
Flypaper Effect of General Allocation Funds and Regional Revenue in Central Java-Indonesia

Astari¹, Sobrotul Imtikhanah², M. Fitrayudi³

^{1,2,3} Accounting Department, Economic and Business Faculty Of Muhammadiyah Pekajangan Pekalongan University, Indonesia

emmaferdiz.umpp@gmail.com

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ABSTRACT

Indonesia, with its 38 provinces, requires significant oversight and regulation by the central government. Decentralization offers a solution for managing numerous local governments, aiming to empower regions and ensure equitable development nationwide. Despite nearly a decade of decentralization, regions remain financially dependent on the central government. This study examines the flypaper effect as an indicator of decentralization's success, focusing on Central Java Province's regencies and cities, specifically the Ex-Pekalongan Residency area. The data utilized is financial statement of the Regional Government in the eks-Pekalongan Residency during the period spanning 2018 to 2023. The regression model was processed and tested using the SPSS program. It investigates (1) the impact of the General Government Allocation and Regionally Sourced Income on regional expenditure, (2) which has a greater influence, (3) the presence of a flypaper effect, and (4) if the effect varies with high Regionally Original Income. The findings reveal that both income sources affect regional expenditure and that the flypaper effect persisted in Central Java from 2018-2023, even in regions with high original income.

Keywords: *Flypaper Effect, Decentralization, Regionally Original Income, General Allocation Fund, Regional Expenditure*



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Corresponding Author:

Sobrotul Imtikhanah
Department of Accounting
Faculty of Economics and Business
Muhammadiyah Pekajangan pekalongan University
Email: emmaferdiz.umpp@gmail.com

1. INTRODUCTION

Indonesia is a country comprised of various islands with a significant number of provinces. Given the vastness and numerous provinces, the central government naturally faces a burden in administering the country. Additionally, numerous issues related to state governance arise from the

demands of various regions for their contributions to the central government. This condition has led to the formulation of regional autonomy policies, which delegate authority from the central government to local administrations for self-governance. This transfer of power is accompanied by the responsibility for matters concerning the division of authority, duties, and responsibilities in governing their regions independently without central government interference (Suparto, 2017).

The implementation of regional autonomy has transformed the governmental paradigm from a centralized system to a decentralized one. A decentralized system allows regions to form autonomous areas that are responsible for managing and overseeing the interests of the local community according to their conditions and capabilities. Primary aim of granting autonomy to regions is to enhance the capability and effectiveness of local governments, particularly in terms of development and public service provision, as well as to strengthen political and national unity (Faisal; Nasution, 2016). Decentralization is not exclusive to unitary or federal states; in a unitary state, there is a single power that is distributed to local governments, which can be understood as a top-down relationship where one unified power is divided among the lower regions. Conversely, a federal state consists of sovereign regions that come together. Decentralization comprises multiple forms and dimensions, most notably in the areas of fiscal policy, political authority, administrative structures, governance systems, and socio-economic development (Yustika & Erani, 2008).

Hartmann & Crawford (2015) explain that “Decentralization entails the transfer of power, responsibilities, and finance from central government to sub-national levels of government at provincial and or local levels.” Decentralization is defined as the delegation of power from the central government to local governments, which includes three aspects: power, responsibility, and funds. Taufiq (2010) states that decentralization can essentially be divided into three major parts: political decentralization, administrative decentralization, and fiscal decentralization, all of which are closely related and should ideally be implemented together to achieve various regional autonomy goals, such as improving public services. The implementation of Law No. 1 of 2022 regarding Financial Relations between the Central and Regional Governments represents a significant reform in Indonesia’s public administration, altering the governance landscape by redefining the distribution of power and obligations among regional authorities. The regional autonomy implemented by the government also affects fiscal decentralization, which refers to the process of budget allocation from a higher level of government, in this case, the central government, to a lower level of government or regional governments to support the execution of governmental functions and public service provision. This process is adjusted based on the extent of authority granted to the lower level of government, thereby providing regions with the opportunity to maximize their potential. With regional autonomy, it is expected that regional governments become more independent and less reliant on the central government in terms of financial management and development funding. The Law No. 1 of 2022 on the Financial Relationship between Central and Regional Governments stipulates that the allocation of funds is intended to facilitate the financing of regional expenditures in the context of implementing decentralization.

