
BUDGET RATCHETING, ORIGINAL LOCAL GOVERNMENT REVENUE ORIGINAL LOCAL GOVERNMENT REVENUE, FISCAL BALANCE FUND ON CAPITAL EXPENDITURE ALLOCATIONS IN INDONESIA

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Abstract

The implementation of regional autonomy enables local governments to independently manage various activities aimed at enhancing regional welfare, including financial management that is more community-oriented. In Indonesia, nearly all regional governments revise their budgets annually, making the examination of changes in capital expenditure budgets a compelling area of study. This research seeks to investigate the role of budget ratcheting in moderating the relationship between local revenue and balancing funds with capital expenditure allocation in Indonesia. The study utilizes secondary data comprising financial statements, specifically the regional revenue and expenditure budgets and budget realization reports published by respective local governments over a five-year period (2019–2023). Data analysis is conducted using hierarchical linear regression techniques. This research adopts a causative design and a quantitative methodological approach. Partially, Local Own-Source Revenue and Balance Funds have a positive and significant effect on capital expenditure allocation, while Budget Ratcheting does not moderate this relationship. This implies local governments must consider both external and internal conditions (uncertainty) when formulating budgets. Therefore, the budget should not always be based solely on past achievements, particularly for PAD, balance funds, and capital expenditure, which cannot be planned only based on previous performance.

Keywords: Balancing Funds, Budget Ratcheting, Local Revenue

Abstrak

Penerapan otonomi daerah memungkinkan pemerintah daerah untuk secara mandiri mengelola berbagai kegiatan yang bertujuan meningkatkan kesejahteraan daerah, termasuk pengelolaan keuangan yang lebih berorientasi pada masyarakat. Di Indonesia, hampir seluruh pemerintah daerah melakukan revisi anggaran setiap tahun, menjadikan kajian terhadap perubahan dalam anggaran belanja modal sebagai bidang studi yang menarik. Penelitian ini bertujuan untuk menyelidiki peran ratcheting anggaran dalam memoderasi hubungan antara pendapatan asli daerah dan dana perimbangan terhadap alokasi belanja modal di Indonesia. Studi ini menggunakan data sekunder yang terdiri dari laporan keuangan, khususnya Anggaran Pendapatan dan Belanja Daerah dan Laporan Realisasi Anggaran yang dipublikasikan oleh masing-masing pemerintah daerah selama periode lima tahun (2019–2023). Analisis data dilakukan menggunakan teknik regresi linier hierarkis. Penelitian ini mengadopsi desain kausatif dan pendekatan metodologi kuantitatif. Secara parsial, Pendapatan Asli Daerah (PAD) dan Dana Perimbangan memiliki pengaruh positif dan signifikan terhadap alokasi belanja modal, sementara Ratcheting Anggaran tidak memoderasi hubungan ini. Hal ini menyiratkan bahwa pemerintah daerah harus mempertimbangkan kondisi eksternal dan internal (ketidakpastian) ketika menyusun anggaran. Oleh karena itu, anggaran tidak boleh selalu didasarkan hanya pada pencapaian masa lalu, terutama untuk PAD, dana perimbangan, dan belanja modal, yang tidak dapat direncanakan hanya berdasarkan kinerja masa lalu.

Kata Kunci: Dana Perimbangan, Ratcheting Anggaran, Pendapatan Asli Daerah

INTRODUCTION

The adoption of regional autonomy grants each region the authority to independently manage its activities in order to promote regional welfare, including the administration of finances in a manner that is more attuned to community needs, a process referred to as fiscal decentralization. Fiscal decentralization within the context of regional autonomy seeks to enhance regional development by promoting more efficient planning and resource allocation.

