

The Effect of Legislative Bargaining Power on Asymmetric Budget Ratcheting in Local Governments

Effect of Legislative Bargaining Power on Asymmetric Budget

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ABSTRACT

In many decentralized systems, local governments face persistent challenges in aligning fiscal discipline with political and administrative incentives. This study examines the persistence of asymmetric budget ratcheting in Indonesian local governments following the enactment of Law Number 1 of 2022 on Fiscal Relations between the Central and Regional Governments. Despite mandates for performance-based budgeting, incrementalism remains prevalent. The research analyzes how legislative bargaining power, shaped by political coalition dynamics, influences budget adjustments. Using a longitudinal quantitative dataset of 508 regencies and cities, the study employs panel data regression and Structural Equation Modelling (SEM) to assess budget reactivity. The findings show a pronounced asymmetric pattern, future budgets increase by 99.7% of overspending variance but decrease by only 21% of underspending variance. SEM results indicate that legislative bargaining power significantly affects budget variance, supporting opportunistic target-setting behavior. Sub-sample analyzes reveal that budget ratcheting is most dominant in regions with high fiscal capacity and strong managerial capabilities, where performance information is strategically used to justify budget increases. The evidence suggests that political affiliations act as a key driver of incremental budget growth, weakening the intended effects of performance-based budgeting reforms and undermining technical efficiency goals.

Keywords: *Bargaining Power, Budget Ratcheting, Fiscal Decentralization, Incrementalism, Performance-Based Budgeting.*

INTRODUCTION

Indonesia's post-crisis reform trajectory, marked by the 2001 "big bang" of fiscal decentralization and the strengthening of budget accountability frameworks in the early 2000s, has fundamentally reshaped regional autonomy and public finance, while also revealing uneven implementation and persistent capacity gaps across jurisdictions (Ministry of Finance of Indonesia, 2021; Negara et al., 2021). In this context, Law Number 1 of 2022 on Fiscal Relations between the Central and Regional Governments (*Hubungan Keuangan Pemerintah Daerah/HKPD*) introduces a renewed architecture of intergovernmental finance by strengthening local taxing power, reorienting intergovernmental transfers toward performance, and emphasizing spending quality to reduce vertical and horizontal imbalances and improve allocative efficiency (Directorate General of Fiscal Balance, 2022; Directorate General of Treasury, 2023). Despite these reforms, the political economy of local budgeting remains complex. Evidence from Indonesian districts indicates that limited administrative capacity, electoral commitments, particularly in infrastructure and contentious executive-legislative bargaining can delay budget approval and weaken participatory processes (Vidyattama et al., 2022). These challenges are further compounded by persistent corruption risks linked

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to institutional weaknesses, underscoring the importance of stronger internal oversight and incentive-compatible governance mechanisms (Paranata, 2025).

Against this backdrop, a growing body of public sector literature highlights the persistence of incrementalism in budgeting through the phenomenon of budget ratcheting, whereby prior-period performance becomes the baseline for subsequent targets. This process generates asymmetric adjustments, as budgets tend to increase more readily following favorable outcomes (overspending) but adjust downward only slowly after unfavorable outcomes (Susanto & Halim, 2017; Sandalgaard & Bukh, 2023). From a theoretical perspective, the ratchet effect may weaken organizational incentives when past performance cannot be credibly excluded from future target setting, thereby encouraging strategic behavior in reporting and planning (Matějka et al., 2024). Related research on asymmetric cost behavior in local governments further shows that cost stickiness contributes to budget rigidity, with its intensity shaped by fiscal conditions, institutional settings, and electoral timing (Fabre & Borgert, 2022; Karatzimas et al., 2024).

In the Indonesian context, these behavioral dynamics intersect with well-documented political budget cycles, where local government expenditures tend to increase ahead of elections, particularly on visible and politically salient programs, and such tendencies are amplified when incumbents seek re-election or command larger political coalitions (Wiguna & Khoirunurrofik, 2021; Syam & Afdal, 2025). This suggests that budgeting outcomes are not purely technocratic but are deeply embedded in political negotiation processes, where coalition structures and bargaining power can influence the direction and magnitude of fiscal decisions. However, empirical evidence on how legislative bargaining power interacts with ratcheting behavior in the presence of performance-based reforms remains limited, particularly in decentralized settings such as Indonesia.

