FLYPAPER EFFECT ON REGIONAL CAPABILITY OF DISTRICTS/CITIES IN WEST NUSA TENGGARA

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Abstract

This research aims to provide empirical proof that (a) unconditional transfer influence the regional finance capability and local expenditure, (b) flypaper effect occurred in fiscal decentralization policy at west nusa tenggara municipalities. Transfer of funds encourage the increase in the expenditure of local goverment. Using secondary data from the local government budget realization covering the period 2001-2015, we analyzing the contributions of unconditional transfer and regional finance capability to local expenditure. The results of this research by using partial least square showed unconditional transfer has significant effect to the regional finance capability and local expenditure. Other result indicate occurrence of flypaper effect, unconditional transfer have positif and significant effect on local expenditure more than regional capability. These indicated that local government still depend on unconditional transfer to realize number of local expenditure and regional capability. The implication of this research can use as the base of local government decision making on local own revenue and intergovernmental revenue management for local expenditure on public need, as well as base judgement on financial performance of local government (agen) and public (principal).

Keywords: flypaper effect, unconditional transfer, regional capability, local expenditure

1. Introduction

The implementation of regional autonomy and fiscal decentralization began in 2001 in Indonesia. Regional autonomy is in line with the enactment of Law no. 22 of 1999 on Regional Government in which the regions are granted the right and authority to realize regional independence. The consequences of the implementation of regional autonomy and decentralization in Indonesia since 2001 resulted in each region having a big responsibility that was not accompanied by adequate fiscal capacity. To overcome this problem, the Central Government provides funds transfer funds to the Regional Government according to Law no. 25 of 1999 on Fiscal Balance between Central and Regional Government as a form of fiscal decentralization

Central Government transfers consist of revenue sharing (DBH), general allocation fund (DAU) and special allocation fund (DAK). In general DBH and DAU are classified into unconditional transfers or commonly referred to as unconditional transfers (Brodjonegoro & Vazquez, 2002). Unconditional transfer is considered more flexible so that optimum utilization can be one of the driving forces of the regional economy.

In reality, local governments rely on funding from central government transfers primarily from Unconditional transfers rather than PAD for local spending. The local government finances its main daily operations with transfer funds due to different interpretations of DAU by the regions. In Saragih (2003), such interpretations include 1) DAU transfer funds are grants provided by the Central Government without any returns and 2) DAU is not required to be accounted for because DAU is a consequence of the transfer of authority or general duties of government to the regions. Figure 1 shows the trend of transfer to an increasingly large area from 2006 to 2015.

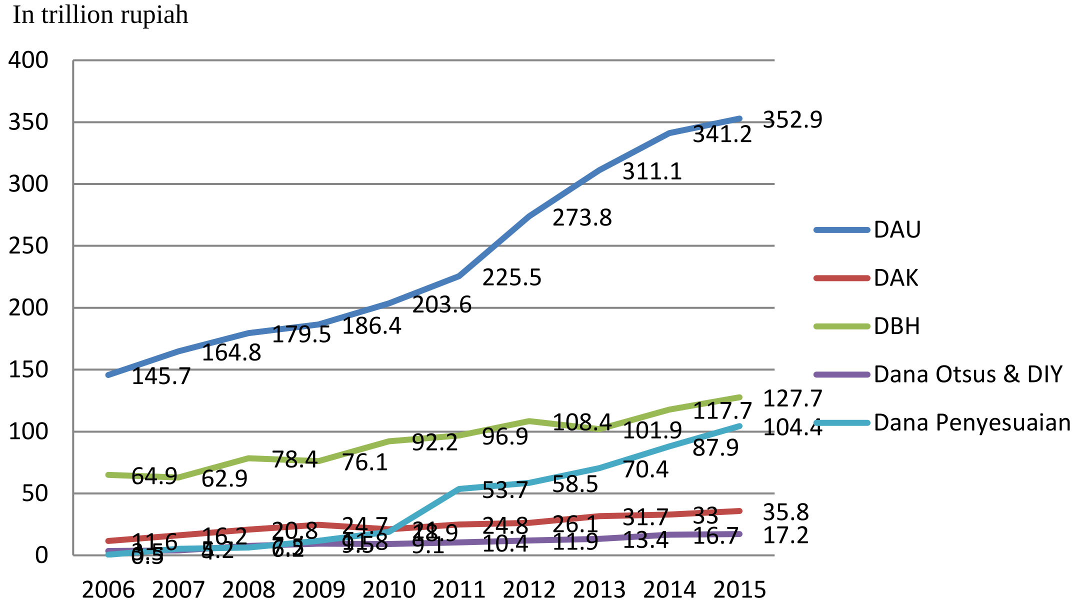

Figure 1. Transfer Trends to the Region 2006-2015

Source: kemenkeu.go.id (processed data)

Based on Figure 1 above, until 2015, it appears that the DAU transfer funds received by the region increased to reach 352.9 trillion rupiah (up by 142.21% compared to 2006) while the DBH to 127.7 trillion (up 96.76% Compared to 2006).

The increase in government transfers is always followed by an increase in local expenditures (Rokhaniyah & Nugroho, 2011 and Kuncoro, 2007) which are feared to occur due to fiscal laziness (Nanga, 2005) where the regions do not seek maximization of PAD so that they can obtain transfer from the Central Government (Afrizawati, 2012 ; And Dollery & Worthington, 1996).

