

The Importance of Regional Original Income, Balance Fund and Demography on *Flypaper Effect* through the Regional Government Expenditure

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ABSTRACT

The purpose of this study was to investigate the effect of regional original income, balancing funds and demographic on flypaper effect. An explanatory research work was used with sampling method on 38 cities in East Java Province. Analysis techniques were carried out using path analysis. The results of the study show that regional original income, balancing funds, and demographics influenced on government expenditures. Regional original income and balancing funds affected the flypaper effect. Demographics had no effect on the flypaper effect. The government expenditure affected on the flypaper effect. Regional original income and balancing funds affected the flypaper effect through government expenditure. Demographics did not provide an effect to the flypaper through the government expenditure.

Keywords: Regional original income, Balancing fund, Demographic, Flypaper effect, Government expenditures

INTRODUCTION

Regional autonomy is not an easy challenge, because of regional autonomy must be based on the awareness that regional autonomy is an opportunity for local government to prove its independence. This means that regional autonomy cannot be seen as a failure. The implementation of regional autonomy must be directed to accelerate the realization of community welfare through empowering roles of community and increasing regional competitiveness. Transfer funds called also balancing funds, consist of profit sharing, general allocation, and special allocation funds. In addition to the balancing funds, the regional government also has its own funding source in the form of local revenue. Policy funding of all these funds is submitted to the regional government. These balancing funds have different goals among each other. All balancing funds are channeled into regional income and expenditure budget. Therefore, the regional government must provide a responsibility to the house of representative based on Ministry of Home Affairs Regulation Number 13 of 2006. Regional expenditure is

classified into direct and indirect expenditures. The central government also provides loans and assistances to the local government. The transfer fund is the fiscal policy of the central government in the framework of implementing regional autonomy in order to reduce fiscal gap between the center and the region, as well as between the regions themselves, and reduce regional disparity in public services.

Regional revenue is all regional government revenues originating from regional economic sources. Optimization of receipt of original income of regions shall be encouraged by local government by improving the quality of public services (Mardiasmo, 2009). Regional government financing is conducted on top burden of regional income and expenditure budget. In the framework of organization, local government is provided an authority to take taxes and to manage natural resources. Original ability of most regions reflected in regional revenue is only capable to collect not more than 15% of the value of the regional revenue and expenditure budget. Therefore, the shortcomings must be assisted by the central government

through balance fund mechanism, such as profit sharing funds, general allocation funds, and special allocation funds, that complement each other (Usman *et al.*, 2008).

The low financial capacity of the local region often causes a negative cycle, namely, the low quality of community service may invite interference from central government, which will eventually cause the transfer of some functions of the regional government to the central government level (Isdijoso and Brahmantio, 2002). Receipt of local governments originating from central government in the form of balancing funds is stimulation for the local governments on regions spending. The transfer funds create a difference in regional income especially in regional taxes. The results in evaluating the use of fiscal balance funds in Indonesia showed that the regional government is very dependent on the central government transfers to finance limited regional income with the level of government spending (Hofman *et al.*, 2006).

The fiscal dependence on transfer funds of regional government to central government, called as a flypaper effect (Aragon 2009), is the condition in which local government spending are more likely to respond the transfer funds income from central government rather than local revenue. If the dependence of local government on the transfer funds is greater than that on local original income, then this indicates the occurrence of a flypaper effect. The flypaper effect can also cause an asymmetry when fiscal changes occur. When general allocation funds increase, regional governments will spend extra income, but when the amount of general allocation funds decreases, regional spending are not reduced (Junaidi, 2012). Fiscal behavior of local governments in responding the transfers from the central government is a major concern in supporting the effectiveness of transfers. In practice, transfers from the central government are the main funding source for regional government to finance its main daily operations, in which by regional government is reported and calculated in the regional income and expenditure budget. The purpose of this transfer is to reduce fiscal disparity between governments and guarantee the achievement of minimum public service standards throughout the country (Sidiket *al.*, 2002). Empirical evidence shows that the high dependence on

transfers is negatively related to the results of government (Mello and Barenstein, 2001).

In fact, some regions in Indonesia have not been able to maximize the potential of the region. Thus, it still relies heavily on balancing funds, especially general allocation fund. According to data from the Ministry of Finance of the Directorate General of Balance Finance, the balance fund reaches 73% where most of the balance funds (amounting to 67%) are a general allocation fund. It is seen that the regional government is still highly dependent on transfer funds. According to Melo (2002) in Rokhaniyah and Nugroho (2011) flypaper effect is a condition where the response of regional expenditure is greater for transfers.

The phenomenon of flypaper effect brings wider implications that the transfer will increase regional government spending which is greater than revenue of local government itself. A flypaper effect is not only found on low-income regional governments but also on high-income regional government and on agrarian or non-agricultural regency/city. Flypaper effects, in the various regions, produce a contradictive conclusion with indications that the flypaper effect does not only occur in the research local government. Gorodnichenko (2001) stated that the flypaper effect phenomenon can occur in two versions. First, it refers to increase regional taxes and excessive government budgets. Second, it leads to higher expenditure elasticity of transfers rather than expenditure elasticity for local tax revenues.

