

# Fiscal Decentralization

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## Fiscal Decentralization and Corruption: The Facts in Regional Autonomy in Indonesia

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### Abstract:

There are tricky effects of fiscal decentralization on corruption both in concept and empirical studies. This study aims to determine the influence of fiscal decentralization on corruption in local level (provinces) governments in Indonesia. Using the Supreme Court (Mahkamah Agung) cassation, in 2001-2009, this research applies econometric method exactly Tobit model to provide the evidence utilizing modified model of Yardstick Competition. Result shows that the higher the level of fiscal decentralization will increase corruption. Population also increases corruption. Detection rate from neighbor area could hit the corruption. State official salary level, GDP per capita, and literacy rates and dummy variables of special autonomy do not affect corruption. Rich areas have lower levels of corruption than the poor. Areas outside Java-Bali (non Greater Jakarta) have an average lower corruption than corruption in the area on the island of Java and Bali. The Greater Jakarta has higher corruption than others.

**Keywords:** Fiscal Decentralization; Corruption; Tobit Model; Supreme Court; Province

**JEL Classification:** K42; H39.

### Introduction

Many researches had found in contrary conclusion in stating the impact of decentralization to corruption. The greater decentralization will decrease the level of corruption in the country (Mello and Barenstein 2001). In developing countries or less developing countries, it found that political instability does not directly affect corruption. Conditions that have not been established in the political field influence corruption through the institution first. When there is political instability it creates the severe corrupt conditions become more widespread and will be difficult to be reduced. Thus, the institution has the structure, it increase corruption (Damanian *et al.* 2004). Fiscal decentralization has a positive impact on the quality of its institutions but the impact goes down along with the wealth of the country (Kyriacou and Roca-Sagales 2008). The richer countries the more lower-level corruption but in poor countries was found that decentralization weakens the eradication of corruption because of the less developed countries have (poor) lack or weakness of oversight bureaucrats (Lessmann and Markwardt 2009). In smaller scope, the fact in US, the higher the level of decentralization in these states will decrease corruption in the states (Ellis and Dincer 2005).

When the power granted increase rapidly especially but decentralization is not prepared well or it occurs suddenly, corruption tends to increase. Such as in the financial sector, the authority of the financial management is large but in other hand it has low or limited management capacity therefore it will result in the creation of vulnerability for local bureaucrats to engage in corruption (Chene 2007). Another concept says that the more

centralized authority possessed the power to pile up and good governance is not well done. By decentralization, the governance is expected to be better so that corruption will be reduced. The governance will be better as indicated by the increase in the quality of governance as measured by community participation, political accountability and bureaucratic, social justice, and improve economic management and reduce corruption (Huther and Shah 1998).

Uncompromised concept of decentralization was proved by research Lessmann and Markwardt (2009) which stated that for the developed countries decentralization opposite (negatively associated), or will reduce the occurrence of corruption. Conversely, for the less developed countries, decentralization weakens the eradication of corruption. Fisman and Gatti (2002) showed that with increasing fiscal decentralization increases corruption. While on the other hand, Treisman research in 2000 showed result that there was a negative relationship of them showed a negative coefficient on the dummy variable federal corruption (Serra 2006, 229).

Many empirical studies stating that by decentralization, the control of corruption will be better. But it does not mean, the corruption will be lost. With decentralization, the corruption at the center of a number of very large but otherwise corruption will decrease in areas with small amount (petty corruption) will be a lot. These facts as found by Crook and Manor in 2000 (in Chene 2007) who conducted research in India, Bangladesh, Ivory Coast, and Ghana.

In general, the relationship between decentralization and corruption can not be determined surely in empirical evidence and concept. They provide reassurance to the uncertainty of the effect of decentralization on corruption which could have positive or negative. In other words there is no empirical evidence or concepts that are dominant. This paper is intended to see whether Indonesia's fiscal decentralization affects corruption and how its influence. It also aims to see how the influence of various factors against corruption.

Furthermore, this paper is organized into several sections. Part II will describe the concept of decentralization, corruption, and how to do. Section III will describe the methods used in this research. Section IV will describe the results of estimation and analysis. The last part will give the conclusions, propose recommendations, and give suggestions for improving future research in the same field.

## 1. Literature review

### 1.1. Decentralization and the Quality of Government

Agrawal and Ribot (2002) define that decentralization and deconcentration is essentially reducing the accountability of the central government. When a power is delegated into lower level authority and it is accountable to the superior in hierarchy then this is called deconcentration. When the power supplied to the lower players whose accountability to their constituents even when the executive is determined, the reform is said to be a political decentralization.

According to the Law in RI No.32 of 2004, decentralization and deconcentration are defined explicitly in article 1, verse 7 and 8. It explains that 'Desentralisasi adalah penyerahan wewenang pemerintahan oleh Pemerintah kepada daerah otonom untuk mengatur dan mengurus urusan pemerintahan dalam sistem Negara Kesatuan Republik Indonesia' and 'Dekonsentrasi adalah pelimpahan wewenang pemerintahan oleh Pemerintah kepada Gubernur sebagai wakil pemerintah dan/atau kepada instansi vertikal di wilayah tertentu'.

Treisman (2002) considers decentralization to various sides. These are the structure, the decisions, the resources, the electoral, and the institutional. Kaufman et al (2006) consider the six dimensions of governance. They are accountability and freedom of speech, political stability and the low level violations, government effectiveness, regulatory quality, rules, and control of corruption. La Porta et al (1998) classify government performance variables into five groups: interference with the private sector, efficiency, output of public goods, the size of the public sector, and political freedom.

Agrawal and Ribot (2002) propose the necessary dimension in the decentralization is as stated by menor namely administrative, fiscal, and democracy. Meanwhile, according to Binswanger is decentralization has a political dimension, fiscal, and administrative. Meanwhile, Agrawal and Ribot themselves argue that to run decentralization then it needs actor, power, and accountability. Without understanding the power of various actors, the domain in implementing the rule, and to who should be responsible, it is impossible to define well the meaning of decentralization itself. Furthermore, Agrawal and Ribot argue that political and administrative domain of decentralization were characterized by a combination of the three dimensions.

