

Analysis of the Budget-ratcheting Phenomenon in Local Government Budgeting in West Sumatra Province

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ABSTRACT

Reformation that happened in Indonesia brought many changes in government system, which one is changes from centralized systems to decentralized systems. The decentralization systems constrain every local government to manage their own household affairs include budgeting process. Indonesia adopts performance budgeting that concern on outcome as the key characteristic. Based on agency theory, regional government acts as agent that runs the government budgeting process. In fact, budget preparation process has various risks and incrementalism in budgeting process often occurs which arises budget ratcheting. This study aims to identify whether budget-ratcheting phenomenon occurs in local government budgeting in West Sumatra province. The population of this study are 19 districts/cities in West Sumatera Province with total sampling method. This research classified as descriptive quantitative study. The result indicated that budget-ratcheting effect occurs in each component of local government revenue, balance fund and capital expenditure.

Keywords: *agency theory, budget-ratcheting, local government, performance budgeting.*

1. INTRODUCTION

The reform era carried out by the Country of Indonesia to date is a reform of the government system from the New Order era. Many changes have been felt by the Indonesian State, one of which is the change in regional autonomy policy which previously used a centralized system and then changed to a decentralized system (Kusnandar & Siswanto, 2012).

The decentralization system is a government system that explains the transfer of authority from the central government to local governments to manage their own household affairs. This aims to create a more transparent and controlled regional

government. With the support of a decentralized system, various regulations were formed that oversee the running of the decentralized system. Several regulations that have been formed have undergone amendments until finally the regulations used are Law Number 23 of 2014 concerning Regional Government. The regulation regulates regional government affairs as widely as possible. Another regulation that plays an important role in implementing the decentralization system in Indonesia is PP. 58 of 2005 which regulates how to manage local finances properly. The regulation also explains how the regional financial management cycle starts with planning, implementation, reporting,

accountability and supervision of regional finances.

Regions have a Regional Revenue and Expenditure Budget which is later abbreviated as APBD. The preparation of the budget program begins with mem forms of activities are planned with the largest initiatives were in the executive during the discussion of RKPD. This activity illustrates the participation of *agents* (executives) and *principles* (legislative parties) who form contracts (*incomplete contracts*) which can be a means for the *principle* to oversee the course of budgeting carried out by the *agent*. The Regional Head and the Regional People's Representative Council work together to form participatory relationships for the preparation of the APBD so that there is an agency relationship that collaborates with each other to produce the right target APBD (Ahyani, 2019). In this case, the Regional Government (executive) acts as an *agent* and DPRD (legislative) acts as a *principle* as the direct representative of the community in the region. The legislative body is the party that measures and supervises budget performance in regional government in Indonesia (Bawono, Halim, & Lord, 2012), while the regional executive body is the party that runs the budgeting system in a region.

Minister of Home Affairs Regulation No. 59 of 2007 explains that the APBD consists of financial plans for various elements of Regional Revenue, Regional Expenditure, Transfers and Regional Financing. Regional income consists of three main components, namely Original Regional Income (PAD), Transfer Income, and Other Legal Income. In this study focuses on how the budgeting occurs in each of the components contained in Original Regional Income, Balancing Funds and Regional Capital Expenditures.

Research by Isaksen (2005) explains that the budget preparation process has various risks, such as corruption and bias. Motivation and incrementalism in the budgeting process also often occur (Leloup & Moreland, 1978). Another problem that arises in the budget formulation process in regional governments is the emergence of *budget ratcheting*. Lim's research (2011) explains that the *ratcheting budget* is caused by a shortage in

current income, not related to the high and low income in the next period That is, *Budget Ratcheting* describes an increase in the budget in the next period due to the variance of the budget from the current year. In contrast to this research, this study will explain descriptively how the role of the components of Regional Original Income, Balancing Funds and Capital Expenditures in influencing the level of budget changes caused by the *ratchet* effect that occurs in them.

The occurrence of budget variances (budget variance) in APBD posts is also inseparable from opportunistic behavior in fulfilling the *self-interest* of various parties which then creates a *ratchet* effect, but this incident is still very rarely studied in depth in the implementation of the budgeting system in Indonesia. This is important to be examined again because there is still little research that reveals this. Generally, in governments in various regions, budget preparation follows the pattern or how much of the last year's total budget, which is called *budget ratcheting*.