Effect of local revenues, balancing funds and demographics on flypaper effect through regional expenditure produces various different conclusions. Mentayani *et al.* (2012) stated that the results of the study in a region cannot be generalized to other regions, because each region has its characteristics, whether in terms of geography, people's lives and economic conditions. Different allocation of transfer funds in each local government raises difference (gap) between the implementation of decentralization and regional autonomy expected. By considering the fact happened above, it would become an important idea to conduct this research.

The purpose of this study was to analyze the effects of regional revenues, balancing funds and demographics on regions expenditures, to

The Importance of Regional Original Income, Balance Fund and Demography on *Flypaper Effect* through the Regional Government Expenditure

analyze the effect of regional original income, balancing funds and demographics of flypaper effect, to analyze the effect of regional expenditures on flypaper effect, and to analyze the influence of regional original income, balancing funds, and demography of flypaper effect through local regional expenditures in East Java province.

FLYPAPER EFFECT

According to Vegh and Vuletin (2015), the flypaper effect is widely documented as a regulation in public finance that holds the tendency of local governments to spend transfer funds higher than spending their own regional income. Hamilton (1983) also defines the flypaper effect as the tendency of local governments to rely more on transfer funds rather than using regional own-source revenues. The flypaper effect is seen as an oddity in behavior that is difficult to rationalize, where local governments use funds received from the central government to increase regional spending that is inconsistent with economic theory (Hines and Thaler, 1995).

Sagbas and Saruc (2008) stated that there are two main theories from several studies on the source of the emergence of flypaper effects that are often used, namely fiscal illusion and the bureaucratic model. The fiscal illusion theory suggests that the flypaper effect occurs due to the ignorance or indifference of the local community regarding financing and spending and decisions taken as a result of these misperceptions. Schwallie (2008) stated that the essence of the flypaper effect in the model of the fiscal illusion on government transfers actually produces output requested by the public, but people's demand for public goods is based on misperceptions about how to finance public goods and the distribution of costs borne by the public. In other words, the regional people indeed see the actual output of government spending on public goods and the benefits obtained, but have a wrong perception about the source of the expenditure financing that comes from central government transfers, which should also be borne by the regional government such as through regions taxes to increase the original income of the region as well.

REGIONAL OWN-SOURCE REVENUE

Halim (2002) states that regional own-source revenue is all regional income that comes from regional native economic sources. Regional

original income is one of the components of regional revenue, in addition to the balance funds and other valid regional income. The types of income that can be classified as regency/municipal original revenues are regional taxes, regional levies, the results of the management of separated regional assets, and other legitimate regional original revenues

BALANCE FUNDS

Reality shows that not all regions are able to escape from the government center, because the level of needs of each region is different, which in the end the government transfers funds. This fund transfer is in the form of a balancing fund. Balancing fund consists of: (1) general allocation funds aimed at equitable financial capacity between regions that are intended to reduce inequality in financial capacity between regions. The total number of general allocation funds is set at least 26% of Net Domestic Revenues determined in the state expenditure budget. General allocation fund for a region determined on the size of the fiscal gap of a region, which is difference between regional needs and regional potential; (2) allocation funds specifically intended to help financing special activities in certain local governments in accordance with national priorities, especially for finance the needs of basic community service facilities and infrastructure; (3) Revenue-sharing funds are funds sourced from income state expenditures that are divided into regions. Profit sharing funds originate from taxes and natural resources

GENERAL ALLOCATION FUNDS

General allocation funds are authorized grants that are fully handed over to the recipient local government. Financial balance between the central and regional governments gives the understanding that general allocation funds are funds sourced from revenue received from state revenues and expenditure allocated for equitable financial capacity purposes among regions. General allocation funds are meant for even distribution of financial capabilities between regions intended to reduce inequality in financial capacity between regions. Funding general allocations are prioritized in regions that have low fiscal capacity where the local government has not been able to maximize the local revenue because of something. For regions that have high fiscal capacity precisely will get a smaller amount of general allocation funds, hence it is expected to be able to reduce fiscal

The Importance of Regional Original Income, Balance Fund and Demography on *Flypaper Effect* through the Regional Government Expenditure

imbalances between regions. General allocation funds prioritize their use to fund salaries and employee benefits, employee welfares, operations and maintenance activities as well physical construction of facilities and infrastructures in order to improve basic services and public services needed by the community.

