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Good governance and the impact of government spending on performance of local government in Indonesia

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Abstract: This paper studies the links between public spending, good governance, and its outcomes which measured by performance of local governments. This paper aims to examine the effect of government spending and good governance on performance of local government and whether good governance can strengthen the effect of government spending on performance. This paper based on 1,044 observations of local governments in Indonesia from 2009 until 2012. This paper contributes by providing an understanding of the relationship between public spending, governance and government performance and provides explanation of the mixed evidence that public spending often does not yield the expected outcomes. This research provides interesting empirical evidence that the expenditure of local government in Indonesia is inefficient in increasing performance. In the contrary, the result shows the negative effect of government spending on performance. The good public governance influenced positively toward performance and reduced the inefficiency of government spending.

Keywords: public sector; local government; efficiency; government spending; good governance; Indonesia.

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1 Introduction

One of the government's functions is to provide service to the people. To achieve the goal, the government needs to improve the quality of public services. In these efforts, some countries have done public sector reform in the last decade. The government reforms have been associated with the application *new public management* (NPM) (Pollitt and Bouckaert, 2000). NPM emphasises on decentralisation and modernising the service of public sector. In the modern public sector management, the ultimate goal of the government is to provide high quality of public service. This research aims to examine the link between government spending, good public governance, and performance – as measured by the quality of public service – of the local government in Indonesia.

Most of previous researches on NPM focus on the western countries, not many of the researches focus on the emerging countries, especially countries in Asia. Asian countries face wide divergence within this vast geographic region. The magnitude of the variation among countries will make a large difference in the economic growth among countries in Asia region (Dana, 2014). This research focuses on Indonesia for several reasons. First, Indonesia is the largest economy in Southeast Asia that has charted impressive economic growth since the Asian financial crisis of the late 1990s. Today, Indonesia is the world's fourth most populous nation, the world's tenth largest economy in terms of purchasing power parity, and a member of the G-20 (World Bank, 2016). Second, Indonesia, as one of the emerging country in Asia has begun to decentralise the power of central government to local government in 1999. Indonesian Act No. 22 Year 1999 about Local Government and Indonesian Act No. 25 Year 1999 about the Financial Balance between Central and Local Governments start the era of fiscal decentralisation in Indonesia. Decentralisation aims to give the authority to the local government to exercise regional autonomy in developing the region except for some matters that are still in the control of the central government. Third, with regard to the management of government spending, Indonesia still has a serious problem. The significant increase in the government spending cannot be managed properly by the local government. The condition is worsened by the high number of corruption cases in the local government level. Therefore, we believe that the research on the impact of government spending on performance and the role of good governance in the context of local government in Indonesia is very important.

Among the authorities that are decentralised includes giving service to the people in the areas of health, education and infrastructure development. The Indonesian Government, both central and regional level has large budgeted funds. Budget for education, health, and infrastructure for example, has experienced a significant growth from year to year. Based on data from 2009 until 2014, the public spending for education both spend by central government and local government has contribute more than 20% of the total spending, while the ratio of public health spending to the National Budget reached more than 3%.

However, the increase in the government spending apparently is not accompanied with the improvement of the quality of the output. The quality of education, based on several indicators such as the participation in education both in formal and informal programs, the level of education attained by the people 15 years old and above, and illiteracy rates showed a small growth and tends to stagnate in some regions. While the outputs from health expenditures also show that the health quality that based on several indicators such as the number of health infrastructure such as hospitals, community

health centres, number of medical doctors, the midwives, and nurses, the number of protein per capita, mortality rates, and the nutrition status for children under five also experienced insignificant improvement, and even tend to decreasing in several indicators.

One of the main problems in the management of public sector in Indonesia is inefficiency of government spending which government spending cannot increase the quality of public service and the welfare of the society. Inefficiency happened when the government spending do not result expected outcome. One of the main objectives of the government spending is to deliver service to the people at high quality of service. A higher government spending should lead to better outcome. If the local government spend their money and yet cannot give the high quality of service, then the local government spending is not efficient. Based on this argument, we define efficiency in government spending as a positive effect of the spending on the economic outcome. If the government cannot manage their spending efficiently, then increase in the government spending do not lead to increase in the economic outcome.

There are many factors that determined the inefficiency of government spending. Poor governance and corruptive environment is one of main factors that have been cited from previous literatures. The difference between inefficiency and corruption is often unclear. Inefficiency occurs when spending as a resources produce less than maximum economic outcome. While corruption is a dishonest or fraudulent conduct by those in power. The two definitions link each other, that are the inefficiency and corruption are two different things but inefficiency can (most likely) due to corruption. Moreover, the corruption is a result of poor governance. The existence of good governance should lead to improvement of efficiency in government spending.

Poor management and governance has frequently been cited from previous literatures as one of the main reasons why governments in developing countries fails to transform a huge public spending into high quality of service. Based on this problem, this research aims to empirically examine the effect of government spending on the performance – as measured by the quality of public service – of the local government in Indonesia, and how the good governance of public sector especially local government in Indonesia effect the efficiency of government spending.

This paper contributes the literature in several ways. First, this paper develops the construct and measurement of good public governance for local government in Indonesia. Second, this paper considers the role of good governance in increasing the efficiency of government spending. The role of good governance in increasing the efficiency of local government spending has not been considered in the previous research especially using the emerging country context. Based on the empirical data of local government in Indonesia during the year 2009–2012, we show that public sector governance experience an increasing trend. The increase indicates that there is improvement of the quality of governance by the local government. We show empirically that the government spending by local government is not efficient in improving performance and the governance of public sector significantly influenced positively toward performance. Governance in general can moderate the relationship between the local government spending and the performance. The results of the study showed that the quality of governance can improve the inefficiency in government spending in improving performance. These findings provide one possible explanation on the mixed evidence of the effect of public spending on the outcomes.

In measuring performance and the quality of governance of local government, this research uses data from Indonesian Ministry of Domestic Affairs. For the performance measurement, the data used in this research are based on the evaluation result of the quality of service based on several areas such as education, health, infrastructure, environment, investment, etc. The Indonesian Ministry of Domestic Affairs scored the quality of service performance based on the disclosure in the financial and activity reports from local government. For the quality of governance, the data used in this research also based on the evaluation report from Indonesian Ministry of Domestic Affairs. We then classify the result scoring from the Ministry of Domestic Affairs into five principles of governance, democracy, transparency, accountability, culture of law, and fairness and equitable. We believe our data sources are qualified for at least three reasons. First, the scoring done by the Ministry of Domestic Affairs based on the publicly available data which are the financial statement and report of the local government activity implementation and the scoring method was also published through government regulation. The Ministry of Domestic Affairs also published the score result each year. Second, the scoring uses a comprehensive element of performance and governance. The content of the performance measurement and government measurement covers a comprehensive aspect of both variables. For performance measurement it covers the quality of service provided by local government in several affairs such as education, health, infrastructure, investment, etc. For the governance measurement it covers the main principles in governance. Third, the performance data that we used is consistent with other economic outcome because this data indicate the same direction of movement with other economic data, then we can conclude that the data is robust with other outcome data. Based on those arguments we believe that the data that we used provide a strong data baseline.

