

The Effect of Financial Performance and Budget Ratcheting on Capital Expenditure Allocation in Districts/Cities of Central Java Province



Fahtia Nur Hanifah^{1*}, Jaka Winarna²

¹Magister Accounting, Faculty Economics and Business, University of Sebelas Maret Surakarta, Indonesia

²Faculty Economics and Business, University of Sebelas Maret Surakarta, Indonesia

ABSTRACT: This study examines the effect of regional financial performance (effectiveness ratio, efficiency, fiscal decentralization) and budget ratcheting on the allocation of capital expenditure in local governments in Central Java Province from 2018-2021. The population in this study were all Regency/City Regional Governments in Central Java Province in 2018-2021. The sample used was 35 local governments. Hypothesis testing using panel data regression. The results showed that regional financial performance (effectiveness ratio, efficiency, fiscal decentralization) and budget ratcheting affect capital expenditure allocation. Effectiveness and efficiency ratios negatively affect capital expenditure allocation, fiscal decentralization ratio positively affects capital expenditure allocation, and budget ratcheting negatively affects capital expenditure allocation. This study provides empirical evidence that one of the tools to analyze regional financial performance in managing regional finances is to conduct a financial ratio analysis. The novelty of this research is the addition of budget ratcheting variables that have not been widely studied in Indonesia, especially those using local government objects.

KEYWORDS: Capital Expenditure Allocation, Regional Financial Performance, Regional Financial Ratios, Budget Ratcheting

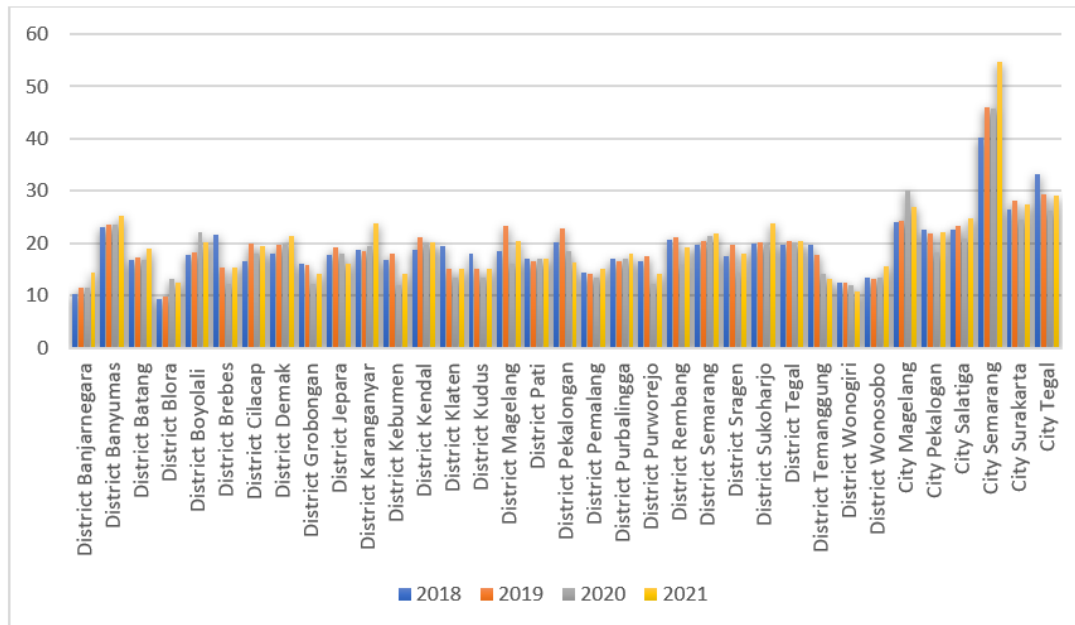
I. INTRODUCTION

Information about final paper submission is available from the conference website. Article 66, paragraph 1 of Law No. 33 of 2004 states that the government's ability to manage its limited resources in an orderly, economical, law-abiding, efficient, effective, transparent, and responsible manner is a prerequisite for the success of regional autonomy. Value for money, an output-oriented performance approach, and sound governance principles are all used in regional financial management. Since the budget is used to evaluate the government's performance, capital expenditures, or the money spent on community services, are expected to account for a sizable portion of the budget (Halim, 2008: 226).

