This dependence is very obvious from the financial aspect. The granting of this authority has an impact on financial performance in the area. There is a close relationship between transfers from the central government and local government spending (Holtz-eaken et.al, 1985). Income levels will have a positive influence on public spending (Prakosa, 2004) and (Ashworth et.al, 2005). In this case, local government expenditures will be adjusted to local government revenues.

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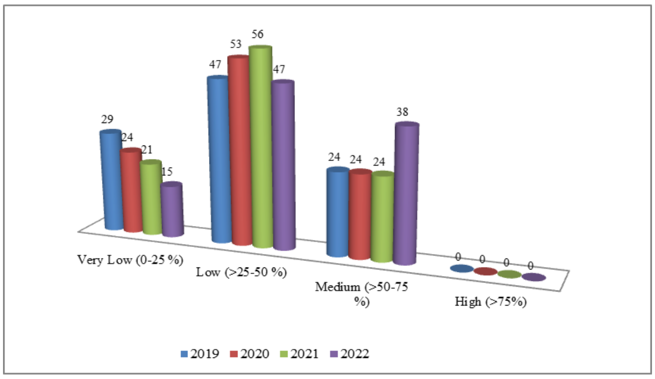
According to Otaes (1999), the main purpose of providing transfer funds is to overcome fiscal gaps between the central government and local governments, fiscal gaps between local governments, improve the tax system, and correct fiscal inefficiencies. According to Saragih (2003), fiscal decentralization policy aims to enable local governments to carry out their functions properly and can support and improve local government finances in implementing autonomy (Saragih, 2003). In the implementation of this transfer fund from the government, it should be able to improve welfare and services to the societies, the development of democratic life, justice, equity and maintenance of harmonious relations between the central and regional, as well as between regions. However, in its development, the level of regional independence has not improved, and even tends to decrease (Adi, 2007). According to Adi and Ekaristi (2009), Local governments rely on the General Allocation Fund (GAF) rather than increasing Local Own-Source Revenue (OSR). The percentage classification of provincial governments based on financial independence can be seen in graph 1.



Source: Central Bureau of Statistics, processed (2023)

Graph.1 The Distribution of Province in Indonesia by Independence Rate Categories 2019-2022 (percent).

Based on graph 1, it can be seen the size of the distribution of provinces in Indonesia according to the level of independence during the 2019-2022 period. Based on these data, it can be concluded that the majority of provinces in Indonesia are still in the category of low level of independence. As for provinces that are in the low self-reliance category as much as 51 percent, then those in the very low self-reliance category as much as 22 percent, medium independence category as much as 28 percent and there is not a single province that is in the high independence category. In addition, graph 1 also shows a positive trend in the level of provincial independence in Indonesia. This can be seen from the number of provinces that fall into the category of low self-reliance level is decreasing. Central Bureau of Statistics (2022), regional financial independence is important related to the economic growth of the region itself. Regions with high independence demonstrate the ability to carry out development without high dependence on central fund transfers. Regions can also be more flexible in developing if they have high independence.
Therefore, based on these problems, researchers intend to analyze the phenomenon of the possibility of Flypaper effect on the financial performance of provincial governments in Indonesia.

II. RESEARCH METHODS

The basic method used in this study is the explanation method. This method will explain the relationship of one variable with another variable, by looking at the relationship between variables. This study uses one dependent variable, namely regional expenditure and two independent variables, namely General Allocation Fund (GAF) and Local Own-Source Revenue (OSR). The data used in this study is secondary data in the form of panel data consisting of time series data (2018-2022) cross section with the number of observations as many as 33 provinces. Then, the data of this study was collected from Directorate-General of Regional Fiscal Balance (Ministry of Finance of Indonesia) and other supporting reports. Furthermore, the object of this research is all provinces in Indonesia, except DKI Jakarta. This study was analyzed using panel data regression analysis. The panel data regression model or equation in this study is:

$$RE_{it} = \beta_0 + \beta_1 OSR_{it} + \beta_2 GAF_{2it} + \varepsilon_{it}$$

Information :

RE is Regional Expenditure

OSR is local own-source revenue

GAF is General Allocation Fund

β0 is Intercept/Constant

β1, β2 is variable regression coefficient local own-source revenue, General Allocation Fund
i is unit cross section (Provinces of Indonesia)
t is period of time (2018-2022)
ε is Error term

To determine whether the flypaper effect occurred, the standard beta coefficient and t-statistic values for each variable were compared. It is said by Ghozali (2005) that the standard coefficient beta is used to see the relative importance of each independent variable. Likewise, to test the meaning of each coefficient a, b1, b2 and b3 can be seen in the value of t stat (Supranto, 2001). The statistical test t basically shows how far the influence of the explanatory / independent variable individually in explaining the variation of the dependent variable (Ghozali, 2005).