Although the HKPD framework embeds Performance-Based Budgeting (PBB) mandates intended to enhance transparency, accountability, and spending efficiency, recent empirical studies indicate that the use and quality of performance information in budget decision-making remain uneven and constrained by rigid institutional arrangements and limited administrative capacity (Salomo & Rahmayanti, 2023; Sahara & Roy, 2025). Similar evidence from Indonesian local governments shows that variations in budget performance and managerial control can significantly influence fiscal decision-making, highlighting the practical relevance of performance monitoring for budget effectiveness (Fardianti & Astuti, 2022; Sari & Tuah, 2025). Under such conditions, performance data are often utilized more for control and learning purposes than for enforcing fiscal discipline, thereby creating opportunities for political actors to selectively mobilize performance indicators to justify expansionary allocations rather than improve efficiency (Azam & Bouckaert, 2025a). These dynamics point to a potential tension between formal institutional reforms and the underlying political incentives that shape budget outcomes (Acosta & Albornoz, 2009).

This study examines the persistence of asymmetric budget ratcheting in Indonesian local governments following the enactment of Law Number 1 of 2022 on Fiscal Relations between the Central and Regional Governments. Despite formal mandates for performance-based budgeting, incrementalism remains pervasive. The study investigates whether legislative bargaining power under the post-HKPD regime amplifies budget ratcheting, assessing the extent to which political coalition dynamics can overshadow reforms, and how prior budget outcomes, institutional capacity, and performance information interact to shape asymmetric budget adjustments.

LITERATURE REVIEW & HYPOTHESIS DEVELOPMENT

Budget Ratcheting and Incrementalism in Public Sector Organizations

Recent public-sector budgeting research continues to reaffirm the incremental nature of budget setting while clarifying the mechanisms that produce persistent ratcheting dynamics in government organizations. In nonprofit and public settings, next-period targets are commonly anchored to prior outcomes, which, combined with funding dependencies and incentive misalignments, yield asymmetric adjustments. Budgets tend

to rise readily after overspending but decline sluggishly after underspending. These patterns have been demonstrated empirically in publicly funded organizations and are interpreted as the result of incentive conflicts between funders and recipients as well as information-processing constraints within bureaucracies (Grossi et al., 2020; Liguori et al., 2021; Sandalgaard & Bukh, 2023; Matějka et al., 2024). Related macro public finance research further suggests that “ratchet-type” responses can leave expenditure trajectories durably elevated after shocks, although the magnitude varies across contexts (Jaén-García, 2021).

A growing empirical stream also links these dynamics to broader fiscal and institutional conditions. Evidence indicates that ratcheting intensity and related asymmetric cost behavior vary with fiscal constraints and electoral timing, where factors such as debt levels and election cycles may either attenuate or amplify incremental tendencies (Karatzimas et al., 2024). Complementary findings highlight that bargaining power among local actors can reshape or even reverse such asymmetries, underscoring the importance of institutional heterogeneity in understanding budget ratcheting (Anessi-Pessina et al., 2016; Choi et al., 2021).

Political Incentives, Institutional Constraints, and Budgeting Dynamics in Indonesia

Within a public-sector agency framework, local executives and legislatures engage in strategic interactions shaped by information asymmetries, political incentives, and coalition structures, conditions under which budgeting may shift from technocratic planning toward negotiated political outcomes. Evidence from Indonesian districts shows that capacity constraints and executive–legislative bargaining, often linked to electoral commitments, can delay budget approval and weaken participatory processes, reflecting classic agency problems in decentralized systems (Vidyattama et al., 2022). These challenges are further compounded by governance issues, as stronger internal controls and audit functions are associated with lower corruption, while higher capital expenditures correlate with increased corruption risk, indicating that institutional quality plays a crucial role in shaping fiscal outcomes (Shidqi & Arfiansyah, 2025; Paranata, 2025).

Political incentives also influence spending behavior through political budget cycles, where expenditures tend to increase ahead of elections, particularly for visible programs and are more pronounced when incumbents are supported by larger coalitions (Klomp & De Haan, 2013; Wiguna & Khoirunurrofik, 2021; Syam & Afdal, 2025). These dynamics interact with the implementation of Performance-Based Budgeting (PBB) under Indonesia’s HKPD Law Number 1 of 2022, which aims to enhance spending quality and fiscal efficiency (Directorate General of Treasury, 2023). However, empirical evidence shows that the use and quality of performance information remain uneven due to capacity constraints and rigid institutional frameworks, resulting in performance data being used more for control and learning than for disciplining resource allocation (Azam & Bouckaert, 2025b). Taken together, these findings suggest that in Indonesia’s post-HKPD context, where performance-based reforms are not yet fully embedded, legislative bargaining power and coalition dynamics remain critical in determining whether prior budget outcomes translate into persistent increases in future allocations, thereby reinforcing budget ratcheting behavior.