Capital expenditure represents local government spending that yields long-term benefits extending beyond a single fiscal year and enhances the region's asset base. The determination of budget allocation for capital expenditure falls under the authority of local governments. Within the framework of local financial management, capital expenditure allocation is integral to long-term financial planning, given that it may result in ongoing maintenance obligations (Nufus & Asmara, 2017). Based on Presidential Regulation No. 54 of 2010 concerning the Procurement of Government Goods and Services, capital expenditure in the Regional Budget (APBD) is mandated to constitute a minimum of 29% of total regional expenditure. Nonetheless, actual implementation often reveals that the share of capital expenditure remains relatively low. In practice, local government budgets are predominantly allocated to routine operational expenses, which are generally less productive (Nurhayati, 2018).

This is also supported by financial data provided by Indonesia's Ministry of Finance, where government expenditure realization in the regional budget by the end of May 2022 was dominated by personnel expenses, specifically salaries for civil servants. Of the realized expenditure amounting to IDR 223 trillion, IDR 113 trillion was allocated for salaries, while capital expenditure accounted for only IDR 12 trillion. This capital expenditure realization in 2022 decreased by 14% from 2021, where the capital expenditure reached IDR 14 trillion by the end of May 2021 (Ulya & Kusdiana, 2022).

The allocation of capital expenditure is the responsibility of local governments, which, according to Ministerial Regulation No. 13 of 2006, is influenced not only by the level of routine expenditures but also by the financial resources available to the local government. Local revenues to support capital expenditure include Local Own-Source Revenue (PAD) and Balance Funds. Apart from these sources, the formulation of the capital expenditure budget is also affected by the budgeting methods applied by the government.

Weitzman (1980) stated that, in government budget planning, information on the variation of the previous year's budget is often used as a benchmark for allocating the next year's budget. Using budget variance as a basis indicates a tendency for incrementalism or opportunistic behavior in the budgeting process, which can result in the ratchet effect, also known as budget ratcheting. Budget ratcheting is evident when the next period's budget is increased in response to a negative budget variance from the previous period. The preparation of work unit budgets is always related to motivation and the gaps in incrementalism (Abdullah & Junita, 2016).

Several prior studies have addressed the ratchet effect in the public sector in various contexts. For instance, Abdullah & Junita (2016) stated that each party involved in budget preparation has its own interests, which can lead to agency problems. This can result in an increase in regional spending, known as budget ratcheting, causing performance budget planning to diverge from its actual implementation. This, in turn, can lead to losses, where local revenue cannot cover the local spending. Andrean & Sari (2020) conducted a study involving 19 districts and cities in West Sumatra from 2013 to 2017. This study supported previous research, stating that when budget ratcheting is applied, regional spending increases at the end of the year, which leads to substantial losses and results in a financial crisis in the region, requiring future funding disbursements. The study also showed that the city of Palembang had the highest budget ratcheting among the 19 cities and districts in Sumatra.

A study conducted by Silviani & Adiputra (2023) on the APBD of regencies/cities in Bali from 2016 to 2021 also found that both PAD and Balance Funds influence capital expenditure allocation,

with budget ratcheting moderating and strengthening this effect. Susanto & Halim (2018), through their study of 17 SKPD samples in the Special Region of Yogyakarta during the 2012–2015 period, verified the existence of the ratchet effect in the formulation of local government budgets. Similarly, Abdullah & Junita (2016) provided empirical evidence from their research on 23 districts in Aceh between 2010 and 2012, demonstrating that local revenue impacts regional spending, moderated by budget adjustments.

Arsani & Sihombing (2020) found indications of asymmetrical ratcheting in expenditure categories during the pandemic in Indonesia. This is evident from budget planning that used previous year's budgets, but the previous year's budget, which was pre-pandemic and considered normal, could no longer serve as a reference. The previous year's budget, which had changed due to the pandemic, could no longer be used as a benchmark for current budget planning. As a result, budget revisions were made, compared with the initially planned budget, reflecting what was actually used until needs were met, known as budget variance (Bawono et al., 2012). A study on budget ratcheting was also conducted in South Korea by Choi et al. (2021), who found that factors influencing ratcheting in the budgeting process in South Korea using data from 1,455 regions from 2010 to 2015 revealed that budgets continued to increase when excessive spending occurred.