The quality of government varies depending on how the executive run it. There is a government that protects or confiscates property, allows or suppresses differences, serves or ignores the public. There are many perceptions dimensions of governance; those are (La Porta et al, 1998) (1). The most common standard of good



government is to protect property, maintain the regulations, and burden taxes (the government is not interventionist), (2). Efficient government or good quality bureaucracy, with the quality, the government bureaucracy can intervene efficiently, (3). Government also performs an essential public service such as provision of health services, provision of educational facilities, and provision of infrastructure, (4). Other performance indicators are the expenditure on subsidies, consumption by the government, and empowering the public sector where greater government expenditure shows that higher public willingness to pay taxes to finance these expenditures, other measures how much state-owned or how many people employed in the public sector, and (5). The last is democratic and political rights.

The more centralized governmental authority the more centralized the power also make the agents easier to corrupt. Through decentralization, the corruption is decreasing. But on the contrary, many empirical studies show that the more decentralized, the more increase the marginal propensity to accept bribery as a result the implementing decentralization. This happens because of potential corruption will easily arise when only a small agent of the bureaucrats who need to be persuaded to engage in corruption (Fjeldstad 2004).

When the local government has greater capacity constraints than the central government does or has a less precise system in reporting and accounting, or has contributed to less open system of government and have criticized the lack of opposition then decentralization tends to make even more rampant corruption. In this case, the corruption in central government is less than in local government that tends to increase. Thus the capacity and quality of local institutions and characters in the local political arena are important variables to predict the impact of fiscal decentralization on corruption (Kolstad and Fjeldstad 2006).

## 1.2. Corruption and Concepts of Corruption

Corruption occurs when the abuse of public official for private gain. It is defined as abusing when the officer accepts, solicits, and exhorts bribes. It is also abused when an active employee offers to accept bribes to make the policy and process for the benefit of gains in competitiveness and economic benefits. As noted by the World Bank in 1997, abuse of authority can also be done for personal gain without any bribes, but it occurs because of nepotism and patronage, theft of state property, or harm state revenues. Form of corruption in addition to monetary rewards that are more complicated such as (Vazquez *et al.* 2004, 12).

Article 2 of RI Law No.31 of 1999 on Pemberantasan Tindak Pidana Korupsi stated that '... Any person who unlawfully commits an act of enrichment of himself or another person or a corporation that may harm the state's finances or the state's economy'. According to the collaboration of RI Law No.31 of 1999 which was revised by RI Law No. 20 of 2001 concluded that corruption is covering 30 corruption cases that grouped into seven major groups such as the loss to the state, bribery, fraud in office, extortion, fraudulent, conflicts of interest in procurement, and gratuities (KPK 2006).

### 1.2.1 Two Primary Building of Corruption Concepts

According to Perdana (2009,117), the basic theory of corruption in general emerged from the two theoretical concepts of corruption, namely the theory of rent-seeking and principal-agent theory (PA) problem. From the concepts, it will be known to the various conditions that could lead to corruption.

The theory of rent-seeking was proposed by Anne Krueger in 1974, although it is considered that the pioneer argued is Gordon Tullock. Term 'rent' is derived from the rent (lease) which is termed by Adam Smith on the compensation of production factors. One of compensations of production factors are in form rent. The production factors are such as capital, land, and building. Problem in achieving the rents would arise when there are parties which were not the owner of these assets but also want to enjoy the benefits. From this issue, then Anne called it as rent-seeking and those who did called rent-seekers. Source of this type of rent is derived from monopoly power or authority to grant the monopoly that owned by government (Perdana 2009).

The second concept is the theory of PA, principal (boss) is a party has a particular purpose. To achieve these objectives, it is necessary to need help from agents (subordinates). This agent is given delegation by the supervisor with a particular incentive or compensation. PA relationship is not only a subordinate-supervisor in the organizational structure but more than that which is more look at the relationship of delegation. Relation of government-parliament with its people as a voter is also the relationship of PA. Where, bureaucrats, parliamentarians are the agents, while the people are the principal (Perdana 2009). From here we can see and have many examples of PA problems. Let's say between bureaucrats with parliament itself.

The relationship of PA is ideal when the information possesses to be symmetric. The problem arises when the cost of monitoring the agent is huge and the agent itself has personal goals in addition to the desired destination



by his superiors. Thus the third party could use this situation to be profitable for the third parties or its subordinate (Perdana 2009).

### 1.2.2 Models of Corruption Analysis

Wijayanto (2009) put forward several models in the analysis of corruption. Each model proposed is unique and can not be applied in all contexts of corruption. Those are such as a). Willingness and opportunity, b). CDMA / V Model, c). Cost-Benefit Analysis, d). Supply and Demand, and e). Principal-Agent Problem.

#### Willingness and Opportunity

Corruption will occur when there is a willingness to corrupt, an internal factor that can be influenced by external factors, and an opportunity to corrupt, which is an external factor (Wijayanto 2009). If both factors satisfy each other, there will be corruption. Human being will probably have human selfishness naturally. Besides humans running their lives are also influenced by their morals, where it fluctuates. When maximizing the benefits of an economic activity is not based on moral owned then it will lead to corruption. Weak systems will create many opportunities for corruption.

#### CDMA/V Model

Wijayanto (2009) suggested that the reference model of CDMA/V is corruption (C) is a phenomenon that is influenced by the level of discretion (D), monopoly (M), and accountability (A). In addition, corruption is also influenced by the values that are applicable to the culture within the community itself (V). Discretion and monopoly have positive influence on the occurrence of corruption, while accountability has negative effect, but it all depends on the value that exists in society itself. If the value in the community is good, it will create leaders who have integrity so that it will reduce corruption and vice versa.

#### Cost and Benefit Analysis

Humans are rational beings who always took the action based on the incentives they receive. In short, a corruption will occur when the benefits gained from the corruption would be greater than the costs and vice versa (Wijayanto 2009). Mathematically, if the net benefit of corruption  $> 0$  then they will make corruption and vice versa if the net benefits of corruption  $< 0$  or if the costs is greater than the benefits they shall not engage in corruption.

#### Supply and Demand

Economic activity could occur when there is intersection between supply and demand. So does it in corruption, corruption will occur while the supply meets the demand. Corruption is just like a commodity. So there are consumers and there are producers. In the case of corruption, bureaucrat acts as the producer, while the people as clients of both individuals and companies act as buyers of corruption or the consumers (Wijayanto 2009). Thus the anti-corruption strategy is better when both sides are pressed.