The remainder of the paper is organised as follows: in Section 2, we briefly review previous literatures and develop the hypothesis; Section 3 we discuss the research methodology; Section 4 we analyse the research results and also discuss the robustness test of our empirical results. We conclude our discussion and explain out limitation and suggestion for further research in Section 5.

2 Literature review and hypothesis development

2.1 Agency theory in public sector

Jensen and Meckling (1976) in the agency theory explained that the agency relationship arises when one or more people as the principal employ others as the agent and then delegate the decision-making authority to the agent. In the public sector, agency relationship can be seen from the relationship between the government as the agent and the people as the principal that delegate the authority to the government in decision making including in budget decision and provide services to the interests of the people. The government can do the policies that self-interested and sacrificing the interests and welfare of the people. In this condition the agency problem emerges.

The agency relation may cause a positive effect in the form of efficiency and may also cause an opportunistic behaviour. The agency problem exists when the government or executive tend to maximise their personal or group interests, while sacrificing the interests of the people. In the budgeting process in the local government, the executive

will secure their position by doing the budgetary slack for their personal interests rather than for the people interests (Latifah, 2010). In the issue of local government spending, agency problems often appear when the government represented by the heads of local government takes policies for the benefit of themselves and the group but at the expense of the people. This will cause inefficiency in the government spending.

2.2 Regulatory control on the local government

Regulation is normally thought of as government regulation of the private sector and public sector (James, 2000). Regulatory control for government is a limitation stated in the regulation that controls the activities of a government entity in compliance with the requirement of a regulatory agency. The local governments face many regulatory controls, for example they have to publish financial statement and activity report according to the standard, and the financial statement is audited by the supreme auditor. The supreme auditor audits the financial report of the local governments and release audit opinion and publish audit findings and evaluation of internal control of the local government. Other regulatory control example is in the budgeting process; the local government must submit the budget based on the regulation about the budget process.

In regard to regulatory control, the local government in Indonesia, as well as various institutions in the country, is facing problems in term of enforcement of the existing regulations. Control environment in the application of good governance has been built with the support by regulations. However, in practice the implementation of the regulation is limited by weak enforcement of the regulations. This leads to inefficient regulatory control in Indonesia. Because this weak regulatory control in Indonesia, therefore the evaluation on how the quality of governance implementation impact the economic outcomes would be crucial.

2.3 Public sector performance

The performance of public sector organisations is a multi-dimensional concept because the performance of the public sector organisation can be seen from various aspects. Niven (2003) stated that there are some concepts of performance measurements, namely:

- 1 financial accountability, which focuses on the size of the budget
- 2 output program which based on the amount of products or services produced or on the number of people served
- 3 adherence to standards of quality in service delivery which based on the fulfilment of the standard services required by the government
- 4 participant related measures which based on the quality of service in accordance with priority needs
- 5 key performance indicators which based on the formation of certain criteria that are considered to represent an area that is evaluated and then built an indicator that can measure the criteria
- 6 client satisfaction which based on the customer satisfaction on the provision of goods or public services.

Ministry of Domestic Affairs in Indonesia already developed performance evaluation measurement for local government which measure the quality of service based on several areas such as education, health, infrastructure, environment, investment, etc. This measurement fits with the concept of outcome for public spending because this measurement comprehensively measures the program achieved by the local government, the fulfilment of the standard services, and the quality of service from local governance. This measurement of performance of local governance is based on the perspective of output program, adherence to standards of quality in service delivery and participation related measures.

2.4 Government spending

Government spending is amount of money that government spends in a particular period for the activities which include government consumption, investments, and transfer payment. The goal of this government spending is for the achievement of the overall prosperity of the society. Government spending includes spending by the central government and local government (province and district/city). The central government spending covers the expenditures at the national level. While the local government spending covers the expenditures for the local employees, procurement of goods and services, maintenance, official travel, loans, subsidy spending, grants, social assistance and other operational spending, and capital spending by local government which includes investment in fixed assets, other assets and unexpected spending.

2.5 Public sector governance

Public governance focuses on the relationship of power between government authorities, civil society and the market that aimed at generating rules and regulations and delivering services to the community of citizens. Good public governance is a condition of public governance which has eight main characteristics which are participation, the rule of law, transparency, responsiveness, consensus orientation, equity and inclusiveness, effectiveness and efficiency and accountability (Sancoko et al., 2008). Specific to government, OECD defines government governance as:

"Safeguarding the interrelationship between management, control and supervision by government organisations and by organisations set up by government authorities, aimed at realising policy objectives efficiently and effectively, as well as communicating openly thereon and providing an account thereof for the benefit of the stakeholders."

The International Federation of Accountants (IFAC) in cooperation with the Chartered Institute of Public Finance and Accountancy (CIPFA) on 2013 issued the consultation draft about the international framework for implementation the principles of good governance in the public sector. Main principles in good governance in the public sector are explained as follows:

- 1 The function of good governance in the public sector is to ensure that the public entity at any time act according to public interests. In acting in accordance with the interests of the public, it needs:

- a a strong commitment on the integrity of the values ethics and the rule of law
 - b openness and comprehensive ties with stakeholders.
- 2 As additional requirements in the act in accordance with public interests, achieving good governance in the public sector also requires:
 - a define outcomes in the form of sustainable economic, social and benefits for the environment
 - b determine the need for the intervention needed to optimise the achievement of outcomes
 - c build the capacity of the entity including the capabilities of the leadership and the individuals in it
 - d manage risk and performance through a strong internal control and public financial management is good
 - e implement good practice in transparency and reporting to convey an effective accountability.

The Indonesian National Committee of Governance Policy (2010) formulate principles in the public good public governance namely democracy, transparency, accountability, culture of the law and fairness and equality. The committee also made the guidelines of the actualisation of those principles for the local government that includes guidelines for legislative, executive, judiciary, and non-structural agencies. The principles of good governance in the public sector are defined as follows:

- 1 democracy: state implementation that is based on the elements of participation, the recognition of difference opinion and the embodiment of public interest
- 2 transparency: transparency contains elements of the disclosure and the provision of adequate information and easily accessible by the stakeholders
- 3 accountability: accountability contains elements of the clarity of the function in the organisation and how to accountable the government policy
- 4 the culture of the law: the culture of the law contains elements of the law enforcement explicitly without respect of persons and obedience to the law by the community-based awareness
- 5 fairness and equality: fairness and equality contain elements of justice and honesty so that in its implementation can be realised equal treatment of stakeholders in a responsible.