To address the substantial fiscal demands of regional governments, Law No. 33 of 2004 on the Financial Balance between the Central and Regional Governments was promulgated. This legal framework institutionalizes intergovernmental fiscal transfers through the provision of balancing funds sourced from national budget revenues, intended to strengthen the operationalization of decentralization at the regional level. The structure of these transfers comprises the General Allocation Fund (DAU), the Special Allocation Fund (DAK), and Revenue Sharing Funds, which are derived from both tax revenues and natural resource exploitation. When combined with Regional Own-Source Revenue (PAD), these funds constitute the primary fiscal instruments used to support subnational government functions. Each mechanism serves a specific policy objective: Revenue Sharing Funds aim to ensure a fair distribution of nationally collected revenues; the DAU serves as an equalization tool to reduce horizontal fiscal imbalances across regions; and the DAK is allocated for targeted interventions aligned with national priorities, often in response to urgent or sector-specific needs." (Saragih & Panglima, 2003)

According to the provisions outlined in Government Regulation of the Republic of Indonesia No. 55 of 2005 concerning Balancing Funds, the General Allocation Fund (DAU) is sourced from the State Budget (APBN) and allocated to balance fiscal capacity among regions. The DAU aims to equalize regional fiscal performance by applying calculations that consider spending needs, budget requirements, and regional potential. In addition to serving as a fiscal instrument for income equalization across all regional governments, the allocation of the DAU should ideally be used as a tool to leverage potential and stimulate local economic resources to increase a region's PAD (Regional Own-Source Revenue). However, achieving this goal remains

a challenge. Regional governments face obstacles in optimizing PAD potential, such as ownership issues and limited management of scarce natural resources, ultimately leading to continued reliance on funding or allocations from the central government. Over time, deviations from the intended purpose of regional transfers have become more frequent in efforts to reduce budget disparities among regions. This is evident from the structure of the Regional Budget (APBD), where the proportion of the DAU remains quite substantial and relatively larger compared to the amount of PAD or other legitimate regional revenues.

On the other hand, regional expenditure always attracts significant public attention. As contributors to public funds through local tax payments, the community has an interest in ensuring that these funds are managed properly, efficiently, effectively, and in the public interest. Regional expenditure encompasses all cash outflows by regional governments within a fiscal year (F Simanjuntak et al., 2013). According to him, regional expenditure includes costs incurred by regional governments to carry out tasks assigned by the government and to address certain aspects that can be handled by either the regional or central government or both. Therefore, regional development should be comprehensive and aligned to ensure that each area progresses according to its priorities and potential. Regional governments compete in their development efforts by designing strategies to increase PAD and allocate these funds to the economic sector. Since PAD constitutes regional governments' own-source revenue and is managed independently, it becomes their responsibility to ensure that its use is directed toward development efforts with tangible community impact.

The focus of this research is the flypaper effect, which indicates that regional governments are more inclined to use balancing funds such as DAU, DAK and DBH to increase expenditure rather than using Local Own-source Revenue (PAD) to meet regional expenditure needs. Turnbull (1992) and according to Pratiwi and Paramita (2016), the flypaper effect suggests that fiscal transfers lead to a disproportionately higher rise in regional government spending compared to the actual value of the funds received. The flypaper effect reflects a condition in which regional governments' dependency on central government transfers leads to increased public spending that is more responsive to external funds than to locally generated revenue (Putra & Dwirandra, 2015). The flypaper effect itself is a response to the fluctuations in the use of balancing funds or transfers from the central government (Pratiwi & Paramita, 2016). The flypaper effect can be measured by comparing the high coefficient of transfer funds with Regional Original Revenue from the results of Maimunah's (2006) test in (Melda & Syofyan, 2020). The term "Flypaper Effect" arises because of the discrepancy from the conditional government aid theory, which states that an increase in transfers from the central government does indeed increase public goods consumption expenditure but does not replace the role of local taxes. (Kurnia, 2013).