In the supply side, those can be as a revision system, increasing the salaries of employees, applying the code of ethics, opening public complaints centers by ensuring the confidentiality of the reporter (whistle blower), establishing an ombudsman, carrying out rotation, and aggravating punishment of corruptor. In the demand side is to simplify the rules in public services, socialize service procedure, open a service office for the same services to increase competition, reduce the direct interaction between the client and its employees, aggravate punishment briber, and conduct all transactions with the authentic evidence (Wijayanto 2009)

#### Principal Agent (PA) Problem

As stated also by Perdana (2009), the importance of the analysis model of PA corruption problem in the model analysis. PA Problems arises when there is asymmetric information (information inequality), mainly owned by the agent are not all owned by a principal, the result will appear abuse conducted by the agency. To overcome this, the boss put the supervisor to supervise an agent, but in fact will cost more expensive so it is necessary supervision. Supervision in any form of street-level bureaucrats, bureaucrat operates in the community such as police, secret agents, police superintendent of forests, and others.

Concept-level bureaucrats had been popularized by Michael Lipsky in 1980 even for the case of PA problems that cause crimes, these issues are solved with violence such as shooting and murdering in Latin American countries where there is not clear enforcement of the rule of law (Wijayanto 2009). The approach might be to put pressure on the PA problem in both of government and companies such as lawyers approach, approach businessman, economist/market approach, and cultural approach.

### 1.2.3 Decision Theory and Game Theory in Criminality (including Corruption)

Pradipto (2009, 154) argues that there are two main approaches in the analysis of crime economics including corruption. The approaches are decision theory and game theory. Decision theory approach was pioneered by Becker in 1968 and approach with game theory was pioneered by Tsebelis in 1989.

Decision theory approach was conducted by observing benefits of expectation and probability of success and failure of the crime was committed. While the calculation of expected benefit is greater rate than expected costs incurred, the offender crime (corruption) will choose to commit crimes and vice versa. In this approach, Becker suggested two ways to create a deterrent effect against perpetrators of crime (corruption). Those were 1). Applying a high detection capability but gave lenient sentences to the perpetrators of crime, and 2). Low detection capabilities but provides a high intensity of punishment against perpetrators of crimes. Becker recommended the first option by considering the second option actually creates greater social costs (Pradipto 2009, 155).

Game theory is an approach by applying interaction of strategy game of the players. In real life, they are such as law enforcer and the offender of crime (corruption). This approach is said to be better because both parties consider the strategy of law enforcement and the perpetrators of crime rather than the theory of decisions that only consider the strategy undertaken by law enforcer from the offender side. Further it does not accommodate the strategy chosen by authorities to observe the possible strategies that will be performed by the offender (Pradipto 2009, 156). In the game theory, the offender will pay attention to law enforcer strategies and vice versa law enforcer will also observe strategies to be taken by the offender. For a more complete summary of the theory of games by Tsebelis was put forward by Pradipto (2007).

The relationship between two actors is that if people violate, the police should do inspect and when people obey, the police should not inspect because it would have cost if done a lot of patrol. Conversely, if the police inspect, the community prefers not to violate and when the police do not patrol the community is more like breaking. Thus there is no pure strategy that ensures successful of the actor but there will be a mixture of strategies that imply a total reduction in the number of violations that are not possible (Pradipto 2007). For the case of determining balance position of probabilities, policy of the police to conduct inspections decreased but the tendency of individuals to commit a crime does not change. This result is controversial and counterintuitive. Various criticisms aimed at the conclusion of this study Tsebelis although more towards how the game was done rather than evaluate the real level of the implications of the game (Pradipto 2009).

Next, Pradipto (2007) improve pay-off table proposed by Tsebelis in order to avoid the counterintuitive result. This revision was incorporated by considering the various results of empirical studies. Pradipto further in 2009 also make improvement to the Tsebelis approach and the result is any selected method makes the probability of punishment can reduce crime. But in the second revision Pradipto still recommend that prevention remains better than the criminal penalty. Because increased prevention strategies are not ambiguous on the probability of occurrence of crime than punishment improvement strategy (Pradipto 2009).

### 1.3. Factors of Corruption

Corruption and its causes become difficult to be analyzed because of the cause itself often also caused by the corruption itself (Lamsdorff 2006). With this pattern of corruption and its causes will be a kind of round that could not be determined where the beginning and where the ends. According Lamsdorff as demonstrated by a variety of current research, there are a lot of factors causing corruption, among others, the public sector (size of the public sector), the quality of regulation is low, the low economic competition (lack of economic competition), the structure of government, decentralization, culture, values, gender, and geography and history.

Hunt (2006) in literary studies got a lot of things that could be associated with corruption. Various things negatively related to corruption include a legitimate legal system, the Protestant tradition and the British colonies, fiscal decentralization, greater salaries to civil servants, and a larger portion in the parliament and public service.

Perdana (2009,120) states that there are some conditions that encourage corruption. These conditions include the nature of power or authority diskretis, potential sources of the creation of economic rents, and weak institutions. Thus, weak or strong of the three conditions will affect the size of the corruption that occurred.

Of the various factors that have been raised in previous literature that also define the institutional conditions are realized with good or bad governance carried out. Good governance contains good pillars, of course. Good Corporate Governance (GCG) has five solid pillars (Hardjapamengkas and Rukmana 2009, 288). The pillars are the responsibility, accountability, fairness/equality, transparency, and independency.



#### 1.4. Corruption Impact

From various empirical studies in transition countries, found that corruption is causing barriers in economic development. Those are such as inhibition of both foreign and domestic investment, decrease in growth, inhibiting trade, distortion the size and composition of government expenditure, weakening the financial system, and increase of the underground economy. The most important issue is a strong correlation between corruption with increased poverty and income inequality (World Bank 2000).

Interesting discussion is the existence of corruption in the tax this fiscal. The first, with the existence of corruption in the tax field, confidence of tax collectors in particular will decline, more than that also reduce confidence against the government at the end of the tax revenue will decrease. The second, with ongoing fraud, the commitment and honesty to run the task with a good bit more will be eroded or weakened by the attitude of their colleagues who actually make tax evasion. The third, if it continues there will be a vicious circle in which it influences the new people will tend to be corrupt when its habitat was already prevalent corruption. The fourth, if corruption as a norm it will eventually appear official resistance against the reform of the taxation system (Fjeldstad and Tungodden 2003). Emergence of this resistance has also occurred in Indonesia's most powerful significantly challenged by the tax officials themselves.

Various consequences of corruption are clearly negative for the economy was also expressed by (Lamsdorff 2006). The consequence, among others, is causing income inequality, its role not as a catalyst in the economic system instead it is like sand in the machine then the economy may decrease resource that belongs to your productivity, lower capital stock, occur misallocation of existing resources. In the private sector, corruption can be a double-edged. One side with private sector corruption, the bureaucracy will reduce the delay of service. But in essence, corruption had a negative impact, with the corruption there will be a deviation of the market (both domestic and international) and will also create much economic activity underground (underground economy) and tax violation.