The annual revision of budgets by nearly all Indonesian local governments makes examining changes in capital expenditure a compelling research area. The results of this study are anticipated to contribute to enhancing the quality of APBD formulation and minimizing potential errors during budget revisions. This study seeks to analyze the impact of PAD and Balance Funds on capital expenditure allocation in provincial governments across Indonesia from 2019 to 2023, and to evaluate the moderating role of budget ratcheting.

The urgency of this research lies in analyzing the correlation between PAD and Balance Funds with regional autonomy. This study can provide a deeper understanding of how effective regional autonomy policies are in improving regional independence through PAD and to what extent Balance Funds support regional fiscal sustainability. Budget ratcheting, which refers to the tendency for increased spending that is difficult to reduce in the short term, even when revenues decline, is a significant issue in the context of regional finances. The period of 2019–2023 is a time when Indonesia faced various economic and social challenges, including the impact of the COVID-19 pandemic. This research can provide insights into how well regional fiscal systems and budget allocations have coped with these challenges and how they have supported economic recovery and inclusive development. The novelty of this research lies in testing samples from provincial governments in Indonesia to align with the urgency of this study's findings.

LITERATURE REVIEW

Agency Theory

Agency Theory conceptualizes the contracting process between two or more parties, each seeking to maximize their own interests (Scott, 2000). In public sector organizations, the implications of agency theory are particularly evident within the budgeting process. These organizations aim to deliver optimal public services by effectively utilizing available resources. Within this framework, both central and regional governments bear the responsibility of managing and deploying resources to promote the welfare of their populations, thereby positioning budget formulation as a critical governance mechanism. The application of agency theory to budgeting can be viewed from two dimensions: first, the relationship between the public and the legislature; and second, the relationship between the legislature and the executive. In the relationship between the legislature and the executive, the executive functions as the agent, while the legislature serves as the principal (Abdullah & Halim, 2006). Conversely, in the relationship between the legislature and the public, the legislature assumes the role of agent representing the interests of the public (the principal), although the

delegation of authority from the public to the legislature often lacks a clearly defined mechanism or regulatory framework. Eisenhardt (1989) argues that although budgeting serves as an information system designed to mitigate agency opportunism, conflicts of interest inevitably emerge among actors during the resource allocation process. Furthermore, Eisenhardt (1989) identifies three fundamental assumptions of agency theory concerning human behavior: (1) individuals predominantly act in their own self-interest, (2) individuals possess bounded rationality, meaning their cognitive capacity to foresee the future is limited, and (3) individuals exhibit risk aversion. Based on the premises of Agency Theory, budget formulators are likely to prioritize their own interests, leading to distorted allocations. The theory is relevant here as local governments, acting as agents, allocate capital expenditure within the APBD (using PAD and Balance Funds) on behalf of the public (principals). This allocation process risks distortion because the agents may be influenced by self-interest and limited rationality, resulting in budgets that fail to accurately reflect public resource needs. Moreover, in the process of budget formulation and allocation, governments frequently rely on previous years' budgetary figures perceived as advantageous as the foundation for current allocations, a phenomenon referred to as budget ratcheting. This bias may further contribute to the misuse of the APBD as a vehicle for corruption, ultimately resulting in budgets that are misaligned with the actual needs of the public.