The progress of a region can be shown by the allocation of capital expenditure, which is issued by the local government and aims for long-term investment, which can increase Regional Original Revenue (PAD). Based on the daily news tempo.com, the director general of Bina Kemendagri Agus Fathoni stated that PAD revenue must continue to be improved. This must be done because there are still many regional potentials that still need to be appropriately maximised. The average PAD revenue of regencies/cities in Central Java in 2020 has decreased; this situation has occurred since COVID-19, which has hurt the Indonesian economy. Regional Original Revenue 2020 decreased by 5,6 per cent, from Rp 14.4 trillion in 2019 to 13.6 trillion in 2020.

In this instance, the capital expenditure ratio can show how well local government budgets are used to construct infrastructure to improve community access to public services. The higher the capital expenditure ratio, the greater the investment made by local governments to repair or improve the infrastructure needed by the community. Conversely, the capital expenditure ratio is low. In that case, the budget is more allocated to operational expenditures, such as employee salaries, purchase of goods, etc. Therefore, local governments quality of existing public services. All districts/cities in Central Java experience constraints related to capital expenditure. None of the 6 towns and 29 communities in Central Java reached the 40 per cent capital expenditure allocation limit.

The Effect of Financial Performance and Budget Ratcheting on Capital Expenditure Allocation in Districts/Cities of Central Java Province



Graphics 1. Capital Expenditure Ratio of Regency / City in Central Java Province in 2018-2021

According to the Law on Financial Relations between Central and Local Governments (UU HPKD), local governments must allocate 30 per cent of total expenditures for personnel outside of allowances and teachers' salaries. Meanwhile, at least 40 per cent of total spending outside the region must be public infrastructure expenditure. By the PRSP Law, the capital expenditure allocation limit is at least 40 per cent. Therefore, in fiscal years 2018-2021, Semarang City has reached the capital expenditure allocation limit. Based on graphics 1, Semarang City in 2021 is the region with the highest portion of capital expenditure, reaching 54,7 per cent of total regional spending. The lowest amount of capital expenditure is Bora Regency, which only accounts for 9,4 per cent.

In this case, efforts need to be made to increase the share of capital expenditure in these districts and cities through targeted and effective programs. Increasing the portion of capital expenditure can boost investment, create jobs, increase productivity, and encourage economic growth in the region. In addition, it is necessary to improve human resources and classy infrastructure to increase the region's competitiveness. Thus, it is expected that in the future, districts and cities in Central Java Province will pay more attention to the portion of capital expenditure to encourage sustainable economic growth.

Local governments use their more extensive revenue sources for capital expenditures, but the government needs help increasing its regional capital expenditures due to moral hazard. Riswan and Affandi (2014) suggest that good financial performance positively affects capital expenditure for public services. Regional financial performance changes impact the allocation of regional capital expenditures (Prihastuti et al., 2015).

Mahmudi (2007: 92-96), in Suyono (2010), financial performance is usually defined as financial ratios identified based on local government financial statements. However, not all financial ratios have the same influence on financial performance. Based on this, it is necessary to analyze these factors comprehensively to understand better the factors that influence the financial performance of local governments. The results of the analysis can be used as a consideration for parties involved in planning and decision-making related to local government economic policies.

Financial ratio analysis based on the Value of Money concept can be done through the APBD report. This analysis is one way to evaluate regional financial performance. Through financial ratio analysis, the weaknesses and strengths of local government financial management can be identified to become the basis for making decisions in making a rational policy based on predetermined goals (Patarai, 2017).

One way to determine whether the regional financial performance is good is to analyze financial ratios. The fiscal decentralization ratio, the regional financial management efficiency ratio, and the PAD effectiveness ratio are the regional financial performance indicators used in this study.