As noted by Mehmet in 1994 (in Jaya 2005), in the micro level, corruption is one of the principal sources of institutions dysfunctional. Principal source of dysfunctional institutions are opportunistic behaviors as well as rent-seeking, corruption, lobbying, and as well as refunds for personal projects (kick back). Where many such opportunistic behavior results in transaction costs and loss of social welfare (welfare loss), and inflation due to high cost pressures (cosh-pushing inflation).

It means that from various impacts that have shown in micro and macro side obviously corruption raises many negative impacts. Thus it is clear that corruption was agreed as an action that is the bottleneck of economic growth and welfare improvement of the community.

#### 1.5. The History of Corruption in Indonesia

History of corruption in Indonesia actually has happened since before independence i.e. since the existence of a trading company in the Netherlands East Indies, VOC. In the 1950's Muhammad Hatta once noted that corruption in this period has been plagued various departments and pervasive in society. In 1958, the government issued the Law No.86/1958 on the policy of nationalization of Dutch companies. However, this policy would encourage the emergence of corruption among businessmen and officials. Indigenous businessmen close to the official gets a lot of facilities that leads into the term in which Ali Baba businessman where who has a license is the Ali (indigenous entrepreneurs), but that doing business is the Baba (Chinese businessmen). Along with corruption corruption in the 1950's then issued various regulations and the ends, the Orde Lama regime through Presidential Decree No.275 of 1963 pointed AH Nasution, who served as Minister of Defence and Security, to lead the Operations Bundhi devoted to combat corruption with the primary objective enterprises and state institutions that are considered vulnerable to corruption and collusion (Rukmana 2009, 1048).

Historical-sociologically, corruption in Indonesia is believed to be the heritage of Indonesia since colonial and imperium age. Corruption is regarded as a legacy of the feudal government of Mataram Javanese style and colonial rule that followed the style of VOC in the Dutch East Indies government. This is confirmed by history of government alternating in of the kingdom and the period of Indonesia's independence that are accompanied by corruption note in it and the incidence of corruption is effective to reduce the existing government. Although the typical antropologic foundation is but this must be proved further for proving the truth of corruption, collusion and nepotism as a Javanese typical (Margana 2009, 417-442).

Behavior entrenched corruption that now is indeed the legacy of the reign of 'kompeni' (VOC) in which the VOC officials had a small salary but have a large income. This income could come from levies and contributions of indigenous officials, business opportunities in the trade (sort of graft and extortion), or attempt to steal from the



company which is considered as a legal behavior. As a result the Company lost a lot of wealth and the wealth was being its officials (Margana 2009, 417-442). The story is consistent with the pattern of corruption in Indonesia after independence age, in which officials in Indonesia (before remuneration in bureaucracy reform especially in Financial Ministry) mostly have a low salary but the income that can be taken home far exceeds the size and somewhat magical for her salary.

During the RI existed there are few agencies devoted to eradicating corruption. Besides KPK formed in 2003, there are 6 other institutions in the field of combating corruption that has been established (Jasin 2010). The agency is (1). Operasi Militer in 1957, (2). Tim Pemberantasan Korupsi in 1967, (3). Operasi Tertib in 1977, (4). In 1987 Tim Optimalisasi Penerimaan Negara di Sektor Pajak, (5). Tim Gabungan Pemberantasan Tindak Pidana Korupsi (TKPTPK) in 1999, and (6). Year 2005 established Tim Pemberantasan Tindak Pidana Korupsi (Timtas Tipikor). Compared with the six institutions, KPK is seen as the most effective agency to combat corruption.

Recent fact in Indonesia (Simanjuntak 2009), Transparency International Indonesia (TII) surveyed perception of the corruption of 50 cities in Indonesia in 2008 (CPI survey). City cleanest (lowest corruption) are among others Yogyakarta (1), Palangkaraya (2), and Banda Aceh (3). Kupang is the most corrupt city (50), Tegal (49), and Manokwari (48). While the city's middle ranks, among others, Palu (24), Bengkulu (25), Batam (26), and Sorong (27).

Reflection conditions of corruption in Indonesia can be obtained from business people, community, and self-government employees in the CPI. It also can obtain real data on the implementation of local budgets across Indonesia from local financial reports provided an opinion by the BPK (The Financial Investigation Bureau of Indonesia). Although the opinion does not describe the condition of corruption but it can be used as quality indicator of budget governance. In giving his opinion, BPK provides four categories of opinion is that starting from the best to the worst, the fair without exception (WTP), the fair with the exception of (WDP), unfair (TW), and giving no opinion (TMP).

Although recently years, in 2006, 2007, 2008 regional financial reports has increased the WTP financial statements but the portion of local government financial statements (LKPD) who received WTP opinion is still very small. LKPD in 2008 which reported in 2009, it accumulated that total LKPD with WTP opinion is as much as 12 LKPD of the total as many as 482 or as many as three per cent. While the rest are getting opinions WDP 324, 31 opinions TW, and 115 LKPD get opinions TMP (BPK, 2010:3).