Regional Revenue and Expenditure Budget (APBD)

According to Bastian (2006), a budget is a package of projected income and expenditure estimates that are expected to occur in the subsequent period. According to the GASB, the budget is an estimate and financial plan based on projections, used as a source of income to fund needs within a specific period. Government Regulation No. 71 of 2010 defines the budget as a guideline for actions to be implemented by the government, including income plans, transfer expenditures, financing, measured in Rupiah, and classified systematically for a specified period. According to Hagen Von (2002), executive planning, legislative sanction, executive implementation, and ex post accountability are the four primary stages of budgeting. Budgeting is inherently prospective, focusing on future-oriented planning, which public managers must recognize as a critical aspect of governance (Mardiasmo, 2002). Within public sector institutions, particularly local government entities, the budget is formalized through a document known as the APBD. APBD, as stipulated in Ministry of Home Affairs Regulation No. 21 of 2011, represents the local government's annual financial plan, which is subject to review and approval by both the local executive and the Regional People's Representative Council (DPRD), and is subsequently adjusted in accordance with relevant local regulations. The APBD serves as the principal monetary instrument through which local governments deliver public services. It comprises several key components, namely local revenue, regional expenditure, and financing.

Capital Expenditure Allocation

Capital expenditure constitutes one category of regional expenditures outlined within the APBD. Based on Government Regulation No. 12 of 2019, capital expenditure refers to the disbursement of funds aimed at acquiring fixed and other assets that provide benefits over multiple accounting periods. Similarly, the Government Accounting Standards Statement No. 2 of 2011 characterizes capital expenditure as spending by local governments for the acquisition of fixed assets or inventories that deliver economic benefits over more than one accounting cycle. In allocating the capital expenditure budget, local governments must manage and optimize resources effectively because, through capital expenditure, local governments can improve public services and prepare for fiscal decentralization (Nuarisa, 2013). This is relevant as the size of local revenue impacts capital expenditure (Article 50, Minister of Home Affairs Regulation No. 13 of 2006). Through capital

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expenditure, public services can be improved, and local governments can prepare for fiscal decentralization (Nurarifah et al., 2023).

Local Own-Source Revenue (PAD)

According to Law No. 33 of 2004, PAD refers to revenue collected by local governments based on regional regulations and in accordance with national legislation. An alternative definition, offered by Sari et al. (2021), describes PAD as all income generated from local resources through levies governed by regional regulations. Minister of Home Affairs Regulation No. 33 of 2019 further specifies that PAD comprises four main components: (1) Local Taxes, (2) Local Levies, (3) Income derived from the administration of distinct regional assets, and (4) Other Legally Authorized PAD. PAD is regarded as a supplementary source of funding that can be allocated toward various types of expenditures, particularly those exceeding routine government operational costs. In this context, efforts to enhance PAD are seen as essential and are widely pursued by local governments. An increase in PAD provides local governments with greater financial capacity, which, in turn, encourages them to more actively explore and develop the region's economic potential, ultimately leading to higher allocations of regional expenditures, including capital expenditures. There is a prevailing view that expanding capital expenditure allocations contributes to improved public service quality, which subsequently fosters greater public engagement in regional development initiatives, as reflected by further increases in PAD (Devita et al., 2014).

Balance Funds

Balance Funds under Law No. 33 of 2004, are defined as resources derived from the national budget (APBN) and allocated to support regional financial needs in the execution of decentralization. Similarly, Djaenuri (2012) characterizes Balance Funds as local government revenues sourced from the APBN intended to reinforce the exercise of regional autonomy, particularly in enhancing public services and improving societal welfare. According to Law No. 33 of 2004, Balance Funds comprise three main components: (1) the General Allocation Fund (DAU), sourced from the APBN and distributed to equalize fiscal capacities among regions to meet decentralization needs. DAU constitutes the largest proportion of Balance Funds and plays a critical role in promoting regional equity and fairness. Its substantial share and flexible utilization empower local governments with significant fiscal autonomy (Widjaja, 2004, as cited in Wahyuni & Rosmida, 2018). Law No. 33 of 2004 stipulates that the total DAU must amount to at least 26% of the Net Domestic Revenue in the APBN, with allocations determined based on a fiscal gap calculated as the disparity between a region's financial requirements and its fiscal capabilities and a basic allocation tied to the total salary of civil servants. (2) The Special Allocation Fund (DAK), also funded through the APBN, is assigned to specific regions to finance particular activities within the jurisdiction of local governments. DAK recipients must allocate at least 10% of DAK value toward financing physical projects, which must be budgeted in the APBD of the corresponding fiscal year. DAK distribution is governed by general, specific, and technical criteria as outlined in Law No. 33 of 2004. DAK is primarily targeted at enhancing community infrastructure through the construction, procurement, improvement, and maintenance of physical facilities to strengthen long-term public service provision. (3) The Revenue Sharing Fund (DBH), as stated in Law No. 23 of 2014, is sourced from specific APBN revenues and distributed to producing regions based on set percentages. Its purpose is to reduce financial inequalities between the central and regional governments. According to Law No. 33 of 2004 on Financial Balance, DBH is derived from both tax revenues and revenues from natural resources.