Transfers received from the Central Government affect the local government budget. The long-term trend of transfer funds may disrupt the ability of regions to finance their expenditures, especially the management of their own resources. This can be seen from the behavior of regional spending is greatly influenced by the source of revenue in the form of transfer funds. Central government transfers that should be the drivers of regional independence, in fact responded differently by the region. The regions are becoming not independent, increasingly dependent on the Central Government. The reality of this phenomenon has consequences for Local Government to be less motivated in maximizing the potential of local income. This is an indication of the emergence of flypaper effect which is a major phenomenon in this study.

Flypaper effect will make Local Government has tendency to do manipulation of expenditure as high as possible with no effort to maximize PAD so that later can get aid in the form of transfer from Central Government (Afrizawati, 2012). Local governments find it easier to maximize regional expenditure than resort to ways to maximize PAD. The deficit between PAD and substantial regional expenditure also indicates the occurrence of a flypaper effect. The small proportion of PAD to regional expenditure indicates that the regions have not maximized the utilization of sources of PAD growth, such as increasing local tax revenues, as well as other natural resources. This can happen because of the tendency to expect fund transfers from the central government that will weaken the ability of regions to finance their own needs.

When the regional spending response is greater than the transfer, it is called the flypaper effect (Oates, 1999). Meanwhile, according to Maimunah (2006), Flypaper effect is a condition that occurs when the Local Government responds spending more / wasteful using transfer funds rather than using its own ability. Response here is a direct response from Local Government in react the transfer funds on local budgets. The local government awaits the allocation of the transfer funds before determining how much it will spend, so that future spending tends to be larger in number (Oktavia, 2014). In other words, the flypaper effect as a condition in which the spending boost by the Local Government increased more due to changes in transfers from the Central Government compared with changes caused by the original income of his own region (Khoiri, 2015).

Research on the phenomenon of flypaper effect has been widely practiced among others Zampelli (1986), Deller et. Al (2002), and Knight (2002) in the United States; Dollery & Worthington (1995) in Australia; Aaberge & Langorgen (1997) in Norway; Barnett (1991) in England; Legrenzi & Milas (2001) and Gennari & Messina (2012) in Italy; Melo (2002) in Colombia; Lalvani (2002) in India; Dahlberg et. Al (2006) in Sweden; Mattos et. Al (2011) in Brazil; Pevcin (2011) in Slovenia; And

Cappelletti & Soguel (2013) in Switzerland. The results show that public spending has increased substantially through the receipt of transfer funds compared with an increase in local own revenues.

Several studies have shown empirical evidence that the phenomenon of flypaper effect on regional expenditure in Indonesia, with the dominant indication of the role of transfer funds in financing local government expenditure compared with its own PAD. Research that found the occurrence of flypaper effect phenomenon in Indonesia among them by Abdullah & Halim (2003) at the Government of Regency / City in Java and Bali; Maimunah (2006) on the island of Sumatra; Kuncoro (2007), Kusumadewi & Rahman (2007), Rokhaniyah & Nugroho (2011), Junaidi (2012) and Aprillia & Saputra (2013) in the Districts / Cities in Indonesia; Masdjojo & Sukartono (2009) in Central Java; Suyanto (2010) and Oktavia (2014) in East Java; Sasana (2010) in provinces in Indonesia; Kristianti & Hastuti (2011) and Nurdini et. Al (2014) in West Java; Listorini (2012) in North Sumatra; Afrizawati (2012) in South Sumatra; Lambut et. Al (2013) in North Sulawesi; Prahesti & Handayani (2014) in Bondowoso; Santoso et. Al (2015) in Lampung; Amalia et. Al (2015) in South Kalimantan; And Amril et. Al (2015) in Jambi.

Different research results where no flypaper effect phenomenon in Indonesia was performed by Pramuka (2010) at Regency / City Government in Java; Iskandar (2012) and Khoiri (2015) in West Java; Burhanuddin (2012) in Central Java; Darmayasa & Sedanayasa (2012) in Bali; Shiddieqy & Afriana (2013) on the island of Borneo; Hidayan & Riduwan (2014) and Rahmawati & Suryono (2015) in East Java; Adiputra (2014) in Karangasem Bali; Amalia (2015) in Banten; And Purbarini & Masdjojo (2015) in 56 cities in Indonesia. The results of this different research that encourages researchers to do research whether there flypaper effect on regional expenditure in West Nusa Tenggara.

The financial condition in the NTB Regional Economic and Financial Review (KEKR NTB) of the fourth quarter of 2015 shows that regional revenues in NTB province and districts / cities in NTB are largely from transfers and City / Kabupaten in NTB province are still unable to pay personnel expenditures from PAD. Meanwhile, based on the Fiscal Capacity Map issued by the Ministry of Finance since 2005, the province of NTB always stays in the category of low fiscal capacity and the bottom three positions nationally. Areas belonging to the Low Fiscal Capacity category are regions whose Fiscal Capacity index is less than or equal to 0.5 (index ≤ 0.5).

Research conducted by Susanto (2014) and Anjani et. Al (2015) in NTB shows that the high level of fiscal dependence on the central government and NTB has very low financial capability. According to Dethan (2015), the relatively small revenue from PAD in the districts / citie in NTB province is caused by the ability to explore the sources of income is still limited compared to the potential that exists.