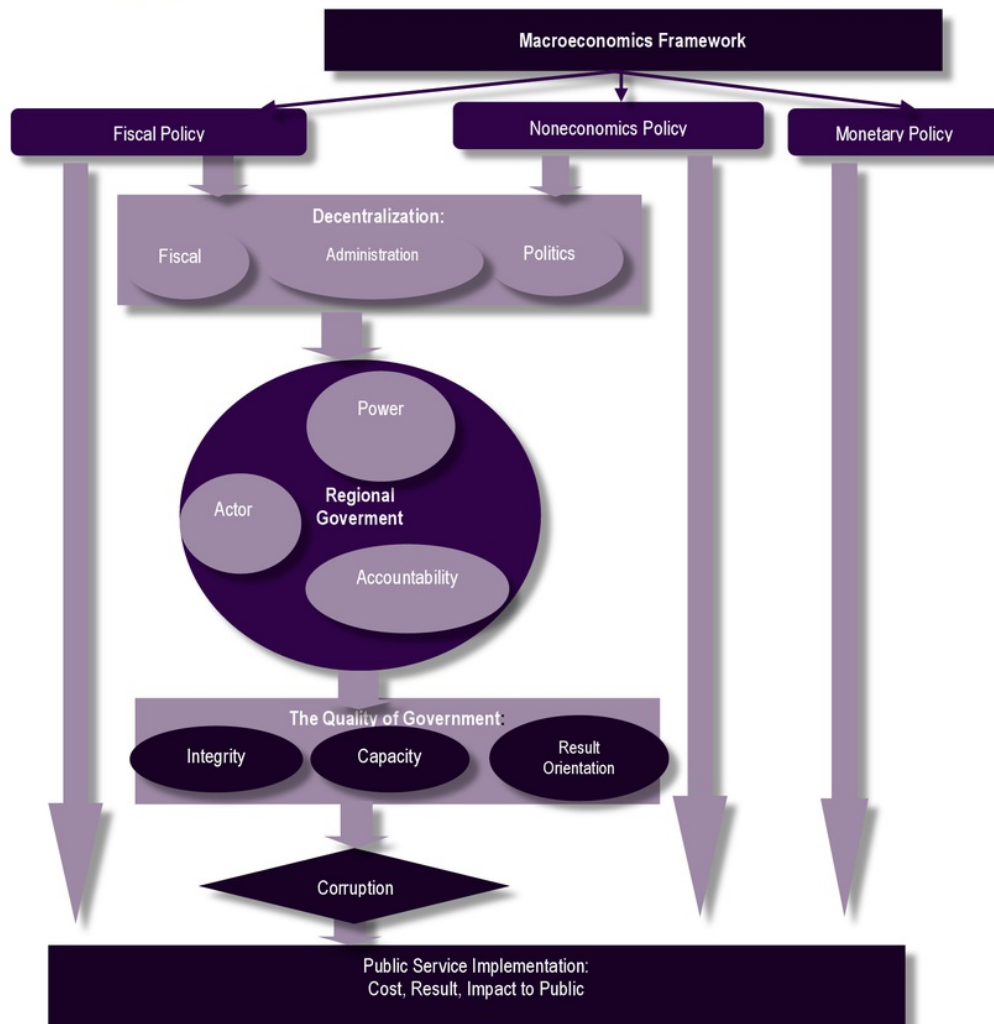
#### 1.6. Transmission of Decentralization to Corruption

Macroeconomic framework can work well when it combined well for the three main key to achieve better public services. The first is to build integrity systemically within the community and uphold the rule of law. The second is to strengthen the capacity of public sector institutions and civil society organizations therefore system and public sector can perform better. The third is reorienting of the government so that it can improve performance and results. What to do with institutional reform is not only aimed to reduce corruption or improve the integrity, more than that of institutional reforms to give the real impact of improving public services, enforcing laws, as well as providing a conducive climate for private sector (Langseth 1999).

Decentralization is a process of fiscal and political delegation to the region. There are three dimensions of decentralization; those are decentralization of fiscal, administrative, and political. On the local government, existing components in the system consists of actors, authority, and accountability, so good or bad depending on how the local government combine all the three.

Good or bad quality of the local government can be seen from the resultant of combining integrity, capacity, and orientation results. The better lattice is then of course the lower corruption. Thus the service provided to the community is truly results-oriented, cost, and benefits that benefit and enhance people's welfare. Conversely, bad government quality will increase the level of corruption so that later the result was not optimal to serve the community, increasing the burden of people with high economic costs, and benefits received by common people or worsen the welfare of the people.

Figure 1. Process of the Transmission of Decentralization to Influence the Corruption in Regional Level



### 1.7 Previous Empirical Studies

Author	Data	Methodology	Result
Mello and Barenstein (2001)	<ul style="list-style-type: none"> <li>78 countries;</li> <li>1980 – 1998</li> </ul>	<ul style="list-style-type: none"> <li>Tobit;</li> <li>ICRG corruption index (which in-rescale), gratuities, law enforcement, government effectiveness and regulatory burden, accountability and sound, as well as violations and political instability;</li> <li>Various indicators such as the share of expenditure decentralization of government (local to the total), vertical inequality, tax autonomy, non-tax autonomy. To complete the analysis, it also included other variables such as GDP</li> </ul>	<ul style="list-style-type: none"> <li>The greater decentralization will decrease the level of corruption in the country.</li> </ul>

Author	Data	Methodology	Result
		per capita, population, land area, and civil liberties index (GASTIL);	
Damania <i>et al.</i> 2004	<ul style="list-style-type: none"> <li>82 countries;</li> <li>end of 1990's</li> </ul>	<ul style="list-style-type: none"> <li>OLS</li> <li>Level of corruption;</li> <li>Economic factors (level of openness and GDP), social structure (democracy), and political and legal factors (party lists, legal efficiency, and the federal structure).</li> </ul>	<ul style="list-style-type: none"> <li>In developing countries or less developed countries found that political instability does not directly affect corruption;</li> <li>Conditions that have not been established in the political field influence corruption through the institution first. When there is political instability it creates the severe corrupt conditions become more widespread and will be difficult to be reduced. Thus, the institution that is structured like it even increase corruption</li> </ul>
Ellis and Dincer (2005)	<ul style="list-style-type: none"> <li>States in United States;</li> <li>annually (1987 – 2001)</li> </ul>	<ul style="list-style-type: none"> <li>Pooled Ordinary Least Square;</li> <li>Corruption in the state;</li> <li>Decentralization, the average level of corruption on neighborhood state, the GDP per capita, the proportion of ethnicity, level of salaries, and population .</li> </ul>	<ul style="list-style-type: none"> <li>In line with population growth there found that decentralization makes less and less corruption.</li> <li>The higher-corruption area surrounding influence corruption in the region to increase.</li> <li>Decentralization has negative effect on corruption, this can be interpreted that the higher the level of decentralization in these states will decrease corruption in the states.</li> </ul>
Kyriacou and Roca-Sagales (2008)	<ul style="list-style-type: none"> <li>Panel Data of 29 develop and developing countries;</li> <li>1984 – 1997.</li> </ul>	<ul style="list-style-type: none"> <li>Panel Data;</li> <li>Fiscal decentralization and the quality of government;</li> <li>The data used is the variable used as an approach to the quality of government is the International Country Risk Guide (ICRG). The focus of the quality of government- there are 3 dimensions namely corruption, enforcement of rules, and bureaucracy quality;</li> <li>Fiscal decentralization represented by the distribution of tax revenues and expenditures of local governments;</li> <li>Corruption-grid refers to the demand for bribes by the bureaucrats and politicians as cronies, nepotism, job orders, and others.</li> </ul>	<ul style="list-style-type: none"> <li>Fiscal decentralization has a positive impact on the quality of its institutions but the impact goes down along with the wealth of the country.</li> </ul>
Lessmann and Markwardt (2009)	<ul style="list-style-type: none"> <li>Cross section of 61 countries;</li> <li>on average 1996 – 2005.</li> </ul>	<ul style="list-style-type: none"> <li>OLS dan TSLS ;</li> <li>Level corruption involving the three measures of corruption that is ICRG, WorldBank or Commonly or Kaufman Index (WBC), and CPI;</li> <li>Degree of decentralization that obtained from the proportion of state and local revenue to total revenue (REVDEC) and the proportion of state and local expenditure to total expenditure (EXPDEC);</li> <li>Control-variables such as population size, GDP at constant prices, the level of openness (total exports and imports to</li> </ul>	<ul style="list-style-type: none"> <li>The higher the more lower-level decentralization of corruption;</li> <li>The richer countries the more lower-level corruption but in poor countries was found that decentralization weakens the eradication of corruption because of the less developed countries have (poor) lack or weakness of oversight bureaucrats.</li> </ul>