The objective of this research is to examine the role of good governance on performance by evaluating how the quality of implementation of good governance principles affects performance and moderate the spending-performance relationship. Different with Giroux and McLelland (2003) that study the effect of governance by examine different structure of governance, this research examine the quality of good governance based on the five principles above, namely democracy, transparency, accountability, culture of law, and fairness and equality. We measure the quality of governance based on the governance principles not based on the government structure as study by Giroux and McLelland (2003) because in term of structure there are no differences among local governments in Indonesia.

2.5 Previous research and hypotheses development

Efficiency in the government spending has become an issue that is currently widely studied in the area of public finance. In the country with high economic growth, high level of efficiency of the government spending aimed to satisfied the interest of opposition and tax payer (Heller and Hauner, 2006), whereas in developing countries, the level of efficiency in government spending is a complement to social spending by the public. In line with the economic growth of a country, the demand for efficiency on government spending will increase.

Previous research on how the impact of government spending on the outcome provide mixed results. A number of previous studies that examine the public sector efficiency link the government spending with some socio-economic outcome such as education, the number of mortality ratio baby, the number of infrastructure, and others (Afonso et al., 2006; Gupta et al., 2002; Tanzi and Schuknecht, 1997, 2000). Schultz (1961) states that health spending increases growth through an increase in productivity. Manasan et al. (2007) state that education spending positively affects the wealth of the people. Gupta et al. (2002) study on the effectiveness of the health and education expenditures with samples of 50 developing countries. The research provides empirical evidence that public expenditures in the field of education have a positive impact in improving basic education in school participation (primary and secondary school). The 1% increase in health expenditures can reduce mortality rate under five years around 3 per 1,000 births. Allocation for expenditures to education and health can improve the economic growth and increase the welfare, so that every developing country need to give special attention to allocating expenditures education and health expenditures.

Filmer and Pritchett (1999) study the impact of public health and non-health expenditures (economy, education, culture) to the mortality of the children under age of five years. The research shows that public health expenditures have little impact in reducing the number of mortality under age of 5. Rajkumar and Swaroop (2008) doing research about the relationship between public expenditure and *outcome* in 91 countries. Their research shows that public expenditures often do not produce the expected increase to the outcome.

Despite of the mixed result from the previous literatures, most of the literatures provide evidence on the effect of government spending on the number of the economic outcome indicators. Since the objective of the government spending is to achieve the overall prosperity of the society by providing high quality of the public service, thus government spending should increase performance of the government, both central and local government. In the context of local government, the local government spending should increase the performance of the local government measured by the service quality provided by local government as intended by decentralisation.

Based on the above arguments, the hypothesis proposed research in this research is as follows:

H1 Local government spending positively affects the performance of local government.

The function of good governance in the public sector is to ensure that the public entity at any time act according to public interests. By doing good government governance, the government will take policies that align with the implementation of the principles in the public good public governance. Thus the policies will focus on the fulfilment of high quality of public service. Some other research also shows the good governance is one of

determining factor of economic outcome. Easterly and Levine (1997) reveal that good governance is the aspects that are crucial in pursuing high economic growth. To test the effect of public governance on the performance we develop hypothesis as follow:

H2 The public governance positively affects the performance of local government.

Good public governance can help the government in evaluating and monitoring the government spending in order to increase performance. The local government that has better governance should perform better because their policy and decision is made in order to meet the interest of the public. Keefer and Knack (2007) study the effect of public spending on the economic productivity and they state that the effect of public spending on productivity depends on the quality of government. They reveal that the negative effect of the public spending on productivity is due to low quality of governance. Rajkumar and Swaroop (2008) also show that there is a difference effectiveness of public expenditure due to quality good governance. Public health expenditures reduce the number of mortality under 5 years old in countries with good governance. That is also the case with basic education expenditures to be more effective in countries with good governance principles. Instead, in the country with bad governance, the expenditures for the health sector and public education almost do not affect the outcome. Butkiewicz and Yanikkaya (2011) also show that consumption spending decrease economic growth in developing countries that has low quality of government.

To test whether the good governance in the public sector can increase the efficiency of public expenditure in increasing performance we develop hypothesis as follow:

H3 The efficiency of the government spending in improving the performance is strengthened with good governance of the local government.

3 Research methodology

The purpose of this research is to examine the effect of government spending and good governance on performance and whether good governance moderates the relationship between government spending and performance. This research evaluates all local government, districts and cities in Indonesia during 2009 to 2012. The year of 2009 is chosen as starting year because government of Indonesia start to make performance evaluation for local government and published the evaluation report in this year.

This research uses quantitative approach to test the hypothesis. To test the effect of government spending on performance, we develop following regression models. To test the effect of government spending on the performance we use $t + 1$ performance because the impact of government spending cannot be directly perceived at the moment, but will have an impact in the period thereafter. To control for differences in performance due to the characteristics of the local government, the model bellow controls for several aspects such as population to control the size differences between region, Gini ratio to control differences in the level economic discrepancy between region, local income to control differences in the region's ability to generate their own revenue independently, and current period performance to control the differences of performance due to previous year performance. The model is as follow:

$$PERF_{it+1} = \alpha_0 + \alpha_1 TOTSPEND_{it} + \alpha_2 GOV_{it} + \alpha_3 POP_{it} + \alpha_4 GINI_{it} + \alpha_5 LOCALINC_{it} + \alpha_6 PERF_{it} + \varepsilon_{it} \quad (1)$$

where $PERF_{it+1}$ is the level of performance for the local government i in year of $t + 1$; $TotSpend_{it}$ is the total government spending for local government i in year t ; Gov_{it} is the good governance score for local government i in year t ; Pop_{it} is the log natural of total population for local government i in year t ; $Gini_{it}$ is the Gini ratio for local government i in year t ; $Localinc_{it}$ is the ratio of local income to total income for local government i in year t ; $PERF_{it}$ is the level of performance for the local government i in year of t .