This research is motivated by the phenomenon of the increasing regional dependence on the transfer fund which is seen from the increasing of central government fund transfer to region including NTB area. This indicates that local government expenditure in NTB is still dependent on central government transfers indicating the occurrence of flypaper effect. Amid increasing DAU transfers to the regions, Anjani (2015) found that NTB Regional Government has not yet used the transfer fund optimally to realize capital expenditures. Differences in the results of the research on the flypaper effect on regional expenditure in several regions in Indonesia and the financial performance of local governments in NTB which are still not independent and are always at low fiscal capacity into research opportunities in the research area.

The study was conducted based on the above phenomenon to re-examine the consistency of previous research results with the latest periods and different regions (specific in NTB) related to the regional financial performance after the implementation of fiscal decentralization. It is interesting to examine further whether flypaper effect phenomenon on public needs and how the implications to the financial performance of the region in West Nusa Tenggara after the implementation of fiscal decentralization.

2. Theoretical Framework and Hypothesis Development

The consequences of the implementation of regional autonomy and decentralization in Indonesia since 2001 resulted in each region having a big responsibility that was not accompanied by adequate fiscal capacity. To overcome this problem, the Central Government provides transfer of funds to the Regional Government. One form of transfer provided by the Central Government is an unconditional transfer. DAU and DBH are classified into unconditional transfers (Brodjonegoro and Vazquez, 2002).

In reality, local governments rely on funding from central government transfers primarily from Unconditional transfers rather than PAD for local spending. The local government finances its main daily operations with transfer funds due to different interpretations of DAU by the regions. In Saragih (2003), such interpretations include 1) DAU transfer funds are grants provided by the Central Government without any returns and 2) DAU is not required to be accounted for because DAU is a consequence of the transfer of authority or general duties of government to the regions. Several studies have shown empirical evidence that the phenomenon of flypaper effect on regional expenditure in Indonesia, with the dominant indication of the role of transfer funds in financing local government expenditure compared with its own PAD.

Flypaper effect is a condition that occurs when the Local Government responds to more spending / wasteful use of transfer funds rather than using its own ability (Maimunah, 2006). Response here is a direct response from Local Government in react the transfer funds in the local budgets. When the regional spending response is greater than the transfer, it is called the flypaper effect (Oates, 1999). The local government awaits the allocation of the transfer funds before determining how much it will spend, so that future spending tends to be larger in number (Oktavia, 2014).

Provision of transfer funds that should be a driver of local capacity improvement, it responded differently by the region. The reality of this phenomenon has consequences for Local Government to be less motivated in maximizing the potential of local income. Flypaper effect will make Local Government has tendency to do manipulation of expenditure as high as possible with no effort to maximize PAD so that later can get aid in the form of transfer from Central Government (Afrizawati, 2012). Local governments find it easier to maximize regional expenditure than resort to ways to maximize PAD.

In agency theory it is explained that the parties involved in the budgeting process have a tendency to maximize their utility through the allocation of resources within the budget. The executive as a budget advocate and simultaneously as the budget executive seeks to maximize the budget. In addition there is information asymmetry between local government as agent and society as principal. Communities pay taxes and expect equal indirect contracting in public services but local governments in meeting public needs tend to respond more than transfer funds and not from taxes (PAD) paid by communities.

Based on the previously mentioned study, this study will detect the flypaper effect on public needs and how the implications for the financial performance of the region in West Nusa Tenggara after the implementation of fiscal decentralization. The following figure is a conceptual framework and as a plot of thought in testing the hypothesis.