Author	Data	Methodology	Result
		GDP), the diversity index of how many parts of ethnicity, and proportion of government expenditure to GDP.	

## 2. Methodology

Yardstick Competition Model was proposed by Besley and Case in 1995. Besley and Case put forward a model of autonomous local government performance can be evaluated based on the comparison with other autonomous regions. Ellis and Dincer modified the model of Besley and Case to investigate empirically the relationship between decentralization and corruption (Ellis and Dincer 2005, 2).

In this research, it used as secondary data of cross section of criminal corruption conviction in (cassation) MA and used average data for the period 2001-2009, in which the unit of analysis is the provincial level. The data corruption was used as the dependent variable, as independent variables; there are various data from other institutions for provinces such as Balancing Fund, Official Expenditure, GDP per capita, literacy rate, and population.

This research modified model used by Ellis and Dincer (2005) considering a variety of necessary information especially proper context of Indonesia. Thus the model is modified into below equation and estimated through Tobit Model:

$$\text{COR} = \hat{\alpha}_0 + \hat{\alpha}_1 \text{DEC} + \hat{\alpha}_2 \text{NECOR} + \hat{\alpha}_3 \text{OW} + \hat{\alpha}_4 \text{GDRPCAP} + \hat{\alpha}_{51} \text{P1} + \hat{\alpha}_{52} \text{P2} + \hat{\alpha}_{53} \text{P3} + \hat{\alpha}_{54} \text{P4} + \hat{\alpha}_{55} \text{P5} + \hat{\alpha}_6 \text{OT} + \hat{\alpha}_7 \text{RR} + \hat{\alpha}_8 \text{LR} + \hat{\alpha}_9 \text{POP} + \epsilon \quad (1)$$

COR is the level of corruption as independent variable. The data used is the cross section data of 33 provinces. Level of corruption which is represented by the COR that uses the number of corruption in each province was sentenced in MA (Supreme Court) decision which can be downloaded from the web. It has been made in the form of a data base by Rimawan Pradiptya, GMU (Universitas Gadjah Mada) economists, who pursue Economic Crime.

DEC is the level of fiscal decentralization and represented balancing fund in each local government budgets. NECOR is the level of corruption surrounding area is represented with an average score of corruption surrounding areas that border. OW is the level of official salaries that is represented by the amount of expenditures (the budget) for the official per capita. GDRPCAP is the Gross Domestic Regional Product per capita. P is a dummy for corruption in each island. It is used to distinguish Java-Bali (non-DKI-Jabar-Banten), Sumatra, Kalimantan, Sulawesi and Nusa Tenggara-Maluku-Papua archipelago. RR is an area relatively rich or poor by comparing GDRP per capita to the National GDP per capita. LR is Literacy Rate. POP is the size of the population in the province and OT is the province special autonomy fund recipients.

## 3. Result and the analysis

### 3.1 Data Description

Here is a description of the statistical data used in the research.

Table 1. Statistic Descriptive of the Data

Variabel (unit)	Obs	Mean	Std.DEv	Min	Max
Corruption	33	2.434545	2.206442	0	10
Decentralization (RpMillion)	33	859828.6	1044558	225485.4	5973044
Neighbour Corruption	33	2.62	1.703678	0.11	6.11
Official Salary Level (Rp1000/Capita)	33	3852.4	3004.643	1703.31	18446.82
GDRP per Capita (Rp1000)	33	13328.73	12986.6	3076.35	60809.79
Literacy Rate	33	92.20515	5.826949	74.29	99.19
Population (1000 jiwa)	33	6678.753	9783.457	708.97	39023.48

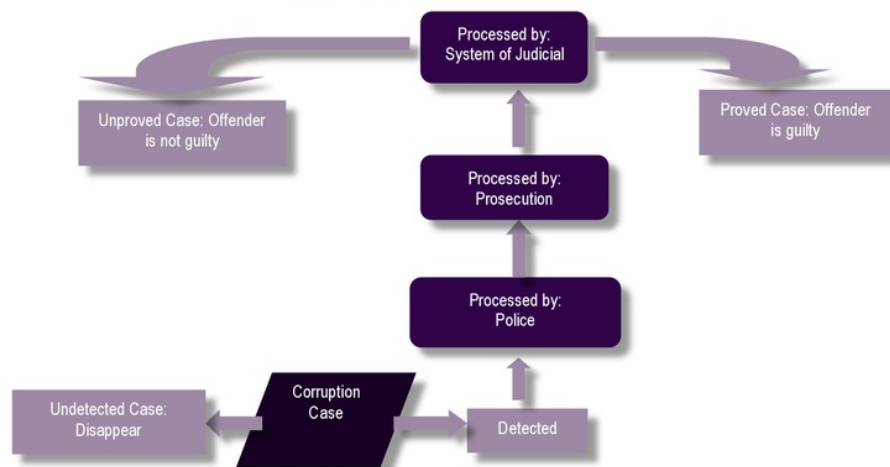
The data as presented in the table above is obtained from various sources. Corruption of data abstracted from MA. Corruption is of course not the actual corruption but the detected corruption and convicted by the Supreme Court in Kasasi as the final decision. The real data of corruption occurs so difficult to be obtained because there is corruption that is not reported and are not actionable well before entering the court.

Decentralization and level of salaries data obtained from sources in the Ministry of Finance and the BPS with the operational definition as set out in the previous session. GDRP, literacy rate, and population are obtained from various sources published by BPS.