Budget Ratcheting

A commonly utilized reference in setting budget targets for the subsequent fiscal year is the

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performance outcomes of the preceding year. The practice of relying on favorable prior-period information to establish future targets is known as the ratchet effect, or ratcheting. Within the budgeting framework, this phenomenon is referred to as budget ratcheting. The notion of budget ratcheting is based on the knowledge asymmetry between superiors and subordinates, where superiors utilize prior performance outcomes to establish and modify future performance expectations (Weitzman, 1980). Accordingly, budgets tend to adjust or ratchet based on past performance: superior performance leads to increased future performance standards, while poor performance results in lowered expectations. This aligns with the assertion by Leone & Rock (2002), who emphasize that ratcheting emerges as a consequence of the information imbalance between agents and principals.

Research Framework

Considering the explanation of the research problem, relevant theoretical reviews, and previous studies, a research framework can be developed with the following model:

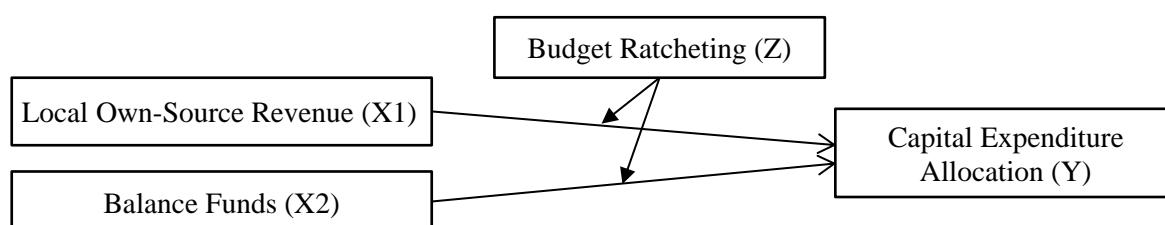


Figure 1. Research Framework

Research Hypothesis

The research hypothesis can be explained as follows:

- H1: Local own-source revenue has a positive and significant effect on capital expenditure allocation.
- H2: Balance funds has a positive and significant effect on capital expenditure allocation.
- H3: Budget ratcheting strengthens the positive effect of local own-source revenue on capital expenditure allocation
- H4: Budget ratcheting strengthens the positive effect of balance funds on capital expenditure allocation

METHOD

This study is causal research using a quantitative approach. Sugiyono (2020) explains that causal research is a study aimed at proving the cause of a problem and determining the extent to which independent variables affect the dependent variable. This study examined financial data from all Indonesian provincial governments. The population was the 38 provincial financial reports (APBD and LRA) published over the 2019–2023 period. The 2019–2023 period was selected to ensure the completeness of data from the APBD and LRA of provincial governments in Indonesia. The study sample consists of 34 provinces, using the financial reports in the form of APBD and LRA that have been prepared by the relevant local governments and published on the official website of the DJPK Ministry of Finance of the Republic of Indonesia at <https://djpk.kemenkeu.go.id>. Four samples were eliminated because the provinces only appeared in 2023, resulting in incomplete data.

