

OPPORTUNISTIC BEHAVIOR AND PUBLIC SPENDING: THE CASE OF INDONESIA

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Abstract

This paper investigates the determinants of opportunistic behavior of executives in the local governments in Indonesia. We study 502 regional governments over the 2008-2013 periods. Opportunistic behavior is measured by the level of social spending and capital expenditures. The main determinants of opportunistic behavior come from the composition of local government income. We also include the integrity of apparatus as the determinant of opportunistic behavior. Our results reveal that the composition of income matters to explain the budget allocation. Some policy implications are discussed.

Keywords: Opportunistic Behavior, Local Government, Public Spending, Income Structure, Integrity

1. INTRODUCTION

The implementation of regional autonomy, which has lasted for more than fifteen years, has not capable in changing the paradigm of regional financial management. The issuance of Regulation Number 23 of 2014 on Local Government as the replacement of Regulation Number 32 of 2014 aims to encourage the acceleration of regional autonomy objective achievement. Regulation Number 23 of 2014 explicitly states that "Local Government administration aims to accelerate the achievement of community welfare through service improvement, empowerment, and community participation, as well as improving local government competitiveness by considering democratic principle, equitable distribution, justice, and distinctiveness of a region in the Unitary State of the Republic of Indonesia".

Local government apparatus' lack of integrity, which leads to weak internal control, is one of many factors that caused inefficiency and lack of accountability in Local Government financial management, both accountability for probity and legal accountability. Accountability for probity related with abuse of power avoidance, while legal accountability related with assurance in legal compliance and other regulation that is required to use public fund (Mardiasmo, 2000). Local Government administration efficiency and effectiveness need to be improved by considering some aspects related with the relationship of central government with local government or the relationship between local governments, regional potential and diversity, as well as opportunity and the challenges of global competition under the unified system of state governance. Fiscal decentralization, which is implemented along with the regional autonomy, has not improving community welfare; instead it is increasing the opportunistic behavior of the local government apparatus and legislative, which leads to phenomenon known as the 'small king' in local government (Arifin *et al.*, 2015). The low understanding of the local government apparatus on the financial management procedure is an indication of the lack of understanding of the accountability process, because accountability process is related with whether the applied procedure is appropriate in

term of accounting information system, management information system, and administration procedure. Accountability process is manifested through a fast, responsive, and cheap public service (Mardiasmo, 2000)

Decentralized Local Government financial management faces many problems. Local Government is not fully prepared or not serious in implementing the regulations issued by Central Government (Abdullah, 2012). Some corruption cases and financial management misappropriation in Local Government, either happened in its executive level or in its legislative (Regional People's Representative Assembly - DPRD), is viewed as a result from the Local Government's unpreparedness.

Regional Revenue and Expenditure Budget (APBD) is the most important document in the Local Government financial management. The APBD formulation process constitutes political and administrative process which is filled with related parties' self-interest (executive and legislative). The relationship between executive-legislative is facing an agency problems which came from information asymmetry and authority in policy making between the two bodies (Khan and Hildreth, 2001; Halim and Abdullah, 2006).

The policy making and resource allocation in APBD is loaded with a variety of interests (Abdullah and Asmara, 2007). When such interest harms the society (voters), thus it can be called as political corruption or administrative corruption (Martinez-Vazquez *et al.* 2004). Such phenomenon can occurred in the APBD drafting process that will be implemented since the beginning of related fiscal year and the amendment of the implemented APBD which will be implemented in the third quarter of related fiscal year.

The ongoing budget amendment (also known as APBD Perubahan - APBD-P) is a necessity when assumptions and uncontrollable factors are different with the predicted assumptions in the beginning fiscal year; that is when an agreement of APBD's policy and priority is signed. On the other side, amendment in APBD is something that is expected by Local Government to ensure that the expected performance of an ongoing program is achieved. Moreover, APBD amendment is intended to take advantages over the variance (especially gain) in

revenues for the current fiscal period, thus in the end of fiscal year there will be a low remaining budget balance (sisa lebih perhitungan anggaran - SILPA). Therefore the problem is, whether the allocation in APBD-P does not contain agency problem?

Regional financial management covers all activities such as planning, implementation, administration, reporting, accountability, and supervision of regional finance.¹⁶ Regional financial management is conducted under an integrated system that is embodied in APBD which is implemented each year according to regional regulation. Regional regulation on APBD is determined by District's head after approved by DPRD and evaluated by Minister of Home Affairs (for Province APBD) or Governor (for district and city APBD).

APBD is a budgeting document and an important document in State's finance. Such document explains all governmental activities by listing on how the public fund is spent (Rubin, 2006:1). Therefore, the planning and allocation of resource is a crucial part in budgeting process (Jackson, 1982), thus the discussion and approval on the budget allocation give a 'space' for legislative to defend the interest of its constituent they represent. In reality, the politician as legislative members does not always prioritize public preference which leads to budget misallocation (Gilligan and Matsusaka, 1995, 2001; Karyana, 2004; Keefer and Khemani, 2003, 2004, 2005; Mauro, 1998a; 1998b). Mueller and Pereira (2003) states that politician has their own self-interest in making decision on allocating resource in the budget. Therefore, to earn an approval from DPRD, district's head should do 'bargaining' during the discussion and establishment of APBD.

Theoretical explanation on how public resource is allocated and used in government budget based on agency theory is stated by Bergman and Lane (1990), Christensen (1992), Smith and Bertozzi (1998), and Von Hagen (2002). Even though budgeting is a part of information system that can be used to reduce agent opportunistic behavior (Eisenhardt, 1989), however during the resource allocation process there is always an agency problem arisen i.e. prioritizing personal interest (Fozzard, 2001; Jackson, 1982; Krause, 2002; Von Hagen, 2003). Johnson (1994) addresses this conflict as self-interest model.

The use of power by legislative in allocating budget bring two implications, the budget is allocated according to public interest or based on legislative's self-interest. A preference difference in allocating resource between the executive and legislative occurred because of a difference in viewing the output achieved of certain allocation (Havens, 1996). As legislative agent, executive should follow legislative recommendation. But in reality executive tend to do a moral hazard in submitting the budget proposal, because they have better information than legislative (asymmetric information).