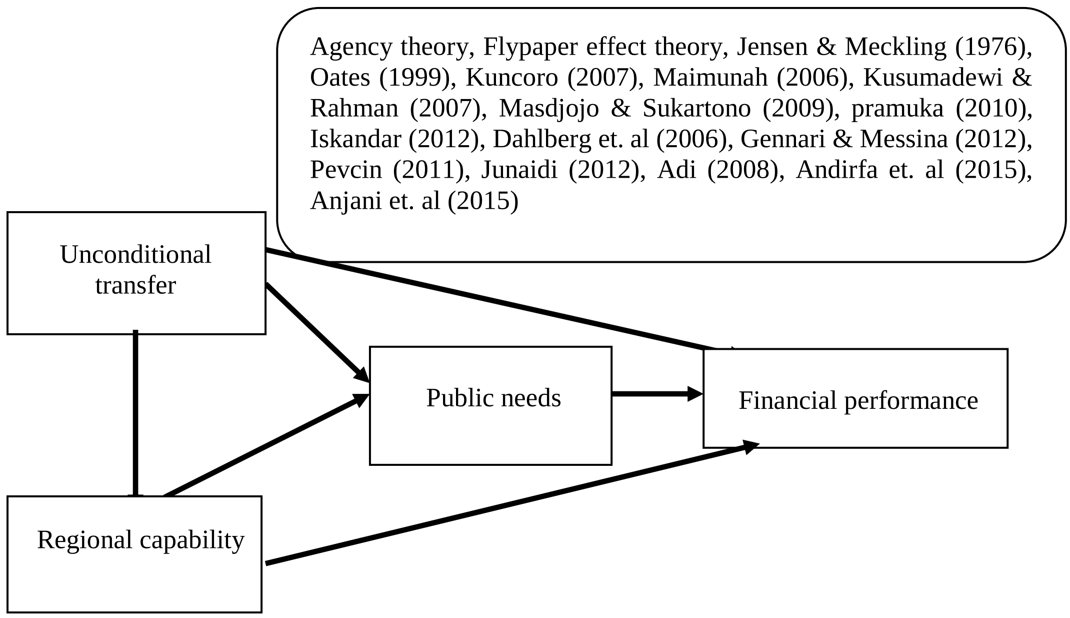

Figure 2 Theoretical framework

2.1.Flypaper Effect on Public Needs

Dahlberg et. Al (2006) found that regional expenditures due to transfers increased more than regional revenues. Gennari & Messina (2012) found that local governments respond more (local expenditure) by using unconditional grants rather than using local revenue alone. Pevcin (2011) finds the elasticity of equity transfer greater than the income elasticity of total cities expenditure. This indicates that the presence of flypaper effects can be observed, as seen from the effect of grant money greater than the effect of PAD. Abdullah & Halim (2003) found flypaper effects on regional spending in Java and Bali in 2001. Kusumadewi & Rahman (2007) also showed a flypaper effect on district / city spending in Indonesia in 2001-2004. Oktavia (2014) indicates that the response of Regional Expenditure is still greater due to the balancing fund especially derived from the DAU component.

Deller & Maher (2005) conducted a study in Wisconsin. When grants are not given a requirement then municipal spend their income for non-essential needs or needs of luxury goods rather than essential needs or normal needs in general. Maimunah (2006) found that there was no flypaper effect on the Regional Expenditure of Education while in the Regional Expenditure of Health field found the occurrence of flypaper effect.

Communities (principals) who have paid taxes and are expecting contracts in public services but the local government (agent) to meet public needs tend to respond more than central transfers and not from taxes (PAD) paid by the public. To be able to say there has been a flypaper effect then the result obtained must show (1) the DAU coefficient value is greater than the PAD coefficient value and both are significant, or (2) PAD is not significant (Maimunah, 2006). In this study flypaper effect is a condition generated by the three variables Unconditional Transfer, Local Capability and Public Needs. Where when the coefficient of Unconditional Transfer (DAU and DBH) has more significant effect on public needs (Regional Expenditure) than the Regional Capability (PAD and PDRB) then this condition is called flypaper effect. Then the hypothesis to test flypaper effect on Public Needs of Local Government in NTB is:

H1. *Unconditional transfer is more influential than Local capability to public Needs*

2.2. Unconditional Transfer on Regional Capability

Gamkhar and Oates (1996) found that the elasticity of regional expenditure significantly affected transfers. When the transfers growth, local governments spend their local expenditures in excess of additional revenues derived from grants / transfers. Conversely, when the transfers fell, the Local Government compensated the decline by raising local taxes.

Naganathan & Sivagnanam (1999) disclose that transfer allocations in developing countries are generally based largely on expenditure but are less concerned with local tax collection capabilities. The impact is that local governments are always demanding greater transfers from the center (Shah, 1994), and less exploring the local tax base more optimally (Oates, 1999). Local governments are increasingly relying on transfers from the center rather than seeking to increase PAD so that the level of regional self-sufficiency decreases (Adi, 2007).

The study by Adi (2008) found that DAU has a negative effect on local tax effort (at the level of 10% significance). Giving DAU that should be a stimulus to increase regional independence, it responded differently by the region. The regions do not become more self-sufficient and DAU becomes a disincentive for regions to seek to improve fiscal capacity. While Junaidi (2012) found a decrease in DAU transfers resulted in Local Government increase local taxes to fund government spending. The DAU receiving government reacts asymmetrically to the increase in DAU value received. Increasing the grant of DAU from the previous year may result in less than the maximum amount of local government to increase its tax revenue potential.

The reality of this phenomenon causes the local government to become less motivated in maximizing its PAD potential. In addition, central transfers with unconditional transfers result in fiscal pressure on the local tax base will decrease, which in turn leads to lower tax revenues. This means that transfers will reduce the public tax burden so that the Regional Government does not need to raise taxes to finance the provision of public goods. From the description, then developed the hypothesis:

H2. *Unconditional transfer has negative effect on Regional Capability*

2.3. *Unconditional transfer, Regional capability and Public Needs on Regional Financial Performance*

The Regional Government as an agent should use its funding sources for public services and optimize regional capability to improve local financial performance in order to improve services to the public. PAD and PDRB can be used as a benchmark of local financial capacity. The greater and growing the PAD and PDRB the more likely it is for the region to meet its needs and less dependence on the Central Government. With its free use, unconditional transfers in general are also used as the main instruments of equitable distribution of interregional fiscal capabilities. This equity can be considered as an attempt to place the regions in the same fiscal position to carry out public service duties.

The local government will provide the services needed by the community, which is reflected in the allocation of expenditure of each service sector to regional spending. According to Law no. 32 of 2004 Article 167 paragraph 1, regional spending is used to protect and improve the quality of life of the community. This is manifested in the form of improved mandatory and optional services, such as basic services in education, provision of health care facilities, social facilities, decent public facilities and developing social security systems. The higher the regional spending, the Local Government will provide better service and quality to the community. The higher the level of service provided to the community, the higher the value of the performance of the Regional Government.

Several studies related to the effect of transfers, regional capabilities and regional spending on regional financial performance show mixed results. Research by Rustiyaningsih & Immanuela (2014) shows that PAD has a significant effect on local government performance, while DAU and regional expenditure have no significant effect on the performance of local government in cities / districts in Indonesia. Simanullang (2013) shows that capital expenditures have no significant effect on regional financial performance, while PAD and Intergovernmental revenue have significant effect on regional financial performance in Riau Province. Manik (2015) shows Capital Expenditures, balancing funds and PAD have a significant effect on the financial performance of the district and city of Riau Province. Andirfa et. (2016) shows that capital expenditure has a positive effect on regional financial performance, balance funds have a negative effect and PAD has no effect on the financial performance of regencies and cities in Aceh province. Mustikarini & Fitriasari (2012) found that local wealth (PAD) and regional dependency on central government (DAU) have a positive effect on local government performance scores, while regional expenditure variables negatively affect the performance scores of Local Government.