The Flypaper Effect refers to the phenomenon where government grants or transfer funds result in local governments increasing their spending more than their own revenue (Serbes & Çetinkaya, 2022). The characteristics of flypaper effect generally identified as a condition where the financing of local government consumption or capital expenditure tends to be higher when using transfer funds compared to utilizing Regional Original Revenue (PAD).

Literature Review

Agency Theory

The core of agency theory lies in the principal-agent relationship, a concept that is widely applicable in different contexts such as civil society organizations, collective groups, and regional governments. In the context of the preparation or planning of the Regional Revenue and Expenditure Budget (APBD), agency theory becomes relevant. At this stage, the regional government acts as the agent designing the budget, while the Regional House of Representatives (DPRD) serves as the principal overseeing the budget's use. This situation often leads to conflicts, where the DPRD seeks to optimize programs and activities for the community's benefit, while on the other hand, revenue is needed to implement these programs and activities. Regional governments tend to prefer relying on funds from the central government rather than exploring the potential within their own regions. The budget prepared by the principal includes Regional Original Revenue, which will impact the amount of expenditure.

Based on data from djpb.kemenkeu.go.id, there was an increase in the Regional Revenue and Expenditure Budget (APBD) of Central Java in the first quarter of the 2018 fiscal year compared to the first quarter of the 2017 fiscal year. The revenue target increased by 3.82%, from Rp93.732 trillion to Rp97.313 trillion. Meanwhile, the Budget for Expenditure and Transfers also increased by 5.06%, from Rp97.981 trillion to Rp102.934 trillion. The budget deficit also rose, from Rp4.249 trillion in the first quarter of the 2018 fiscal year to Rp5.621 trillion. The aggregate revenue target for Central Java in the first quarter of the 2018 fiscal year was Rp97.313 trillion. In the first quarter of the 2018 fiscal year, revenue realization only reached 22.97%, slightly below the previous figure of 23.01%. The surplus also decreased to Rp11.296 trillion, indicating the

need to accelerate budget realization to drive regional economic growth. Thus, it can be concluded that Transfer Revenue remains the largest contributor at 69%, followed by Regional Original Revenue (PAD) at 26%, and Other Legitimate Revenue at 5%.

In 2020, the realization of Regional Original Revenue (PAD) in Central Java reached Rp5.097 trillion, or 17% of the target. This figure represents an increase compared to the previous period, which was Rp4.278 trillion or 16% of the target. Although there was a nominal increase, the percentage of realization against the target was lower than the same period in 2019. Nevertheless, the element of Other Legitimate PAD showed a significant increase in the percentage of realization, from 9% of the previous target (Rp749 billion) to 17% of the target in the first quarter of 2020 (Rp1.481 trillion).

This achievement indicates that the Central Java Regional Government's (Pemda) policy in managing revenue up to the first quarter can be considered good. However, the outbreak that became a hindrance in revenue collection at the end of the first quarter shows the need for anticipation and preparation of subsequent steps through comprehensive policies as part of the overall pandemic handling efforts.

Meanwhile, for transfer funds, the realization in the first quarter of 2020 reached Rp13.273 trillion, which is equivalent to 19% of the target, showing a decrease from the previous year's Rp13.973 trillion, or 20% of the target. Transfer Revenue became the largest contributor, reaching 71.9% of Central Java's Total Revenue. The majority of the realization came from types of Central Government Transfers/Balancing Funds, reaching Rp12.249 trillion, which contributed 92% of the Total Transfer Revenue.