When a budget is approved, most likely there will be some differences between the proposed budget allocation by executive with which then, approved by legislative through some compromise with the executive. Therefore, because of budgeting is a bargaining process between executive and legislative, thus the enacted budget is a result of compromise between two parties (Hagen et al.,

1996; Johnson, 1994; Lee and Johnson, 1998). If the compromise serves as a "common-ground" of each party's self-interest which is an abuse of power, thus such phenomenon is known as state capture (Garamfalvi, 1997; Martinez-Vasquez et al., 2004). One of many reasons to do such compromise is to earn rent which indeed can be obtained through budget allocation (Allard, 1995; Katz and Rosenberg, 1989; Khan and Sundaram, 2000) that expressed in government regulation (Banerjee, 1997).

Indonesian Government budgeting system, including Local Government budgeting system, allows its stake holders to have opportunistic behavior, especially legislative (DPRD) and executive (District head and other apparatus). Government budgeting involves strong institutions that have an interest to maximize their budget through bargaining process (Niskanen, 1991). The bargaining power during the allocation process in regional budget depends on the information complexity owned by each parties (legislative and executive). A decision maker is limited by the lack of time, cash flow information, and other resources (Cope Stephen, 1990). The executive usually has more information about cash inflow in a local government compared to legislative. This information asymmetry has enabled local government apparatus to have opportunistic behavior.

2. EXECUTIVE OPPORTUNISM IN BUDGET ALLOCATION

The misallocation in government budget is related with corrupt and opportunistic behavior of the politicians and government apparatus (Keefer and Khemani, 2003; Mauro, 1998a). With a substantial power owned by politician in taking the decision on budget and public policy related with budget as well as other policy, has create bigger opportunities to take a decision based on personal interest (Colombatto, 2001). In term of regional autonomy in Indonesia, such matter is regulated in Regulation Number 23 of 2014 on Local Government.

The amount of executive authority in the budgeting process as the result of Executive Regional Budgeting Team authority as regulated in Regulation Number 23 of 2014, such as arranging Regional Development Action Plan (Rencana Kerja Pembangunan Daerah - RKPD), gives an opportunity to the executive to "inserting" their personal interest. Bigger authority and space owned by the executive, has make executive become the decisive party in allocating the budget. On the other hand, legislative as the supervisor of policy implementation by the Local Government (including the implementation of budget), as a consequence of its position in represent the society, could cause an agency problem when they use such authority to prioritize their preference in allocating resource in the budget component. Various motivations may underlying the difference in preference between executive and legislative in allocating resource in a budget, whether by reason of defending the public interest, politics, or in rent-seeking effort within the allocation process. Therefore, sectoral allocation set can be different from the proposed by the executive.

According to Keefer and Khemani (2003) there is a tendency if politician allocate resource to the expenditures with targetable outcome. Politician who serves as legislative expect an allocation that represent an alignment to voters or supporters, in

narrower form than the appropriate public service such as education and health, even though these expenditures are the most important matter for the poor (Keefer and Khemani, 2004). Physical or infrastructure development and job creation (job program) are policies which in short term provide evidence of fulfillment of campaign promises, but in long term do not give any contribution to economic development just as education and health.

A study in Indonesia conducted by Abdullah (2004) finds that preference in sectoral expenditure is different between legislative and executive. Legislative prefer higher allocation for infrastructure and legislative sector. Sectoral allocation such as expenditures on education, health, and infrastructure are expenditure areas that absorb relatively large resource and have strategic value politically. Keefer and Khemani (2003) state that health and education expenditure allocation are used as a proxy of the level of service provided by the government to poor people in developing countries.

Legislative alignments to the interests of their principals (public) is reflected in how much they can increase budget allocation for broad public services, especially education and health, from the proposed allocation by executive. An increase (spread positive) in education and health budget shows that the legislative does not have rent-seeking behavior or prioritize their personal interest, because education and health budget only give small opportunity to get rent and opportunistic behavior (Mauro, 1998b). In a short term, the advantage of allocation policy for education and health is insignificant to support legislative self-interest fulfilment, such as in the allocation on infrastructure allocation (Keefer and Khemani, 2003). Tanzi and Davoodi (2002) find empirical evidence that corrupt politician and bureaucrat tend to allocate more resource on public investment project, because it gives higher rent in form of commission or bigger bribe. However, the amount of allocation for public investment does not necessarily increasing service quality to the society, because the quality of infrastructure built is always below the appropriate standard (Mauro, 1997b).

Mauro (1997a, 1997b, 1998a, 1998b), Gupta et al. (2002), and Tanzi and Davoodi (2002) state that corrupt politician will allocate less resource for education and health sector, because these expenditure are hard to be corrupted. An Analysis conducted by Tanzi (1999) and Schiavo-Campo (1999) support the finding. Politician wants more allocation for infrastructure and job programs because such programs is an easy way to fulfill their campaign promise (Keefer and Khemani, 2003; 2004) and/or easy to get rent (Mauro, 1998a; Tanzi and Davoodi, 2002). Meanwhile, Katz and Rosenberg (1989) states that there is a rent seeking activity in budget allocation i.e. in real resource such as human resource expenditure and capital expenditure.

Based on the argument above, it can be concluded that legislative have opportunistic behavior or rent-seeking or doing corruption (because corruption can be a proxy for rent-seeking) when the amendment of budget proposal proposed by executive, which is accommodated in budget allocation, is assigned not in accordance with the public interest. When there is a rise in budget allocation for education and health, hence we can say that legislative do not have self-interest behavior, because it is hard to get rent form such expenditure. Meanwhile, when budget allocation for

education and health is reduced, while the budget allocation for infrastructure is increasing, hence we can say that there is an opportunistic behavior from the legislative. Infrastructure expenditure gives huge opportunity to get high rent and to fulfill their self-interest (Keefer and Khemani, 2003, 2004; Mauro, 1997b, 1998a; Tanzi and Davoodi, 2002).