The research sample was established using purposive sampling. The criteria or considerations used for sample selection are as follows: 1) The local government selected as the sample must be a provincial government located within Indonesia. 2) The selected provincial governments must have complete financial data available for a 5-year period, from 2019 to 2023. 3) The provincial government selected as the sample must not be from a newly established province or, at the very least, must have been established for at least 5 years. Based on these criteria, a total of 170 samples were

obtained.

In building the research model, this study uses a hierarchical linear regression model because it applies a moderating effect. This model consists of two equations constructed with the following criteria:

Equation 1: Includes the independent variables without the moderating variable in one equation.

Equation 2: Integrates the moderating variable as well as the new independent variable representing the interaction between the independent and moderating variable.

The structure of these equations is illustrated as follows:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \epsilon \dots \dots \dots \text{(Equation 1)}$$

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 Z + \beta_4 (X_1 * Z) + \beta_5 (X_2 * Z) + \epsilon \dots \dots \dots \text{(Equation 2)}$$

Explanation:

Y: Capital Expenditure

X1: Local Own-Source Revenue (PAD)

X2: Balance Funds

Z: Budget Ratcheting

α : Constant

$\beta_1, \beta_2, \beta_3, \beta_4, \beta_5$: Regression coefficients

ϵ : Standard Error

After hypothesis testing is conducted through regression analysis, the next step is to perform the t-test and R² test. The final step of the testing process is to assess the moderating effect by comparing the R-Square (R²) values before and after the moderating variable is included in the analysis.

RESULT AND DISCUSSION

Results of Classical Assumption Tests

Classical assumption tests were conducted during the preliminary analytical phase. Upon conducting the normality assessment via the One-Sample Kolmogorov-Smirnov Test, both regression models exhibited a significance value of 0.200, exceeding the threshold of 0.05. This signifies that the data distribution for all analytical units adheres to a normal distribution. The multicollinearity test results indicated that the model lacks correlation among the independent variables, as evidenced by tolerance values above 0.10 and VIF values remaining below 10. The Glejser test results indicated that the variance of the residuals for all observations does not demonstrate heteroscedasticity. The significance values for all independent variables exceeded 0.05, confirming this finding. Consequently, it can be inferred that the regression model does not exhibit heteroscedasticity (untestable). The final test conducted was autocorrelation.

As per the decision rule for the Durbin-Watson test, it can be concluded that there is no autocorrelation in these two research models. Thus, overall, the classical assumption tests were satisfied: the data are normally distributed, no multicollinearity or heteroscedasticity was detected, and no autocorrelation issue was found. Consequently, the multiple linear regression analysis can proceed.

Results of Hierarchical Linear Regression Analysis

The first equation of the hierarchical linear regression analysis represents multiple regression without the moderating variable, and its results are presented below.

Table 1. Results of Hierarchical Linear Regression Analysis Equation 1

Parameter	B	t	Sig
Constant	0.493	0.295	0.769

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Local Own-Source Revenue (X1)	0.158	3.285	0.001
Balance Funds (X2)	0.787	8.979	0.000

The second equation's hierarchical regression includes the moderating variable and its interaction with the independent variables. In the second equation, there are five variables tested, including PAD (X1), Balance Funds (X2), Budget Ratcheting (Z), Interaction 1 (X1*Z), and Interaction 2 (X2*Z). The test results are presented in the table below.

Table 2. Results of Hierarchical Linear Regression Analysis Equation 2

Parameter	B	t	Sig
Constant	1.606	0.886	0.377
Local Own-Source Revenue (X1)	0.156	3.246	0.001
Balance Funds (X2)	0.785	8.974	0.000
Budget Ratcheting (Z)	-0.033	-2.224	0.028
Moderation Interaction 1 (X1*Z)	10.737	1.311	0.192
Moderation Interaction 2 (X2*Z)	25.414	1.746	0.083

Based on the results presented in the table above, the significance value for the Local Own-Source Revenue (PAD) variable is $0.001 < 0.05$, with a t-value of $3.285 > 1.654$. These results indicate that PAD (X1) has a positive and significant effect on Capital Expenditure Allocation. Therefore, H1 is accepted. The significance value for the Balance Funds (X2) variable is $0.000 < 0.05$, with a t-value of $8.979 > 1.654$. These results indicate that Balance Funds (X2) have a positive and significant effect on Capital Expenditure Allocation. Therefore, H2 is accepted.