The Flypaper Effect refers to the phenomenon where government grants or transfer funds result in local governments increasing their spending more than their own revenue (Serbes & Çetinkaya, 2022). The characteristics of the flypaper effect can generally be identified as a condition where the financing of local government consumption or capital expenditure tends to be higher when using transfer funds compared to utilizing Regional Original Revenue (PAD). In their research, Serbes & Çetinkaya (2022) explain that this relationship has been tested in various studies in Turkey, which concluded that the effect of increased spending from transfer funds from the general budget tax revenue of Turkey is greater compared to revenue from Turkey's own sources.

The flypaper effect has been studied in several other countries, such as Poland and Indonesia, where the impact of intergovernmental transfers on infrastructure spending has been analyzed. These studies contribute to a deeper understanding of the relationship between government subsidies and local government spending, as well as revealing the complexity of fiscal decentralization and intergovernmental fiscal relations. Maimunah (2006) in (Adiputra, 2014) states that the flypaper effect phenomenon occurs when local governments tend to increase their spending using transfer funds (grants) allocated from the General Allocation Fund (DAU), rather than relying on their own financial strength, as proxied by Regional Original Revenue (PAD).

Research on the flypaper effect phenomenon has been extensively reviewed both domestically and internationally. For example, the study conducted by F Simanjuntak et al. (2013) found that both DAU (General Allocation Fund) and PAD (Regional Original Revenue) simultaneously influence regional expenditure in districts/cities in South Sumatra. Higher amounts of DAU and PAD have a greater impact on regional expenditures in these districts/cities, but lower DAU does not affect overall regional spending. The survey results indicate that the flypaper effect does not impact DAU and PAD for regional spending in districts/cities in South Sumatra, regardless of whether the levels are high or low.

Another study conducted by Kurnia (2013) empirically tested and found that both DAU and PAD have a significant and positive influence on Regional Expenditure. Out of 38 districts/cities in East Java, 9 did not experience the flypaper effect. Meanwhile, 14 districts/cities had the potential to experience the flypaper effect, and 15 districts/cities were proven to experience the flypaper effect. Further testing showed the flypaper effect on regional expenditure in the Provincial Government of South Sumatra during the period between 2012 and 2016. Pratiwi & Paramita (2016) found that regional expenditure in Indonesia experiences the flypaper effect because the two independent variables, DAU and PAD, each significantly affect the dependent variable, which is regional expenditure. However, it is noteworthy that DAU has a greater influence than PAD. Geographically,

regions in Western Indonesia such as Sumatra, Java, and Kalimantan do not experience the flypaper effect. On the other hand, the flypaper effect occurs in Sulawesi, Bali-NT, and Papua-Maluku. These studies indicate a complex and varied impact of the flypaper effect across different regions and conditions, demonstrating the importance of considering local context in fiscal policy and management.

Research by Yuliana et al. (2017) found evidence that the General Allocation Fund (DAU) provided by the central government influences the amount of capital expenditure. They discovered that regional governments' dependence on central government transfer funds (DAU) has increased. As mentioned, it can be concluded that the larger the DAU, the greater the allocation of regional expenditure budgets. This is because regions with high DAU have larger budget allocations for spending. Subadriyah (2017) indicated that after the implementation of Government Accounting Standards, the flypaper effect decreased, although the reduction was still modest. This is attributed to the lack of clear technical policies and requirements for the distribution of general funds. Yuliana et al. (2017) findings that Revenue Sharing Funds, General Allocation Funds, Special Allocation Funds, and Regional Original Revenue each had a positive and significant impact on regional expenditure in South Sumatra during the 2012-2016 period. Ansori & Muthmainah (2018) showed that the Flypaper Effect occurred in districts/cities in Bali and Nusa Tenggara from 2012 to 2016, as evidenced by the fact that the influence of Balancing Funds on regional expenditure was greater than that of PAD.