The Effect of Legislative Bargaining Power on Budget Ratcheting

In public budgeting, deliberation is intrinsically a negotiated political process rather than a purely technocratic exercise, as competing actors reconcile divergent preferences under resource constraints and electoral pressures. In decentralized Indonesia, these bargaining dynamics are intensified by agency relationships between executives and local councils: administrative capacity limits and information asymmetries give the executive informational advantages, while legislators weigh programmatic goals against constituency demands, often stretching negotiations and delaying approval of the local budget (Vidyattama et al., 2022; Hafel & Ibrahim, 2024). In such settings, legislative

bargaining power shaped by party affiliations and the size of coalitions tilts the allocation outcome, enabling councils that back the incumbent to press for additions and re-prioritizations with long-term political payoffs (Wiguna & Khoirunurrofik, 2021; Andonoska & Alda, 2025). When bargaining power is strong, legislators face stronger incentives to justify upward budget revisions by appealing to favourable performance variance, thereby creating "fiscal space" for politically salient items; this logic aligns with the ratchet effect, in which prior-period performance is used to defend higher future targets and is supported by recent evidence that ratcheting emerges where funders and recipients have conflicting incentives and performance signals are selectively mobilized (Sandalgaard & Bukh, 2023; Matějka et al., 2024; Effendi et al., 2024).

Moreover, Performance-Based Budgeting (PBB) mandates under Indonesia's HKPD Law have not fully closed the gap between performance information and allocation decisions (Chotib et al., 2025). Empirical evidence indicates that both the use and quality of performance information remain uneven and are applied more for control and learning purposes than for enforcing resource discipline, thereby leaving room for political coalitions to legitimize incremental budget expansions rather than enhance efficiency (Directorate General of Fiscal Balance, 2022; Azam & Bouckaert, 2025a; Fauziah et al., 2025). Taken together, these findings suggest that when legislative coalitions aligned with the executive possess greater bargaining power, budget ratcheting is more likely to materialize in subsequent budget cycles.

H1: Legislative bargaining power has a positive effect on budget ratcheting in local government budgeting processes.

Heterogeneity Analysis of Budget Ratcheting

The effectiveness of fiscal decentralization ultimately depends on the quality of public financial management and its ability to translate resources into service delivery (Dick-Sagoe, 2020). However, substantial heterogeneity across jurisdictions may lead to variation in budget behavior, including ratcheting dynamics. To assess whether ratcheting is persistent or context-specific, subsample analyses are conducted along three dimensions: fiscal capacity, financial management quality, and jurisdictional typology (regencies vs. cities).

First, the analysis is partitioned based on the regional fiscal capacity map issued by the Ministry of Finance, which classifies local governments according to their fiscal capacity. The most recent framework (PMK 65/2024), which updates earlier regulations (PMK 193/PMK.07/2022; PMK 84/2023), indicates that higher-capacity jurisdictions possess greater budget flexibility. However, such flexibility may also strengthen incentives to create budgetary slack or under-forecast revenues, thereby amplifying ratcheting when favorable variances are used to justify upward adjustments (Sandalgaard & Bukh, 2023; Matějka et al., 2024).

Second, the sample is divided based on the Local Financial Management Index (*Insentif dan Penyesuaian Keuangan Daerah/IPKD*), a regulatory composite measure capturing effectiveness, efficiency, transparency, and accountability in local financial management in Permendagri Number 19 of 2020. Higher IPKD scores indicate more reliable performance information and stronger feedback mechanisms in budgeting, whereas lower scores reflect managerial weaknesses and limited capacity to restrain opportunistic expansions. Examining ratcheting across IPKD levels allows for distinguishing whether asymmetric adjustments arise from the strategic use of performance information in mature systems or from weak oversight that fails to enforce fiscal discipline (Azam & Bouckaert, 2025a).

Third, differences between regencies and cities are analyzed to capture structural variation in economic base and service demands. Urban jurisdictions face more complex and immediate pressures in areas such as transport, housing, and environmental services, which may intensify planning responsiveness and encourage incremental budgeting. At the same time, evidence suggests that rapid urbanization has outpaced local capacity,

complicating efficient service provision and fiscal management. Comparative findings further indicate that city size and service access are systematically related, implying that urban complexity may condition the intensity and direction of ratcheting behavior (World Bank, 2020; OECD, 2021; Post & Kuipers, 2023).