The study by Lee and Plummer (2007) explains that the government budgeting for several schools indicates a *ratchet* effect. The study also showed that there was an excess of spending from last year which led to a higher increase in spending budgeted for the current year. Lim's research (2011) also shows the emergence of problems in setting budget targets among local governments that have resulted in *budget ratcheting*. This becomes important to be examined again to ensure that there is still or not a *ratcheting budget* that arises in the budgeting process at the central and local governments.

Several cases of changes and increases in regional revenue and expenditure budgets that occurred in Indonesia, one of which was the case of budget changes that occurred in the West Sumatra Province in 2018. Reported from www.sumbarprov.go.id revealed that the regional revenue target had increased from Rp. 6,1 trillion to Rp.6,4 trillion, an increase of 4,9 percent from 2017 revenue target area of West Sumatra DPRD mention that the regional income targets derived from various sources including from revenue of Rp.2,04 rose to Rp.2,2 Trillion, the Balancing Fund of Rp.3,9 trillion, up to Rp.4,2 trillion, and other

legitimate income of Rp.75 billion, which increases to Rp. 87,7 billion. This illustrates that the positive variance of regional income targets experienced by Provinces West Sumatra in the year 2017-2018. Thus, if there is a shortage of income for the current period, it is not related to high or low income in the future (Lim, 2011) but because of the determination of income according to how much the region needs to be financed by the income.

The regional expenditure has increased in the revised 2018 budget for Rp.4 trillion or 6,45 percent. Thus increasing the amount of Rp 6,2 trillion in APBD 2018 to Rp.6,6 trillion in APBD-P 2018. The increase of the shopping area, it can be concluded that the shopping areas in West Sumatra province also experienced a negative variance. Thus, further discussion is needed to see the effect is there *ratcheting* the budgeting process the budget.

Abdullah R.'s research (2014) found that the remaining previous budget has an influence on changes in expenditure allocations that occur in districts / cities throughout Indonesia. This means that there are irregularities in the implementation of expenditure budgeting in Indonesia, which should have been carried out and planned by various parties for a long time in accordance with regional needs in the future, not from the percentage of the previous remaining budget.

In total it can be concluded that the APBD of West Sumatra Province in 2018 increased by Rp.0,3 trillion or 4,9 percent, from Rp. 6,1 trillion to Rp. 6,4 trillion. This explains that there have been changes

2. METHODS

This type of research is a descriptive analysis research. According to Sugiono (2009) explaining that descriptive analysis research is a research method that aims to describe or explain the description of an object to be studied through samples or data collected as it is. This study focuses attention on various problems according to actual events when the research is carried out. The results of the research are concluded from the processed data and then analyzed to draw conclusions.

This research was conducted to analyze *Budget Ratcheting* on each component of Original

in budgets related to budget variants made by local governments. The existence of a performance variant in the previous year serves as a sufficiently relevant information for the principal if the performance variant is permanent (Aranda, Arellano, & Davila, 2010). This means that the performance of local governments becomes the benchmark for consideration in determining the budget draft that will be submitted in the next period.

The scope of the West Sumatra Regional Government's APBD provides interesting insights and increases the interest of researchers to conduct research. It is certainly in accordance with the purpose of the study knew *efek budget ratcheting* in government budgeting with performance-based budgeting application that occurs in PAD, DBH and Capital Expenditure. The results of the research are expected to be able to add to the literature related to the research objectives and to broaden the readers' insight in understanding the issues that are currently developing among local governments in Indonesia. The results of this study are also expected to provide implementation for local governments in improving the budgeting process that will be carried out in the future.

This research will try to use capacity building and workshop as treatment in order to improve vocational accounting teachers' professionalism in teaching government accounting. This paper consists of 4 parts which are introduction, research methods, results and discussion, and the last part conclusions.

Regional Income, Balancing Fund, and Capital Expenditure. The population in this study used 19 district/city governments in West Sumatra Province. The District Governments in West Sumatra Province are 12 districts, while the City Governments are 7 cities. The population under study is small, so sampling is not carried out because if a sample is taken, it cannot represent the population and the values calculated are based on total sampling as an estimate of population values (Cooper and Schinder; 114).