The community as the principal for the Regional Government (agent), must continue to control the Local Government in the implementation of government, including the source and use of funds. Evaluating the financial performance of the region is one of the controls that can be done by the community. From the description, then developed the hypothesis:

H3. *Unconditional transfer has a positive effect on Regional Financial Performance.*

H4. *Local capacity has a positive effect on Regional Financial Performance.*

H5. *Public Need has a positive effect on Regional Financial Performance.*

3. Research Methods

This type of research is a comparative causal study. Comparative causal research aims to identify facts or events under study as influenced variables (dependent variables) and investigate variables that influence (independent variables).

3.2. Population and Sample

The study population is all local government in West Nusa Tenggara. This study analyzed the budget realization report data of each Local Government in NTB. Sampling technique with purposive sampling is taking samples based on a certain consideration / criteria (Sugiyono, 2014). Sampling consideration is the availability of budget realization report data from 2001 to 2015 (15 years). The sample in this study became 8 Local Government by issuing North Lombok district, Bima city and West Sumbawa district. Unavailability of data on the budget realization report of the three districts / city because the region was formed after 2001.

This study uses time series data on the realization of province / district / city APBD in the province of NTB within a period of 15 years ie 2001 to 2015. The amount of data in this study as many as 8 local governments x 15 years = 120 observations. The reason for the use of secondary data on the consideration that this data has the validity of data guaranteed by others, so reliable for use in research. Secondary data source obtained from government agency that is from website of Directorate General of Fiscal Balance (DJPK) at www.djpk.kemenkeu.go.id and website of Badan Pusat Statistik that is www.bps.go.id. The supporting data are derived from the literature and books that are the relevant references for this research.

3.3. Operasional Variable Definition

1. Unconditional Transfer. According to BPPK (2006) unconditional transfer is aimed at ensuring equity in inter-regional fiscal capability, so that each region can carry out its own household affairs at a reasonable level. In general, DBH and DAU are classified into unconditional transfers or commonly referred to as unconditional transfers (Brojonegoro and Vazquez, 2002). According to Law 33 of 2004 the definition of DAU is funding derived from APBN revenues allocated for the purpose of equitable financial capacity among regions to fund regional needs in the context of decentralization implementation. DBH is a fund sourced from APBN revenues allocated to the Region based on percentage figures to fund the needs of the Region in the implementation of decentralization. DAU and DBH in this research is the realization of DAU and DBH of Local Government in NTB in fiscal year 2001-2015.
2. Regional Capability. Regional capability indicates the ability of local governments to finance government activities, development and services to people who have paid taxes and retribution as a necessary source of area (Halim, 2007). Regional Ability in PP no. 45 of 1992 is a fact based on factors and calculations convincing that a Region really has been able to accept the handover of certain governmental affairs as a household matter. Tangkilisan (2005) suggests that there are factors that affect the financial capability of the region, among others, the potential of areas reflected in the PDRB and the ability of regional revenue agencies to collect PAD. PDRB is the total value added of goods and services produced from all economic activities throughout the region within a

particular year or a particular period and usually one year. PDRB can describe the ability of an area to manage its natural resources. According to Law No.33 of 2004, PAD is revenue derived by the area levied according to the Regional Regulation in accordance with the laws and regulations. PAD and PDRB in this research is the realization of PAD and PDRB of Local Government in NTB in fiscal year 2001-2015.

3. Public needs. Expenditures made by the Regional Government in the era of regional autonomy should provide public services so that people in the region achieve prosperity in accordance with the objectives of regional autonomy. The public service is a series of activities in order to fulfill the need for services in accordance with the laws and regulations for every citizen and residents of the goods, services and administrative services provided by the public service providers (Law No. 25 of 2009). In order for LGs to provide adequate public services, a larger allocation of public expenditure is required. Public needs in this study will be measured by regional expenditure. According to the Minister of Home Affairs Decree Number 29 of 2002 Regional Expenditure is all regional cash expenditure within certain budgeting period that becomes the burden of the region. Regional expenditure shall be used in the framework of financing the execution of governmental affairs under the authority of a province or district / cities comprising compulsory functions, affairs of choice and matters handling them in certain sections or fields which may be undertaken jointly between the government and local governments or between local governments stipulated by Provisions of legislation. Regional Expenditure in this research is the number of realization of Regional Expenditure at Regency / City / Province Government in West Nusa Tenggara in budget year 2001-2015.
4. Regional Financial Performance. The performance of Regional Finance is measured by using the indicators of regional financial ratios as follows: Mahmudi (2009: 142)
   a. Decentralization Degrees The percentage of decentralization is calculated based on the ratio between the amount of Own Regional Revenue to total regional revenue.

$$DD = \frac{\text{Own regional revenue (PAD)}}{\text{Total regional revenue}} \text{ x100\%}$$

b. The ratio of local financial independence is calculated by comparing the total revenue of the Own Regional Revenue divided by the revenue earned from the Central and Provincial and regional loans.

$$KM = \frac{\text{Own regional revenue}}{\text{revenue earned from the Central and Provincial and regional loans}} \text{ x100\%}$$