To test the third hypothesis, we add interaction term between total spending and good governance. The model is as follow:

$$PERF_{it+1} = \alpha_0 + \alpha_1 TOTSPEND_{it} + \alpha_2 GOV_{it} + \alpha_3 TOTSPEND_{it} * GOV_{it} + \alpha_4 POP_{it} + \alpha_5 GINI_{it} + \alpha_6 LOCALINC_{it} + \alpha_7 PERF_{it} + \varepsilon_{it} \quad (2)$$

To test the impact of government spending to performance and the role of good governance in several main affairs such as education, health and infrastructure, we also conduct additional test using above model with adjustment to the type of spending and performance. We choose education, health and infrastructure because spending in these affairs is the highest portion of local government spending. For education affair, we test model 1 and 2 using education spending and local government performance in education affair. For health affair, we test model 1 and 2 using health spending and local government performance in health affair. For infrastructure affair, we test model 1 and 2 using infrastructure spending and local government performance in infrastructure affair.

The explanation about the measurement of the variables is as follows:

1 Performance

This study uses performance score based on the performance evaluation conducted by the Indonesian Ministry of Domestic Affairs which measure the quality of service provided by the local government. This measurement is used because it is most comprehensive performance measurement that score the quality of service which covers several areas of affairs such as education, health and the environment, infrastructure, youth and sports, investment, population, employment, food resilience, empowerment of women and children protection, family planning and welfare, transportation, communication and information, politics, community and villages empowerment, social, culture, etc. The score range from 0 to 4, score 0 to 1 is classify as low performance, score 1 to 2 is classify as moderate performance, score 2 to 3 is classify as high performance, and score 3 to 4 is classify very high performance. For main analysis we use total score of performance and for additional analysis we focus on three affairs namely education performance, health performance, and infrastructure performance. The detail of measurement item for performance can be seen in Appendix 1.

2 The government spending

Government spending measured by natural logarithm of total local government expenditures for one period. Local government spending data were taken from the database of the Indonesian Ministry of Finance. For additional analysis we use spending from three main affairs, namely education spending, health spending and infrastructure spending.

3 Governance

Good governance measurement used in this research was taken from the score data based on evaluation score of the implementation of regional government published by Indonesian Ministry of Domestic Affairs which includes several indicators. We develop the governance measurement based on the five principles of good public governance published by Indonesian National Committee on Governance Policy which are democracy, transparency, accountability, culture of law, and fairness and equality. Based on the principles we develop the indicators of each principle which described in Table 1 and Appendix 2 describes the detail measurement of governance variables.

4 Population

Total population is used as a variable control to control the size of the difference between the regions. This research used total population as the size of the district.

5 Gini ratio

GINI ratio is used to control the differences between the regions level of prosperity from the perspective of the level of imbalance of prosperity. To calculate the GINI ratio we used the equation below:

$$G = 1 - \sum_{i=1}^k f p_i (F c_i + F c_{i-1})$$

where

$f p_i$ frequency of inhabitant in i^{th} class of income

$F c_i$ cumulative frequency of total income of i^{th} class of income

k number of class of income

$F c_{i-1}$ cumulative frequency of total income of $i^{\text{th}} - 1$ class of income

6 Local income

The total income of local government consists of local income which is income generated by the local government from their own sources of revenue, and income from transfer from central government to local government. The original regional income represents the level of independence of the region. The larger the ratio of local income to total income against the total regional income it can be said that regions are more independently. This variable is measured using the ratio between the numbers local income with total income.

Table 1 Indicator for measurement of good governance

Principle	Definition	Indicator
Democracy	The conduct of the government that is based on the elements of participation, the recognition of different opinion and the embodiment of public interest.	Participation Recognition of differences Embodiment of public interest
Transparency	Transparency contains elements of the disclosure and the provision of adequate information and easily accessible by the stakeholders.	Disclosure Provision of adequate information
Accountability	Accountability contains elements of the clarity of the function in the organisation and how to account it.	Clarity of the function Accountability
Culture of law	The culture of the law contains elements of the law enforcement explicitly without respect of persons and obedience to the law by the community-based awareness.	Law enforcement Law obedience
Fairness and equality	Fairness and equality contain elements of justice and honesty so that in its implementation can be realised equal treatment of stakeholders with high responsible.	Fairness Equality Honesty

4 Analysis of research results

4.1 Research sample

This research uses the local government data from 2009 until 2012. The sample selection procedure can be seen in Table 2. The sample exclude for outlier observations that are outside the average ± 3 times the standard deviation for each of the variables in each models of research.

Table 2 The sample selection procedure

The number of the regional government of the year 2009–2012	2,141
The number of local government that have performance and governance assessment	1,781
The number of local government which have complete data for all variables	813
The number of samples after the outlier spending	1,044

4.2 Descriptive statistics

Table 3 provides descriptive statistics for dependent and independent variables. The average performance of local government for our sample is 2.28 and the highest performance is 3.2 and the lowest is 1.47. For education, health, and infrastructure affairs the average performance is 2.93, 2.60 and 2.41 respectively. Based on the statistics, the education affair has the lowest standard deviation which implies that education

performance in local government in Indonesia is less vary across observation. The governance score is 2.37 with the highest score is 3.42 and the lowest score is 0.76.

Table 3 Descriptive statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
Perf	1,044	2.284425	.5082017	.1476952	3.278811
Edu_Perf	1,044	2.934175	.6836386	0	3.9984
Health_Perf	1,044	2.608477	.7283525	0	4
Inf_Perf	1,044	2.414432	1.04605	0	4
Gov	1,044	2.375933	.443262	.7618067	3.425342
TotSpend	1,044	7.47e+11	6.05e+11	2.89e+10	1.33e+13
EduSpend	1,044	2.84e+11	2.38e+11	1.10e+08	3.30e+12
HealthSpend	1,044	8.58e+10	8.28e+10	3.08e+08	1.78e+12
Infraspend	1,044	2.08e+11	1.63e+11	1.83e+09	2.85e+12
Pop	1,044	507431.5	573977	16625	5072116
Gini	1,044	.307388	.0514323	.13225	.50532
LocalInc	1,044	.0687036	.0573534	.0017854	.686931

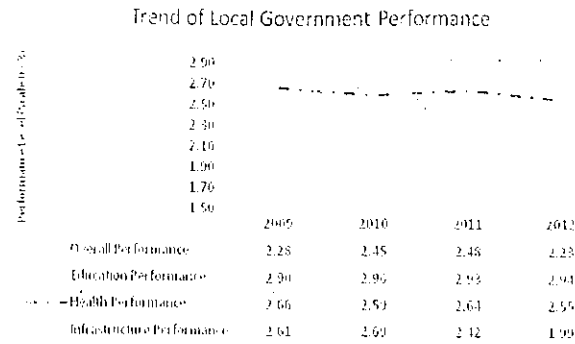
Figures 1 and 2 show that despite of the significant increasing trend in the government spending during 2009 until 2012, average performance of local governance is increasing modestly during 2009 to 2011 and decreasing during 2012, with the average number are 2.2804, 2.4524, 2.4819 and 2.2360 for year of 2009, 2010, 2011 and 2012 respectively. Based on the descriptive analysis, the movement of the average total spending tends to significantly increased during year 2009 to 2012. On the other hand, the levels of performance for local governments (districts and cities) tend to slightly decreasing. This indicates that during the period the efficiencies of government spending are decreasing. Meanwhile, based on the education, health and infrastructure affairs, Figures 1 and 2 also show that the government spending in those three affairs are also increasing during the sample period and the performance in education slightly increases but performance in health and infrastructure tend to decrease.