DEMOGRAPHICS

Demography is a term derived from two Greek words, namely *demos* means people or residents and *graphein* means drawing or writing. Bogue (1973) defines demography as a study of statistics and mathematics about the size, composition and distribution of population and changes over time through the work of five demographic components, namely fertility, mortality, marriage, migration and social mobility. Demography can be interpreted as a description of the population, especially about birth, marriage, death and migration. Demography also includes scientific studies about the number, geographical distribution, composition of the population, and how these factors change from time to time. Demographics are also expressed as formal demographics who pay attention to population, distribution, population structure or composition, and population dynamics or changes. The size of the population states the number of people in a region at a certain time, both based on geography and concentration of residential local governments. The population structure states the composition of the population by sex or age group. Demographics also pay attention to various individual characteristics and groups that cover social, cultural and economic levels. Characteristics social can include family status, place of birth, and education level. Economic characteristics include economic activity, type of work and income.

REGIONAL EXPENDITURES

Regional expenditure is all regional obligations recognized as a deduction from net worth in the period related fiscal year. Expenditure differs from expenditure financing. The difference lies in whether or not there is a refund which has been issued. Local governments will not get payment returns to expenditure incurred, both in the current fiscal year and in the next fiscal year. While financing expense is the expenditure that will be repaid in current year budget or in the

next fiscal year. According to Government Regulations number 71 of 2010 concerning government accounting standards, regional expenditure structures used in regional income and expenditure budgets are classified according to economic classification, namely: operating expenses; capital expenditure, and unexpected expenditure. Operational expenditure is the expenditure of the budget for local government's daily activities that provide short-term benefits. Expenditure operations consist of employee expenditure, goods expenditure, interest expenditure, subsidy spending, grant spending, and social assistance spending. Capital expenditure is budgeted expenditure to purchase or procure fixed assets and other assets to be used in governmental activities. Capital expenditure consists of land expenditure, equipment expenditure and machinery, expenditure for buildings; road expenditure, irrigation and networks, asset expenditure fixed and others, and other asset expenditures. Unexpected expenditure is expenditure for activities that are unusual and expected not to be repeated like disaster management, social disasters and other unexpected expenses are very much needed in the context of implementing the authority of the central government or local government. Unexpected expenditure includes handling expenses disasters and spending on implementation of authority.

RESEARCH METHODS

Research Design

According with the subject matter and objectives of the study, this study applied an explanatory research, which was intended to explain the relationship or influence between two or more variables. It was studied the influence of regional original income, balance funds and demographics against flypaper effect and regional expenditures. The samples of this study were 29 regencies and 9 cities in East Java Province.

Operational Definition of Variables

Based on conceptual definitions and empirical studies, operational definitions of research's variables are:

Regional Original Income (PAD)

Regional original income is the realization of regional revenues sourced from regional taxes, regional levies, result of separated regional

The Importance of Regional Original Income, Balance Fund and Demography on *Flypaper Effect* through the Regional Government Expenditure

wealth management and other receipts of legitimate regional revenue. PAD in this study was calculated using the following formulation:

$$PAD = PD + RD + HPKD + LPAD$$

Information:

PD: Regional tax

RD: Regional retribution

HPKD: Results of regional resources management

LPAD: Others legitimate local revenue

Balancing Fund (DP)

Balancing fund is a source of regional income originating from the state budget revenue (APBN) to support the implementation of regional government authority in achieving the purpose of giving autonomy to the regions, especially to improve services and community welfare getting better.

In this study, balancing funds were sourced from general allocation funds, which are the total transfers from the central government in the general form. Special allocation funds are total transfers from the central government in the particular form, as well as revenue sharing funds from the central government in the form of profit sharing tax and non-tax collection. Balancing funds in this study were measured using the following formulations:

$$DP = DAU + DAK + DBH$$

Information:

DAU : General allocation funds

DAK : Special allocation funds

DBH : Fund for profit sharing

Demography (DM)

Demographics in this research work were the population of East Java Province.

Regional Expenditure (BD)

Regional expenditures are all regional cash expenditures that are directly or indirectly related to the program or activity carried out by local government. Regional expenditure in this study used formulations as follows:

$$BD = BL + BTL$$

Information:

BL: direct expenditure

BTL: indirect expenditure

Flypaper Effect

Flypaper effect is a condition occurred due to the regional government use more balancing funds (the general allocation fund, special allocation funds, funds profit sharing) rather than use their one's own abilities (locally generated revenue). The flypaper effect (FE) in this study was characterized by degree of fiscal autonomy (DOF) with the following formulation:

$$DOF = \frac{\text{Regional Original Income}}{\text{Total Income}}$$

Data Analysis

Path analysis was used in this research to find out relationship between a set of variables. Path analysis models are similar to multiple regression models. Regression equation models and images pathway were used to analyze the influence of PAD, DP, DM on flypaper effects and regional expenditure (BD), with the following formulations:

1. Model 1

$$BD = \rho_{BD.PAD} \cdot PAD + \rho_{BD.DP} \cdot DP + \rho_{BD.DM} \cdot DM + \varepsilon_1$$

2. Model 2

$$FE = \rho_{FE.PAD} \cdot PAD + \rho_{FE.DP} \cdot DP + \rho_{FE.DM} \cdot DM + \rho_{FE.BD} \cdot BD + \varepsilon_2$$