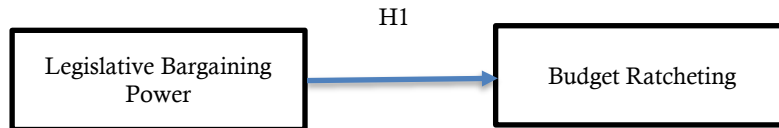


Figure 1. Research Framework

Figure 1 illustrates a positive relationship between legislative bargaining power and budget ratcheting. This means that the greater the legislative bargaining power, the higher the likelihood of incremental budget increases as the executive adjusts allocations to meet legislative demands.

RESEARCH METHODS

This study employs a quantitative research design to examine the policy implications of Law Number 1 of 2022 on HKPD for local government budgeting in Indonesia, focusing on whether Performance-Based Budgeting (PBB) can mitigate budget ratcheting. The analysis is based on audited fiscal year 2023 financial statements from 508 local governments (415 regencies and 93 cities), combined with legislative composition data from official local government portals and the General Elections Commission (KPU). All datasets were manually compiled and merged using official identifiers, cross-checked for consistency, and incomplete observations were excluded to ensure data reliability. Panel data regression is employed to estimate the effects of interest. Although the principal post-regulatory observation window covers one fiscal year, the specification remains longitudinal because it requires lagged realization data ($t-1$) to construct the ratcheting and control variables. Estimation is conducted using Stata, with model diagnostics performed to ensure the appropriateness of panel estimators and standard error structures.

To satisfy panel data conventions and capture spatial heterogeneity, the 508 entities are grouped into six geographic clusters: Sumatra, Java, Kalimantan, Sulawesi, Papua, and an “Other Islands” category comprising Bali, West Nusa Tenggara (*Nusa Tenggara Barat/NTB*), and East Nusa Tenggara (*Nusa Tenggara Timur/NTT*). These clusters are incorporated as fixed effects, interaction terms, or robustness checks, as appropriate, to examine whether geographic factors condition the intensity of budget ratcheting and the influence of performance-based budgeting mechanisms. The baseline model follows the “ratchet principle” introduced by Weitzman (1980), whereby the current-period budget target (B_t) is influenced by the variance between planned and realized expenditure in the preceding year (A_{t-1}). However, given the characteristics of the public sector, where agencies typically face incentives to maximize budget absorption and seldom benefit from savings or efficiency gains, this structure requires refinement. As noted by Lee and Plummer (2007), the absence of bonus incentives or reward mechanisms in government organizations results in asymmetric adjustments that differ from those observed in profit-motivated settings. Accordingly, the model is adapted based on the approaches of Leone and Rock (2002) and Aranda et al. (2014), and is specified as follows:

Equation 1:

$$(B_{i,t} - B_{i,t-1}) / B_{i,t-1} = \delta_0 + \lambda_+(A_{i,t-1} - B_{i,t-1}) / B_{i,t-1} + \lambda_- U_{i,t-1} * (A_{i,t-1} - B_{i,t-1}) / B_{i,t-1} + \varepsilon$$

Variables Explanation:

- B_t : the regional revenue and expenditure budget in year t.
 B_{t-1} : the regional revenue and expenditure budget in year t-1 (the preceding fiscal year).
 Δ : intercept term (constant) in the regression model.
 Λ : the regression coefficient associated with the explanatory variable.
 A_{t-1} : actual expenditure (actual regional revenue and expenditure budget realization) in year t-1.
 $U_{(i,t-1)}$: a dummy variable that takes the value 1 if $(A_{i,t-1} - B_{i,t-1})$ is negative (an unfavorable variance), and 0 otherwise.