The findings above are in line with the condition in reality, especially in Indonesia. Jaya (2005) finds that government's elite in Local area violates the regulation on budget allocation for District's Head and legislative (DPRD). Furthermore, he concludes that the excess of allocation for the budgets exceed the standard set by the government. There is often budget allocation that is not regulated in Government Regulation 110/2000 or legislative member who entrust budget in some agencies to increase the accumulation of total budget for regional politician. Another method is by inflating budget allocation for expenditures, especially in goods purchasing and construction project.

According to Niles (2001), in his study conducted in three countries (Indonesia, Mexico, and Ghana), there are two motives in allocating social expenditure in government budget. Economic motive explains that social assistance is needed and addressed to community groups that face financial difficulty. Meanwhile, political motive states that the provision of social assistance that is distributed from government budget is a political tool for politician to get support from society who has received the social expenditure allocation. The second motive is more dominant in developing countries with low institutional development.

Therefore, in this research, the level of executive opportunism measured from two measurements i.e. the proportion of social expenditure to total budget and the proportion of capital expenditure to total budget.

3. THE EFFECT OF REVENUE SOURCE ON EXECUTIVE OPPORTUNISM

3.1. Local Government Income

The general perception on regional autonomy is a Local Government is given an authority to explore their potential revenue in the widest as possible. This matter is reflected in some regulations issued by government such as Government Regulation 109/2000 on the financial position of District Head and Vice District Head and Government Regulation 110/2000 on financial position of DPRD. In those regulations, it has asserted that the allocation amount for executive and legislative is related with local financial capacity that is measured from the Locally-Generated Revenue (*Pendapatan Asli Daerah* - PAD). Therefore, it is indirectly motivates legislative to encourage the executive in increasing revenue budget sourced from PAD, thus it will increase the allocation for DPRD. Therefore, an increase in PAD has a positive effect on the allocation amount for Local Government legislative and executive. However, the revision or replacement of Government Regulation PP 110/2000 into PP 24/2004-PP 37/2005-PP 21/2007, is "narrowing" the space for legislative to maximize their utility through PAD budget, because the allocation for legislative is no longer linked directly to PAD, but for the allocation to executive the legal basis is remain the same (Government Regulation

109/2000). Thus, executive has bigger chance to do an opportunistic behavior in budgeting process.

A study by Abdullah (2004) finds that there is a preference difference between executive and legislative in allocating PAD budget increase (spread) to sectoral budget. The allocation for infrastructure and DPRD is increasing, but the allocation for education and health is decreasing. Abdullah (2004) assumes that legislative is overpowering executive, (as mandated in Regulation Number 22 of 1999 and Government Regulation Number 105 of 2000), in the agency perspective, which is likely to cause the discretion over the application of PAD spread or increase is not in accordance with public preference. This finding support the opinion of Colombatto (2001) on the connection of discretionary power with corruption, and in accordance with Keefer and Khemani (2003) viewpoint as well as Mauro (1998a; 1998b) finding, where corrupt politician or politician with self-interest tend to allocate resource on expenditures that is easily embezzled.

Conceptually, changes in government's income will affect its spending or expenditure, but not all of additional income will be allocated on expenditures. Empirically, there is a flypaper effect in connection between income with expenditures (Moisiso, 2002; Hines and Thaler, 1995) which states that a person will be more efficient in spending the revenue generated independently compared to revenue granted by other parties (such as transfer or grants). Therefore, the determination of expenditure budget allocation which depend on the legislative and executive preference, while both parties have agency relationship (Fozzard, 2001; Lupia and McCubbins, 1994; Moe, 1984), which allegedly will create a preference difference between the parties before there is a deal through a bargaining process, which later become the enacted budget.

Revenue budget increase itself is an additional resource which can get allocated to other (new) expenditures. Therefore, when legislative views executive budgeted PAD that is lower than the actual potential (budgetary slack), thus legislative will increase the revenue budget. The increase in revenue (PAD) budget, which is not allocated to any expenditure (free), can be used by legislative to accommodate their self-interest by allocating the revenue to certain expenditures (Abdullah, 2004).

Based on the theoretical background and empirical result, the hypothesis to test the effect of preference difference between executive and legislative (spread) of PAD on legislative opportunistic behavior is as follow:

H₁: PAD Proportion has a positive effect on executive opportunism.

3.2. Transfer Fund from Central Government

PAD revenue has a relatively small proportion compared to all regional revenue. Based on the APBD data for the fiscal year of 2015 in 33 Provinces and 503 Districts and Cities, the PAD contribution to total revenue is 11.19%, while PAD contribution to total expenditures is 10.42%, smaller than the General Allocation Fund (*Dana Alokasi Umum* - DAU). Hence, PAD role in regional development financing is insignificant (Sidik et al., 2002) even though most of government apparatus assume that regional autonomy aims to encourage Local Government to optimize PAD (Dwiyanto et al., 2003).

Legislative who has an influence in expenditure budget allocation with public-oriented, especially in

education and health, would assume DAU as the main financing source to accommodate such public interest. Allocation proposal proposed by executive can be recommended to get amended based on knowledge and information owned by legislative. In general, it can be seen that an increase in DAU (higher DAU in the following year compared to current DAU), proportionally will directly related with the increase in expense allocation in the following year. This means, revenue increase, at least, will increase the budget for basic service with the same proportion. For example, a 5% increase in DAU will increase the budget for education and health for 5%.

In an agency perspective, legislative as public agent is likely to prioritize their interest in allocating resource in the budget. Therefore, the increase in balancing fund will not always proportional to the increase in the allocation for education and health budget, if both sectors only provide small rent for legislative self-interest. In term of regional financial management, expense budget allocation for each sector usually remains the same (unchanged). This is intended to avoid internal conflict inter sectoral and work units in Local Government.

Referring to Keefer and Khemani (2003, 2004), Mauro (1998a, 1998b), and Shleifer and Vishny (1993) legislative recommendation on the expenditure composition is not always in accordance with public interest (legislative's moral hazard). When the increase in balancing fund is viewed as an opportunity to create new expense budget, then politician can take opportunity to recommend the allocation to certain sector that can fulfill their self-interest. With an information asymmetry between executive and legislative, on the planning and implementation of program and activities, especially in allocating and setting the expected performance, legislative knowledge on the increase in balancing fund will affect the recommendation on expense budget allocation which might be different with the executive proposal. Based on the argument above, the hypothesis is:

H₂: The proportion of transfer fund from Central Government positively affects executive opportunism.