Determination Test

The coefficient of determination quantifies the proportion of total variation in the dependent variable that is elucidated by the independent variables. This study employs R-Square (R^2) for analysis. A low R-Square value indicates that the independent variables have a restricted capacity to elucidate the dependent variable. The test results are shown in Table 3 below.

Table 3. Results of the Determination Test

Parameter	Value R^2
Regression Equation 1	0,692
Regression Equation 2	0,699
PAD	0,543
PAD Moderated by Z	0,485
Balance Funds	0,672
Balance Funds Moderated by Z	0,508

The table above shows that the significance value for Interaction Variable 1 is 0.192, which exceeds 0.05. The t-value is also less than the critical t-value ($1.311 < 1.654$). The R-Square value for the regression of PAD's effect on Capital Expenditure is 0.543, or 54.3%. After adding the moderating variable in the form of Interaction 1 (X1*Z), the R-Square value for the regression decreases to 0.485, or 48.5%, showing a decrease of 0.058, or 5.8%. From this result, it can be concluded that budget ratcheting has an effect on the relationship between local own-source revenue (PAD) and capital expenditure allocation, with the moderating effect weakening the relationship. Therefore, H3 is rejected, and it can be concluded from this test that budget ratcheting weakens the

effect of PAD on capital expenditure allocation.

The significance value for Interaction Variable 2, as indicated in the table above, is 0.083, exceeding 0.05. The t-value exceeds the critical t-value ($1.746 > 1.654$). The R-Square value for the regression of the effect of Balance Funds on Capital Expenditure is 0.672, or 67.2%. After adding the moderating variable in the form of Interaction 2 ($X_2 * Z$), the R-Square value for the regression decreases to 0.508, or 50.8%, showing a decrease of 0.164, or 16.4%. From this result, it can be concluded that budget ratcheting has an effect on the relationship between balance funds and capital expenditure allocation, with the moderating effect weakening the relationship. Therefore, H4 is rejected, it can be concluded that budget ratcheting weakens the effect of balance funds on capital expenditure allocation.

Discussion

The Effect of Local Own-Source Revenue (PAD) on Capital Expenditure Allocation

The results of the testing indicate that PAD is able to influence Capital Expenditure Allocation, thus H1 is accepted. This result shows that one of the factors that can increase the allocation of capital expenditure in the budget is the amount of PAD in local governments. The higher the PAD, the larger the budget allocation for regional expenditure, especially capital expenditure. This means that in the APBD, the government should consider adjusting between PAD receipts and the region's economic potential. The R-Square value of 69.2% indicates that PAD has a significant effect on capital expenditure allocation in the provincial governments' APBD in Indonesia, suggesting that PAD accounts for more than half of the allocated capital expenditure, which is classified as high. This shows that the government has succeeded in increasing Local Own-Source Revenue to ensure greater financial independence for the region and reduce dependence on the central government (Setyarini & Rustiyangsih, 2021). These results are consistent with the study by Hasibuan & Tiara (2021), Setyarini & Rustiyangsih (2021), and Malau et al. (2020). By increasing PAD in the budget, it shows that the local government has succeeded in optimizing and exploring the available resources in their regions, which will also be reflected in the increased allocation of capital expenditure in the APBD. This is further supported by Susanto & Halim (2018), who stated that the PAD component in the APBD and the direct expenditure component significantly affect each other. The government successfully identified regional potential and assumed responsibility for enhancing local welfare by raising public expenditure through increased APBD investment allocation. This study illustrates that Indonesian provinces have sufficient capacity to improve citizen welfare and regional development, successfully utilizing PAD for capital expenditure allocation consistent with the revenues received