3. RESULTS AND DISCUSSIONS

Data for each variable is obtained by adding up the posts in each component of the Districts/City APBD in West Sumatra Province in 2014-2018. Based on the results of descriptive statistics, it can be concluded that the Local Own Revenue budget in the first hypothesis grows by 11,03%, while the variant of Original Regional

Income has a positive value of 0,018. In the Balancing Fund budget, it experiences growth in each period of 11,40%, while the Balancing Fund variant has a positive variant of 0,25. Capital expenditure in each budget period has grown by 11,11% with a positive variant of 0,24.

3.1 Ratcheting in Original Regional Income (PAD) Components

Table 2
Estimation Results of Growth Regression Test in PAD Components

Component	Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
		Locally-generated revenue				
Local tax	(Constant)	4,911	3,429		1,432	,156
	X (At-1) - (Bt-1)	,554	,324	,177	1,711	,090
Regional Retribution						
Regional Retribution	(Constant)	11,643	,548		21,265	,000
	X (At-1) - (Bt-1)	-,129	,056	-,236	-2,316	,023
Separated Wealth Management Results						
Separated Wealth Management Results	(Constant)	8,293	,726		11,424	,000
	X (At-1) - (Bt-1)	,152	,080	,195	1,898	,061
Other Legal PAD						
Other Legal PAD	(Constant)	9,976	,805		12,394	,000
	X (At-1) - (Bt-1)	,084	,080	,110	1,054	,295

Based on the hypothesis testing design, the requirement to state the ratcheting effect in the regional Revenue and Expenditure budget if $\lambda \neq 0$. The results of the growth regression test show that the ratcheting coefficient value in the PAD budgets of districts/cities in West Sumatra Province in 2014-2018 in total shows There is a ratchet effect, but if

you look at each component of the PAD budget, it shows that one of the PAD components shows the lowest ratchet effect, namely the regional retribution component which has a ratchet coefficient of -0,129. Meanwhile, three of the four PAD components show a positive ratchet coefficient value in the PAD budgeting process,

where the PAD component that has the highest ratchet coefficient value is in the regional tax budget with a ratchet coefficient of 0,554. Referring to these requirements, it can be said that there is a

ratcheting effect in the Regional Original Revenue of the districts/City in West Sumatra Province in 2014-2018.

3.2 Ratcheting in the Balancing Fund Components

Table 3
Estimation Results of Growth Regression Test in Balancing Fund Components

Balancing Fund Components	Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
Tax Profit Sharing Fund	(Constant)	9,572	, 843		11,357	, 000
	X (At-1) - (Bt-1)	, 058	, 085	, 075	, 681	, 498
SDA Profit Sharing Fund	(Constant)	7,115	1,106		6,432	, 000
	X (At-1) - (Bt-1)	, 306	, 113	, 291	2,720	, 008
General Allocation Fund	(Constant)	11,434	, 373		30,658	, 000
	X (At-1) - (Bt-1)	, 037	, 034	, 118	1,085	, 281
Special Allocation Fund	(Constant)	11,641	, 028	, 399	41, 517	, 000
	X (At-1) - (Bt-1)	, 013	, 003	, 399	3,961	, 000

The ratcheting coefficient value in the Balancing Fund budget component shows a ratchet effect. This is indicated by the positive value of each ratchet coefficient for each component of the Balancing Fund budget. Tax Revenue Sharing Funds have a ratchet coefficient value of 0,058, SDA revenue sharing funds have a ratchet coefficient value of 0,306, General Allocation

Funds have a ratchet coefficient value of 0,037 and Special Allocation Funds have a ratchet coefficient value of 0,013. Based on the hypothesis testing design, the requirement to state the ratcheting effect in the regional Revenue and Expenditure budget is if $\lambda \neq 0$. the highest ratchet effect is in the component of the SDA Revenue Sharing Fund.