### 3.2 Corruption Data in Indonesia

In brief, in accordance with RI Law No. 4 of 2004, the decision of the district court level (located in districts throughout Indonesia in accordance with the crime scenes) can be appealed to higher court by the parties concerned except the law decides otherwise. Further in article 21, against the decision of the court of appeal may be requested in an appeal to the Supreme Court by the parties concerned, unless the law decides otherwise (article 22). On the other hand in accordance with article 45 of RI Law No.14 of 1985, the prosecution as the prosecutor can make an appeal directly to the Supreme Court if there are objections to the decisions made at the court of first instance (District Court) or high-level (decision High Court).

Figure 2. Process of Corruption Case



From figures above, bias of the data corruption may appear before the case came within the justice system. Where the fact of data corruption has problems with corruption cases was observed with corruption cases that are not observed yet again and also corruption cases was observed (detected by law enforcement authorities) but not followed up with a good well of the system before entering the justice system. Starting from the detected or not incidents of corruption, the process in some institutions, police, prosecution, there is the possibility of corruption lost trace events. But when the case is entered the court, the track of the case is clear. All the cases that came in the lowest level of court have same opportunity to achieve appeal level in MA (kasasi). Thus by taking the case on appeal in MA we actually also get all the cases at a low level and MA decision is the final decision.

Beyond the formal mechanism, there are non-technical issues in legal system and judiciary in Indonesia. Many violations of internal law enforcement agencies occur and supported by outside parties such as lawyers, defendants, or the emergence of a case broker. In addition, except appeal in the Supreme Court data, no data corruption is integrated both in the prosecution, judicial, or police. Thus it is need too much cost for tracking one by one district/city. When no better data can be used as a representative of the data corruption, data corruption of the results of this appeal in the Supreme Court is the best proxy of data corruption.

Figure 3. Appeal Mechanism in Judicial System of Indonesia (Pradiptyo 2010)

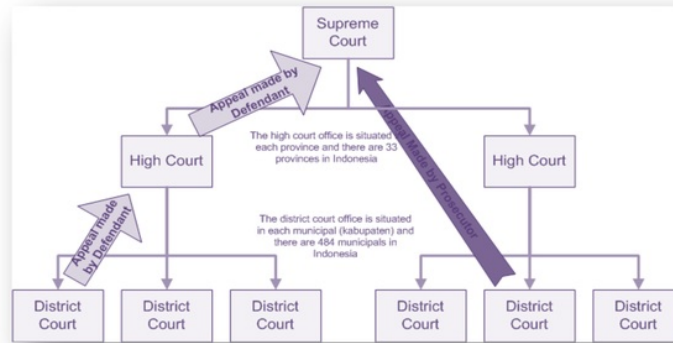
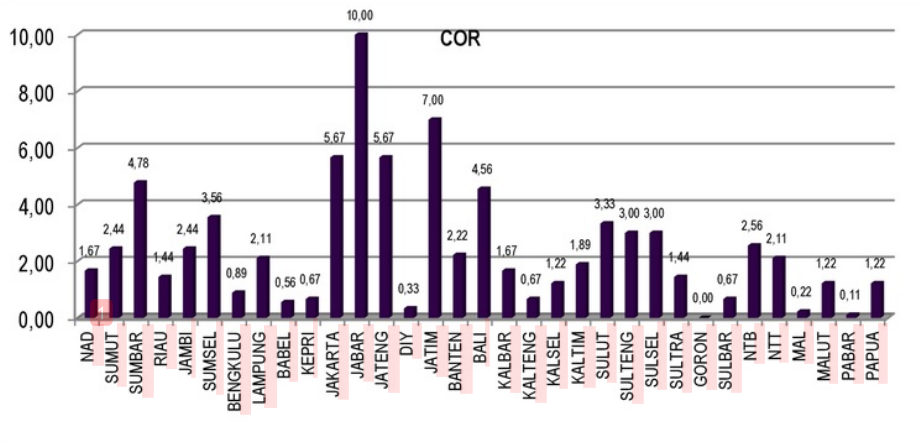


Diagram above shows the amount of corruption in every province. This is number of the incidents decided by the Supreme Court from the year 2001-2009. At first glance it appears that the incidence of corruption is prevalent in Java, especially in Jakarta, West Java, Central Java and East Java where it is located central of both power and economic activity.

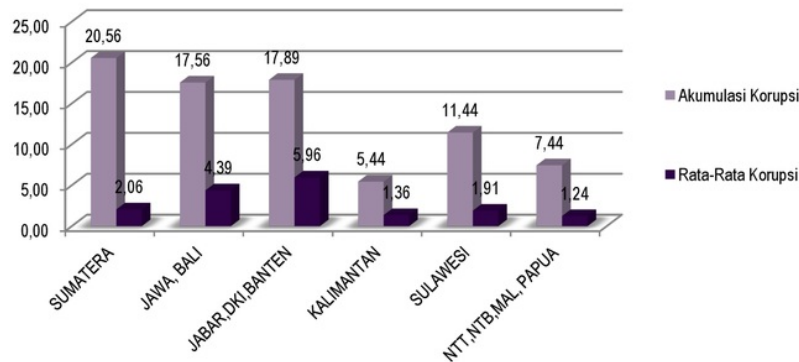
Figure 4. Number of Corruption Convicted in MA on average 2001 – 2009



Furthermore, diagram below describes the incidence of corruption based on the average and accumulation of the corruption of the province by island or island group. From the diagram it can be seen that the cumulative incidence of corruption is the highest in Sumatra and Java and followed the accumulation of corruption in Sulawesi, the Nusa Tenggara, Maluku and Papua, and the last is Borneo. On average the largest incidence of corruption is a group of West Java Province, Jakarta, and Banten (the Greater Jakarta), followed by the Java-Bali (exclude the Greater Jakarta) and Sumatra, while the lowest average is the corruption that occurred in the province of islands in the group Nusa Tenggara-Maluku-Papua and the province in Kalimantan.



Figure 5. Convicted Corruption in MA Appeal on Average (2001-2009) Based on the Island



### 3.3 Estimation Result

Estimation is carried through three models with the consideration of whether the specification of the model the better when included variables that are considered important.

