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Good Public Governance, Corruption and Public Service Quality: Indonesia Evidence

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Abstract: The purpose of this study is to examine the relationship between good public governance, corruption and public service quality. We use observations from local government (districts and cities) in Indonesia during 2010-2015. Good public governance (GPG) measured by GPG Index based on public governance principles from The Indonesian National Committee of Governance Policy. The result shows that higher good public governance is associated with lower corruption; and lower corruption is associated with high public service quality. Improving good public governance is one of effective strategies in combating corruption in developing countries like Indonesia. The local government need to be encouraged to increase public governance as it is proved to reduce corruption and subsequently increase public service quality.

Type of Paper: Empirical.

Keywords: Good Public Governance; Corruption; Public Service Quality; Local Government; Principle Component Analysis.

1. INTRODUCTION

Public spending is expenditure incurred by the public sector in the course of its activities. The term public spending and government spending is used interchangeably. Public spending refers to the aggregate sum of all public-sector expenditures. It includes government consumption, investments and transfer payment. The purpose of public spending is the increase the overall welfare of the society. Heller and Hauner (2006) mentioned that in the country with high economic growth and high level of efficiency, the government spending aimed to satisfy the interest of opposition and tax payer, whereas in developing countries, the level of efficiency in government spending is a complement to social spending by the public. There is still

mixed evidence on the impact of government spending to outcome. Manasan *et. al.* (2008) stated that education spending positively affects people's wealth. Gupta *et. al.* (2002) found that allocation for expenditures to education and health in developing country can improve the economic growth and increase the welfare. On the other hand, Rajkumar and Swaroop (2008) showed that public expenditures often do not produce the expected increase to the outcome.

Indonesia's average government spending percent of GDP from 1960 to 2015 is 8.93% among the top 150 spending in the world (http://www.theglobaleconomy.com/Indonesia/Government_size/). Based on budget realization data from year 2010-2015, there is an upward trend of local government spending as well as spending for healthcare and education. The ratio of spending in healthcare and education sector to total spending in local government is 11% and 37% respectively. However, the increase in the government spending is not accompanied with increase in public welfare. Wardhani *et. al.* (2017) found negative association of government spending in Indonesia with performance. Otherwise stated there is inefficiency in the government spending in Indonesia's local government. Corruption may be one of the reasons of the spending inefficiency/misallocation.

Julius (2011) mentioned that large sums of government revenue have been undermined by the corrupt practices of the political and economic elite (both local and international), which have enriched a few, but impoverished most. Corruption has played a major role in causing serious damage to the economic and social landscape in developing countries. This in turn has undermined social welfare and also investment in the public services, thereby eroding the quality of life and producing a decline in average life expectancy. Nguyen *et. al.* (2017) also found that corruption has a negative association with public service quality especially in healthcare and education sector. Based on Corruption Perception Index, Indonesia was ranked No 88 among 168 countries in 2015; not significantly change since 2012 (www.transparency.org). This fact shows that corruption is still serious problem in Indonesia. Indonesia Corruption Watch (ICW) recorded 425 corruption cases in education during 2006-2015 and worth IDR 1,3 trillion. Most corruption cases in education is embezzlement. Moreover, in healthcare sector, ICW mentioned during 2010-2015, there are 219 corruption cases worth IDR 1,6 billion and most of corruption cases in healthcare sector is mark up. Those case is only an example on how corruption can cause serious damage on public welfare.

Khan (2004) mentioned that previous studies conclude that most developing countries with relatively low growth and poor governance and corruption indicators show a positive relationship between better governance and lower corruption, on the other hand, and growth and other economic performance indicators. Nguyen *et. al.* (2017) found that transparency, accountability and participation are associated with lower levels of corruption. This result supports the good governance hypothesis which proposes that transparency, accountability and participation are effective anti-corruption strategies, even in developing countries.