Based on the research by Irsyadhea Putri & Haryanto (2019), it was concluded that General Allocation Funds (DAU) and Regional Original Revenue (PAD) have a positive and significant impact on regional expenditure. However, compared to DAU, PAD tends to have a lower impact. This indicates that when formulating expenditure policies, regional governments are more likely to rely on the amount of DAU rather than on PAD.

Hypotheses Development

Regional Original Revenue (PAD)

Ikhwani et al. (2019) find that the flypaper effect occurs in districts/cities in Aceh Province. Melda & Syofyan (2020) showed that General Allocation Funds, Special Allocation Funds, and Regional Original Revenue each had a significant positive effect on regional expenditure. Conversely, Revenue Sharing Funds did not significantly impact regional expenditure in some districts and cities in West Sumatra. The results also indicated that the coefficient for transfer funds was higher than the coefficient for Regional Original Revenue, demonstrating the presence of the flypaper effect in districts and cities in West Sumatra.

Wati et al. (2022) used actual data from the Regional Revenue and Expenditure Budget (APBD) of Indonesia for 2019 and 2020, involving 531 local governments, including regencies, cities, and provinces. The sample was selected using purposive sampling based on specific criteria. According to this study, there is a flypaper effect phenomenon that encourages local governments to use DAU rather than PAD for their expenditures. This flypaper effect led to increased regional government spending on GAF and PAD during the Covid-19 pandemic.

Kustianingsih et al. (2022) focused on regencies and cities in East Java Province with data on the realization of APBD (PAD, DAU, and regional expenditure) from 2019 to 2020. Out of 29 regencies and 9 cities in East Java Province, the sample consisted of 28 regencies and 9 cities that had PAD, DAU, and Regional Expenditure data from 2019 to 2020. According to the results, regional revenue and general allocation funds affect regional expenditure in East Java Province. Additional testing revealed that the flypaper effect occurred in East Java Province. Research by Isik et al. (2023), the flypaper effect is present in both Nigeria and South Africa, both in the short term and the long term. The study found that the flypaper effect is significantly larger for provincial governments in South Africa compared to state governments in Nigeria.

This study seeks to explore how DAU and PAD individually and collectively affect regional spending decisions. By employing multiple regression analysis, the research will evaluate the

significance of DAU and PAD as predictors of regional expenditures, aiming to determine which of the two has a more substantial impact on local spending. This research will compare the effectiveness of DAU and PAD in stimulating regional development. It will evaluate how each type of revenue contributes to achieving developmental goals and whether the dependency on DAU leads to better or worse outcomes compared to reliance on PAD. This comparison will provide insights into the relative efficiency of different revenue sources in promoting sustainable regional growth.

H1 : The impact of Regional Original Revenue (PAD) on Regional Expenditure is significant and positive.

The primary objective of this research is to examine the phenomenon of the flypaper effect in the context of General Allocation Funds (DAU) and Regional Revenue (PAD) and their impact on regional spending in Central Java. The study aims to provide a comprehensive understanding of how these financial resources influence local government expenditures and the extent to which DAU and PAD contribute to regional financial management.

H2: The impact of the General Allocation Fund (DAU) on Regional Expenditure is significant and positive.

This study seeks to explore how DAU and PAD individually and collectively affect regional spending decisions. By employing multiple regression analysis, the research will evaluate the significance of DAU and PAD as predictors of regional expenditures, aiming to determine which of the two has a more substantial impact on local spending. This research will compare the effectiveness of DAU and PAD in stimulating regional development. It will evaluate how each type of revenue contributes to achieving developmental goals and whether the dependency on DAU leads to better or worse outcomes compared to reliance on PAD. This comparison will provide insights into the relative efficiency of different revenue sources in promoting sustainable regional growth.