Asymmetric ratcheting is confirmed when the increase in the subsequent budget following overspending is larger than the decrease following underspending (Leone & Rock, 2002; Lee & Plummer, 2007). To assess contextual heterogeneity, this phenomenon is also examined across six sub-samples, allowing us to evaluate the role of fiscal capacity, the quality of financial governance, and jurisdictional differences between regencies and cities. To examine the influence of legislative bargaining power on the ratcheting phenomenon, this study employs the variable LEGIS, defined as the proportion of members of the regional legislature affiliated with political parties that either form a governing coalition with the regional head or directly support the executive. The model is specified as follows:

Equation 2:

$$(A_{i,t-1} - B_{i,t-1}) / B_{i,t-1} = \delta_0 + \delta_1 \text{LEGIS} + \varepsilon$$

The analysis is conducted separately for overspending and underspending conditions using Structural Equation Modelling (SEM) in Stata. SEM is particularly important in this context because it enables simultaneous estimation of relationships between latent and observed variables, while also facilitating separate modelling of overspending and underspending behaviour. To enhance the robustness of the longitudinal panel structure, all 508 local governments are assigned unique identifiers based on their geographic regions, comprising Indonesia's five major islands, with an additional category for Bali, NTB, and NTT.

RESULTS

To examine budget ratcheting in Indonesian local governments, descriptive statistics, correlation analyses, and regression models were conducted. The study focuses on budget growth, prior period budget variances, ratcheting interaction terms, and legislative bargaining power. Subsample analyses explore differences across fiscal capacity, financial management quality, and jurisdictional type, providing a comprehensive view of asymmetric budget behavior and the influence of political and institutional factors on local fiscal decisions.

Table 1. Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
Budget Growth $B_{i,t} - B_{i,t-1} / B_{i,t-1}$	508	0.064	0.139	-0.24	1.008
Budget Variance $A_{i,t-1} - B_{i,t-1} / B_{i,t-1}$	508	0.018	0.097	-0.256	0.554
Ratcheting Interaction Term $U_{i,t-1} * A_{i,t-1} - B_{i,t-1} / B_{i,t-1}$	508	-0.023	0.046	-0.256	0
LEGIS	508	14.551	9.407	0	50

Based on Table 1, the average rate of budget growth (Δ Budget) is 6.4%, with a standard deviation of 13.9%, indicating substantial variability in budget allocations

across local governments. The positive mean of the prior period budget variance (subscript base, VarBudget, end base, sub, i.,t minus 1 end subscript) of 1.8% suggests a general tendency toward overspending, that is, realizations exceeding the estimate. In contrast, term $U_{i,t-1} \times \text{VarBudget}_{i,t-1}$ has a mean of -2.3%, which specifically isolates and captures the effect of underspending conditions in the model.

On the political side, the variable LEGIS shows an average coalition strength of 14.55, implying that, typically, a regional head in Indonesia is supported by roughly 14 to 15 council members from coalition parties. The wide disparity between the minimum (0) and maximum (50) values reflects pronounced heterogeneity in legislative support for the executive across jurisdictions, ranging from local governments with no coalition support to those characterized by dominant, broad-based coalitions. A pairwise correlation analysis is first employed to identify the strength and direction of associations among variables prior to undertaking more complex regression estimation.

Table 2. Pairwise Correlation

Variables	(1)	(2)	(3)	(4)
(1) Budget Growth $B_{i,t} - B_{i,t-1}/B_{i,t-1}$	1.000			
(2) Budget Variance $A_{i,t-1} - B_{i,t-1}/B_{i,t-1}$	0.647 (0.000)	1.000		
(3) Ratcheting Interaction Term $U_{i,t-1} * A_{i,t-1} - B_{i,t-1}/B_{i,t-1}$	0.304 (0.000)	0.638 (0.000)	1.000	
(4) LEGIS	0.003 (0.947)	0.054 (0.221)	0.077 (0.083)	1.000

The results in Table 2 indicate that budget growth (1) is strongly and positively correlated with the prior-year budget variance (2) and with the ratcheting interaction term (3), both at the 1% significance level ($p < 0.01$). By contrast, the correlation between bargaining power (LEGIS) and the ratcheting interaction (3) is 0.077 with a p-value of 0.083. Although this coefficient is small, its marginal significance ($p < 0.10$) suggests a potential association that warrants further investigation using regression techniques. The Variance Inflation Factor (VIF) for all explanatory variables is used to ensure there is no near-perfect linear relationship among regressors that could undermine the reliability of coefficient estimates. All variables record VIF values below conservative thresholds (5 or 10), and the Mean VIF of 1.33 indicates that the regressors are largely independent of one another. Accordingly, there is no evidence of problematic multicollinearity, and the regression model is well-suited to provide reliable tests of the effect of legislative bargaining power on the budget ratcheting phenomenon.