III. RESULTS AND DISCUSSIONS

According to Widarjono (2009), in the method of estimating panel data regression models can be done through three approaches, including the common effect model, fixed effect model and random effect model. In determining the best model, several tests were carried out. First, test the chow to choose the best model between the common effect model and the fixed effect model. Second, hausman test to determine the best model between fixed effect model and random effect model. Third, test the lagrange multiplier, to determine the best model between the common effect model and the random effect model. The results of the chow test, hausman test and lagrange multiplier test can be seen in the following table.

Table 1: Results of Chow Test, Hausman Test and Lagrange Multiplier Test

Chow Test			
Effects Test	**Stat.**	**df**	**Prob.**
Cross-section F	4.881138	(32.128)	0.0000
Cross-section Chi-square	130.014554	32	0.0080
Hausman Test			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	0.207514	2	0.9014
Lagrange Multiplier Test			
	Cross-section	Test Hypothesis Time	Both
Breusch-Pagan	62.57825 (0.0000)	0.001299 (0.9712)	62.57955 (0.0000)

Source: Research data, processed (2023)

Based on Table 1 can be seen the results of the chow test, hausman test and lagrange multiplier test. Based on the chow test, it can be seen that the probability value of cross section F of 0.0000 is less than α (0.05). This shows that the best model between CEM and FEM is FEM. Furthermore, based on the results of the hausman test, a random cross-section probability value of 0.92014 was obtained, so the best model between FEM and REM is REM. Then it is necessary to test the lagrange multiplier to determine the best model between REM and CEM. Based on the results of the lagrange test, a Breush-Pagan probability value of 0.0000 is obtained, so the best model is the Random Effect Model. The best model regression results can be seen in Table 2.

Table 2: Best Model Results (Random Effect Model)

Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
C	1447.743	843.6259	1.716096	0.0881*
OSR	1.421945	0.065561	21.68874	0.0000***
GAF	1.740974	0.079058	22.02150	0.0000***

R2 : 0.9710
Adjusted R-Square : 0.9707
F-statistic : 2686.078
Prob (F-Statistic) : 0.000000

Source: Research data, processed (2023)

Based on the test results in Table 2, the regression equation is obtained as follows:

$$RE = 41447.743 + 1.421945 OSR + 1.740974 GAF$$

In this study, hypothesis testing was carried out consisting of a coefficient of determination test (R2), F test and t test. Based on the results of the coefficient of determination (R2) test, an Adj R2 value of 0.9707 was obtained. This shows that local own-source revenue (OSR), General Allocation Fund (GAF) is able to explain regional expenditure in Indonesia by 97.07 percent, while 2.93 percent is explained by other variables outside this research model. Meanwhile, based on the F test, an F-statistic value of 2686,078 was obtained with an F-statistic probability of 0.000000 < 0.05. This result shows that simultaneously local own-source revenue (OSR), General Allocation Fund (GAF) have a positive and significant effect on regional expenditure in Indonesia at α=5 percent. Furthermore, based on the results of the t test, the t-Statistic local local own-source revenue (OSR) value of 21.68874 (positive value) was obtained with a t-Statistic probability value of 0.0000. The probability number t-This statistic is smaller than α = 5% or α = 0.05, so Ho is rejected and H1 is accepted. This result shows that Local Own-Source Revenue (OSR) has a positive and significant effect on regional expenditure in Indonesia at α = 5%. Then the t-Statistics General Allocation Fund (GAF) value is 2.550312 (positive value) with the probability value of t-Statistics General Allocation Fund (GAF) of 0.0131. The probability number t-This statistic is less than α =5%, so Ho is rejected and H1 is accepted. This result shows that the General Allocation Fund (GAF) has a positive and significant effect on regional expenditure in Indonesia at α = 5%.