Table 2. Estimation Result of Tobit Model

Variable	Model I	Model II	Model III
	Coeff.	Coeff.	Coeff.
C	1.253367	1.20545	11.4016***
DEC	7.49e-07**	6.21e-07	1.10e-06*
NECOR	-0.13331	-0.14310	-0.8694***
OW		0.00005	-0.00013
PDRBKAP	0.00001	0.00001	0.00002
RR	-1.55248**	-1.60185**	-2.09054***
LR	-0.00062	-0.00123	-0.06079
POP	0.00017***	0.00018***	0.00012***
P1			-1.86467*
P2			-4.11986***
P3			-2.62821**
P4			-3.64734***
P5			1.41544*
Ot			-0.30126
LR Chi2	LR	LR	LR
	47.16***	47.29***	63.10***

Notes: \*\*\*, \*\*, \* show significancy at 1%, 5%, and 10% level.

Estimation Model II by including the level of salaries is expected to make a better model than Model I. Although basically the salary of civil servants in Indonesia are relatively the same but with different policies

according to local capabilities, the take home pay earned by civil servants across regions to be different. Furthermore, it also made estimates of Model III with the consideration of adjusting to different regions (island) which has different corruption in Indonesia. Other consideration, there are several provinces accept special autonomy fund. From all of estimation result shows that in general, its output is successively better. This is indicated by the larger value of LR  $\chi^2$  and seen that all three have a significance of 1%.

### 3.4 Marginal Effect and Its Articulation

With a note that the marginal effect ( $dy/dx$ ) at mean will actually have the same value with the estimated output is displayed from the previous Tobit coefficient estimation. From the estimated model above can be summarized his marginal effect as follows:

Table 3. Marginal Effect at Mean

Variable	Estimation Model
	(Dependent Variable: COR)
	DY/DX
DEC	1.10e-06*
NECOR	-0.8694***
OW	-0.00013
PDRBKAP	0.00002
RR	-2.09054**
LR	-0.06079
POP	0.00012***
P1	-1.86467*
P2	-4.11986***
P3	-2.62821**
P4	-3.64734***
P5	1.41544*
ot	-0.30126

From the table it can be seen that the marginal effect of POP and DEC significantly have positive effect on COR. OW, PDRBKAP, and LR although is not significant but the coefficient has the expected sign. Dummy variable RR and P has a significant. While the special autonomy dummy variable (OT) has no effect on COR.

Fiscal decentralization has positive impact (it increasing the corruption). It shows that large transfer of funds from central government is not managed properly. It causes much corruption so that funds are also increasingly large leak. From total examination of 482 LKPD (Local Government Financial Report) which were reported as implemented budget in fiscal year 2008 in 2009 report obtained a number of only 3% of them or as many as 12 LKPD who get WTP criteria of CPC. The remaining 67%, 6%, and 24% respectively receive WDP, TW, and TMP. This data shows that the capacity of local government management of finances is poor.

Neighbor Corruption has negative effect on local corruption can be interpreted that by increasing the level of detection of corruption surrounding area to put pressure on that area so that corruption can reduce corruption. The relatively rich regions have lower levels of corruption compared to relatively poor areas.

In addition, the levels of the official salaries and the literacy rate were found not significantly reducing corruption even though the sign coefficient as expected. Corruption is a significant difference among the islands can occur because of other factors such as the condition of infrastructure of the law enforcement.

Significant coefficient for the dummy variable of this island can be articulated that the area on the island of Sumatra (P1) has a level of corruption is on average 1.86467 lower than the area in Java-Bali, the area on the island of Borneo/Kalimantan (P2) has a level of corruption on average 4.11986 lower than local in Java-Bali, the area on the island of Sulawesi (P3) has a level of corruption is on average 2.62821 lower than the area in Java-

Bali, and areas on the islands of Nusa Tenggara, Maluku-Papua (P4) has level of corruption on average 3.64734 lower than the area in Java-Bali. The last, groups such as provinces of the Greater Jakarta (DKI-Jabar-Banten) have level corruption on average 1.41544 higher than the Java-Bali provinces (Jateng-DIY-Jatim-Bali).

Java-Bali itself is the central island of Indonesia's national economy, even as no surprise that the Greater Jakarta themselves have a greater level of corruption than other area because the Greater Jakarta itself is located government center as well as economic centers. As the economic center of government and it's no wonder this area is the most occurrence of corruption. The corruption itself is detected as culture and the prevalence of which is irrelevant (not permitted by law, such as graft, bribery, and extortion). In addition to the current infrastructure has also been formed eradication of corruption in addition to the Act, the institution is well established in the areas although not optimal, such as BPK and KPK.

#### 4. Conclusion, policy recommendation, and suggestion

##### 4.1. Conclusion

This research results that fiscal decentralization has positive effect on corruption. The higher fund is delegated to the regions further increased corruption in the region concerned. Neighbor Corruption decreases local corruption. It can be interpreted that by increasing the level of detection of corruption surrounding area to put pressure on that area so that the corruption can decrease.

The level of salaries, GDP per capita, and levels of literacy despite having influence coefficient as expected but statistically insignificant effect on the extent of corruption. The greater population then increases the amount of corruption that occurred in the area. This is consistent with the expectation that the more people there are, the more that can be used as subject and object to the occurrence of corruption.

According to the area, the relatively rich regions (have average incomes levels above the average national income) have lower corruption than areas that have average incomes lower than the national average income (relatively poor regions). Concerning the island where the corruption occurs, on average, the area outside the Java-Bali (exclude DKI-Banten-Jabar) have lower corruption than the area on the island of Java-Bali, those are Sumatera, Kalimantan, Sulawesi, and groups of archipelago Nusa Tenggara-Maluku-Papua. Provinces such as DKI-Banten-Jabar (the Great Jakarta) have the corruption which is higher than other regions.

##### 4.2. Policy recommendation

It is always important to do increase the capacity of local financial management for areas that are deemed not good. Therefore the funds are devolved to the regions can be optimized the realization of its budget.

More education is needed for the population in order to eradicate corruption. Corruption itself apart due to poor system is also backed by the value that was born from a bad culture. In addition to formal education, informal education is also needed, such as education, training, and dissemination of prevention of corruption. Also must not forget the non-formal education such as education within the family environment.

In addition to have the competence to detect and crack down on corruption, the KPK should make the institution itself as a place of consultations for other public agencies to create a good system. The good governance will create as small as possible to emerge opportunities for corruption.

##### 4.3. Research suggestion

For better research in the next session concerns the relationship of corruption and decentralization then (1). It takes a better data base on corruption so that data corruption can be used more optimally for the benefit of better research; (2). It is better to include components in addition to fiscal decentralization namely administration and politics; (3). To view more details about this relationship then these estimates can also be done with a multilevel modeling considering the conditions in Indonesia, which consists of several islands and areas in the region.

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# Fiscal Desentralization

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