A key objective is to identify whether the flypaper effect is present in Central Java. The flypaper effect, as described by various studies, suggests that local governments may exhibit a tendency to increase their spending more in response to increases in DAU compared to increases in PAD. This research will measure the magnitude of this effect by comparing the coefficients of DAU and PAD in regression models

H3: The flypaper effect occurs, with the General Allocation Fund (DAU) and Regional Original Revenue (PAD) having an impact on Regional Expenditure.

By examining the utilization of DAU and PAD, the study aims to provide insights into the financial management practices of local governments in Central Java. This includes assessing the effectiveness of current financial strategies and identifying areas where improvements can be made to optimize regional expenditures. Based on the findings, the research will offer recommendations for policymakers on how to improve the allocation and utilization of DAU and PAD. These recommendations will focus on enhancing the efficiency of financial management, reducing dependency on DAU, and maximizing the benefits of PAD for regional development. The study aims to contribute to the academic discourse on fiscal decentralization by providing empirical evidence on the flypaper effect within the context of Central Java. The research will add to the body of knowledge on how intergovernmental transfers impact local government behavior and expenditure patterns.

H4: Regions with lower PAD compared to DAU experience the flypaper effect

2. METHOD

Sample Selection and Data Sources

This research uses quantitative analysis, the data are all of the districts/cities of Central Java Province from 2018 to 2023 which consists of 29 districts and 6 cities, as the population. The former Pekalongan residency area is used as the sample for this research.

Variable Measurement

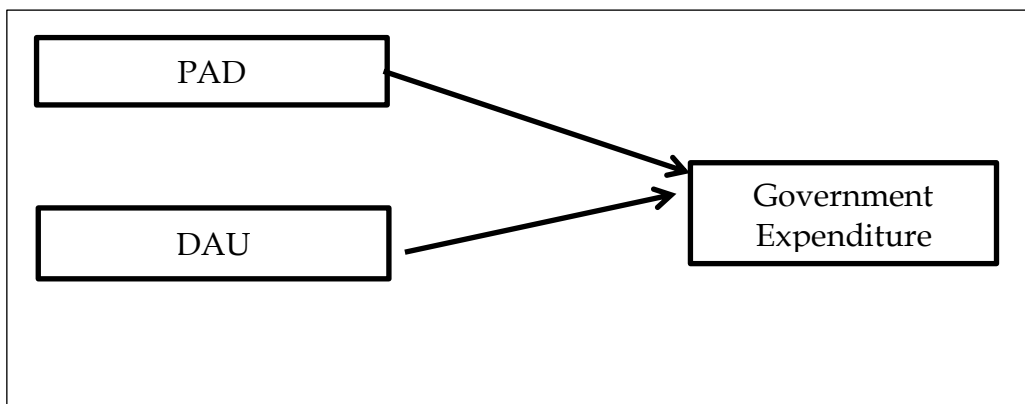
Regional Original Revenue (PAD) refers to income obtained by a region from sources within its own authority. These sources include Regional Taxes, Regional Levies, The Results of Separated Regional Wealth Management and Other Legitimate Regional Original Revenues. General Allocation Funds (DAU) in this study is a funds transferred from the central government to regional governments in Indonesia to support regional autonomy and reduce fiscal disparities between regions., and Regional Expenditure (BD) is all financial obligations incurred by regional governments in the implementation of government affairs under their authority, funded from the Regional Revenue and Expenditure Budget (APBD). The data collection comes from the Regional Budget (APBD) reports of each district or city. These reports include data on Regional Original Revenue (PAD) and General Allocation Funds (DAU), which can be accessed through the Ministry of Finance's website, specifically the Directorate General of Fiscal Balance between Central and Regional Governments.

Data analysis method

The data used in this research was analyzed using the panel data regression analysis method with the following regression model:

$$BD_{it} = \alpha + \beta_1 PAD_{it} + \beta_2 DAU_{it} + \epsilon \dots\dots\dots$$

To ensure that the developed model does not violate classical assumptions, three classical assumption tests are conducted on the panel data: Normality Test, Multicollinearity Test, Autocorrelation Test, and Heteroscedasticity Test.