IV. DISCUSSION

Based on the results of the t test, a local own-source revenue (OSR) coefficient of 1.421945 was obtained and a positive t-statistic with a probability of OSR t-statistic (0.0001) smaller than α = 5%. This result shows that partially local own-source revenue (OSR) has a positive and significant effect on regional expenditure in Indonesia. That is, when local own-source revenue (OSR) increases by 1 billion, then regional expenditure in Indonesia will also increase by IDR1.421.945.000, conversely, if local own-source revenue (OSR) decreases by 1 billion, then regional expenditure in Indonesia will also decrease by IDR1.421.945.000.

The positive influence of Local Own-Source Revenue (OSR) on regional expenditure in provincial governments in Indonesia shows that each local government expenditure is influenced by the amount of Local Own-Source Revenue (OSR) of the provincial government. According to Septriani et.al (2020), the greater the value of local own-source revenue (OSR), the greater the stimulus to increase regional expenditure. This means that the higher the independence of local governments in exploring the potential of Local Own-Source Revenue (OSR). This will certainly have an impact on increasing the ability to realize revenue obtained from local own-source revenue (OSR) and the greater allocation of regional budgets for the following year. Berdasarkan data yang diperoleh dari Directorate-General of Regional Fiscal Balance (Ministry of Finance of Indonesia), It is known that during the 2018-2022 period, the average local own-source revenue (OSR) of the Provincial Government in Indonesia continues to fluctuate and tends to increase from year to year with an average local own-source revenue (OSR) growth of 5.3 percent per year. This local own-source revenue (OSR) comes from several components, including Regional Taxes, Regional Levies, Segregated Regional Wealth Management Results and Other Legal OSR. During the 2018-2022 period, the main source of local own-source revenue (OSR) for all provinces in Indonesia is sourced from Regional Tax revenue. Local taxes on average contribute to local own-source revenue (OSR) at 70 percent, while local levies and segregated wealth management results contribute to Local Own-Source Revenue (OSR), each at 3 percent, while other legitimate OSRs contribute 24 percent. The increase in Local Own-Source Revenue (OSR) from year to year indicates an increase in economic activity in the societies, especially the high Local Own-Source Revenue (OSR) derived from taxes. The high local own-source revenue (OSR) derived from local taxes has had an impact on increasing regional expenditure. As stated by Maimunah and Akbar (2008), that regional revenues (especially taxes) will affect local government spending budgets known as the taxspend hypothesis or government expenditures will be adjusted to government revenues.

Further, this result corresponds to Adolph Wagner's law (Musgrave, 1984), who states that the law of rising public expenditure. Furthermore, Musgave (1984), stated that in the 19th century, government spending in developed countries always increased from year to year in comparison with national income. The main causes of expenditure growth are, first, the purchase of goods and services as a result of growth in people's per capita income, technological changes, an increase in population, an increase in the relative cost of public goods and services, and the movement of people from villages to cities which requires an increase in the number of urban public service facilities and infrastructure. Second, there are changes in the scope and range of transfers made by the government such as increasing old-age insurance, welfare payments to balance income, and others.

The results of this study are in line with research conducted by Prakosa (2004), Ashworth et al. (2005), Iskandar (2012), which states that income levels will have a positive and significant influence on regional expenditure. The higher the income level of an area, the higher the expenditure or expenditure of the area. In addition, the results of this study are also supported by research findings from Dahliah (2022), Septriani (2023), Mbuinga, et.al (2022), Mali, et.al (2021), Sofiyani and Subadriyah (2020), Ferdiansyah et.al (2018), Setiyawan (2018), Bitamala (2018), Apriliawati (2016), Aqnisa (2016), Mangunkusumo (2012), Sidik, et.al (2002), which also found that Local Own-Source Revenue (OSR) has a positive effect on regional expenditure.