The ability of local governments to achieve planned Regional Original Revenue (PAD) in comparison to the target set based on a region's actual potential is described by the effectiveness ratio of PAD (Halim, 2008, p. 234). The realization of

The Effect of Financial Performance and Budget Ratcheting on Capital Expenditure Allocation in Districts/Cities of Central Java Province

payment received and the amount spent to generate revenue are compared in the regional financial management efficiency ratio (Halim, 2008, p. 234). According to Halim and Damayanti (2007: 262), the fiscal decentralization ratio illustrates the extent to which local revenue (PAD) contributes to overall local revenue.

Hercowitz and Strawczynski (2002) and research conducted by Lee and Plummer (2007) mention that budget ratcheting influences capital expenditure allocation. Budget ratcheting in capital expenditure budgeting is inseparable from the existence of biased behaviour. Budget ratcheting occurs because of the tendency to use current-year performance targets to plan future targets.

Solikhin (2014) states that the obstacle faced in implementing budgeting is the tendency for lower expenditure disbursements at the beginning but a buildup of budget disbursements at the end of the fiscal year. Usually, at the beginning of the program related to the procurement of goods/services, the community should have received benefits so that it can be expected to provide a greater impetus for increased economic growth (Annisa, 2020). However, evidence in the field shows that local government budget realization in Indonesia tends to be lower at the beginning and higher at the end of the fiscal year. What should happen is that at the end of the fiscal year, local governments only carry out the remaining activities and tidy up the financial management administration (Rokhman, 2013).

Better public services are anticipated in proportion to the budget allotted for capital expenditures. This is because fixed assets resulting from capital expenditure play a significant role in the public services that the government provides. However, the actual practice in the field demonstrates that there is still a sizable additional budgetary allotment for capital expenditures.

Various studies on capital expenditure have been conducted, among others, by Putri and Rahyu (2019) and Gerung (2015), which state that the effectiveness ratio of PAD has a positive and significant effect on capital expenditure. Another study by Dinarossi and Darma (2016) found that the efficiency of regional financial management significantly affects capital expenditure. Other research conducted by Arsa and Djinar (2015) found that the degree of decentralization and the effectiveness of PAD positively affect capital expenditure. Marlina's research (2018) states that budget ratcheting simultaneously affects capital expenditure allocation. Meanwhile, research conducted by Safitri and Sari (2020) and Hidayah and Sari (2022) states that there is a budget ratcheting effect in capital expenditure.

By the HKPD Law, the minimum allocation for infrastructure expenditure, part of capital expenditure, is 40 per cent. However, most districts/cities in Indonesia allocate less capital expenditure than personnel expenditure. This is also the case for regions in Central Java. According to observations, all districts/cities in Central Java Province in 2018-2021 have a capital expenditure ratio of at most 25 per cent, far from the minimum capital expenditure allocation limit of 40 per cent. With this phenomenon and the establishment of new regulations regarding the minimum limit for capital expenditure allocation, this research is essential. It must be carried out immediately because this research topic is current conditions; namely, the allocation of medical expenditure plays a significant role in developing public facilities in improving community welfare. By conducting this research, the effect of regional financial performance on capital expenditure can be known so that the following year, the local government can increase capital expenditure allocation to a minimum limit of 40 per cent by the PRSP Law.

The renewal in this study is the addition of budget ratcheting variables, which have yet to be widely studied in Indonesia, especially those using local government objects. Based on this description, this research is interesting for researchers to investigate further. In addition, previous studies with similar research variables have different research results.

II. LITERATURE REVIEWS AND HYPOTESIS

A. Literature Review

Allocating Capital Expenditures. According to Fees (2008), capital expenditures include the price of purchasing fixed assets as well as any upgrades or additions made to them in order to raise their overall value or prolong their useful lives. A capital expenditure is a budgetary expense for the purchase of fixed assets and other assets that yield benefits over the course of multiple accounting periods, as defined by Government Regulation No. 71/2010 on Government Accounting Standards. Purchasing land, buildings and other structures, machinery, and intangible assets are a few examples of capital expenditures. Mardiasmo (2009) defines capital expenditures as expenses that will raise the regular budget for operating and maintenance costs and whose benefits typically extend beyond a single fiscal year.