Table 3. Regression Results

Variable	Coef.	Std. Err.	t-statistics	p-value	Sig.
Budget Variance (VarBudget-1)	0.997	0.064	15.69	0.000	***
Ratcheting Interaction Term ($U \times \text{VarBudgett-1}$)	-0.787	0.148	-5.31	0.000	***
Constant	0.028	0.006	4.68	0.000	***

Standard errors in parentheses, *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

The regression estimates in Table 3 indicate that Indonesian local government budgets exhibit asymmetric ratcheting. The coefficient for the overspending condition, $\lambda_+ = 0.997$ ($p < 0.01$), suggests that when realized expenditures exceed the prior-year budget, approximately 99.7% of that variance is carried forward as an increase in the subsequent budget ceiling. By contrast, the net effect under underspending, computed as $\lambda_+ + \lambda_- = 0.21$ This implies that only 21% of realized savings are translated into future budget reductions. These findings provide clear evidence that budgets are highly responsive to deficits (nearly one-for-one) but notably rigid in the face of surpluses or savings.

Table 4. Model Summary

Statistic	Value	Statistic	Value
Mean dependent var	0.064	SD dependent var	0.139
R-squared	0.359	Number of obs	508
F-test	140.209	Prob > F	0.000
Akaike (AIC)	-936.981	Bayesian (BIC)	-924.290

As reported in Table 4, the model summary indicates that the mean of the dependent variable (budget growth) is 0.064, suggesting an average increase of 6.4%, while the standard deviation of 0.139 reflects substantial variation across local governments. The R-squared value of 0.359 implies that approximately 35.9% of the variation in budget growth is explained by the independent variables included in the model, with the remaining 64.1% attributable to factors outside the specification. Furthermore, the F-test value of 140.209 with a probability of 0.000 demonstrates that the model is statistically significant at the 1% level, indicating that the independent variables jointly have a meaningful effect on budget growth. The number of observations (508) suggests a sufficiently large sample size, enhancing the robustness of the estimation results. The Akaike Information Criterion (AIC) of -936.981 and the Bayesian Information Criterion (BIC) of -924.290 indicate a good model fit, with lower values reflecting a more optimal balance between model accuracy and complexity.

Table 5. Sub Sample Regression Results

Variables	IKFD (Strong Type)	IKFD (Standard)	IPKD (Good)	IPKD (Weak)	Regent	City
Prior Year Budget Variance (VarBudgett-1)	1.145***	-1.042	1.320***	0.127	1.117***	0.458***
	(0.125)	(0.827)	(0.191)	(0.193)	(0.0698)	(0.120)
Ratcheting Interaction (U × VarBudgett-1)	-1.266**	1.768**	-1.451***	0.133	-0.867***	-0.398*
	(0.399)	(0.911)	(0.441)	(0.328)	(0.171)	(0.223)
Constant	0.0742***	0.0356**	0.0000	0.0408***	0.0282***	0.0292***
	(0.0161)	(0.0141)	(0.0123)	(0.0151)	(0.00552)	(0.0122)
Observations	113	56	51	63	415	93
R-squared	0.433	0.150	0.582	0.036	0.414	0.130
Number of Clusters (Island)	6	4	6	6	6	6

Standard errors in parentheses, *** p<0.01, ** p<0.05, * p<0.1

Table 5 reports subsample tests designed to examine how budget behavior varies across fiscal capacity, financial management quality, and jurisdictional type. The results show that ratcheting intensity depends critically on regional fiscal capacity as defined in Indonesia’s regional fiscal capacity map. In jurisdictions classified as having “Very High” capacity, ratcheting is strong (coefficient ≈ 1.145), indicating that more ample resources are associated with incremental planning and upward budget adjustments. This finding is consistent with policy diagnostics suggesting that higher-capacity governments possess greater spending flexibility and a wider range of financing instruments, which may reinforce incremental growth in expenditures (PMK 65/2024). By contrast, in “Very Low” capacity areas, typically more dependent on central transfers, ratcheting is not statistically detected, reflecting tighter intergovernmental constraints and more limited managerial discretion, which can dampen strategic budgeting behavior (OECD, 2021). From the perspective of financial management quality, regions with high IPKD scores (A/”Good”) exhibit the strongest model fit ($R^2 \approx 0.582$), suggesting that performance information functions as a credible feedback mechanism in budget formulation and justification. This aligns with recent studies showing that stronger financial management

systems enhance the use and quality of performance information, although such use may still be selective and influenced by institutional capacity (Azam & Bouckaert, 2025b). Conversely, in regions with weaker IPKD scores (C/”Weak”), budget behavior appears less systematic, consistent with evidence that deficiencies in internal control and audit mechanisms weaken fiscal discipline and reduce the effectiveness of performance-based evaluation (Shidqi & Arfiansyah, 2025).