The purpose of this study is to examine the relationship between good public governance, corruption and public service quality. It expected that higher good public governance is associated with lower corruption; and lower corruption is associated with high public service quality. This study is important because it gives several contributions to the literature. First, as one of the developing countries which is still struggling in combating corruption, Indonesia is an ideal setting for this topic. There is contradictory view on corruption impact in developing countries, whether it has harmful or positive effect on country's development. The lesson learned from this empirical study will be relevant to other developing countries which are undergoing different degrees of combating corruption. Second, this study proposes comprehensive governance index

for local government. Previous study uses single measure to proxy good public governance, such as transparency, accountability and participation. This study will develop comprehensive good public governance index based on best practices of governance principles. Third, to examine the relationship between good public governance, corruption and public service quality, we use two-stage least square. Corruption is not pure exogeneous variables since it mediates the relationship between good public governance and public service quality. Previous study does not consider this simultaneous relationship.

The remainder of this study proceeds as follows; section II briefly explain literature review and hypothesis development. Section III discusses research method followed by the discussion of empirical results. Section V concludes the study, implication and suggestion for further research.

2. LITERATURE REVIEW

2.1. Agency Problem and Corruption

The agency theory describes a possible conflict in the relationship between agents and principals (Jensen and Meckling, 1976). The agency relationship also occurs in the government public sector, where the public (voters) is the principal who delegate authority to the government official acting as an agent. Conflict between principal and agent can trigger corruption, where public interest is sacrificed for individual gain. Definition of corruption is now broadened, not only generated by economic motive (Klitgaard, 1998; Rose-Ackerman, 1999) but also motivated by the desire to attain or retain political power (Sikka, 2008). Political corruption takes place at the highest levels of political authority where policy formulation and legislation are tailored to enable politicians and legislators to derive economic gain (Bakre, 2008). Recent corruption cases in Indonesia involved both politicians and legislators where they involved from budgeting process up to the alleged flow of funds to parties that led to state losses.

Tanzi (1998) argued that corruption is more severe in developing countries than in their developed counterparts. Developing countries are often found to have excessive government interventions and discretionary spending along with nontransparent procedures. The law enforcement in these countries is often found weak. Julius (2011) found that most of the studies found harmful effect of corruption; such as reduces the incentive of making private investment, distorts public investment decisions and erodes integrity values. On the other hand, corruption is believed to create some positive impact for a country's development by:

1. speed up bureaucratic procedures,
2. serve as additional incentive that attract government official to perform better services and
3. resources and licenses can be allocated more efficiently as the most efficient firms can pay the highest bribes (Meon and Sekkat, 2005).

Which impact is more profound in each developing country become interesting issues to explore.

2.2. Public Service Quality

Gowan *et. al.* (2001) mentioned that service quality in public sector is more complex because it is not simply a matter of meeting expressed public needs, but also finding out unexpressed needs, setting priorities, allocating resources and justifying for what has been done. To meet or exceed the service quality in public

sector, the government spending is needed. At local government level, government spending covers operational spending, capital spending, unexpected spending and transfer to village. Government spending can also be broken into functional expenditure such as economic, healthcare, education, tourism, infrastructure, housing, environment, social and another general affairs expenditure. In this research, we use public spending to proxy public service quality. Martani and Pramudya (2017) found that spending on education and health affect the national objective to improve the welfare and intellectual life of the nation. Moreover, Setyaningrum and Martani (2015) also found that non-routine expenditures (capital expenditure, goods and services expenditure, and social assistance expenditure) also has positive effect on performance.

2.3. Good Public Governance

Good governance is believed as one of the mechanisms to reduce corrupt practices (Hofheimer, 2005) and eventually will have positive impact on public welfare. Local government with better governance should perform better because their policy and decision making is in line with public interest. OECD (2011) define public governance as the formal and informal arrangements that determine how public decisions are made and how public actions are carried out, from the perspective of maintaining a country's constitutional values when facing changing problems and environments. Prihatni (2014) summarize governance principles based on best practices used in several countries. Most of the countries refers to OECD (2011) and UNDP (2014) public governance principles which are also adopted in Indonesia by The Indonesian National Committee of Governance Policy (KNKG). KNKG (2010) set out good public governance based on five principles:

1. democracy,
2. transparency,
3. accountability,
4. culture of law and
5. fairness and equity.