3.3. The Effect of SiLPA on Executive Opportunism

SiLPA is the excess of revenue and expenditure realization during a budget period (PP 58/2005). Previous year's SiLPA in a District budget has many meanings that is not necessarily efficiency, in budget realization, in previous year. Previous year SiLPA might indicates that the allocation is bigger than the necessity, because executive wants more space in implementing programs and activities or because the revenue budgeted is lower than the actual potential. In a country with corrupt apparatus, resource allocation in the budget might get distorted (Shleifer and Vishny, 1993), thus the expenditures that is easily to be embezzled get more allocation (Mauro, 1998a, 1998b). Johnson (1994:5) addresses the relationship between executive and bureaucrats with legislative or congress as self-interest model. In this case, legislators want to get elected again, bureaucrats want to maximize their budget, and constituent want to maximize their utility.

Public policymaking process in democracy involves society through their participation in the government, which has legislative function called legislator. This legislative function is also conducted

in the budgeting process of Local Government. This representative will defend their constituent interest (voters) in government policy making, which is represented in the regional budget. The representative mechanism is different in each country, even though in general most countries use proportionality concept.

Based on the argument above, thus the next hypothesis to be tested to find the effect of previous year's SiLPA amount on executive opportunism is as follow:

H₃: SiLPA positively affects executive opportunism.

3.4. The Effect of Apparatus Integrity on Executive Opportunism

Integrity, according to Random House College Dictionary (1975), is compliance to moral and ethics principles. A person is considered to have integrity when there is a harmony between what they say and what they do (Simons, 2002). Action integrity is certain comfort feeling from a certain act in the past, which aims to protect their identity. Self-integrity is strengthened when "its current self" is respecting its value, even though there is another choice to disrespect it (Khalil, 2004). When one's integrity is "sold", they will feel ashamed (Cohen and Nisbett, 1994), while shame is a certain discomfort feeling which arises, which is mostly not included under breach of honesty (Tangey, 1990).

Righteousness, honesty, dignity, and shame are diverse in one person to another within different culture (Cohen and Nisbett, 1994). An act toward other person within the same group might consider as dishonest. But it might also consider as "smart" act when it is performed on outsider party. Such difference could be an aspect in solidarity within an ethnicity or clan which related to historical oddity or cultural oddity (Mosquera et al 2002).

Shame feeling is happened when someone consider their act as failure toward a standard, rules, and its objectives. Ashamed person want to hide or disappeared or even dead. This is a negative and painful condition, which can disrupt current behavior or communication ability. The body of ashamed person shrinks as if they want to fade away. The power of such emotion and its effect to the whole body makes the only option to get rid of it, is by escaping from such feeling (Lewis, 1995).

Honesty can be "sold" only if the cost of law enforcement is high enough. If the cost of law enforcement is "zero", then honesty will also have "zero" value. Therefore, honesty is not an ordinary item, thus it should not get "sold" for a certain amount of money (bribe) on the expense of others (Coase, 1937). The cost of honesty transaction is a form of opportunity utilization (Williamson, 1975), which is a sense of play or a violation of a binding attachment or consistency over time, that is, honesty.

Honesty is about the "past" and "current" self-consistency, thus it is a form of identity defense, which can be analogized as capital stock (share capital). Akerlof and Kranton (2000) illustrate identity as barrier function of historical and cultural environment. Identity defense and shame avoidance, is centered in a human and its physical and mental health, thus a failure would causing a multiple personality disorder (Lewis, 1995),

Social psychologists have collecting many empirical finding on sense of play and pathology it may produce (Buss, 1980; Tangney and Dearing,

2002). Sociologists have studied the symptoms of shame associated with violence and social deviation (Scheff and Retzinger, 1991). The economists have put some concern on shame, especially related with several term such as "honesty" "trust", "justice", "revenge", etc. (Fher and Gachier cited by Ben-Ner and Putterman, 1998; Khalil, 2004).

The cost of honesty is a gain released to take an advantage over an opportunity. However, such cost is considered as unusual opportunity cost. This means, honesty is a by product of an opportunity over several options taken, thus, in this context honesty could not be reduced and included in one of the options. Honesty in this context requires that it cannot be separated entirely from its foundation, as if a sentence could not stand independently apart of the words that form the sentence (Khalil, 2004).

H₄: Apparatus integrity positively affects executive opportunism

4. RESEARCH METHOD

The data used in this study is quantitative data; the data in numerical that shows the value of variable studied. The data are gathered from secondary sources; or the data from another party who have collected it prior to the research. The sources are; (1) Audit Report from the Audit Board of Republic of Indonesia (Badan Pemeriksa Keuangan-BPK) published from 2008 to 2013; (2) Annual report from the Central Statistical Bureau (Badan Pusat Statistik-BPS) for all district/cities in Indonesia, start from 2008 to 2013.

The population in this study is all districts/cities government in Indonesia with the observation period started from 2008 until 2013. The reason to take this time period is because this study uses panel data or pooled data which is the mixture between cross-section data and time series data. Thus, the wider the time period, the larger samples can be generated.

The sampling method employed in this study is purposive sampling. The sampling criteria in this study are as follows: (1) District/city government has been audited by BPK for started from 2008 until 2013 (budget period); (2) District/city is in Indonesia territorial.

The dependent variable in this study is local government executive opportunistic behavior in preparing budget or executive opportunism. The executive opportunism in this study is proxied using two measurements: 1) the proportion of social expenditure in local government budget, and 2) the proportion of capital expenditure in local government budget.

Social expenditure can become a tool for the government (executive) to gain political support from the people who receive the allocation of these social aids. Executive tends to increase the proportion of social expenditure because it provides discretions (discretion) for they who gain personal benefits (self-interest motive).

According to Mauro (1997a, 1997b, 1998a, 1998b), and Gupta et al. (2002), moral hazard from the politicians and executives in allocation the budget is by allocating smaller funds for education and health care section, because it is hard for them to abuse these two types of expenditure. Further, politicians want larger allocation for infrastructure and job programs because it is a mean for them to fulfill their campaign promises, and it is relatively easy to perform (Keefer and Khemani, 2003; 2004)

and or it is easier to get rents from it (Mauro, 1998a). Meanwhile, Katz and Rosenberg (1989) state that there is rent seeking behavior in the allocation of expenditure in the budgeting process; in the real resources such as labor expenditure and capital expenditure, to be precise.