Finally, differences also emerge across jurisdictional types. Regencies display a stronger tendency toward budget growth (coefficient ≈ 1.117) compared to cities (≈ 0.458). This pattern is consistent with both international and Indonesia-specific findings: urban governments generally benefit from broader tax bases, stronger own-source revenues, and tighter accountability pressures, all of which promote greater fiscal discipline. In contrast, more rural regencies tend to rely more heavily on intergovernmental transfers and face capacity limitations that may encourage incremental spending patterns (World Bank, 2020; OECD, 2021). Supporting evidence from comparative studies on city size and service provision further highlights that urban complexity shapes how local governments allocate resources, reinforcing the importance of spatial context in understanding budget behavior (Post & Kuipers, 2023).

Having established the presence of asymmetric ratcheting and its heterogeneity across sub-samples, the next step is to test whether legislative bargaining power shapes this phenomenon. Implement a Structural Equation Model (SEM) with maximum likelihood estimation, an approach well-suited to the study’s large sample of 508 observations.

Table 6. Regression Results

Path	Coef.	Std. Err.	z-value	p-value
LEGIS → Budget Variance (VarBudget)	0.001	0.000	1.910	0.057
Sumatra → Budget Variance (VarBudget)	0.051	0.013	3.970	0.000
Java → Budget Variance (VarBudget)	0.056	0.014	3.970	0.000
Kalimantan → Budget Variance (VarBudget)	0.111	0.016	7.030	0.000
Sulawesi → Budget Variance (VarBudget)	0.052	0.014	3.620	0.000
Papua → Budget Variance (VarBudget)	0.087	0.017	5.070	0.000
Budget Variance (VarBudget) → Budget Growth (Δ Budget)	0.814	0.061	13.230	0.000
LEGIS → Budget Growth (Δ Budget)	-0.001	0.001	-1.050	0.293

As reported in Table 6, the LEGIS variable exhibits a positive coefficient of 0.001 with respect to prior period budget variance. The corresponding p-value of 0.057 indicates statistical significance at the 10% level ($\alpha = 0.10$). Substantively, this suggests that a larger share of coalition-aligned legislators is associated with greater budget variance, which in turn provides an entry point for ratcheting behavior in subsequent budget cycles. In addition, the regional dummy variables show consistently positive and statistically significant effects on budget variance across all regions. In particular, Kalimantan displays the largest coefficient (0.111, $p < 0.01$), followed by Papua (0.087, $p < 0.01$), Java (0.056, $p < 0.01$), Sulawesi (0.052, $p < 0.01$), and Sumatra (0.051, $p < 0.01$), indicating that spatial heterogeneity plays an important role in shaping fiscal deviations.

Furthermore, budget variance strongly and positively affects budget growth, as indicated by a coefficient of 0.814 ($p < 0.01$), confirming the presence of a ratcheting mechanism whereby higher past deviations translate into upward adjustments in subsequent budgets. By contrast, the direct effect of LEGIS on budget growth is negative but statistically insignificant (coefficient = -0.001, $p = 0.293$), suggesting that legislative bargaining power does not directly influence budget expansion but operates indirectly through its effect on budget variance. The overall model adequacy is supported by $\text{Prob} > \chi^2 = 0.000$, indicating that the model fits the data well and that the null hypothesis of no joint explanatory power is rejected.

DISCUSSION

The findings provide strong evidence of incrementalist behavior in local government budgeting, where current appropriations serve as a baseline that administrators seek to

maintain or expand. The results indicate an asymmetric adjustment pattern in which budget increases following overspending are almost fully carried forward into subsequent periods, whereas reductions following underspending are relatively weak. This pattern is consistent with the logic of budget ratcheting and aligns with international evidence suggesting that public sector budgets tend to respond more aggressively to deficits than to surpluses (World Bank, 2020; OECD, 2021). The estimated coefficients further confirm that prior-period budget variance significantly drives future budget growth, supporting recent empirical findings that ratcheting is prevalent in public and nonprofit organizations characterized by funding dependency and incentive misalignment (Sandalgaard & Bukh, 2023). From a theoretical perspective, this behavior reflects the difficulty of credibly excluding past performance from future target setting, which may weaken incentives and encourage strategic budget adjustments (Matějka et al., 2024).