3.3 Ratcheting in the Capital Expenditure Component

Table 4
Estimation Results of the Growth Regression Test in the Capital Expenditure Component

Capital Expenditure Components	Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
Expenditure Land	(Constant)	10,538	, 183		57,709	, 000
	X (At-1) - (Bt-1)	, 001	, 020	, 007	, 066	, 948
Expenditure for Equipment & Machinery	(Constant)	8,208	, 688		11,938	, 000
	X (At-1) - (Bt-1)	, 232	, 071	, 324	3,268	, 002

Table Cont....						
Expenditure for Buildings & Buildings	(Constant)	10,716	, 356			30,072 , 000
	X (At-1) - (Bt-1)	, 038	, 036	, 107		1,031 , 305
Expenditure Street, Irrigation And Networks	(Constant)	10,742	, 343			31,291 , 000
	X (At-1) - (Bt-1)	, 022	, 035	, 065		, 625 , 534
Expenditures for Other Fixed Assets	(Constant)	9,207	, 186			49,384 , 000
	X (At-1) - (Bt-1)	, 105	, 022	, 450		4,808 , 000

Based on the hypothesis testing design, the requirement to state the ratcheting effect in the regional Revenue and Expenditure budget is if $\lambda \neq 0$. Referring to these requirements it can be said that there is a ratcheting effect in the districts/city capital expenditure budget components in West Sumatra Province in 2014-2018. This is evidenced by the variance or positive value on the ratchet coefficient in each component of capital expenditure. The component of capital expenditure that is most affected by the ratchet effect can be seen in the table above, which is equipment and machinery spending which has a positive coefficient value of 0,232.

Budget Ratcheting in the Original Local Income Component

The Growth Regression Test shows that there is a ratchet coefficient value that is not equal to zero or $\lambda \neq 0$. This indicates that there is a partial budget ratcheting effect on each component of the budgeting of Local Original Income in districts/cities in West Sumatra Province from 2014 to 2018. The findings of the study explain how much the ratchet effect occurs in the budgeting for the components of local revenue, including local taxes, which have a ratchet coefficient value of 0.554, local levies have a ratchet coefficient value of -0.129, the results of separated wealth management have a ratchet coefficient value of 0.084, and

Another valid PAD has a ratchet coefficient value of 0.152. This finding explains that the PAD component indicated to have the highest ratchet effect is found in the regional tax budget with a ratchet coefficient of 0.554.

The findings of this study support the results of Halim's (2009) study which states that the obstacles that occur in regional government are often associated with the exploitation of local tax sources and levies, both of which are components of PAD which still have not fully contributed to the overall income received. area. Abdullah and Junita (2016) explain that PAD plays a very small role and varies between regions, namely around 10% to 50% in financing regional expenditure needs.

The increased revenue target as a result of local taxes will increase the level of government spending (tax-spend hypothesis). However, if there is an increase in spending, it will not return to its original level despite various objections to the increase in local taxes. Arranda (2010) in his research stated that if you use the ratchet model in observing problems in budgeting, you can predict that the target expenditure tends to be relatively constant unless there are obstacles that come from external events.

The agency principle explains that if the budget is used as a benchmark for measuring performance and disbursing incentives, then if there is a budget gap, the setting of revenue targets

will tend to be lower than the actual potential. This means that the agency or SKPD will tend to act as a budget minimizer. In the event of a recession, the government will tend to implement a policy of increasing income in line with spending. Finally, the government will experience difficulties in reducing spending targets that have already been high along with high income (Hercowitz & Strawczynski, 2002).

Budget Ratcheting in the Balancing Fund Component

The results of the growth regression data processing that have been carried out show that there is a ratchet effect in each budgeting component of the balance funds. This is evidenced by the presence of a positive ratchet coefficient on each component of the balance fund, including tax-sharing funds having a ratchet coefficient value of 0,058, SDA revenue sharing funds having a ratchet coefficient value of 0,306, General Allocation funds having a ratchet coefficient value of 0,037, and The Special Allocation Fund has a ratchet coefficient value of 0,013. This finding explains that the component of the Balancing Fund that is most affected by the ratchet effect is in the SDA Revenue Sharing Fund with a ratchet coefficient of 0,306. impacted effect *ratchet* contained in the fund for Hasi l SDA coefficient *ratchet* at 0,306.