Where:

FE = Flypaper Effect

BD = Regional Expenditure

PAD = Regional Original Income

DP = Balancing Funds

DM = Demography

$\rho_{BD.PAD}$ = contribution coefficient of Regional Original Income to *Regional Expenditure*

$\rho_{BD.DP}$ = contribution coefficient of the Balancing Fund to *Regional Expenditure*

$\rho_{BD.DM}$ = contribution coefficient of Demographic on *Regional Expenditure*

$\rho_{FE.PAD}$ = contribution coefficient of Regional Original Income to *Flypaper effect*

$\rho_{FE.DP}$ = contribution coefficient of the Balancing Fund to *Flypaper Effect*

$\rho_{FE.DM}$ = contribution coefficient of Demographic on *Flypaper Effect*

The Importance of Regional Original Income, Balance Fund and Demography on *Flypaper Effect* through the Regional Government Expenditure

$\rho_{FE.BD}$ =contribution coefficient of Regional Expenditure on Flypaper Effect

ε_1 = the remaining value of model 1

ε_2 = the remaining value of model 2

RESULTS

Descriptive Analysis

The data used in this study was secondary data in the form of reports of the regional budget revenue (APBD) for district and

city government in East Java Province. Data on regional revenue, regional expenditure and balance funds (general allocation funds, special allocation funds, and revenue sharing funds) were originated from the APBD realization report for all Regencies / Cities in East Java Province during the period 2015-2017. The results in Table 1 presented descriptive statistics regarding regional original income, balance funds, demographics, regional expenditure and flypaper.

Table1. Descriptive statistics on the values of PAD, DP, DM, BD and FE

Variabel	Minimum	Maximum	Mean	Std. Deviation
PAD	104.233.584.925	4.212.569.176.921	382.073.247.702	641.961.093.386
DP	457.456.088.791	2.750.148.976.272	1.302.187.289.270	467.773.164.595
DM	120.623	2.848.583	1.008.978	636.160
BD	706.783.751.689	8.561.848.147.400	2.166.778.629.761	1.159.018.091.120
FE	1,61	14,97	8,29	2,91

Table 1 shows that PAD ranged from Rp. 104,233,584,925 to Rp. 4,212,569,176,921 with an average of Rp. 382,073,247,702. This indicates that the regional government varied in local revenues. PAD was the realization of regional income sourced from regional taxes, regional levies, results of regional separated wealth management and other receipts of legitimate local revenue. PAD in this study was assessed using an indicator of original tax regency / city in East Java Province that has been realized.

Balancing funds ranged from Rp. 457,456,088,791 to Rp. 2,750,148,976,272 with an average of Rp 1,302,187,289,270. The balance funds sourced from general allocation funds, particular allocation funds, and profit sharing funds from the central government in the form of revenue sharing tax and non-tax. The indicator of balance funds in this study was realization of the regional general allocation funds in East Java Province, of regional particular funds and realization of regional revenue sharing funds in East Java Province for three consecutive years of 2015-2017.

Demographics ranged from 120,623 to 2,848,583 with an average population of

1,008,978 people. Population changes declared a population increase or a decline in population as a result of changing the three main components of birth, death and migration.

Regional expenditure ranged from Rp. 706,783,751,689 to Rp. 8,561,848,147,400 with an average of Rp 2,166,778,629.76. Regional expenditure is very important to evaluate whether the local governments have been using APBD economically, efficiently, and effectively. Local governments in East Java Province have made efficiency budget by far; avoiding unnecessary expenses and improper spending target.

Flypaper effects ranged from 1.61 to 14.97 with an average of 8.29. These values indicate that local governments have not been optimal in exploring potential income to finance the regions and would be continuously dependent on the central government.

Path Diagram

In order to complete path analysis, it is necessary to know the path coefficient and path diagram. Path coefficients and the parameters are presented in Table 2.

Table2. Summary of parameter results in the model

Model	Contribution Coefficient	T	P Value	R	Adjusted R ²
Sub Structural 1					
PAD	0,186	4,459	0,000	0,975	0,949
DP	0,309	8,539	0,000		
DM	0,544	10,401	0,000		
Sub Structural 2					
PAD	-1,403	11,906	0,000	0,814	0,650
DP	0,462	3,798	0,000		
DM	0,183	0,954	0,342		

The Importance of Regional Original Income, Balance Fund and Demography on *Flypaper Effect* through the Regional Government Expenditure