Figure 1 Local government spending (see online version for colours)

Trend of Government Spending (District and City)

	2009	2010	2011	2012
Education Spending	151,200,000,000.00	250,000,000,000.00	323,775,000,000.00	400,000,000,000.00
Health Spending	100,000,000,000.00	120,000,000,000.00	130,000,000,000.00	150,000,000,000.00
Infrastructure Spending	300,000,000,000.00	400,000,000,000.00	470,000,000,000.00	500,000,000,000.00
Total Spending	750,000,000,000.00	800,000,000,000.00	920,000,000,000.00	1,000,000,000,000.00

Figure 2 Local government performance (see online version for colours)



Public sector governance during 2009–2012 experiences an increasing trend. This can be seen in Figure 3 which shows that in the period 2009 until 2012 governance score has increased. The increase indicates that there is improvement of the quality of governance by the local government. The quality of governance has increased from a score of 2.278 on 2009 become 2.379 on 2010, and experience a slight decrease in 2011 to 2.353, then increase return on 2012 become 2.466. During the year 2009–2012, the quality of public sector governance achieved by local government can be categorised as high quality as a score ranging between 2 to 3. Based on the principles of good governance, Figure 4 shows that culture of law index has a value of the highest score compared with other index. While transparency index has the lowest score compared with other index.

Figure 3 The quality of public sector governance at the local government during 2009–2012 (see online version for colours)

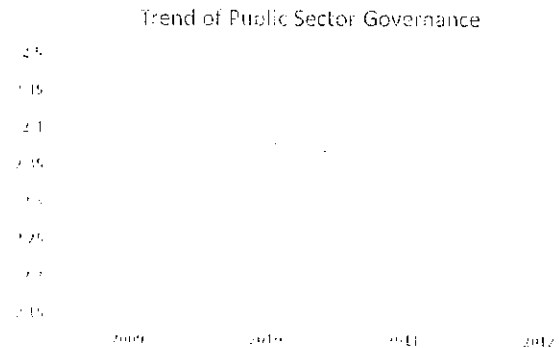


Figure 4 Governance score based on the principle (see online version for colours)

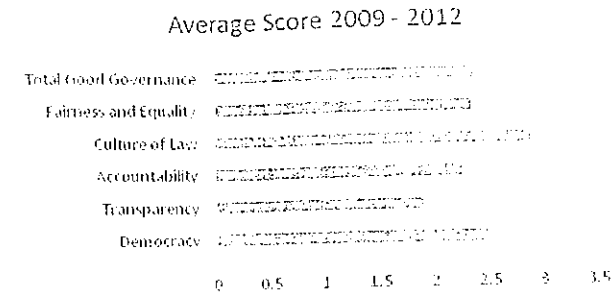


Table 4 Regression results the influence of the total expenditures and governance on the performance

Dependent variable	Performance			
	Expected sign	Coefficients	Sign	VIF
CONSTANT		4.0785***	0.000	
TOTSPEND	+	-0.3652***	0.000	2.45
GOV	+	0.7873***	0.000	2.35
POP	+	0.2537***	0.000	2.55
GINI	-	-0.7216***	0.000	1.16
LOCALINC	+	0.5378***	0.000	1.48
PERF-1	+	0.5431***	0.000	1.78
F test sign		0.009		
Adj R square		0.876		
N		1,044		

Notes: ***Significant at 1%. **Significant at 5%. * Significant at 10%.

4.3 Analysis of regression

Hypothesis 1 stated that the government spending has a positive effect on the performance. Table 4 shows that the total expenditure of the regional government negatively affects the performance. The result shows that Hypothesis 1 is rejected. It indicates that the government spending which done by local government is not efficient in improving performance. This indicates that there is inefficiency in the government spending in the local government in Indonesia. This result is consistent with Rajkumar and Swaroop (2008) which state that public spending often does not produce the improvement expected in the *outcome*. Filmer and Pritchett (1999) study on the impact of public health spending and non-health factors (economic health, education, culture) on the number of death under five years. The results of their research also provide empirical evidence that public health spending has a little effect in lowering the number of death under five years. Table 4 also shows that the good public governance positively affects the performance of local government. Higher quality of public governance will increase the *outcome* and the quality of services provided by the local government. The result

supports the argument by Easterly and Levine (1997) which said that good governance is the aspects that are crucial in pursuing high economic growth. The test shows that Hypothesis 2 is not rejected.

For the control variables, the result also shows that the size of the local government measured by population has a positive effect on the performance. This indicates that the local governance that has bigger size will perform better compare to the local government with smaller size. Variable Gini ratio also significant at 1% level and the result shows that Gini ratio affect performance negatively. This indicates that local government with higher income inequality tend to have lower performance. The local income also significant at 1% which shows that the higher local income indicate higher independency of local government affects performance positively. The result shows the previous performance positively affect current performance.

To investigate the effect of the spending in education, health, and infrastructure on the performance related to those three affairs, we conducted a regression with the result shown in Table 5. The test result shows that education spending can efficiently improve performance achievement in education. For health spending and infrastructure affairs the result shows that health and infrastructure expenditures affect negatively on the performance. This result indicates that the expenses in the field of health and infrastructure cannot be efficiently improves performance achievement in the field. The inefficiency of health spending is consistent with Filmer and Pritchett (1999) and Rajkumar and Swaroop (2008) that show a negative link between public health spending and child mortality as their measurement of public health.

Table 5 also reports the effect of governance on performance of local government. It shows that the governance of the public sector positively influences the performance in the field of education, health and infrastructure. This result indicates that the Hypothesis 4 cannot be rejected. Based on the result of the effect of governance on the education, health and infrastructure, it shows that governance has the highest effect on the performance in infrastructure affair, followed by performance in education and health affairs.