Local governments set aside money in the APBD capital expenditure budget to increase fixed assets. This capital expenditure budget is based on the infrastructure and facility requirements of the local area for the efficient execution of public works projects and government duties. Annually, local governments typically purchase fixed assets based on budget priorities and public services that will affect their finances in the long run.

The Effect of Financial Performance and Budget Ratcheting on Capital Expenditure Allocation in Districts/Cities of Central Java Province

Local Government Financial Performance. Article 1, paragraph 37 of Regulation of the Minister of Home Affairs No. 21 of 2011 (second amendment of Permendagri No. 13 of 2006) defines performance as the output or results of activities or programs that will or have been achieved in connection with the use of budgets with measurable quantity and quality. The study defines Local Government Financial Performance as an increase in accomplishing a work result in local finance. It includes the funding and realization of PAD using financial indicators established by a policy or statutory provisions from one budget period.

Performance measurement is required to determine how much actual performance deviates from expected performance. Making improvements and raising performance is possible by being aware of these deviations (Rai, 2008). In the context of the business, measuring the performance of the company that emerges from the management decision-making process is a more complex and complicated matter because it will entail matters about the profitability, efficiency, and effectiveness of capital utilization as well as the value and security of various demands from third parties (Helfert, 1982). Financial analysis is the appropriate analytical tool to measure financial performance because it uses financial indicators.

B. Hypothesis

Although previous research has been conducted, the results are inconsistent. Therefore, researchers are interested in researching by adding the independent variable budget ratcheting. This study aims to examine the effect of financial performance (effectiveness ratio, efficiency ratio, fiscal decentralization ratio) and budget ratcheting on local governments' capital expenditure allocation.

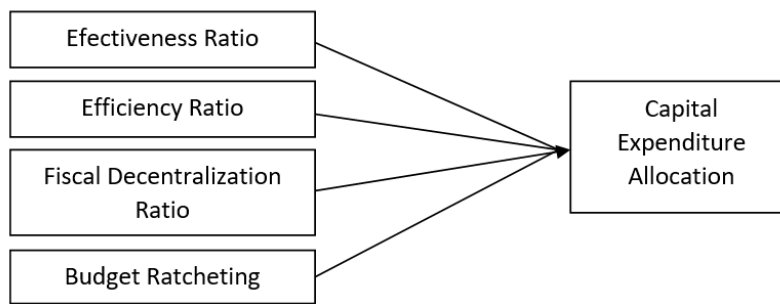


Figure 1. Conceptual Framework

III. OPERATIONAL DEFINITIONS AND RESEARCH METHODS

A. Operational Definitions

The dependent variable in this study is **Capital Expenditure Allocation**. According to Article 53 of Minister of Home Affairs Regulation No. 59 of 2007 (the first amendment of Permendagri No. 13 of 2006), capital expenditures *are* defined as costs incurred in connection with the acquisition of tangible fixed assets with a useful life of more than a year for use in government operations. The purchase price or construction of investments plus all costs associated with the acquisition or construction of support, until the assets are prepared for use, constitute the value of tangible fixed assets budgeted in capital expenditures. The capital expenditure allocation indicator is calculated using the following formula, according to the Directorate General of Fiscal Balance:

$$\text{Capital Expenditure Allocation} = \frac{\text{Capital Expenditure}}{\text{Regional Expenditure}} \times 100\%$$

The independent variables in this study are local financial ratios (effectiveness ratio, efficiency ratio, fiscal decentralization ratio) and budget ratcheting. **Effectiveness Ratio.** Effectiveness ratio can be calculated by comparing actual revenue with potential revenue that can be generated. Potential revenue is based on the income obtained from tax and levy payments available in the area. The effectiveness ratio is calculated using the following proxies:

$$\text{Effectiveness Ratio} = \frac{\text{Realization of Local Revenue (PAD)}}{\text{Local Revenue (PAD) Target}} \times 100\%$$