As far as the researcher observes, research on the effect of *budget ratcheting* in Balancing Funds is very rarely studied. This is because the *budget actors* in Balancing Fund budgeting are not only the Regional Government and the Regional Legislative Council, but there is interference from the Central Government.

Agents often make various efforts to maximize their budgets, which in turn will affect the amount of budget variants with the realization of the budget (Smith & Bertozzi, 1998). The research of Isaksen (2002) and Abdullah (2012) is also in line with the results of this study which states that in every stage of budgeting there is shrouded space for corruption. This means that the opportunistic actions taken by the executive and the legislature in the regions against the balancing fund budget are carried out before submitting these funds to the central government.

The results of this study also support the research findings of Abdullah and Junita (2016) which explain that agency problems occur in the budgeting process in local government due to *moral hazard* from various parties. This can be explained when budget proposers and parties who give approval of the proposal have various separate interests which are subsequently accommodated in the APBD budget.

Budget Ratcheting in the Capital Expenditure Component

The results of the growth regression carried out on each component of the capital expenditure budget in West Sumatra Province in 2014-2018 show that there is a *ratcheting* effect in it. This can be demonstrated by the value of a positive coefficient on each component of the budget of the Capital Expenditure which include Shop Land has a coefficient *ratchet* of 0,001, Shop Equipment & Machinery has a coefficient *ratchet* of 0,232, expenditure Building & Building has a coefficient *ratchet* amounted to 0,038, expenditure for roads, irrigation and networks has a *ratchet* coefficient of 0,022, and expenditures for other fixed assets have a *ratchet* coefficient of 0,105. Capital expenditure component that has a coefficient of *ratchet* highest currently on expenditure Tools & Machinery with coefficient *ratchet* at 0,232.

The results of this study are in line with the research of Lee & Plummer (2007) which found a relationship between the variance of the expenditure budget that can be seen when there is *overspending* and an increase in the expenditure budget in the following year. This means that there is bias in the process of determining APBD budget targets carried out by local governments.

Research Costello, et al. (2012) explains that the balanced budget target area expenditures can be transferred to the next budget period when local governments are not able to finance the development activities for the current year, will but such action is rarely done. This is because the government wants to form a "basis" for the current year which then becomes the "material" in determining the budget target for the following year.

4. CONCLUSIONS

Based on the results of the analysis carried out on the PAD component, the Balancing Fund component and the Capital Expenditure component in the Districts/City in West Sumatra Province from 2014 to 2018 using growth regression, it was concluded that there was a ratchet effect in it, which means that all research hypotheses were accepted. The budget for the PAD component that was affected by the highest ratchet effect was local taxes with a coefficient value of 0,554. The Balancing Fund component which has the highest ratchet effect is in the SDA Revenue Sharing Fund with a ratchet coefficient of 0,306. The capital expenditure component budget that had the highest ratchet effect was Equipment & Machinery Expenditures with a ratchet coefficient of 0,232. This study supports the findings of research conducted by Lee & Plummer (2007) which explains the relationship between the variants of the overspending expenditure budget and the increase in the budget for each component of income and expenditure in the following year. This means that there is a bias caused by opportunistic actions in the process of determining revenue and expenditure budget targets in local governments.

Implications

For local governments with this research, it is hoped that the regional revenue and expenditure budget will be based entirely on performance-based budgets and not on the realization of the previous year's budget and are accountable and transparent. For the legislature, this research is expected to be able to perform a more effective and efficient supervisory function so that the budgeting system in districts/cities in West Sumatra Province is of higher quality.

Limitations

This research uses the scope of research at the districts/city in West Sumatra Province, so it is better to use a wider scope. The results of this study have not been able to explain in detail the impact caused by the *Budget Ratcheting* effect, such as a

decrease in infrastructure development, the level of corruption and others.

Suggestion

- a. Expanding the scope of research, both for districts / cities in several provinces and for all provinces in Indonesia.
- b. Able to explain in detail the impact of the Budget Ratcheting effect on local government budgeting.
- c. Using the method of measuring research variables that can have a better level of validity for the purpose of comparing observations between periods.
- d. Carry out further research using experimental methods in order to gain broader insights.

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