Furthermore, our interest is to examine whether the role of governance quality in public sector can improve the level of efficiency or decrease the level of inefficiency of public spending. To test the Hypothesis 3 which stated that the efficiency of the government spending in improving the performance is strengthened by good governance at the local government, we test the moderation effect of the governance of the public sector toward the relationship between spending and performance. Table 6 shows the results of the test on the Hypothesis 3. The test result shows that the influence of interaction between governance and total expenditures is positive. Based on this testing then the Hypothesis 5 cannot be rejected. The positive coefficient indicates that the higher the quality of governance will reduce the negative impact of the total expenditures of the performance. This result indicates that good governance can reduce the inefficiency in government spending. It indicates that in local government with poor governance, the public spending would be more ineffective. So the quality of governance will decrease the inefficiency of local spending. Our result consistent with Rajkumar and Swaroop (2008) that indicate that in countries which are rated as very corrupt or are rated to have a very ineffective bureaucracy, public health spending at the margin will be ineffective and increasing public spending on primary education is likely to be more effective in raising primary education attainment in countries with good governance.

Table 5 Regression results the influence of spending and governance on the performance of the field of education, health and infrastructure

Dependent variables	PERFEDUC			PERFHEALTH			PERFINFRAS					
	Expected sign	Coeff	Sign	HF	Expected sign	Coeff	Sign	HF	Expected sign	Coeff	Sign	HF
CONSTANT		0.4603*	0.089	1.78		0.9789*	0.085			2.8655*	0.074	
EDUSPEND	+	0.1754*	0.096									
HEALTHSPEND	-	0.7521***	0.000	1.54	-	0.6784***	0.000	1.54	+	-0.2565*	0.057	1.65
INFRASPEND	-	0.0472**	0.058	1.87	+	0.2565***	0.000	1.78	+	0.8565***	0.000	1.48
GOV	-	-0.6854*	0.093	1.55	-	-0.6421*	0.076	1.22	-	0.2122*	0.065	1.89
FQP	-	0.4146	0.121	1.89	+	1.9589***	0.000	1.45	+	-2.3446***	0.000	1.35
GINI	-	1.8921***	0.000	1.88		1.7843***	0.000	1.97		0.0033	0.169	1.79
LOCALINC										1.8675***	0.000	1.89
PERFEDUC												
F test sign		0.000				0.000				0.000		
Adj. R square		0.785				0.769				0.698		
N		1044				1044				1044		

Notes: ***Significant at 1%,
**Significant at 5%,
*Significant at 10%.

Table 6 Regression results of the moderating role of good governance on the relationship between total expenditures and performance

Dependent variable	PERF				
	Independent variables	Expected sign	Coef	Sign	VIF
CONSTANT			2.7862***	0.000	
TOTSPEND	+		-0.3215***	0.076	5.32
GOV	+		0.9657***	0.000	2.76
TOTSPEND * GOV	+		0.0954***	0.028	4.97
POP	+		0.3489***	0.000	3.32
GINI	-		-0.8654***	0.000	1.87
LOCALINC	+		0.6754***	0.005	1.43
PERFt-1	+		1.9578***	0.000	1.67
F test sign			0.000		
Adj R square			0.875		
N			1,044		

Notes: ***Significant at 1%. **Significant at 5%. *Significant at 10%.

The influence of moderation effect of the governance on the relationship between government spending and performance for three main areas namely education, health and infrastructure can be seen in Table 7. Table 7 shows that governance can moderate the relationship between spending and performance on the infrastructure affair, but the moderation role of governance is not significant in the affairs of education and health. This result indicates that the inefficiency expenditures can be reduced by good governance in the field of infrastructure. This implies that with the multitude of development projects in the district and city area if being managed with good governance, the improvements in the performance of the projects is higher.

5 The conclusions, implications, limitations and suggestions for further research

One of the main problems in the management of public sector in Indonesia is the inefficiency of government spending and low quality of governance which fail to increase the welfare of the people and the quality of public services. This research aims to analyse the effect of government spending on the performance and how the role of governance improves the efficiency of the government spending using Indonesian local government (district and city level) as the context of study.

The findings of this research improve our understanding about the links between government spending, public sector governance, and performance in service delivery of the local government. Using 1,044 observation data from local government in Indonesia during 2009 until 2012, the empirical finding of this research shows that the total spending of the local government affect negatively the achievement of the performance of service delivery. This result indicates that the government spending is not efficient in improving performance. We also performed a test using spending and performance in three main affairs, education, health, and infrastructure. The result shows that the link between health spending and infrastructure spending and performance related to the two affairs are also negative, but the link between education spending and performance in education is positive. This shows that the government spending only efficient in increasing performance in certain area, in our case is education.

Table 7 Regression results the influence of moderation governance of the relationship between spending and performance of education, health and infrastructure

Dependent variables	PERFEDU				PERFHEALTH				PERFINFRAS					
	Independent variables	Expected sign	Coef	Sign	VIF	Expected sign	Coef	Sign	VIF	Expected sign	Coef	Sign	VIF	
CONSTANT			1.0456	0.079	8.75			1.2187**	0.067				1.9821**	0.029
EDUSPEND	-		-1.8367	0.088				-1.7542	0.021	+			-2.1352*	0.046
HEALTHSPEND	-												0.0802	0.117
INFRASSPEND	-		0.6745	0.092	6.60	+		0.5123*	0.072	+				
GOV	-		0.6321	0.112	10.2									
EDUSPEND*GOV	-													
HEALTHSPEND*GOV	-													
INFRASSPEND*GOV	-		0.0354	0.270	1.76	-		0.1189	0.356	7.32			1.8754*	0.058
POP	-		-0.6189*	0.082	1.21			0.2121***	0.000	1.76	+		0.2563**	0.008
GINI	-		0.4955*	0.101	1.37	-		-0.4376	0.235	1.25	-		-2.5321***	0.000
LOCALINC	-		1.6521***	0.000	2.65	+		1.8743***	0.000	1.56	+		0.9865	0.060
PERFt-1	-							1.9832	0.000	2.23			2.6781***	0.000
F test sign			0.000					0.000					0.000	
Adj R square			0.7521					0.8243					0.7323	
N			1044					1044					1044	

Notes: ***Significant at 1%.
**Significant at 5%.
*Significant at 10%.

We also found that governance of public sector significantly influenced positively toward performance. This means that the better quality of governance of public sector of local government, the higher performance achievement. Our findings also help explain the surprising result of inefficiency of public spending in increasing performance by showing result that the quality of governance can improve the inefficiency in government spending in improving performance. It indicates that the quality of governance is more important in the local governance that has inefficient spending, so that the higher quality of governance can improve the performance of the service by reducing the inefficiency in government spending.