Efficiency Ratio. Based on the actual potential of the area, the efficiency ratio shows how much local governments can achieve their planned local revenue targets. This ratio contrasts the local revenue realized with the desired outcome (Halim, 2007). The province government has more influence in reaching the set local revenue target, and the higher the effectiveness

The Effect of Financial Performance and Budget Ratcheting on Capital Expenditure Allocation in Districts/Cities of Central Java Province

ratio. On the other hand, should this ratio be below, the provincial government must assess the tactics and laws to boost local revenue efficiency. The following proxy is used to calculate the efficiency ratio:

$$\text{Efficiency Ratio} = \frac{\text{Expenditure Realization}}{\text{Revenue Realization}} \times 100\%$$

Fiscal Decentralization Ratio. The fiscal decentralization ratio is a benchmark for measuring the effectiveness of budgetary decentralization policies implemented by the central government. By creating conditions that allow local governments to obtain adequate revenue, fiscal decentralization policies can support regional economic development. Therefore, the fiscal decentralization ratio must constantly be monitored and maintained to create regional solid financial independence and accelerate economic growth. The fiscal decentralization ratio is calculated using the following proxies:

$$\text{Fiscal Decentralisation Ratio} = \frac{\text{Local Revenue (PAD)}}{\text{Total Local Revenue}} \times 100\%$$

Budget Ratcheting. One budgeting component is budget ratcheting, which occurs when the difference between the target and performance of the previous year affects the budget target for the current year (Aranda & Davilla, 2010). The variance of the Regional Revenue budget between the current and previous periods is used to calculate budget ratcheting, and the model from Aranda (2010) in Abdullah and Junita (2016) is used to measure this variable.

$$PAD_t - PAD_{t-1} = \delta + \lambda (PADR_{t-1} - PAD_{t-1}) + e$$

Note:

- PADt : Local Revenue for the Current Year
- PADt-1 : Local Revenue in the Previous Year
- PADRt-1 : Local Revenue in the last period
- δ : Constant, and
- λ : Coefficient

B. Research Methods

Data analysis in this study uses panel data regression with the Random Effect Model (REM) approach, which is used to determine the effect of effectiveness ratio, efficiency ratio, fiscal decentralization ratio, and budget ratcheting on capital expenditure allocation. Panel data combines cross-sectional and time series data to produce better estimation results with increased observations, which implies increased degrees of freedom. Time series data is derived from an object with a specific time series, while cross-section data is derived from observations of multiple objects without considering time differences (Nuryanto and Pambuko, 2018).

The panel data regression analysis model that was used in this study is as follows:

$$BM = \alpha + \beta_1 EFK + \beta_2 EFS + \beta_3 DSFK + \beta_4 BR + e$$

Note:

- BM : Capital Expenditure Allocation
- EFK : Effectiveness Ratio
- EFS : Efficiency Ratio
- DSFK : Fiscal Decentralization Ratio, and
- BR : Budget Ratcheting

IV. RESULT

The classical assumption test is mandatory in regression analysis before hypothesis testing. In the panel data regression model, not all classical assumption tests can be carried out and not made a Best Linear Unbiased Estimator (BLUE) requirement. The results of the classic assumption test demonstrate that the regression model applied in this work is normally distributed and devoid of heteroscedasticity and multicollinearity symptoms. Based on the results of data processing with Eviews 12.

A. Classical Assumption Test

The classic assumption test is one way to assess whether multicollinearity and heteroscedasticity symptoms are present. The multicollinearity test is utilized to determine if there is a correlation between the independent variables. Good regression

The Effect of Financial Performance and Budget Ratcheting on Capital Expenditure Allocation in Districts/Cities of Central Java Province

models are those in which there is no correlation between the independent variables. Regression models with a correlation coefficient between independent variables less than 0,800 are deemed free of multicollinearity. On the other hand, multicollinear regression models have independent variable correlation coefficients greater than 0,800. The following are the findings of this study's multicollinearity test:

Table 2. The result of the Multicollinearity Test

| | EFK | EFS | DSFK | BR |
|------|-----------|-----------|----------|-----------|
| EFK | 1,000000 | -0,114830 | 0,018479 | -0,037351 |
| EFS | -0,114830 | 1,000000 | 0,419913 | -0,018245 |
| DSFK | 0,018479 | 0,419913 | 1,000000 | 0,095297 |
| BR | -0,037351 | -0,018245 | 0,095297 | 1,000000 |

Source: Data processed by the author (EViews, 2023)

Table 2's multicollinearity test results demonstrate that each variable has a coefficient value of less than 0.80, indicating a high degree of correlation between them. Therefore, there isn't a multicollinearity issue.

The heteroscedasticity test is used to ascertain whether there is an inequality of variance and residuals for every regression model observation. The white test method is used in this study to identify heteroscedasticity symptoms. The probability value above 0,050, which denotes the absence of heteroscedasticity symptoms, meets the criteria used in the heteroscedasticity test. The Harvey heteroscedasticity test is one of the techniques that can be applied to the heteroscedasticity test on Eviews. Using the Harvey test method in this investigation. The heteroscedasticity test results using the white test method are as follows:

Table 3. The result of the Heteroscedasticity Test

| | | | |
|---------------------|----------|-----------------------|--------|
| F-statistic | 2,199801 | Prob. F (4,131) | 0,0725 |
| Obs*R-squared | 8,560074 | Prob. Chi-Squared (4) | 0,0731 |
| Scaled explained SS | 8,637449 | Prob. Chi-Squared (4) | 0,0708 |

Source: Data processed by the author (EViews, 2023)

Table 3 indicates that the Harvey test is used in the heteroscedasticity test. The effectiveness ratio, efficiency ratio, fiscal decentralization ratio, and budget ratcheting are examples of the independent variables used. The F probability of 0.0725 indicates that the sample data for this study does not exhibit heteroscedasticity. Additionally, the signification number is above 5% or 0.05.

B. Panel Data Regression Analysis

This study uses four independent variables, namely the effectiveness ratio, efficiency ratio, fiscal decentralization ratio, budget ratcheting and regional expenditure allocation as the dependent variable. The Fixed Effect Model (FEM) in the Chow and Hausman tests is the model used in this study's panel data regression estimation approach or method. The results are usually distributed. Based on the panel data model test outcomes, the Fixed Effect Model is the most suitable regression model utilized in this investigation. The following are the results of the Fixed Effect Model Test that was carried out:

Table 4. t test (Summary of Hypothesis Test Results)

| Hypothesis | | Direction | Coefficient | Prob. | Description |
|------------|----|-----------|-------------|--------|-------------|
| C | | | 0,36 | 0,0000 | |
| EFK → BM | H1 | - | -0,62 | 0,0000 | Supported |
| EFS → BM | H2 | - | -2,00 | 0,0000 | Supported |
| DSFK → BM | H3 | + | 1,09 | 0,0000 | Supported |
| BR → BM | H4 | - | -1,24 | 0,0144 | Supported |

Source: Data processed by the author (EViews, 2023)

The Effect of Financial Performance and Budget Ratcheting on Capital Expenditure Allocation in Districts/Cities of Central Java Province

Table 5. F Test and Coefficient of Determination (R²)

| | | | |
|--------------------|----------|-----------------------|-----------|
| R-squared | 0,994917 | Mean dependent var | 0,193581 |
| Adjusted R-squared | 0,992997 | S.D. dependent var | 0,065647 |
| S.E. of regression | 0,005493 | Akaike info criterion | -7,339378 |
| Sum squared resid | 0,002957 | Schwarz criterion | -6,525548 |
| Log likelihood | 537,0777 | Hannan-Quinn criter. | -7,008658 |
| F-statistic | 518,3584 | Durbin-Watson stat | 2,077492 |
| Prob(F-statistic) | 0,00000 | | |

Source: Data processed by the author (EViews, 2023)

Table 5 explains the test results of the coefficient of determination (R²); it can be seen that the adjusted R-square value is 0,992997 or 99,2997%. So, it can be concluded that the independent variables of local government financial performance in the form of PAD effectiveness, regional financial management efficiency and fiscal decentralization and budget ratcheting variables can explain capital expenditure in the Regency / City of Central Java Province in 2018-2021 by 99,2997%. At the same time, other variables outside the study explain the rest.