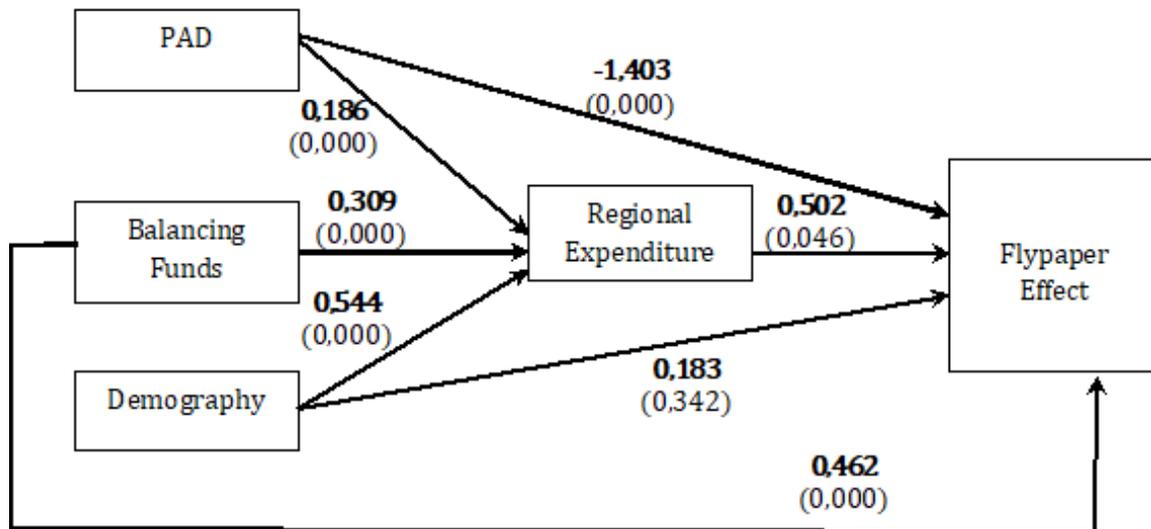


Figure1. Empirical path diagram of flypaper effect

Noted: the bold values are contribution coefficients, the values in brackets are significant levels

Based on the results in Table 2 and Figure 1, the effects can be described as follows:

- 1) PAD had a positive direct effect on regional expenditure indicated by the path coefficient of 0.186 and a significant level of 0.000 < 0.05.
- 2) DP had a positive direct effect on regional expenditure indicated by the path coefficient of 0.309 and a significant level of 0,000 < 0.05.
- 3) DM had a direct positive effect on regional expenditure indicated by the path coefficient of 0.544 and a significant level of 0.00 < 0.05.
- 4) PAD had a negative direct effect on the flypaper effect indicated by the path coefficient of -1.403 and a significant level of 0.000 < 0.05.
- 5) DP had a positive direct effect on the *flypaper effect* indicated by the path coefficient of 0.462 and a significant level of 0.000 < 0.05.
- 6) DM did not have an *effect* on the *flypaper effect* as shown by the path coefficient of 0.183 and a significant level of 0.342 > 0.05.
- 7) Regional expenditure had a positive direct effect on the *flypaper effect* indicated by the path coefficient of 0.502 and a significant level of 0.0406 < 0.05.

DISCUSSION

Effect of Regional Original Income, Balancing Funds and Demography on Regional Expenditures in East Java Province

Regional Original Income had an effect on regional expenditure. This means that the local revenues are an important source of income for a region in fulfilling expenditure. Regional original income can also represent the level of independence of a region. The more PAD obtained by the local governments can allow them to meet the needs of their own expenditure without depending on the central government. Therefore the local governments could be able to be independent, and vice versa. Regional original incomes were obtained from regional taxes, regional management results and other legitimate local revenues in the regencies in the East Java Province. Purpose of the local governments to optimize all revenues originated from local economic sources is to provide flexibility to regions in digging up funding in the implementation of regional autonomy as the realization of the principle of decentralization. Based on the data collected and analyzed for the 2015-2017, the regencies PAD in East Java Province were experienced dynamics (rising and down). The PAD influence on the regional expenditures was positive, meaning that the increases in the regional original income could increase the regional expenditures of regencies in East Java Province. The results of the Regional Original Revenue have an effect on spending regions, for regional governments is a source of funding in carrying out its authority, while the lack of

funding is expected to be explored through own funding source, namely Regional Original Income. PAD is expected to create better utilization to help funding activities that are regional affairs' and in accordance with national priorities.

Regional Original Income revenue shows the ability of an local government to collect sources of funds to finance the development activities of the local government. So that local revenue is income routine was received by the regional government from efforts to utilize the potential financial resources to finance tasks in each region. Thus, PAD is needed to support Regional Expenditures. Increased spending regions to accelerate the pace of development and economic growth regions, local governments can seek to increase PAD, each element in it are elements that need to be improved. In line with (Mardiasmo, 2002), that the optimization of regional income revenue should be supported by local government efforts to improve the quality of public services. The government can identify local sources of income by undergoing researches, determining and deciding which source actually is local revenue by researching and managing large resources of income to provide maximum results. Role government in development is a catalyst and facilitator require various supporting facilities, including the budget in the framework of implementing sustainable development, PAD in each region is different. Regions that have advances in industry and own abundant natural wealth tends to have much better PAD compared to other regions, and vice versa. The results of this study are consistent with Masdjojo and Sukartono (2009) which state regional original income to regional expenditure.