This research will develop comprehensive measure good public governance for local government using principles from KNKG. The good public governance index developed from this study is expected to become alternative measures, since previous study use single measure to proxy each governance principles.

2.4. Hypothesis Development

Hors (2000) and Julius (2011) mentioned several harmful effects of corruption. Not only caused the state loss due stolen revenue (*e.g.* tax evasion and avoidance), corruption also erodes integrity, and promotes misallocation of resources. Instead of investing in health, education, and infrastructure, public investment is made in undesirable directions that reduce the quality of public spending. Based on those finding, corruption control is needed to reduce the negative effect. One of the mechanisms to control corruption found in the literature is by implementing good public governance. IFAC (2013) mentioned that the aim of good governance in the public sector is to encourage better service delivery and improved accountability by establishing a benchmark for good governance in the public sector. Some scholars found that transparency and citizen participation strengthen accountability and reduce corruption (Khan, 2006; Nguyen *et. al.*, 2017).

Previous research examined several governance principles on corruption. Kolstad and Wüig (2011) found that there is a substantial effect of improving democracy in developing countries, where the problem of corruption is the most prevalent. This means that developing democratic institutions should be part of strategies to reduce corruption. Klitgaard (1998) states that corruption arises when the government has the right to monopolize the resources it possesses with its own authority and without adequate accountability. Transparency is the ease of the community in accessing information in a timely, reliable manner in terms of economic, social and political information in accordance with stakeholder needs (Kolstad and Wüig, 2011). Lack of transparency creates an opportunity for government officials to use the public resources for their personal gain. Overall, previous research supports the good governance hypothesis which proposes that transparency, accountability and participation are effective anti-corruption strategies, even in developing countries. Based on the above arguments, the first hypothesis proposed research in this research is as follows:

H1: Good Public Governance have negative association with corruption.

Researches on the impact of government spending on the outcome provide mixed results. Generally speaking, higher spending should have positive association with better public service quality. Gupta *et. al.* (2002), Heller and Hauner (2006), Manasan *et. al.* (2007) found positive association of government spending on economic growth and public welfare mostly in education and healthcare. On the other hand, Rajkumar and Swaroop (2008) found that public expenditures often do not produce the expected increase to the outcome. Poor governance and corrupt practices become one of the main reasons why governments in developing countries fails to transform a huge public spending into high quality of public service. Large sums of government revenue have been undermined by the corrupt practices which have enriched a few, but impoverished most (Julius, 2011).

Nguyen *et. al.* (2017) focused on the association of corruption and quality of public healthcare and education in Vietnam. Similar with Indonesia, education and healthcare are highly prone to corruption due to their large shares in any government's budget. In healthcare sector, corruption acts take various forms such as a doctor's improper use of public facilities for private practice, producing a false bill or giving bribery in return for a contract. Meanwhile, corruption in education occurs at different scales, ranging from national education ministries to university or schools. Nguyen *et. al.* (2017) found negative association between corruption and service quality in healthcare and education. Corruption in healthcare may result in a worse health outcome and corruption in education may erode all social, economic, and political value of the society by destroying personal integrity. This reason is relevant to explain Wardhani *et. al.* (2017) finding on inefficiency of public spending in Indonesia. Corrupt practices promote miss allocation of resources for bureaucrats (politicians and legislators) personal gain and therefore causes public spending inefficiency. Based on the above arguments, the second hypothesis proposed research in this research is as follows:

H2: Corruption has negative association with public spending.