4.1. Independent Variables

The independent variables or the factors that affect the executive opportunism consist of:

4.1.1. Sources of Income

Local government with large increase on income has high tendency of opportunism because its executive must make a decision on the budget allocation to several expenditure budgets. There are two sources of income analyzed, PAD and balancing fund (measured using DAU). The effect of PAD will be different from the effect of DAU (flypaper effect) and thus, we perform separate analysis to find whether larger increase will result in the higher opportunism.

4.1.2. Integrity

This variable is measured using the number of findings on the internal control system (SPI) shortcomings. The SPI shortcomings can be classified into: 1) Accounting and Reporting Control System shortcoming, 2) Budget Implementation Control System shortcoming, and 3) Internal Control System shortcoming. According to the result of study conducted by Arifin et al. (2015), SPI

shortcoming can be used to explain the level of local government official's willingness in realizing a transparent, effective, and efficient financial governance. The data on the findings of SPI shortcoming is collected from the inspection report from BPK.

The second proxy to measure local government official's integrity is by seeing at auditor opinion on local government financial report. Auditor opinions consist of unqualified, unqualified with explanatory paragraph, adverse, and disclaimer.

4.2. Control Variables

The control variables used in this study are as follows:

1. Local government size proxied with natural logarithm of local government income.
2. Type of local government proxied with dummy variable with 1 for district and 0 for city.
3. Geographical location with several dummy variables that show the region (island) in which the local government is located. There are 6 categories: Java, Sumatra, Borneo, Celebes, East Indonesia (Maluku and Papua) and others (Bali and Nusa Tenggara).
4. Time-fixed effect in the form of dummy variable to control the effect of time period.

4.3. Empirical Techniques

To analyze the effect of independent variables on the dependent variable, empirical models are presented below:

$$\text{SOCIAL_EXP}_i = a + b_1 \text{DAU_REV}_{it} + b_2 \text{PAD_REV}_{it} + b_3 \text{SILPA_EXP}_{it} + b_4 \text{SPI}_{it} + b_5 \text{WTP}_{it} + b_6 \text{LN_REVENUE}_{it} + b_7 \text{DISTRICT}_{it} + \text{AREA} + \text{YEARS} + e \quad (1)$$

$$\text{CAP_EXP}_i = a + b_1 \text{DAU_REV}_{it} + b_2 \text{PAD_REV}_{it} + b_3 \text{SILPA_EXP}_{it} + b_4 \text{SPI}_{it} + b_5 \text{WTP}_{it} + b_6 \text{LN_REVENUE}_{it} + b_7 \text{DISTRICT}_{it} + \text{AREA} + \text{YEARS} + e \quad (2)$$

Notes:

SOCIAL_EXP	-	Social Expenditure Proportion
CAP_EXP	-	Capital Expenditure Proportion
DAU_REV	-	DAU Proportion
PAD_REV	-	PAD Proportion
SILPA_EXP	-	SILPA/ Total Expenditure
SPI	-	Total Finding on Internal Control Weaknesses
WTP	-	Dummy Variable: 1 for local government with unqualified audit opinion, 0 for non-unqualified audit opinion
LN_REVENUE	-	Natural Logarithm of Total Revenue
DISTRICT	-	Dummy Variable: 1 for District, 0 for City
AREA	-	Dummy Variables to control region or location
YEARS	-	Dummy Variables to control period/time
e	-	Error term
i, t	-	individual, time

5. RESULTS

5.1. Samples

The population in this study is all second level local government (daerah tingkat II – city and district) in Indonesia during the observation period of 2008-2013. The data in this study is acquired from local government financial report from BPK. The sampling technique employed in this study is purposive sampling with following criteria. First, the financial report is available. Second, the main variables analyzed in this study are available (reported) in the

financial report. The total number of local governments analyzed is 502 (districts and cities) that generate 1287 observations in unbalanced panel data.

Based on the type (form) of local government, 85.63% observations is district government, while the other 14.37% is city government. Based on the geographical position from the observations (table), 24.3% of local governments observed are in Java, while the 28.7% are in Sumatra, 9.3% are in Borneo, 15.2% are in Celebes, 12% are in East Indonesia (Maluku and Papua), and 8% are in Bali and Nusa Tenggara.

Table 1. The Profile of Observed Local Government based on Geographical location

<i>Island</i>	<i>Observation</i>	<i>Percentage</i>
Java	313	24.3%
Sumatra	370	28.7%
Borneo	120	9.3%
Celebes	196	15.2%
East Indonesia	154	12.0%
Bali and Nusa Tenggara	103	8.0%
Total	1287	100

5.2. Variables

Table 2 presents the descriptive statistics used in this study. Table 5.2 presents statistic for overall observations. Overall, the average proportion for social expenditure (SOCIAL_EXP) is 5.8% from total expenditure, with highest (lowest) proportion of 24.4% (0%). From geographical location as presented in table 5.2, the highest percentage of social expenditure is performed by local governments in Maluku and Papua with the average value of 6.9% and Java with 6,8%. The lowest social expenditure is performed by local governments in Celebes with the average value of 4.6% from total expenditure.

Further, the proportion of capital expenditure on total expenditure (CAP_EXP), the aggregate average is 24.6% with the highest (lowest) value of 80.4% (1.1%). The highest average of capital expenditure is performed by local governments in Borneo with 31.9%, while local governments in Java spend the lowest percentage of capital expenditure with 18.7%.

The average local income from balancing fund in the form of DAU (DAU_REV) is 60% from total local income, while the highest (lowest) percentage of DAU in local income is 92.4% (0.1%). The highest average of DAU percentage in local income is in Bali and Nusa Tenggara with 65.2% and the lowest is in the local government in Kalimantan with average DAU percentage of 49.1% from total local income.

For the local government income from PAD (PAD_REV) the average proportion is 6.3% from total income. The highest proportion is 76.4% and the lowest proportion is 0.3%. The highest PAD is in the local government in Java with the average value of 9.7% and the lowest is in Maluku and Papua with 3.7%.