The results of the study indicate that there is an influence of the Balancing Fund towards Regional Expenditures in Districts / Cities in East Java Province. Balancing funds can encourage regional spending for National development activities. This indicates that the local government still has great dependence on the central government in financing expenses and regional expenditure. However, in the long run, this kind of dependency this must be smaller.

Various investments made by the regional government are expected to provide positive results, so that more independent local

governments can exploit their potential and resources in the local government to be able to fulfill regional expenditure and not depend on the central government in terms of financing local government expenditure. Alfian (2009), Wahyuni and Pryo, (2009) mention that "Revenue Sharing Funds (DBH) are a potential source of regional income and is one of the basic capital of the local government to obtain development funds and fulfill regional expenditures other than those originating from Original Income Regions, General Allocation Funds and Special Allocation Funds. Research conducted by Indra (2010), states that the results made show that Regional Original Income, Profit Sharing Funds and General Allocation Funds simultaneously and partial have positive effect on regional expenditure.

Balancing Funds are funds originating from the state budget revenues allocated to regions by taking into account the potential of regions based on certain percentage numbers to fund regional needs in order to implement the decentralization (Deddi, 2007). Balancing Funds are intended to overcome vertical imbalances between levels of government (revenue sharing and general allocation funds) by equating the fiscal capacity of regional governments to encourage spending regions for national development priority activities, encourage achievement of services and minimum standards, and stimulate income mobilization. Balancing funds, one of them is profit sharing funds, is a quite potential regional income source and is one of the basic capital local government in obtaining development funds and fulfilling spending local government. Carol (2005), with a positive influence, and in line with Iskandar (2012) state that these conditions indicate *flypaper* for with the stimulus of regional expenditures caused by changes in the amount of transfers from the Central Government are greater than those caused by changes in Regional income. Likewise, Masdjojo and Sukartono (2009), analyze the effect of Regional Original Income and Balancing Funds on Regional Expenditures, and analyze the *effect of* Regency / City *flypaper* in Central Java. Balancing Funds used are General Allocation Funds, Special Allocation Funds, and Revenue Sharing Funds. This research was conducted in the period 2006 to 2008, with the object of research up to 35 districts / cities in Central Java that have submitted financial statements. The results of this study are

The Importance of Regional Original Income, Balance Fund and Demography on *Flypaper Effect* through the Regional Government Expenditure

supported by empirical studies that has been proposed so that there is an influence of the Balancing Fund towards Regional Expenditures in Districts / Cities in East Java Province.

The results showed that there was a demographic influence on Regional Expenditures in Districts / Cities in East Java Province. Projection demographics with the population show a positive effect, which means if the demographics increased, regional spending also increased. The total population plays an important role because it provides labors, experts, company leaders and business people needed to create economic activity. In addition, population growth has resulted in increased and complex needs, yet suppliers are also users of both goods and services themselves. Home sector and the production sector do have to be mutually beneficial in various ways combination of the flow of goods and services. Development activities are carried out by the region as a demand from the community, this will affect both increased or reduced number of activities and budgets for regional expenditures, as expenditure on the implementation of compulsory affairs can be prioritized to protect and improve the quality of life of the community in an effort to fulfill regional obligations manifested in the form of improving basic services, education, health, decent social facilities and public facilities and develop a guaranteed social system.

The relationship between the two variables is positive along with the increasing government demographic factors and spending as well. The distribution local government that has not been evenly distributed and is not on target, their Regional Expenditures focus on urban local governments while in remote local governments / not yet development is still minimal, resulting in infrastructure, facilities and infrastructure, the level of education and health has not been evenly distributed. GRDP increase during the 2015-2017 period, thus per capita income increased every year as well. In general, this shows success efforts to increase the number of gross regional domestic products and controlling population. One measure of economic growth according to Todaro (2004: 92) is the process of increasing output per capita which is proxied by Gross Regional Domestic Product (GRDP) per Capita which is defined as the amount added value generated from all business units in a region, or is the sum of all final goods and services produced by all economy units in an

local government. Capital accumulation used for implementing development can be influenced by a balance fund which is one of the development capital, from here comes the *flypaper effect*, GDP as an indicators of demographics show a good influence so with the increase in indicators of demographics, regional spending will also experience enhancement.

Effects of Regional Original Income, Balancing Funds and Demographics Against Regency / City Effect *Flypaper* in East Java Province

The results of the study show that there is an influence of local revenue against *flypaper* effects in regencies / cities in East Java Province. In other words the discovery of *flypaper* effects on expenditure allocation, is expected to decrease possible excessive response to regional spending. This matter in line with Wulansari (2015) shows that there is a *flypaper* effect on Government expenditure in East Java, Central Java and West Java provinces, this happened because the influence of DAU on Regional Expenditures is higher than that of the influence of PAD on Regional Expenditures. Tresch (2002: 920), further states that *Flypaper Effect* itself is a response that is not symmetrical or asymmetrical towards increasing and decreasing use of transfer funds from the central government, transfer funds are given for a certain period of time with an indication of existence of people that benefit from the increasing inclined transfers (grants). Along with the increase in Regional Expenditures this will also be raises *Flypaper Effect*. This is consistent with the opinion of Hines and Thaler (1995) that *flypaper* effects are considered an oddity as those are difficult behavior to be rationalized, where the Regional Government uses the transfers received from Central Government to increase Regional expenditures that are inconsistent with economic theory.