3. METHOD

3.1. Sample

The purpose of this study is to examine the relationship between good public governance, corruption and public spending. We use data from local governments (districts and cities) in Indonesia during 2010-2015. Purposive sampling is used to select the sample. The sampling criteria are local government that have

complete data from year 2010-2015. Data sources are obtained from Supreme Audit Agency; Ministry of Internal Affairs; Corruption Eradication Commission and Central Statistical Bureau; which consists of:

1. audited local government financial statement;
2. local Government Performance Score;
3. corruption report; and
4. economics indicator

3.2. Model

We hypothesize that better public governance is associated with lower corruption; and lower corruption is associated with high public quality services. Corruption in this study function as intervening variable that mediates the relationship between public governance to total spending. The research model is as follow:

$$CORR_{it} = \alpha_0 + \alpha_1 GPG_{it} + \alpha_2 HDI_{it} + \alpha_3 GINI_{it} + \alpha_4 REV_{it} + \epsilon_{it} \quad \dots(1)$$

$$TOTSP_{it} = \beta_0 + \beta_1 FCORR_{it} + \beta_2 HDI_{it} + \beta_3 GINI_{it} + \beta_4 REV_{it} + \epsilon_{it} \quad \dots(2)$$

where $CORR_{it}$ is number of public complaints on corruption for local government i in year t ; $FCORR_{it}$ is fitted value of corruption for local government i in year t ; GPG_{it} is good public governance index for local government i in year t ; $TOTSP_{it}$ is total spending for local government i in year t ; HDI_{it} is human development index for local government i in year t ; $GINI_{it}$ is Gini ratio for government i in year t ; and REV_{it} is (log) revenue for local government i in year t .

To overcome the simultaneity problem, we estimate the model using Two Stage Least Square (TSLS) where we use fitted value of corruption from model 1 in model 2. To control the differences due to the characteristics of the local government, the model controls several aspects such as Gini ratio to control differences in the level economic discrepancy between region, human development index to control wealth discrepancy between region, and total revenue to control size of local government.

3.3. Variable Measurement

One of the contribution of the study is development of good public governance (GPG) index. We develop GPG index using five governance principles (democracy, transparency, accountability, culture of law and fairness and equity) of public sector from The Indonesian National Committee of Governance Policy (KNKG). We examine local government performance indicator and match with the governance principles. We use Principal Component Analysis (PCA) to classify the indicator of governance principles as describes in table 1.

Corruption is measured by number of public complaint on corruption. Corruption Eradication Commission use public complaint as basis for further investigation. Azhar and Setyaningrum (2015) proved that there is a high correlation between public complaint and corruption cases that proceed to the court. Total spending measured by natural logarithm of total government spending for one period. The Human Development Index (HDI) is a summary measure of average achievement in key dimensions of human development: having a long and healthy life, being knowledgeable and having a decent standard of living. The health dimension is assessed by life expectancy at birth, the education dimension is measured by the

Table 1
Indicator of Good Public Governance Principles

<i>Governance Principle</i>	<i>Indicator</i>
Democracy	<ul style="list-style-type: none">• Embodiment of public interest• Political support• Public Service Standard• Efficiency and Effectiveness• Participation• Ease of Doing Business
Transparency	<ul style="list-style-type: none">• Usage of Information Technology• Public Satisfaction
Accountability	<ul style="list-style-type: none">• Report Timeliness• Financial Accountability• Administrative Accountability
Culture of Law	Law Enforcement
Fairness and Equity	<ul style="list-style-type: none">• Fairness• Equity

mean of years of schooling for adults aged 25 years or more and expected years of schooling for children of school entering age. The standard of living dimension is measured by gross national income per capita. The HDI uses the logarithm of income to reflect the diminishing importance of income with increasing Gross National Income (GNI). The scores for the three HDI dimension indices are then aggregated into a composite index using geometric mean. The Gini Ratio measures inequality of distribution. The Gini ratio for each local government are available from Central Statistical Bureau. Revenue is measured by natural logarithm of total revenue of local government for one period.