The Effect of Balance Funds on Capital Expenditure Allocation

The results of the testing indicate that Balance Funds are able to influence Capital Expenditure Allocation, thus H2 is accepted. Balance funds are funds received by local governments from the central government to narrow the gap between PAD and the expenditure needed for fulfilling the obligations and activities of local governments. The fiscal gap that occurs in local governments can be minimized with the presence of balance funds. Balance funds, comprising general allocation, special allocation, and revenue-sharing funds, can assist the government in attaining optimal budget allocation. These results are consistent with the study by Hasibuan & Tiara (2021), Setyarini & Rustiyangsih (2021), Malau et al. (2020), and Nufus & Asmara (2017). Balance funds have an important role in determining the allocation of capital expenditure, which can be done through revenue-sharing funds and special allocation funds. These funds are specifically intended to support government expenditures such as civil servant salaries, the purchase of goods and services, and capital investments.

The Moderating Effect of Budget Ratcheting on the Relationship Between Local Own-Source Revenue and Capital Expenditure Allocation

The results of the testing indicate that Budget Ratcheting affects the relationship between Local Own-Source Revenue and Capital Expenditure Allocation, with a moderating effect that does not influence the relationship. Therefore, H3 is rejected. This result is supported by the research of Andrean & Sari (2020), who demonstrated that Budget Ratcheting weakens the correlation between Local Own-Source Revenue and Regional Expenditure, Misra (2020), who found that budget ratcheting does not occur when the preparers use standard expenditure analysis, and Kurniawan & Kusumastuti (2024), who stated that budget ratcheting does not affect the relationship between Local Own-Source Revenue and Regional Expenditure before, during, and after the COVID-19 pandemic. The determination of revenue and expenditure for each local government needs to be based on past achievements. However, focusing too much on past achievements can lead to information asymmetry because local governments cannot control factors related to internal and external uncertainties they face. There is also a need for speed in decision-making in managing budgets for public welfare.

The Moderating Effect of Budget Ratcheting on the Relationship Between Balance Funds and Capital Expenditure Allocation

The testing results demonstrate that Budget Ratcheting influences the correlation between Balance Funds and Capital Expenditure Allocation, with a moderating effect that does not affect the relationship. Therefore, H4 is rejected. This outcome aligns with the conclusions of Hypothesis 3, where budget ratcheting in local governments during the observation period shows an effect of policy direction changes that need to be implemented by the local governments, especially when determining the correlation between balance funds and capital expenditure allocation in the future. This contradicts the findings of (Safitri & Sari, 2020), who found a ratchet effect in the balance funds of local governments in West Sumatra Province, and Abdullah & Junita (2016), who discovered that budget ratcheting moderates the correlation between regional revenue and expenditure. According to agency theory, budget formulation that always follows the previous year's budget tends to create opportunistic behavior in budget allocations, leading to decision-making errors for local governments. The data in this study highlights the need for accurate decision-making in determining programs, revenue, and associated costs.

CONCLUSION

Partially, local own-source revenue and balance funds have a positive and significant effect on capital expenditure allocation, while Budget Ratcheting does not moderate this relationship. This implies local governments must consider both external and internal conditions (uncertainty) when formulating budgets. Therefore, the budget should not always be based solely on past achievements, particularly for PAD, balance funds, and capital expenditure, which cannot be planned only based on previous performance.

This study has limitations regarding its results due to the use of a sample only at the provincial government level. More specific and accurate results could potentially be obtained if the sample included district/city governments. While this study provides generalizable data from local governments in Indonesia, it has not analyzed more specific environmental conditions, such as policies/regulations or other environmental factors, which may yield different research outcomes.

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