Increased Regional Expenditure signifies an increase in quality of life society is realized through work performance in achieving service standards at a minimum based on obligatory functions of regional government in accordance with regulations legislation. The policies stipulated in accompanying financing regional expenditure that can be taken is the optimization of sources of revenue the most likely funding can be done quickly, besides that used to meet the needs of financing expenses arising from

The Importance of Regional Original Income, Balance Fund and Demography on *Flypaper Effect* through the Regional Government Expenditure

capital participation and payment of principal debt due. Development source of regional revenue will have an impact on the amount of transfer funds received by the region, this is very much needed by regions to develop according to own ability. Implications of increased ability of the region in financing its expenditure needs is the fiscal local government able to meet their expenditure needs so that the fiscal gap between regions can be overcome.

Demographics have no effect on flypaper effects, which means that either high or low demographics that are proxied by the population do not have an impact on flypaper effect. Wallpaper effect as a result of more flexible bureaucrat behavior spending transfers rather than raising taxes.

Regional Expenditure Influence on Regency / City Flypaper Effect in Province East Java

The results of the study indicate that there is an influence of regional expenditure on *Flypaper Effect* in Regency / City in East Java Province. The occurrence of a *flypaper effect* influenced by the tendency to increase regional spending or in other words that the Regional Government determines regional expenditure policies in the year runs more determined by the DAU that has been received in the previous year period than PAD received in the previous year period. The results of this study are consistent with Baskaran (2012) also in line with other studies conducted in America Unions (Clark and Whilford, 2011), Argentina (Vegh and Vuletin, 2015), China (Liu and Zhao, 2011), Denmark (Kjaergaard, 2015), Italy (Bracco *et al.* 2015), Japan (Kakamu *et al.* , 2014), Canada (Mehiriz and Marceau, 2014), Slovenia (Pevcin, 2014) and Sweden (Dahl-berg *et al.*, 2008).

Regional Expenditures include all expenses from the regional general cash account which reduce the equity of funds, is a regional obligation in one fiscal year and the payment will not be obtained by the region. Expenditure the local government used in the framework of funding the implementation of government affairs that become the authority of the province or district / city which consists of obligatory affairs, matters of choice and affairs that handle it in certain parts or fields that can carried out jointly between the government and regional government or between governments regions stipulated by statutory provisions. Expenditure the implementation of business must be prioritized to protect and improve the quality of

life of the community as an effort to fulfill regional obligations manifested in the form of improving basic services, education, health, facilities social and public facilities that are feasible and develop social security systems. *Flypaper effects* occur because of the superiority of bureaucrat knowledge about transfers. More information that is owned by bureaucrats allows it to provide expenses the excess.

Effect of Regional Original Income, Balancing Funds and Demography on Flypaper Effect through Regency / City Regional Expenditures in East Java Province

The results of the study indicate that there is an influence of Regional original Income and balance funds for the *Flypaper Effect* through Regional Expenditures, however Demography does not affect the *Flypaper Effect* through Regional Expenditures District / City in East Java Province. Direct and indirect effects of PAD For *Flypaper Effect*, PAD has a very strong direct effect but with the value of indirect influence is also very strong, meaning more PAD increases, regional spending also increases and both are increasingly raises the existence of *Flypaper Effect*. PAD which consists of Regional Tax, Retribution Regions, Regional Wealth Management Results and other Regional Original Income Legitimate will cause *Flypaper Effect*. Regional original Government is an indicator of regional independence as mandated by Law Number 32 of 2004 about Regional Autonomy. Regional taxes and regional levies are sources regional revenues that are significant enough to be able to finance regional expenditures.

This result leads to Chang and Ho (2002), that income relations and extensive regional spending since the late 1950s. Aziz (2000) and Doi (1998) explain that various hypotheses about the relationship have been tested empirically. Some studies state that income affects spending and others state that spending affects income. Holtz-Eakin *et al* (1985) states that there is a very close relationship between transfers from the government with regional expenditure. Legrensi and Milas Studies (2001) in Prakosa (2004), using a *sample of municipalities* in Italy, found empirical evidence that in the long run the transfer from the government affects regional spending.