4. ANALYSIS

4.1. Descriptive Statistics

Based on sampling criteria, total sample used in analysis is 659 observations from year 2010-2015. The sample reduction is mainly due incomplete data in measuring GPG Index. Descriptive statistics can be seen in table 2. There is an upward trend of total spending from 2010-2015 and the average value is IDR 913 billion. The increase in public spending in year 2015 is more than double as compare to 2010. The huge spending should have positive impact on public service quality. The average public complaint on corruption is approximately 6 cases and maximum 58 cases in 2012.

Good public governance for local government shows positive trends. Figure 1 shows that GPG index is improving from year 2010 until 2016. If we look more details on the GPG principle (see figure 2), overall governance principle also shows upward trend from year to year. The most significant improvement is in

Table 2
Descriptive Statistics

<i>Variables</i>	<i>Obs.</i>	<i>Mean</i>	<i>Min</i>	<i>Max</i>
TOTSP	659	11.961	11.114	13.125
CORR	659	5.581	0.000	58.000
HDI	659	67.448	35.450	81.300
GINI	659	0.316	0.180	0.480
REV	659	12.001	11.471	12.821

transparency and accountability. Those principles in previous literature are believed to have significant impact on reducing corruption.

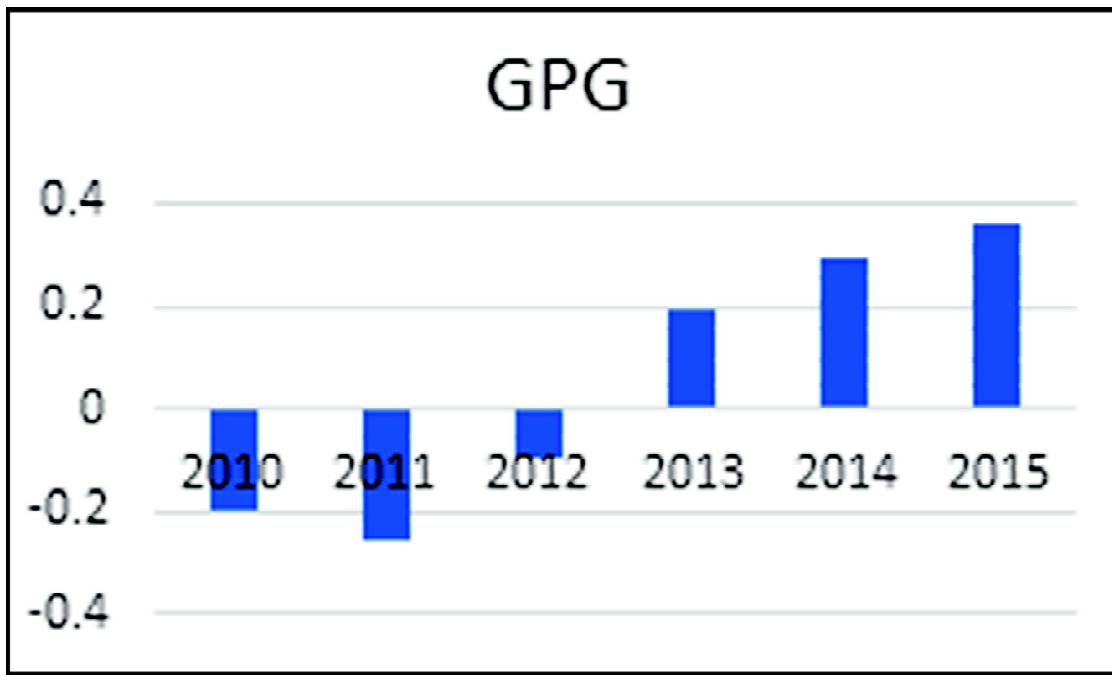


Figure 1: GPG

4.2. Analysis of Regression Result

Hypothesis 1 stated that there is a negative association between good public governance and corruption. The regression result in table 3 support hypothesis 1. It shows that the good governance hypothesis is supported in Indonesia. In the developing countries like Indonesia, where corruption is most prevalent, good public governance role as effective anti-corruption strategies. From the descriptive statistics, we can see that GPG index shows upward trends in Indonesia's local government. High GPG Index means there are substantial improvement in all governance principles that will lead to decrease in corruption. This result is in line with Khan, 2004; Nguyen *et. al.*, 2017 who also found that governance is powerful tools to control corruption.