Meanwhile, the effect of General Allocation Fund (GAF) on regional expenditure, when viewed based on the results of panel data regression, obtained a General Allocation Fund (GAF) variable coefficient of 1.740974 and positive t-statistics with a probability of t-statistics (0.0131) smaller than $\alpha = 5\%$. This result shows that the General Allocation Fund (GAF) has a positive and significant effect on regional expenditure in Indonesia. That is, when the General Allocation Fund (GAF) increases by 1 billion rupiah, then regional expenditure in Indonesia will also increase by IDR1.740.974.000, and vice versa, if the General Allocation Fund (GAF) decreases by 1 billion rupiah, then regional expenditure in Indonesia will also decrease by IDR1,740,974,000. The greater the general allocation fund to local governments, the greater the regional expenditure carried out by local governments (Halim, 2008).

Based on data obtained from the Directorate-General of Regional Fiscal Balance (Ministry of Finance of Indonesia), the amount of General Allocation Fund (GAF) provided by the central government to regional governments continues to fluctuate and tends to decrease since 2020-2022 with an average decrease of 2.9 percent per year. The decrease in the allocation of general funds was caused by the Covid-19 pandemic. In 2020, the Indonesian government prepared various strategies to carry out handling, such as increasing the budget on the health side, social assistance, industrial support, and national economic recovery as well as policies on the regional financial side and the financial sector. Then, the government ensures budget availability while maintaining the health and sustainability of state finances, the government establishes changes to the Posture and Details of the State Budget. In 2021-2022, the Low General Allocation Fund (GAF) as a result of the covid 19 pandemic. During the 2018-2022 period, the average increase in the General Allocation Fund (GAF) is IDR11.820 billion per year.

According to Maimunah (2006), Maimunah and Akbar (2008), local government expenditures will be adjusted to changes in local government revenues. This research is also in line with the results of research conducted by Rahmawati (2010), which found that partially the General Allocation Fund (GAF) has a positive and significant influence on regional spending. If the General Allocation Fund (GAF) increases, then regional spending also increases, on the other hand, if the General Allocation Fund (GAF) decreases, the amount of regional spending will also decrease. This is because the General Allocation Fund (GAF) is the most important form of fund transfer besides profit sharing. Fund transfer from the central government in the form of General Allocation Fund (GAF) is a fund derived from the state budget allocated to each region as a consequence of uneven regional financial and economic capabilities. In addition, the results of this study are in line with the results of research conducted by Rohmah and Rahardjo (2023), Septriani (2023), Ariyanti, et.al (2023), Dahliah (2022), Mbuinga, et.al (2022), Astutiawaty, et.al (2022), Iqbal, et.al (2021), Mangunkusumo (2012), Fernandes and Fauzia (2022), Mali, et.al (2021), Simanjuntak and Ginting (2019), Bitamala (2018), Apriliawati and Handayani (2016), Apriliawati (2016), Sidik, et.al (2002), and Aqnisa (2016), also found that the General Allocation Fund (GAF) has a positive effect on regional spendingFund transfer from the central government in the form of General Allocation Fund (GAF) is a fund derived from the state budget allocated to each region as a consequence of uneven regional financial and economic capabilities. In addition, the results of this study are in line with the results of research conducted by Rohmah and Rahardjo (2023), Septriani (2023), Ariyanti, et.al (2023), Dahliah (2022), Mbuinga, et.al (2022), Astutiawaty, et.al (2022), Iqbal, et.al (2021), Mangunkusumo (2012), Fernandes and Fauzia (2022), Mali, et.al (2021), Simanjuntak and Ginting (2019), Bitamala (2018), Apriliawati (2016), Sidik, et.al (2002), and Aqnisa (2016), also found that the General Allocation Fund (GAF) has a positive effect on regional spending.

Furthermore, to determine the phenomenon of flypaper effect on the financial performance of provincial governments in Indonesia is to compare the value of the standard beta coefficient and the t-statistical value for each variable. Melo (2002) states that the flypaper effect occurs when the influence (coefficient value) of the General Allocation Fund (GAF) on regional expenditure is greater than the effect (coefficient value) of local own-source revenue (OSR) on regional expenditure, and the value of both is significant. Based on the regression results, the Local Own-Source Revenue (OSR) coefficient value was 1.421945, and the General Allocation Fund (GAF) coefficient was 1.740974. From these results, it can be seen that the value of the General Allocation Fund (GAF) coefficient is greater than the Local Own-Source Revenue (OSR) coefficient. This shows that significantly, the financial performance of provincial governments in Indonesia has occurred a flypaper effect phenomenon. This is because the stimulus to local expenditure caused by changes in the amount of transfers (unconditional grants) from the central government is greater than that caused by changes in local own-source revenue (OSR). The standard coefficient of beta is used to see the relative importance of each independent variable. Likewise, to test the meaningfulness of each coefficient α, $\beta 1$, $\beta 2$ and can be seen in the statistical t value (Ghozali, 2005).