3.4. Data Analysis Method

Hypothesis test is using Partial Least Square (PLS). PLS is a powerful analytical method (Wold, 1985 in Ghozali, 2014) because it is not based on many assumptions. For example, the data should be normally distributed, the sample should not be large. In addition can be used to confirm the theory, PLS can also be used to explain the presence or absence of relationships between latent variables. PLS can simultaneously analyze constructs formed with reflexive and formative indicators. In the analysis with PLS there are 2 things done:

1. Assessing the Outer model or Measurement model.

There are three criteria to assess the outer model of Convergent Validity, Discriminant Validity and Composite Reliability. Convergent validity of measurement model with reflexive indicator is judged by correlation between item score / componen score calculated with PLS. Individual reflexive sizes are said to be high if they correlate more than 0.70 with measured constructs. To assess the Discriminant Validity by comparing the Root Of Average Variance Extracted (AVE) value of each construct with the correlation between the construct and the other constructs in the model. If the AVE value of each construct is greater than the correlation value between the construct and the other constructs in the model, then it is said to have a good Discriminant Validity value. Composite reliability block indicator that measures a construct can be evaluated with two sizes of internal consistency and Cronbach Alpha. Data that has a composite reliability greater than 0.7 has a high reliability.

2. Assessing the Inner Model or Structural Model.

Inner model test is done to see the relationship between construct, significance value and R-square of research model. Changes in R-square values can be used to assess the effect of certain latent independent variables on latent dependent variables whether they have substantive effects. Acceptance criteria or rejection of hypothesis in this research is to assess the value of t-statistics (t-count) compared with the t-table value. Criteria for acceptance or rejection of the hypothesis with the following conditions:

1) If the value of t-statistic < t-table signification level 0.05 (one-tailed), then Hypothesis Ha rejected.
2) If the value of t-statistics> t-table 1.64 with a significance level of 0.05 (one-tailed), then Hypothesis Ha accepted.

4. Result

The evaluation model of PLS is done by assessing outer model and inner model (Ghozali and Latan, 2012) For the convergent validity assessed from loading factor> 0.70 and AVE and communality> 0.50..

Table 1. Outer Loadings

	Original Sample (O)	T Statistics (|O/STERR|)	P Values
BD <- KP	1.000		
DAU <- UT	0.838	31.451	0.000
DBH <- UT	0.901	39.114	0.000
DD <- KK	0.999	3,094.529	0.000
KMK <- KK	0.999	3,287.598	0.000
PAD <- KD	0.993	369.468	0.000
PDRB <- KD	0.993	354.367	0.000

Source: PLS Output (Data processed)

From the output of the analysis shown in Table 1, it can be seen that all constructs with reflective indicators produce a loading factor value greater than 0.70 which means that all constructor indicators are valid. In addition to looking at the value of loading factor, the evaluation of convergent validity can also be seen through the AVE value. From the results of the analysis output in Table 2 it can be seen that all constructs produce AVE values above 0.50 so as to satisfy the convergent validity..

Table 2. AVE

	Original Sample (O)	T Statistics (|O/STERR|)	P Values
KD	0.986	181.251	0.000
KK	0.997	1,595.193	0.000
KP	1.000		
UT	0.757	19.914	0.000

Source: PLS Output (Data processed)

According Jogiyanto and Abdillah (2009: 62) the reliability of a construct if the value of composite reliability of each construct more than 0.70. Table 6 below explains the composite reliability values of each construct in the model. From the acquisition value of composite reliability shown in Table 3 can be explained that the value of each construct is worth more than 0.7. So it can be concluded that each construct has been in accordance with reliable criteria.

In addition to looking at the value of composite reliability, reliability test can also be obtained by looking at the results of cronbach's alpha. A model can be said to be reliably if it has a cronbach's alpha value that is greater than 0.6. Judging from the results of cronbach's alpha in Table 4 it can be concluded that each construct meets the criterion reliabel that is by having Cronbach's Alpha value more than 0.6.

Table 3. Composite Reliability

	Original Sample (O)	T Statistics (|O/STERR|)	P Values
KD	0.993	359.206	0.000
KK	0.999	3,184.716	0.000
KP	1.000		

	Original Sample (O)	T Statistics (|O/STERR|)	P Values
UT	0.862	34.437	0.000

Source: PLS Output (Data processed)

Table 4. Cronbachs Alpha

	Original Sample (O)	T Statistics (|O/STERR|)	P Values
KD	0.986	175.445	0.000
KK	0.997	1,585.848	0.000
KP	1.000		
UT	0.683	9.974	0.000

Source: PLS Output (Data processed)

In evaluating the inner model, it begins by looking at the R-Square value for each endogenous latent variable as the predictor force of the structural model (Latan and Ghozali, 2013: 82). The result of the data analysis presented in Table 5 shows the magnitude of R-Square for regional capability (KD) is 0.665 or 66.5% variant of regional ability variable can be explained by unconditional transfer (UT) variable. R-Square for financial performance (KK) is 0.784 or 78.4% variant of financial performance variable can be explained by unconditional transfer (UT) variable, regional capability (KD) and public needs (KP). The last R-Square for public needs (KP) is 0.816 or 81.65% variant of the public needs variable can be explained by the unconditional transfer (UT) and regional capability (KD) variables, while the remainder is explained by other variables outside the model.