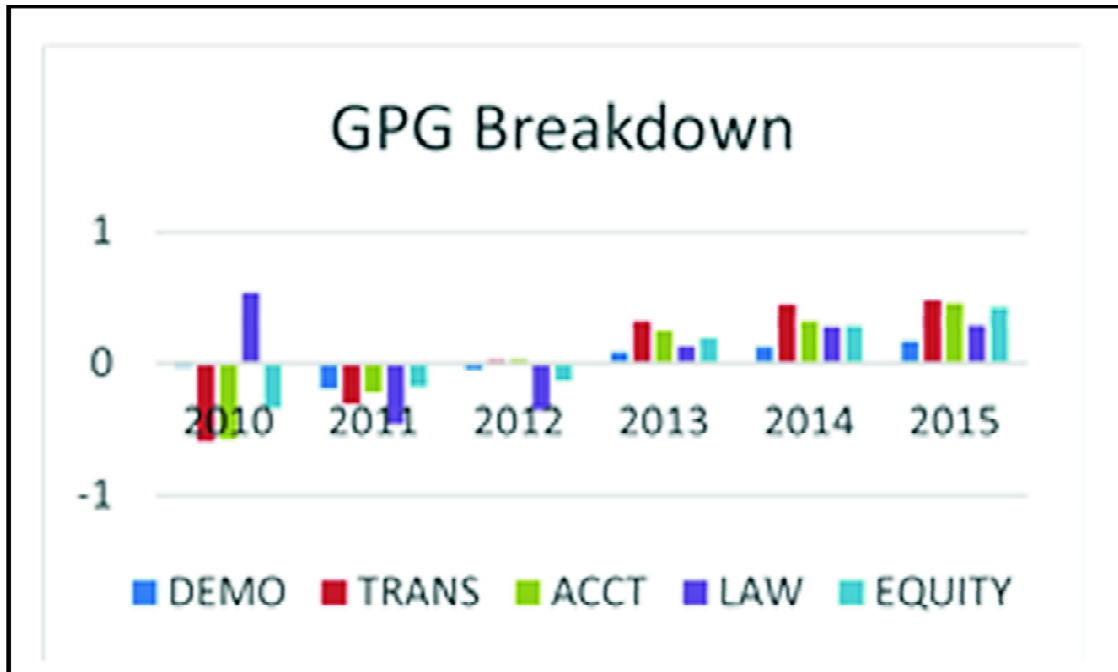


Figure 2: GPG Breakdown by Principle

The second hypothesis expects a negative association between corruption and public spending. From table 2, it can be seen that hypothesis 2 is supported. This result explains why huge spending does not necessarily has positive impact on outcome. Corruption has played a major role in causing serious damage to the economic and social landscape which in turn erodes the quality of life and public welfare (Julius, 2011). World Bank (2003) mentioned several flaws in budgeting systems in Indonesia that triggers corruption. First, budget is driven by bureaucratic needs rather than by a policy focus. Currently, budgets are prepared using performance based, but still with little focus on outputs and outcomes. It creates considerable risk of duplication of recurrent spending and diversion of budgetary resources to unintended purposes. Second, the lack of budget oversight by parliament and its budget committee. Parliament is under-resourced and ill equipped to carry out these functions effectively. Moreover, the effectiveness of its oversight has been compromised by the allegation that ministry has spent money to buy the support of members of parliament for their programs. Both reason among other else triggers corruption and subsequently creates inefficiency in public spending. In this study, corruption function as intervening variables that mediates the relationship between good public governance and spending. We can conclude from the result of hypothesis testing 1 and 2 that if the local government want to increase the public service quality, they have to put effort on reducing corruption; while one of the effective strategies to reduce corruption is by increasing the public governance.