3. RESULTS AND DISCUSSION

Results

Table 1. T-test

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	-128.992.523.364,962	40.223.499.666,842		-3,207	.002
PAD	.984	.031	.475	31,804	.000
DAU	2.104	.044	.709	47,425	.000

a. Dependent Variable: Belanja Daerah

Based on the table above, the following regression equation is obtained:
 $Y = -128,992,523,364.962 + 0.984 \text{ PAD} + 2.104 \text{ DAU} + e$

Table 2. regression

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.979 ^a	.959	.959	145.125.443.260,7

a. Predictors: (Constant), DAU, PAD

Table 3. Anova

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	102.426.932.025.185,4	2	51.213.466.012.592,7	2.431,6	.000 ^b
Residual	4.359.708.609.023,12	207	21.061.394.246,49		
Total	106.786.640.634.208,5	209			

a. Dependent Variable: Belanja Daerah

b. Predictors: (Constant), DAU, PAD

4. DISCUSSION

According to the table above, the Regional Original Revenue variable, the t-statistic value is 31.804, which is greater than the t-table value of 1.971. Therefore, the Regional Original Revenue (X1) variable has a positive effect on Capital Expenditure (Y). The significance value for the Regional Original Revenue variable is 0.00, which is less than 0.05. Thus, the Regional Original Revenue (X1) variable has a significant positive effect on Capital Expenditure (Y), and Hypothesis 1, that PAD affects Regional Expenditure, is accepted. For the General Allocation Fund variable, the t-statistic value is 47.425, which is greater than the t-table value of 1.971. Therefore, the General Allocation Fund (X2) variable has a positive effect on Capital Expenditure (Y). The significance value for the General Allocation Fund variable is 0.00, which is less than 0.05. Thus, the General Allocation Fund (X2) variable has a significant positive effect on Capital Expenditure (Y), and Hypothesis 2, that DAU affects Regional Expenditure, is accepted.

The results from Table 2 show that the regression coefficient for DAU is 2.104 and for PAD is 0.984, both of which are statistically significant. This indicates the presence of a flypaper effect on regional spending in Regency/City areas in Central Java during the period 2018 - 2023, in accordance with the flypaper effect criteria where the DAU coefficient is greater than the PAD coefficient and both are significant. The research findings also support this analysis by showing that the amount of DAU is greater than PAD. Therefore, the third hypothesis, which states that there is a flypaper effect on regional spending, is confirmed. Thus, it can be concluded that H3, stating that the flypaper effect phenomenon occurs and that DAU and PAD have an impact on Regional Spending, is accepted.

The testing of the Flypaper Effect in regions with both low and high PAD (Regional Original Income) shows that the standardized coefficients for PAD and DAU (General Allocation Fund) are 0.475 and 0.709, respectively. When comparing the standardized coefficients, the DAU coefficient is higher, indicating the presence of a Flypaper Effect in the Regency/City Governments of Central Java. Therefore, it can be concluded that H4, which states that regions with PAD lower than DAU experience a Flypaper Effect, is accepted.

5. CONCLUSION

This research aims to investigate and analyze the impact of Regional Original Revenue (PAD) and General Allocation Fund (DAU) on Regional Expenditure, as well as to examine the flypaper effect phenomenon in Central Java Province. The study is a quantitative descriptive statistical analysis, with a population consisting of 29 regencies and 6 cities in Central Java from 2018-2023. The study shows that PAD and DAU have a positive and significant impact on Regional Expenditure, with DAU having the most substantial effect. The testing reveals that the flypaper effect occurs across all cities and regencies in Central Java except Semarang City. These findings indicate that regional expenditures are more sensitive to DAU than to PAD, highlighting the persistent fiscal dependence of local governments on central government funding mechanisms.

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