These dynamics become more pronounced when viewed in the context of Indonesia's decentralized fiscal system. The evidence suggests that ratcheting tendencies are particularly salient in jurisdictions with lower fiscal capacity and higher dependence on central transfers. In such settings, limited own-source revenue and binding service obligations create incentives for local governments to maintain or increase budget ceilings in order to secure adequate funding for essential services. This interpretation is consistent with Indonesia's regional fiscal capacity map, which documents substantial disparities in fiscal capacity across regions and highlights the structural constraints faced by lower-capacity jurisdictions (PMK 193/PMK.07/2022; World Bank, 2020). Moreover, the relatively weak downward adjustment following underspending suggests that performance information is not yet effectively used to discipline budget allocations. Instead, local actors may rely on conservative revenue forecasts or budgetary slack to safeguard programs and administrative resources. This behavior is in line with recent nationwide studies showing that, despite the expansion of performance-based budgeting frameworks, the use and quality of performance information in Indonesia remain uneven and constrained by institutional capacity (Azam & Bouckaert, 2025a). The positive and significant constant term observed in the model further reinforces this interpretation, indicating a baseline tendency toward budget growth even in the absence of performance variance, which reflects persistent institutional and political pressures to expand spending.

In addition to these structural factors, the results highlight the important role of political dynamics in shaping budget behavior. Specifically, the analysis shows that legislative bargaining power proxied by the share of coalition-aligned legislators has a positive, albeit marginally significant, effect on prior-period budget variance, which serves as the entry point for ratcheting. This suggests that stronger executive–legislative alignment may facilitate upward revisions in budget targets, particularly when supported by favorable performance signals. These findings are consistent with Choi et al. (2021), which show that political bargaining power can influence the degree of asymmetry in budgeting outcomes. In the Indonesian context, this interpretation is further supported by studies on political budget cycles, which document that government spending tends to increase ahead of elections and that such increases are more pronounced when incumbents command broader political coalitions (Wiguna & Khoirunurrofik, 2021). Taken together, these results reinforce the view that local budgeting processes are not purely technocratic but are embedded in political negotiation, where coalition dynamics and electoral incentives can legitimize expansionary fiscal behavior.

The findings suggest that while Indonesia's performance-based budgeting reforms aim to enhance efficiency and accountability, their effectiveness may be constrained by underlying political and institutional dynamics. The persistence of ratcheting behavior, combined with the influence of fiscal dependence and legislative bargaining power, indicates that formal rules alone may be insufficient to curb incrementalism. Instead, budgeting outcomes appear to reflect a complex interaction between performance information, institutional capacity, and political incentives, consistent with broader evidence that governance quality and political context play a critical role in shaping fiscal behavior in decentralized systems.

CONCLUSION

This study provides robust evidence of persistent asymmetric budget ratcheting in Indonesia's local governments. The results show that positive budget variance (overspending) is largely carried forward into subsequent budgets, while negative variance (underspending) leads to only limited downward adjustments. This confirms the presence of incremental budgeting behavior consistent with the broader public sector literature. In addition, the findings indicate that legislative bargaining power proxied by coalition alignment acts as a catalyst for ratcheting, suggesting that political dynamics play a significant role in shaping budget outcomes. These results also align with evidence on political budget cycles in Indonesia, where larger coalitions and incumbent advantages tend to encourage expansionary fiscal behavior. Despite the formal adoption of performance-based budgeting, the uneven use of performance information allows for selective justification of budget increases rather than genuine efficiency improvements.

The findings highlight the importance of strengthening institutional mechanisms to better discipline budget adjustments. At the central level, fiscal authorities should introduce rules that convert persistent underspending into baseline reductions and redesign transfer systems to reward efficiency rather than absorption. At the local level, governments can adopt safeguards such as expenditure caps, multi-year budgeting frameworks, and greater transparency in linking past performance to future allocations. In addition, stronger oversight and more effective use of performance information are essential to reduce discretionary and politically driven budget expansions. However, this study has several limitations. It focuses on an early post-HKPD period, so longer-term analysis is needed to assess whether these patterns persist. The proxy for legislative power may not fully capture the complexity of political bargaining, and unobserved factors may still influence the results, suggesting the need for more robust identification strategies. Future research should also examine how performance information is actually used in budgeting processes to better understand its role in shaping fiscal decisions.

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