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The results of this study show that the majority of provincial government expenditures in Indonesia still rely on transfer funds from the central government. In fact, the transfer funds from the central government to regional governments are expected to be able to stimulate an increase in the economic independence of each regional government. However, what is happening now is that local governments are not able to increase independence or make local own-source revenue (OSR) the largest source of revenue for local governments. During the 2018-2022 period, the amount of provincial revenue in Indonesia on average came from central government transfer revenue. Regional expenditures sourced from local own-source revenue (OSR) amounted to 25 percent, sourced from central government transfer funds amounted to 67 percent and other sources of revenue amounted to 8 percent. The low role of Local Own-Source Revenue (OSR) in financing regional expenditures shows that the level of independence of provincial governments in Indonesia is still very low. In addition, the low financial independence of the provincial government is also influenced by the type of regional expenditure issued by each regional government. When viewed based on the type of regional expenditure, the majority of expenditure issued by each regional government is employee spending.

In this case, maximum efforts are needed to increase the amount of local own-source revenue (OSR) so that local governments are no longer dependent on the central government in terms of funding to carry out regional development and governance. According to Mamuka and Elim, (2014), the existence of local own-source revenue (OSR) will reduce the dependence of the local government on the central government. During the 2018-2022 period, the average regional expenditure spent on employee expenditure was 33 percent, service expenditure was 26 percent, capital expenditure was 16 percent and other expenditure was 24 percent. If the budget owned by the government is used for productive things, it will have a significant impact on the economy of the region, otherwise if the budget is not used wisely, then the expenditure will not bring improvements to the regional economy.

In this case, regional governments are given freedom in managing their budgets. As the results of research conducted by Dahliah (2022), states that the use of the General Allocation Fund (GAF) is not regulated by the central government, and the General Allocation Fund (GAF) is a fund whose control over its use is really in the hands of local governments, generally the use of General Allocation Fund (GAF) by local governments is based on regional priorities and needs with a view to improving services to societies in the context of implementing regional autonomy. Increasing regional spending is expected to prioritize aspects of public services, so that there is an increase in welfare (increased economic growth) and in turn there is an increase in tax and levy contributions from the societies.

The results of this study are in line with the results of research conducted by Fintari (2020), that there is a flypaper effect in Bima City, which is seen from the size of the General Allocation Fund (GAF) coefficient compared to the local own-source revenue (OSR) coefficient of Bima City. In addition, the results of this study are also in line with research conducted by Pratiwi and Paramita (2016), which found that in districts in Nusa Tenggara Island, Papua Island and Maluku there was a flypaper effect on regional spending. Furthermore, Pratiwi and Paramita (2016) said that to overcome the flypaper effect phenomenon, local governments must be able to increase local own-source revenue (OSR) by exploring regional potentials other than those sourced from taxes. In addition, local governments must also increase investment by creating regional-owned enterprises in the productive business sector, and using regional expenditures that are adjusted to the potential of the region.

V. CONCLUSION

Based on the results of panel data regression, it was found that partially each variable of local own-source revenue (OSR), General Allocation Fund (GAF) had a positive and significant impact on the regional level of exploration in Indonesia. Meanwhile, simultaneously local own-source revenue (OSR), General Allocation Fund (GAF) has a positive and significant impact on regional expenditure in Indonesia with an Adjusted R-squared amount of 97.07 percent. Then, if you look at the flypaper effect phenomenon, it can be concluded that there is a flypaper effect on the financial performance of provincial governments in Indonesia. Based on the results of this research, each provincial government in Indonesia should increase Local Own-Source Revenue (OSR) to be used as the main source of regional spending, then local governments must also prioritize the use of regional spending for productive things, so that with the transfer funds the central government can increase the financial independence of local governments and ultimately can minimize dependence on the central government. The limitations of this research are that this research only focuses on the General Allocation Fund (GAF) as a source of funds from the central government.

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