The average SILPA (SILPA_EXP) is 12.6% from total local expenditure, with the highest (lowest) value is 93.3% (-17.7%). The average SILPA based on geographical location, the highest SILPA is in Borneo with 18.1% from total local expenditure and the

lowest SILPA is in the local government in Celebes with 9.9%.

The report on internal control system (system pengendalian internal-SPI) shortcomings is 10 reports on average; the highest report contains 36 findings, and the lowest report contains one finding. The local governments with the highest SPI shortcomings are located in Maluku and Papua with 12.38 findings each year, while the local governments with the lowest SPI shortcomings are located in Java with 9.02 findings each year.

From the observed local governments, 6.7% obtain unqualified audit opinion, while the rest obtain qualified, adverse, and disclaimer audit opinion. The region with the highest percentage of local government that obtain unqualified audit opinion is Sumatra with 10.3% of all local governments obtain unqualified audit opinion. While the region with lowest percentage of local government that obtain unqualified audit opinion is Borneo with only 3.3% of its local governments obtain unqualified audit opinion.

On the table that present local government size measured using natural logarithm of total local income (LN_REVENUE), the average size of districts or cities based on total income is Rp. 569,560,017,167, with the highest income of Rp. 4,427,118,336,715 and the lowest income of Rp. 74,355,241,127. Based on the geographical location (island) as presented at table, we can find that the local governments with the highest average of total income are located in Java, Borneo, Sumatra, East Indonesia (Maluku and Papua), Bali and Nusa Tenggara, and Sulawesi consecutively.

We can also find that districts governments have a higher average of social and capital expenditure than cities government. Based on the proportion of DAU on total local income, district government has higher average proportion of DAU. While for the proposition of PAD on total income, city government has higher average of PAD proportion.

Table 2. Descriptive Statistic of Variables (all observations)

	SOCIAL_EXP	MODAL_EXP	DAU_REV	PAD_REV	SILPA_EXP	SPI	WTP	DISTRICT	LN_REVENUE
Mean	0.058	0.246	0.600	0.063	0.126	10.002	0.067	0.856	27.216
Median	0.050	0.231	0.636	0.047	0.091	9.000	0.000	1.000	27.180
Maximum	0.244	0.804	0.924	0.764	0.933	36.000	1.000	1.000	29.442
Minimum	0.000	0.011	0.001	0.003	-0.177	1.000	0.000	0.000	25.032
Std. Dev.	0.039	0.110	0.145	0.061	0.132	4.982	0.250	0.351	0.544
Observations	1287	1287	1287	1287	1287	1287	1287	1287	1287

5.3. Correlation between Variables

Table 3 presents correlation matrix between variables. The independent variable in this study is executive opportunism level measured using the proportion of social expenditure on total expenditure (SOCIAL_EXP) and the proportion of capital expenditure on total expenditure (CAP_EXP). The correlation between both variables is -0.026.

The variable proportion of DAU (DAU_REV) on local income has coefficient of correlation of -0.066 with social expenditure and a coefficient of correlation of -0.266 with capital expenditure. The variable, proportion of PAD on local income has a coefficient of correlation of 0.052 with social expenditure, and a coefficient of correlation of -0.224 with capital expenditure. SILPA that has been deflated with total expenditure (SILPA_EXP) has a correlation with social expenditure of 0.052 and 0.160 with capital expenditure. The aggregate SPI shortcoming (SPI) has a correlation with social expenditure of -0.038 and 0.040 with capital expenditure. The local governments that obtain

unqualified audit opinion have negative correlation both with the proportion of social expenditure (0.002) and the proportion of capital expenditure (-0.028). The district government has a more positive correlation with the proportion of social expenditure (0.056) and the proportion of capital expenditure (0.076). While the relationship between local government size measured with total local income; with the proportion of social expenditure is positive (0.112), however, the correlation between the local government size and the proportion of capital expenditure is negative (-0.215).

To find whether there is a multicollinearity problem between explanatory variables, we can analyze the correlation between the variables. If the correlation between the variables is still under 0.5 coefficient of correlations, thus, the level of collinearity can be tolerated. From the correlation table, we can see that there is no correlation between independent variables that is higher than 0.5 coefficient of correlations. Thus, we can assume that the model in this study is free from multicollinearity problem.

Table 3. Correlation between Variables

	<i>SOCIAL_EXP</i>	<i>CAP_EXP</i>	<i>DAU_REV</i>	<i>PAD_REV</i>	<i>SILPA_EXP</i>	<i>SPI</i>	<i>WTP</i>	<i>DISTRICT</i>	<i>LN_REVENUE</i>
<i>SOCIAL_EXP</i>	1.000								
<i>MODAL_EXP</i>	-0.026	1.000							
<i>DAU_REV</i>	-0.066	-0.226	1.000						
<i>PAD_REV</i>	0.052	-0.224	-0.365	1.000					
<i>SILPA_EXP</i>	0.052	0.160	-0.259	0.160	1.000				
<i>SPI</i>	-0.038	0.040	-0.038	-0.020	0.049	1.000			
<i>WTP</i>	0.002	-0.028	-0.005	0.036	0.015	-0.058	1.000		
<i>DISTRICT</i>	0.056	0.076	0.116	-0.235	-0.032	0.069	-0.085	1.000	
<i>LN_REVENUE</i>	0.112	-0.215	-0.413	0.418	0.082	0.042	0.011	0.113	1.000

5.4. Hypothesis Testing

This study is an empirical study to test the determinant of executive opportunistic behaviour measured with two proxies, the proportion of social expenditure on total expenditure and the proportion of capital expenditure on total expenditure. This study takes 502 second level local governments in Indonesia for the period of 2008-2013 as samples. Table 4 presents the result of hypothesis testing using panel data regression that is estimated with ordinary least square (OLS) technique. To minimize the heteroscedasticity problem, we use robust standard error with White cross-section.