Table 5. R Square

	Original Sample (O)	T Statistics (|O/STERR|)	P Values
KD	0.665	10.117	0.000
KK	0.784	19.620	0.000
KP	0.816	15.611	0.000

Source: PLS Output (Data processed)

Structural model of hypothesis test result using bootstrapping technique can be seen in figure 3 below:

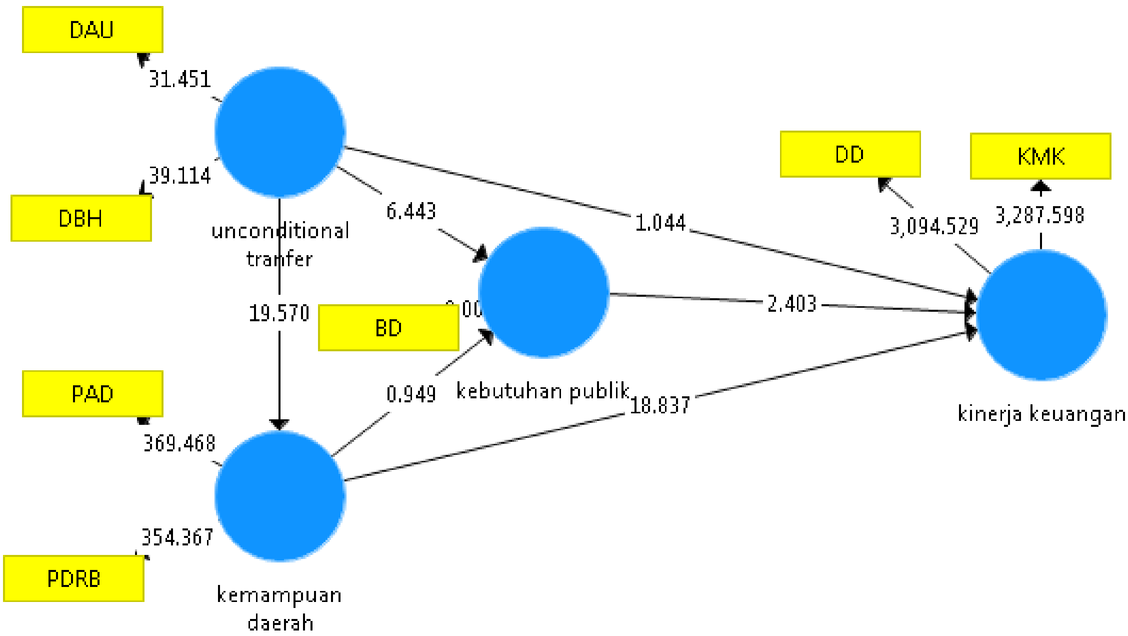

Figure 3. Display Results PLS

Source: PLS Output

Path coefficient is a coefficient showing the level of significance in testing the hypothesis. The hypothesis constructed in this study used one tailed hypothesis test. Therefore, the hypothesis is accepted if the statistical t value is greater than 1.64. Based on Table 6 it can be concluded that H2, H3 and H5 are rejected, while the rest are accepted. The following results of the path coefficients can be seen in Table 6.

Table 6. Path Coefficients

	Original Sample (O)	T Statistics (|O/STERR|)	P Values
KD -> KK	1.085	18.837	0.000
KD -> KP	0.148	0.949	0.343

	Original Sample (O)	T Statistics (|O/STERR|)	P Values
KP -> KK	-0.521	2.403	0.017
UT -> KD	0.816	19.570	0.000
UT -> KK	0.211	1.044	0.297
UT -> KP	0.778	6.443	0.000

Source: PLS Output (Data processed)

4.1. Flypaper Effect on Public Needs

The result of flypaper effect test shows that unconditional transfer (UT) is more influential and significant to public needs (KP) compared with the influence of regional capability (KD) to public needs (KP). This is indicated by the UT path coefficient to KP is 0.778 with t statistics 6.443 is greater than t table 1.64 (significant effect), while the path coefficient of KD to KP 0.184 with t statistic 0.949 is smaller than t table 1.64 (not significant). This means that H1 hypothesis is accepted that there is a flypaper effect on the local government in West Nusa Tenggara. These results support the research by Dahlberg et. (2007), Kusumadewi & Rahman (2007), Kuncoro (2007), Rokhaniyah & Nugroho (2011), Junaidi (2012), Aprillia & Herrera (2006), Gennari & Messina (2012), Pevcin (2011), Abdullah & Halim (2003) Saputra (2013), Masdjojo & Sukartono (2009), Suyanto (2010), Oktavia (2014), Sasana (2010), Kristianti & Hastuti (2011), Nurdini et. Al (2014) and Listorini (2012) who found the occurrence of flypaper effect because the Local Government responded (local expenditure) more by using unconditional grants rather than using local revenue alone.

The small proportion of PAD to regional expenditure in NTB shows that the high level of fiscal dependence on the central government and NTB has very low financial capacity (Susanto, 2014 and Anjani et al., 2015). This is in accordance with the Regional Economic and Financial Review of NTB Province (KEKR NTB) for the fourth quarter of 2015 which shows that regional revenues in NTB and Kota / Kabupaten provinces in NTB Province are mostly transfers and transfers in NTB province are still unable to pay Employee of PAD. This can occur because of the tendency to expect fund transfers from the central government to undermine the ability of regions to finance their own needs. Communities (principals) who have paid taxes and are expecting contracts in public services but the local government (agent) to meet public needs tend to respond more than central transfers and not from taxes (PAD) paid by the public.