4.3. Additional Analysis

We perform two additional analysis to complete the discussion. First, we modify model 1 and enter all five governance principles to see its effect on corruption. The result shows that among five principles, transparency and accountability has strong negative effect on corruption. This result is in line with Nguyen

Table 3
Regression Result

<i>Model 1</i>				
$CORR_{it} = a_0 + a_1GPG_{it} + a_2HDI_{it} + a_3GINI_{it} + a_4REV_{it} + \epsilon_{it}$				
<i>Variables</i>	<i>Expected Sign</i>	<i>Coefficient</i>	<i>P > t</i>	
CONS		-146.205	0.000	***
GPG	H1: (-)	-1.460	0.015	**
HDI	+/-	0.156	0.000	***
GINI	+/-	-12.412	0.009	**
REV	+	12.099	0.000	***
Number of obs				659
Prob > F				0.000
R-squared				0.252
<i>Model 2</i>				
$TOTSP_{it} = b_0 + b_1FCORR_{it} + b_2HDI_{it} + b_3GINI_{it} + b_4REV_{it} + \epsilon_{it}$				
<i>Variables</i>	<i>Expected Sign</i>	<i>Coefficient</i>	<i>P > t</i>	
CONS		-4.578	0.024	**
FCORR	H2: (-)	-0.028	0.069	*
HDI	+	0.005	0.032	**
GINI	+	0.122	0.241	
REV	+	1.361	0.000	***
Number of obs				659
Prob > F				0.000
R-squared				0.887

CORR = number of public complaints on corruption; FCORR = fitted value of CORR; GPG = Good Public Governance using PCA; HDI = Human Development Index; GINI = Gini Ratio; REV = log Total Revenue*** = Significance at 1%; ** = Significance at 5%; * = Significance at 10%

et. al. (2017). Second, we replace total spending in model 2 with total education spending and health care spending. Both sectors receive high budget allocation and more prone to corruption. The result shows that corruption has negative impact both on education and healthcare spending. In Indonesia, the frequent cases of corruption in education is embezzlement followed by mark up, false project and budget cut. While in healthcare sector, highest corruption acts are mark up, followed by embezzlement, abuse of power and also false projects. Thus, in order to increase public service quality in healthcare and education sectors, local governments need to give attentions on area where corruption cases are most prevalent.

5. CONCLUSION

The purpose of this study is to examine the relationship between good public governance, corruption and public service quality. We use data from local government (districts and cities) in Indonesia during 2010-

2015. We measure public governance using data from local government performance report and use principle component analysis to develop GPG Index. The hypothesis is tested using two stages least square. The result shows that higher good public governance is associated with lower corruption; and lower corruption is associated with high public service quality. Based on research findings, there are several important implications. First, improving good public governance is one of effective strategies in combating corruption in developing countries. Second, transparency and accountability is most important principle to reduce corruption. Transparency can be improved by maximizing the usage of information technology (*e-government*) in every public service such as *e-procurement*, *e-budgeting*, *e-passport* etc. Moreover, the government should give more attention to administrative and financial accountability as well as report timeliness as it is proved can reduce corruption. Third, high total spending should transform in increase of public welfare, therefore miss allocation and inefficiency has to be minimized one of which by implementing effective corruption strategies.

This study has several limitations. First, there is a high subjectivity when determining measurement used in each governance indicator. Further research should consider to consult with panel of expert to justify the measurement as well as integrating other governance principle from OECD or IFAC. Second, we use number of public complaints to measure corruption. As far as our concern, this is the only data that can reach wider sample. Further research can consider to use other alternative measure such as integrity survey, perception index or develop corruption checklist.

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