Generally, the annual increase in the absorption of Regional Expenditures shows acceleration of development in the local government, but if the

The Importance of Regional Original Income, Balance Fund and Demography on *Flypaper Effect* through the Regional Government Expenditure

growth of this expenditure moving up every year can indicate a *flypaper effect*, because most of the regional revenue sources come from transfer funds. Response that excessive use of transfer funds will result in the local government tend to depend on the central government, for that the central government should make the performance of monitoring and evaluating on local government in order monitor, control and evaluate. Specifically they assert that policy variables, this indicates a *flypaper effect*, this study also in line with Maimunah (2006), *flypaper effect* is a condition that occurs when the local government responds to spending more / wastefully with use transfer funds (*grants*) that are proxied by DAU (Allocation Funds) General rather than using one's own abilities, proxied by (PAD) Locally-generated revenue. The phenomenon of *flypaper effect* has broader implications that transfers will increase regional government spending which is greater than on receipt of the transfer itself.

The results of this study also sharpen that the *flypaper effect* increases regional government expenditure greater than the receipt of the transfer itself (Turnbull, 1998: 18) and the tendency to wait for help from the center rather than manage the local government's own resources. There are several implications from the occurrence of a *flypaper effect* on district/city expenditure implicitly, such as: cause the *fiscal gap* (*Fiscal gap*) will remain. *Fiscal gap* is a framework of central government policies in providing DAU to the regions, then if they occur *flypaper effect* means that the achievement of transfer funds is not optimal. This is visible in analyzing DAU development and regional expenditure. Excessive response in the use of transfer funds where the central government should make a performance monitoring and evaluation of local governments in order to monitor, control and evaluating the use of DAU funds, this is needed to prevent the response excessive disclosure of DAU revenues in the resulting local government lack of regional financial independence in districts / cities concerned (Walidi, 2008: 35).

CONCLUSION AND SUGGEST

CONCLUSION

This study aims to analyze local revenue, balancing funds and demographics of the *flypaper effect* through regional spending at Regency / City of East Java Province. The results of the study show:

1. Local revenue originates from regional taxes, regional levies, yields management of separated regional wealth and other income receipts legitimate native local government. The biggest regional income is taxable local government. Balancing funds come from general allocation funds, special allocation funds, and revenue sharing funds from the central government. General allocation funds provide the biggest contribution to the balance fund. Demographics that are proxied by the total population in the Regency / City in East Java Province can generally be said to increase slowly.
2. Regional Original Income, Balancing Funds and Demographics affect Regional Expenditures in Districts / Cities in East Java Province. Positive influence where if Regional Original Income, Balancing Funds and Demography increase, it will increase the Expenditure of Regency / City Region in the Province East Java or otherwise.
3. Regional Original Income and Balancing Funds affect *flypaper effect* in Regency / City in East Java Province, while Demography is not affected by the *flypaper effect* in regencies / cities in East Java Province. Lower regional Original Income than balancing funds can increase Regency / City *flypaper effect* in East Java Province or otherwise.
4. Regional Expenditures affect the *flypaper effect* in the Regency / City in the Province East Java. Positive influence where if Regional Expenditure increases, it will increase the *effect of* Regency / City *flypaper* in East Java Province and vice versa.
5. Regional Original Income and Balancing Funds have an effect on *Flypaper Effect* through Regional Expenditures in Districts / Cities in East Java Province, while Demography does not affect *Flypaper Effect* through Expenditure Regions in Regencies / Cities in East Java Province. If Regional Original Income and balancing funds increase, can increase Regional Expenditures, this too will increase the Regency / City *Effect Flypaper* in East Java Province or otherwise.

SUGGEST

Based on the results of the study, and some conclusions that have been stated the suggestions submitted in this study are as follows:

Practically

- a. From the results of this study can be used as a source of information to The Central Government and the Regional Government recognize the effect of Revenue Original Region, Balancing Funds, and Demography on Flypaper Effect Through Regional Expenditures and can encourage the independence of the Region within the implementation of regional autonomy, especially at the Regency / City Government in East Java Province.
- b. Demography is a change in population dynamics caused by fertility (birth), mortality (death), and migration (displacement). The public does not understand the decrease in costs that occur is at cost average or marginal cost. The community only believes in the price of public goods will decrease. If the demand for public goods is not elastic, then the transfer resulting in a tax increase for the community. This means a *flypaper effect* is a result of ignorance of the public on the government budget local government.
- c. In an effort to increase regional original income, the Central Government should be better and the Regional Government conducts related policy making with planning, control and evaluation of the Revenue Budget State Expenditures and Regional Expenditure Budget, as well as Accompanying Government Laws and Regulations.
- d. The results of this study were also used as a basic for increasing original income Regions so that Local Governments Don't Always Hang Funds transfer from the Central Government.

Theoretically

- a. In the study of Regional Revenue, Balancing Funds and demographics as well Regional Expenditures, in order to include other components of regional revenues which are valid as a research variable because it is a component of regional income.

- b. In the study of regional spending and analysis of the *flypaper effect*, we can find out more detailed, so that the next researcher provides clearer indicators, so that clearer in taking data and more valid.

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