4.2. Unconditional Transfer on Regional Capability

The result of unconditional transfers (UT) on regional capability (KD) is shown by path coefficient 0,816 with t statistic 19,57 bigger than t table 1,64. This means that unconditional transfer has a positive and significant influence on regional capability or H2 hypothesis is rejected.

These results differ from those of Naganathan & Sivagnanam (1999), Adi (2008) and Junaidi (2012) which reveal that LGs are increasingly relying on transfers from the center rather than seeking to improve their regional capabilities. Provision of transfers from the center precisely becomes a stimulus to increase regional capability.

4.3. Unconditional Transfer on Financial Performance

The result of unconditional transfer (UT) effect to financial performance (KK) is shown by path coefficient 0,211 with t statistic 1,044 smaller than t table 1,64. This means unconditional transfer is influential but not significant to financial performance or H3 hypothesis is rejected.

These results support research conducted by Rustiyaningsih & Immanuela (2014) which shows the transfer fund has no significant effect on the performance of Local Government. With its free use, unconditional transfers in general are also used as the main instrument of equalization of inter-regional fiscal capability. This equity can be considered as an attempt to place the regions in the same fiscal position to carry out public service duties. But local governments in NTB are less optimizing the use of these transfer funds to improve their performance.

This is in accordance with the Fiscal Capacity Map issued by the Ministry of Finance since 2005 which places the province of NTB always in the category of low fiscal capacity and the bottom three positions nationally. Areas belonging to the Low Fiscal Capacity category are regions whose Fiscal Capacity index is less than or equal to 0.5 (index $\leq$ 0.5).

4.4. Regional Capability on Financial Performance

The test results of the influence of regional capability (KD) on financial performance (KK) is shown by coefficient of line 1.085 with t statistic equal to 18,837 bigger than t table 1,64. This means the ability of the region to have a positive and significant effect on financial performance or hypothesis H4 accepted.

These results support research by Mustikarini & Fitriasari (2012), Rustiyaningsih & Immanuela (2014), Simanullang (2013), and Manik (2015) that transfer funds have a significant effect on local financial performance. Regional Government as an agent should optimize the ability of regions to improve the performance of regional finances in order to improve services to the public. If the financial resources increase then it can be said that the government has been quite good in managing the regional finances.

4.5. Public Needs on Financial Performance

Result of test of influence of public requirement (KP) to financial performance (KK) is shown with path coefficient of -0,521 with t statistic equal to 2,403 bigger than t table 1,64. This means that public needs have a negative and significant effect on financial performance or H5 hypothesis is rejected.

These results support research by Mustikarini & Fitriasari (2012) who found that regional expenditure variables negatively affect the performance of local governments. This is because the government allocates more regional expenditure to finance personnel expenditure. Personnel expenditures are expenditures that have no direct influence in providing services to the public and have no effect on the financial performance of local governments.

5. Conclusion, Implication and Limitation

5.1. Conclusion

1. There has been a flypaper effect on the local government in West Nusa Tenggara. Local governments respond more (local expenditure) by using unconditional grants rather than using their own local revenue.
2. Unconditional transfer has positive and significant impact on regional capability. Provision of transfers from the center precisely becomes a stimulus to increase regional capability.
3. Unconditional transfer is influential but not significant to financial performance. Local governments in NTB are less optimizing the use of these transfer funds to improve local fiscal performance
4. The ability of regions to have a positive and significant impact on financial performance. If the financial resources increase then it can be said that the government has been quite good in managing the regional finances.
5. Public needs have a negative and significant effect on financial performance. This is because the government allocates more local expenditure to finance personnel expenditure does not have a direct effect on the financial performance of local

5.2. Implication

The implication of this research can use as the base of local government decision making on local own revenue and intergovernmental revenue management for local expenditure on public need, as well as base judgement on financial performance of local government (agen) and public (principal).

1. For the Central Government, the model of analysis may be considered as a form of reference in analyzing and evaluating the APBD and Provincial Government Budget Provisions. And for Provincial Government as a reference form in analyzing and evaluating APBD of District Government and City Government. In order to optimize the independence of the region, in addition to optimizing the potential sources of the region, the District and Municipal Government need to optimize the improvement of service and convenience for taxpayers. Local governments in NTB can create a regulation on PAD potentials that are targeted for local revenue each year and regulations on more targeted PAD management.

2. For the public can know the financial management policy related to balance transfer fund and financial performance of regency / municipality government, economic development and people's income in the region. The community as the principal for the Regional Government (agent), must continue to control the Local Government in the implementation of government, including the source and use of funds. Evaluating the financial performance of the region is one of the controls that can be done by the community.

5.3. Limitation

Researchers realize that with the limitations of research can not completely answer the interrelationship between the variables - the variables of the study, the limitations are:

1. Disclosure on the financial performance of Local Government in this study does not include analysis of the efficiency of budgeting or efficiency ratio. This provides an opportunity for future research to use a more comprehensive ratio of other financial performance, in order to obtain a definite picture of local government financial performance, and is expected to use the efficiency ratio so that it can be known how far the efficiency ratio to regional revenue. In addition it also needs to add a variable government policy and competence apparatus. Future research can also add other exogenous variables, especially those related to non-financial variables, such as population and wide area.
2. Law Number 17 Year 2003 regarding State Finances requires Provincial, Regency, and City Governments to prepare regional Balance Sheet, so to further researchers to examine the financial performance of District / Municipal Government with the balance sheet analysis of District Government and City Government, District and City Government eg analysis of Liquidity, Rentability and solvency.

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