The dependent variables in this study are the proportion of social expenditure (SOCIAL_EXP) and the proportion of capital expenditure (CAP_EXP). The explanatory variables used to explain the dependent variables are the proportion of DAU (DAU_REV), the proportion of PAD (PAD_REV), SILPA that is deflated with total expenditure (SILPA_EXP), and two proxies from the apparatus' integrity, the number of SPI shortcoming (SPI) and audit opinion. The audit

opinion is a dummy variable with 1 for unqualified opinion (WTP) and 0 for other opinions.

The control variables inserted in the regression estimation in this study are as follow:

1) The type of government, district or city. In this study, a dummy variable is employed, with 1 for district (DISTRICT) and 0 for city government.

2) The size of second level local government measured with natural logarithm of total local income (LN_REVENUE). Natural logarithm is used to reduce heterogeneity of data due to the high variation on the size of local government (total local income) of each local government.

3) Several dummy variables to control geographical position (island) of the local governments. There are 5 dummy variables, Java, Sumatra, Borneo, Celebes, and East Indonesia (Maluku and Papua), while Bali and Nusa Tenggara is used as benchmark.

4) The dummy variables to control time (period) because the data is panel data which is a combination of time series and cross section data.

Table 4. Regression of Panel Data

	<i>Social Expenditure</i>	<i>Capital Expenditure</i>
DAU_Rev	-0.014*	-0.316***
	(0.007)	(0.039)
PAD_Rev	-0.018	-0.285***
	(0.021)	(0.085)
SILPA_Exp	0.009	0.065*
	(0.008)	(0.035)
SPI	0.00004	-0.0007*
	(0.0002)	(0.0004)
WTP	0.001	-0.009
	(0.003)	(0.006)
DISTRICT	0.012**	0.036***
	(0.005)	(0.008)
LN_Revenue	0.011***	-0.062***
	(0.002)	(0.012)
Java	0.008	-0.023
	(0.007)	(0.017)
Sumatra	-0.007**	-0.005
	(0.002)	(0.008)
Borneo	-0.0005	0.053***
	(0.003)	(0.012)
Celebes	-0.01**	0.022***
	(0.004)	(0.007)
Indo_Timur	0.011*	0.051***
	(0.006)	(0.014)
Constant	-0.237***	2.111***
	(0.072)	(0.345)
Year dummies	Included	Included
White cross-section	Yes	Yes
Method	OLS	OLS
Number of Regions	502	502
Number of Observations	1295	1397
Period	2008-2013	2008-2013
R-Squared	0.273	0.373

Notes:

- Score in brackets is robust standard error
- *, **, *** shows the level of significance at 10%, 5%, 1%

Column 1 at table 4 is the regression model in which the dependent variable is the first proxy of executive opportunism, the proportion of social expenditure. Column 2 is the regression result with the proportion of capital expenditure as the dependent variable. The regression result in column 1 table 4 shows that only the proportion of DAU that is significant (at 1% level) in affecting the proportion of social expenditure. The direction of this effect is negative, which means that the higher the proportion of DAU, the lower the allocation of social expenditure. While the other variables that become the determinant of social expenditure are PAD, SILPA, SPI shortcoming, and audit opinion on financial report do not significantly affect the proportion of social expenditure.

The regression result in column 2 table 4 shows that four independent variables significantly affect the proportion of local government expenditure allocated for capital expenditure. The proportion of local government income from DAU negatively and significantly affects the proportion of capital expenditure. Similarly, the proportion of PAD in local government income significantly and negatively affects the allocation of capital expenditure. SILPA positively affect the allocation of local government expenditure used for capital expenditure. The last, the more shortcomings of SPI found, the lower the allocation of capital expenditure addressed for SPI coefficient.

The regression results for control variable show that district governments tend to allocate the

proportion of its budget on social expenditure and capital expenditure higher than city. This is shown in the coefficient of dummy variable district that is positive and significant in all models. The local government size proxied with total income has positive and significant effect on the proportion of social expenditure; however, it has significant and positive effect on the proportion of capital expenditure.

5.5. Robustness Checks

To test the consistence of the result of this study, we perform some robustness checks. First, switch the previous proxy of executive opportunism to the proportion of grant income on total local government income. Second, grant expenditure has similar characteristic with social expenditure. The result of this test shows a relatively consistent result with previous finding that local government with high proportion of DAU tends to allocate small budget for grant expenditure. Third, to enable researcher to test the empirical model using fixed-effect panel data, the variables which is time-invariant are excluded from the model, the variables are 1) dummy variable to classify type (form) of local government, district or city; and 2) dummy variable to control geographical location (island). The result of regression estimation shows consistent result with the previous result presented in the main regression results.

5.6. The Effect of PAD on Executive Opportunism

The result of this study also shows negative and significant effect (on 1% significance level) of the proportion of PAD on the proportion of capital expenditure (-0.285). This finding does not support the hypothesis 1 in this study. This shows that local government with higher proportion of PAD on total income tends to allocate fewer budgets on capital expenditure, which in fact provide an opportunity for the executives to perform rent-seeking behavior. Further, the regression result on the effect of PAD on the proportion of social expenditure is negative but not significant (-0.018). This finding also does not confirm the hypothesis which proposed that the higher the proportion of PAD will increase the incentive for executives to perform opportunistic behavior.

Research conducted by Torpey-Saboe (2015) explain that the role of local government in providing social spending (social grant) will decreased when there are large number of NGOs (non-governmental organizations) that operate in the region. This due to NGOs substitutes the government's role in performing various social activities for the society. NGOs can be easily found in a local government with high PAD but have not optimally utilized this fund for the society in their area. Besides that, the existence of NGOs in local territory has a role in controlling local government, especially in its relation with the abuse of local government budget for inappropriate social expenditure.

This finding can explain why the high proportion of PAD is not exploited by local government to perform opportunistic behavior by allocating high social expenditure, especially granted to the supporter of ruling party as a part of grabbing hand behavior (Shleifer and Vishny, 1994; 1998) or state assets exploitation for politicians or bureaucrat's interest.

5.7. The Effect of DAU on Executive Opportunism

In line with the regression result presented in table 4.12, the result of this study shows that the proportion of DAU (balancing fund) in total income has negative and significant effect both on social expenditure (-0.014) and capital expenditure (-0.316) as the proxy of executive opportunism. This finding does not support the second hypothesis in this study which proposed that executive tends to utilize DAU which is balancing fund granted by state government to be allocated for the expenditures that benefit their own interest; social expenditure that can be used to attract political support from the society and capital expenditure that provides an opportunity to perform rent seeking behavior.