The results of this research provide important implications for enhancing the efficiency of public spending. In condition of inefficiency in government spending, the central government must evaluate local government spending by associating it with the benchmark performance and governance. Moreover, governance of public sector has a significant role in improving the performance and in improving the inefficiency in government spending. Increasing public spending unlikely to lead to better outcome if the local government has poor governance. Central and local governments should pay more attention to the quality of good governance and put more efforts to improve the aspects that relate to the governance. Increasing public spending may be an easier policy than effort to improve the quality of governance, but as our findings suggest, in the absence of better quality of governance, the option of increasing government spending does not deliver expected achievement of better performance.

Some of the limitations of this research and suggestions for further research should be noted. First, our research uses five principle of governance, democracy, transparency, accountability, culture of law and fairness and equality. We believe that these principles represent general principle of governance in public sector. We are aware that there are other principles in public sector area that can be refer such as principles issued by OECD, IFAC and others. Second, this research use the performance and governance measurements based on the results of scoring on the local government performance evaluation conducted by Ministry of Internal Affairs which based on the report of the activities and the implementation of the regional government. This research does not re-confirmation or survey or interview the local government. There is a possibility where the central government does not report the items or do not disclose the activities. Further research can use multiple data sources to perform cross check between database so that the accuracy of the data can be improved. Third, this research only used quantitative approach in testing the hypothesis. According to Dana and Dana (2005) and Dana and Dumez (2015), quantitative approach can limit the method and miss a true understanding of the real-world behaviour the comprehensive research might be more relevant than qualitative research. Dana and Dana (2005) also suggest that as an alternative of traditional, positivist, hypothetical-deductive quantitative research; further research may explore the holistic-inductive qualitative option or the mixed between the two.

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Appendix 1

The measurement of performance for local government

<i>Affairs</i>	<i>Performance indicator</i>
Education	Early child education Literacy rate for people aged > 15 years School enrolment rate School dropout rates Passing grade score School attainment rate Teachers qualification
Health and environment	Number of obstetric complications treated Number of baby delivery assisted by health professional who has midwifery competency Number of villages/sub-districts that already have universal child immunisation (UCI) Number of treatment for early childhood malnutrition Number of detection and handling patients with infectious diseases Number of health service for poor patients Waste handling Supervision of the environmental impact analysis implementation Waste disposal (TPS) per 1,000 inhabitants Environmental law enforcement

The measurement of performance for local government (continued)

<i>Affairs</i>	<i>Performance indicator</i>
Infrastructure	The length of the road that in good condition Extensive irrigation districts in good condition Household sanitation Slum upgrading Green open space per unit area The availability of short-term and long-term planning documents % consistency of plan implementation Clean water user by household Number of livable houses
Youth and sports	Number of youth hall Number of sports field
Capital investment and trade	The value of domestic investment The contribution of industry sector in gross domestic income The overall industrial growth The contribution of trade sector in gross domestic income Net exports trade
Other affairs	Cooperation and small, medium and micro business Population control Employment Food security The empowerment of women and children Transportation Communication Land affairs Social and cultural Fisheries production and fish consumption Agriculture and forestry Energy Tourism Transmigration

Appendix 2

The measurement of good governance in local government

<i>Principle</i>	<i>Definition</i>	<i>Indicator</i>	<i>Measurement</i>
Democracy	The conduct of the government that is based on the elements of participation, the recognition of different opinion and the embodiment of public interest.	Participation	Whether there is a community satisfaction survey Number of facilities for the people participation
		Recognition of differences Embodiment of public interest	Number of cooperation between the regions counties/city The synchronisation of the implementation of national and regional policy on development priority The allocation of spending on the regional budget The number of compulsory affairs held by local government The existence of public service standards Budget absorption rate Ratio of public expenditure to general allocated fund Ratio of public expenditure to the total budget The realisation of local income against the potential of local income Local income growth The number of national program (inherent in the ministry/non-departmental government institutions) that held by the local government work unit
Transparency	Transparency contains elements of the disclosure and the provision of adequate information and easily accessible by the stakeholders.	Disclosure	The existence of local government information media that can be accessed by the general public (website, mail box, public relations unit, leaflets/brochures) Reporting timeliness for reports from local government to central government Number of award from the central government that is received by the local government.

The measurement of good governance in local government (continued)

<i>Principle</i>	<i>Definition</i>	<i>Indicator</i>	<i>Measurement</i>
Accountability	Accountability contains elements of the clarity of the function in the organisation and how to account it.	Provision of adequate information	The existence of personnel information system Number of the information facility The existence of e-procurement
		Clarity of the function Accountability	The existence of standard operating procedure (SOP) The completeness of development of planning in the local government work unit Audit opinion on the local government financial statement from government supreme auditor Follow up on the audit findings from government supreme auditor The existence of local government work unit financial statements Ratio of budget surplus to total income The time it takes to regulate the budget Ratio of realisation to budget The existence of asset management in local government work unit The number of unused asset in local government work unit
Culture of law	The culture of the law contains elements of the law enforcement explicitly without respect of persons and obedience to the law by the community based awareness.	Law enforcement Law obedience	Number of local government regulations Ratio of number of local police officer to number of population The number of the withdrawal of local government regulation The existence of local government regulation about financial management Number of cases filled in court Number of cases reported to the police

The measurement of good governance in local government (continued)

<i>Principle</i>	<i>Definition</i>	<i>Indicator</i>	<i>Measurement</i>
Fairness and equality	Fairness and equality contain elements of justice and honesty so that in its implementation can be realised equal treatment of stakeholders with high responsible.	Fairness	Allocation ratio for education
			Allocation ratio for health
		Equality	Number of functional positions in the organisational structure of local government work unit
			Number of woman in the board representative
Honesty	Number of corruption cases relate to the local government		
	Corruption perception		

A self-awareness of public servants: an introduction in methodology

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Abstract: Public servants are important actors in the system of public goods delivery. Performance measuring governance in terms of the modern state is centred on establishing the contentment of the customers purchasing these goods. This means the public servants need special professional skills to fulfilling civil clients' needs. We would like to identify the degree of personal support for this conception. The research was carried out in December 2014 in the Republic of Sakha (Yakutia), Russia. The method adopted was a questionnaire; data processing was carried out using SPSS. The results of the research show that public servants are still guided by old skills and requirements. However, staff at the age of 30 years (35%) more frequently choose the satisfaction of client needs as the main goals of authorities. This gives us hope that the professional skills of public servants will change in line with new requirements.

Keywords: governance performance; human capital; public servants.

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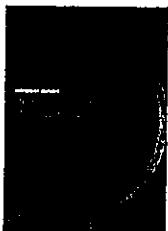
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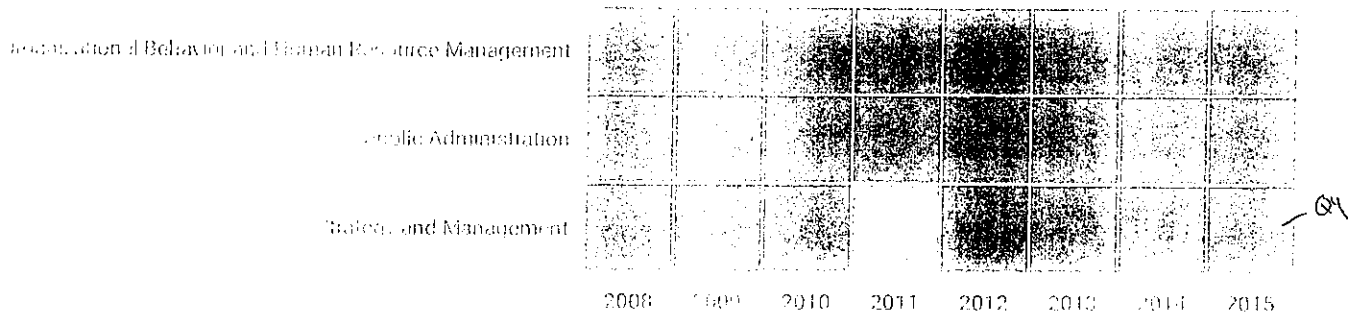
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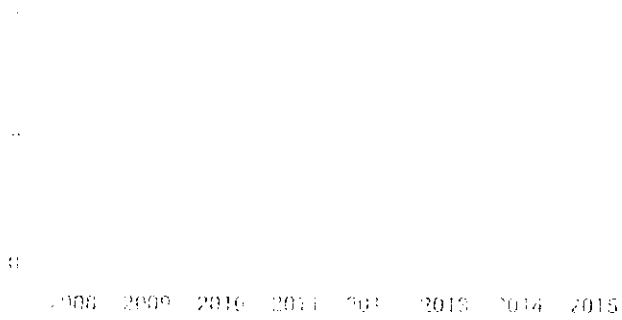


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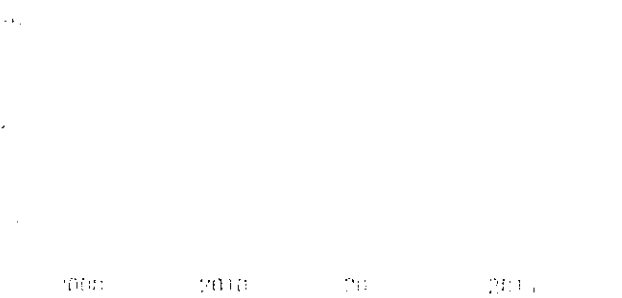
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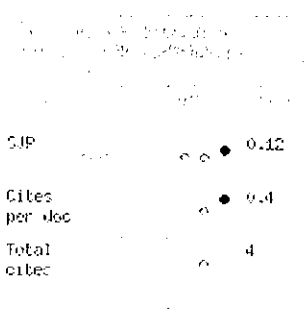
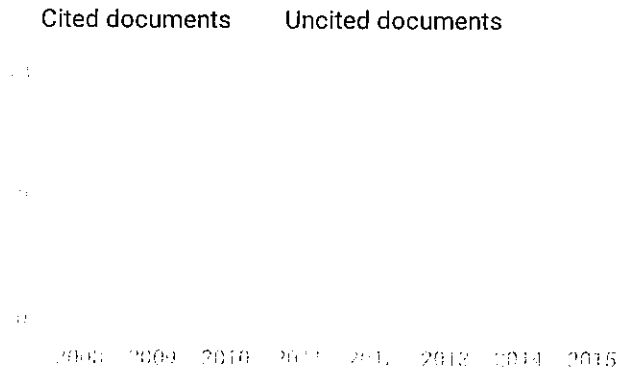
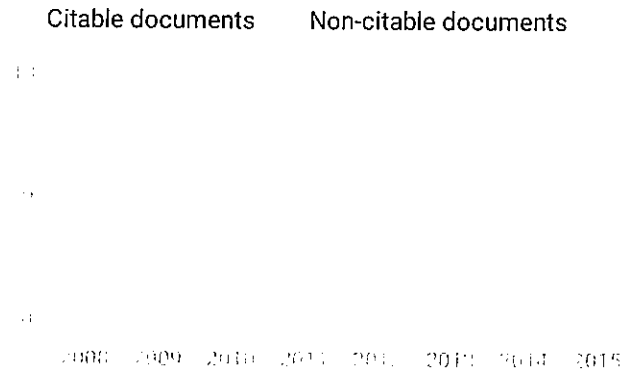


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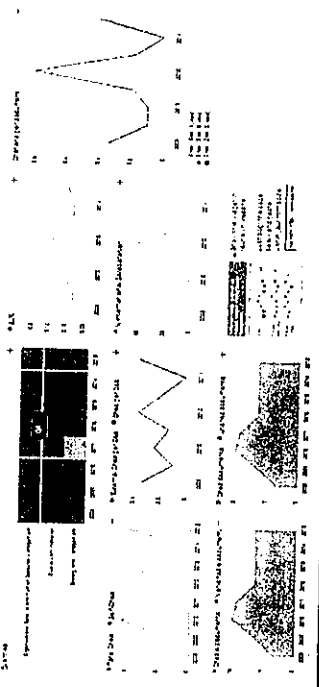
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Good governance and the impact of government spending on performance of local government in Indonesia

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Ratna Wardhani, Hilda Rossieta, Dwi Martani

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Abstract

This paper studies the links between public spending, good governance, and its outcomes which measured by performance of local governments. This paper aims to examine the effect of government spending and good governance on performance of local government and whether good governance can strengthen the effect of government spending on performance. This paper based on 1,044 observations of local governments in Indonesia from 2009 until 2012. This paper contributes by providing an understanding of the relationship between public spending, governance, and government performance and provides explanation of the mixed evidence that public spending often does not yield the expected outcomes. This research provides interesting empirical evidence that the expenditure of local government in Indonesia is inefficient in increasing performance. In the contrary, the result shows the negative effect of government spending on performance. The good public governance influenced positively toward performance and reduced the inefficiency of government spending.

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Keywords: public sector, local government, efficiency, government spending, good governance, Indonesia, government performance

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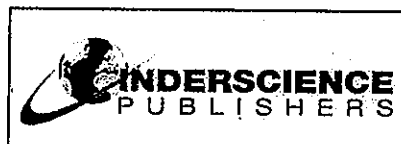
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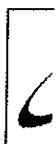
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