This research finding can be explained by the finding of research conducted by Klein and Sakurai (2015). They conduct a study with interesting result. In Brazil, in which the research is performed, they find that local executive who lead for the first time and have an opportunity to run as a candidate for the second period will change the composition of local government budget by spending more fund on social and capital expenditure to attract more support from people when they get closer to the election period. The addition to the proportion of

social and capital expenditure is a populist policy that can be performed by incumbent to maintain and spread public support.

In this study context, during the research period, there are large number of local executives who are incumbent (in their second period of service), thus the incentive that they may acquire from performing populist budget policy (increasing capital and social expenditure) is low. This may become a factor that causes the difference between proposed hypothesis and research result in this study.

5.8. The Effect of SILPA on Executive Opportunism

Refers to the result of empirical model estimation using panel data regression, we find that local government with SILPA allocates more funds for capital expenditure in the form of land, buildings, equipment and machineries, roads, irrigation and network, building in construction progress and other assets that make it easier for executives to extract resources and taking personal advantages. This result confirms the third hypothesis which states that SILPA has positive effect on executive opportunism behavior. However, we do not find the effect of the amount of SILPA on the allocation of social expenditure.

The explanation that can be offered to explain this empirical result is: for local government executive, SILPA provides incentive (encourage) for perform opportunistic behavior in the form of capital expenditure. However, the high proportion of SILPA does not stimulate the increase in social expenditure that is aimed for executive opportunistic interest.

5.9. The Effect of Officials' Integrity on Executive Opportunism

The finding from Arifin et al. (2015) study mentions that in Indonesia the finding on local government internal control shortcomings has positive correlation with the level of corruption in the local government. Thus, the more shortcomings found in internal control shows the low integrity of local government executive because some of those shortcomings are designed to find loopholes in rent seeking or other private benefits. Base on this assumption, this research hypothesized that the more shortcomings found in internal control, the lower the local government officials' integrity, and this, in turn will positively affect local government executive opportunism behavior. However, the hypothesis is not confirmed in this study. The regression result shows negative effect of the number of findings on SPI shortcoming on capital expenditure and no significant effect on the proportion of social expenditure. Likewise with the second measurement of officials' integrity, the audit opinion; there is no significant effect of audit opinion on the proportion of social and capital expenditure.

Even though this study result does not show that officials' integrity, measured using finding of SPI shortcomings, has positive effect on opportunistic behavior, but we can observe that there is a decrease in people trust toward local government caused by ineffective and inefficient

services, low integrity, corruption and inappropriate utilization funds, and poor leadership. This can be seen from the decrease in people participation in local government election in Indonesia.

According to Brillantes and Fernandez (2011), the phenomenon of decreasing people trust on government official's integrity must be addressed and restored immediately through several means such as, institutional and organizational reformation, officials' mindset and behavior reformation, reformation in leadership, and improvement in people involvement and participation. Because integrity is a construct developed from various segments, mainly from morality and inner drive, a comprehensive reform is needed (Barnard et al., 2008).

6. CONCLUSION

Some concluding remarks are gathered from the empirical results. First, local government executive opportunism behavior in local government budgeting can be seen from the allocation of expenditure components. An opportunistic executive will allocate the funds to the expenditure posts that provide discretion and opportunity to seek rents or other private interests, such as by increasing the proportion of social expenditure that can be used for political interest in finding and managing political support from certain constituent group or by increasing the proportion of social expenditure that can provide an opportunity to seek rents. Second, executive opportunistic behavior is encouraged by two factors, internal factor in the form of low integrity and external factor in the form of opportunity to perform opportunistic acts reflected in the composition of income in local government budget.

Third, the result of this study does not confirm the hypothesis that the higher the proportion of balancing fund from state government (DAU), the higher the proportion of budget allocated to capital and social expenditure as a proxy of executive opportunism behavior. Fourth, the result of this study does not confirm the hypothesis which proposed that the higher the proportion of PAD on local government income will increase the incentive for executive to perform opportunistic behavior through the increase in the proportion for social and capital expenditure. Fifth, the result of this study confirms the hypothesis that the higher the difference in budget estimation, the higher the allocation for capital expenditure that may provide an opportunity for the executive to perform rent seeking behavior. Sixth, the result of this study does not confirm the hypothesis that local government officials' integrity has an implication on the high opportunistic behaviors performed by local government executive.

7. IMPLICATIONS

Some policy implications are provided by this study. First, even though some hypotheses are not supported, the opportunism behavior in the local government management especially in the budget politic, really exist. The executive opportunism behavior can be minimized by designing a more transparent budgeting system and based on

integrated information system. Second, the limitation of fiscal room in almost all local governments in Indonesia may create a hindrance for local government executive to perform opportunistic behavior in rent seeking context. Third, the findings on SPI shortcomings in the local governments in Indonesia each year is still relatively high. This may become a loophole or an opportunity for local government executive to perform opportunistic behavior. Fourth, the phenomenon of decreasing people trust level on state officials' integrity must be addressed and restored immediately through several means such as institutional and organizational reformation, officials' mindset and behavior reformation, reformation in leadership, and improvement in people involvement and participation.

8. LIMITATIONS

However, several limitations of this study are acknowledged. First, observation period (time series) is relatively short, only six years (2008-2013), thus, it is impossible to capture wider and longer phenomena. Second, the executive opportunism variable is only measured based on the proportion of social expenditure on total expenditure and the proportion of capital expenditure on total expenditure. The measurement is incapable to find the changes in these proportions. Third, this study employees an estimation on static panel data in which we assume that the dependent variable is not affected by the independent variables value in the previous period. The dynamic panel data method may result in a more solid and robust regression result. Fourth, the model and regression estimation in this study do not test the endogeneity problem that might appear. The endogeneity problem might appear because the explanatory variables are not fully exogenous. Fifth, there is no empirical testing on the effect of local government political configuration on the local government executive opportunistic behavior. The political configuration can be viewed from political incumbency, ruling party characteristic, and the composition of local parliament member might affect the behavior of local government executive.

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