Using the Fixed Effect Model (FEM) approach and the panel data regression estimation output, the following linear regression equation is produced:

$$BM = 0,36 - \beta_1 1,62 - \beta_2 2,00 + \beta_3 1,09 - \beta_4 1,24 + e$$

The relationship between the allocation of capital expenditure in regencies/cities in Central Java Province in 2018–2021 is tested for significance using the F test. Concurrently with the effectiveness of PAD, the efficiency of regional financial management, fiscal decentralization, and budget ratcheting. Table 5's prob (F-statistic) is known to be 0,0000 < α = 5% (0,05). Therefore, it can be said that Ha is accepted, and H0 is rejected. This shows that local government financial performance in the form of PAD effectiveness variables, regional financial management efficiency, fiscal decentralization and budget variables simultaneously affect capital expenditure allocation.

V. DISCUSSION

A. Effectiveness Ratio on Capital Expenditure Allocation

According to the regression test results, financial performance, as measured by the effectiveness of PADs on allocating capital expenditures, has a regression coefficient value of -1,62 with a probability value of 0,00. This suggests that PAD's effectiveness negatively impacts capital expenditure distribution.

This research is in line with Nurena's (2023), which states that the PAD effectiveness ratio significantly negatively affects capital expenditure. So, if there is an increase in the regional effectiveness ratio, it does not affect the amount of capital expenditure. This is because the effectiveness value in each region on the island of Java is in the highly effective category, with the ability to realize PAD almost twice as much as budgeted. Still, this ability is outside the line with the ability to learn capital expenditures.

B. Effect of Efficiency Ratio on Capital Expenditure Allocation

The results identify that the efficiency ratio negatively affects capital expenditure allocation, in accordance with the study's second hypothesis. So, the second hypothesis in this study is accepted. This can be seen from the coefficient value of the efficiency ratio variable of -2,00 with a probability value of 0,000. According to the assumption, the higher the efficiency ratio value, the more inefficient regional finance is. Although the direction of the coefficient is negative, the relationship between the two variables is significant. So, if there is an increase in the regional financial efficiency ratio, it does not affect the amount of capital expenditure realization for public services. Research by Ardhini and Handayani (2011) states that the regional financial efficiency ratio has a negative but significant effect on the allocation of capital expenditure for public services.

The higher the efficiency ratio, the lower the regional expenditure, in this case capital expenditure. Inefficient use of restricted finances with a high ratio figure can be caused because the amount of expenditure realization is greater than the amount of revenue itself, resulting in waste for regional expenditure but not maximally used for capital expenditure (Ardhini, 2014). Based on statistical results, provincial spending in terms of capital expenditure is decreasing. The inefficient use of restricted finances with a high ratio figure can be caused because the amount of expenditure realization is greater than the amount of revenue itself, resulting in waste for regional expenditure but not used optimally for capital expenditure, as stated by

The Effect of Financial Performance and Budget Ratcheting on Capital Expenditure Allocation in Districts/Cities of Central Java Province

the Minister of Finance Agus D. W. Martowardojo (2010) in the online daily Today (April 28, 2011) that throughout 2010 around 60 per cent of the regional budget was spent more on personnel expenditure than on capital expenditure.

This study's results align with research conducted by Martini and Dwirandra (2015) and Arif & Arza (2019), which state that the regional financial efficiency ratio has a significant negative effect. This is due to the incredible amount of personnel expenditure in the regions compared to capital expenditure for development and development in the areas (Martini and Dwirandra, 2015). In line with Darmastuti et al. (2022), the efficiency ratio significantly negatively affects capital expenditure in regencies and cities in East Java Province.

C. Effect of Fiscal Decentralization Ratio on Capital Expenditure Allocation

According to the study's third hypothesis, the results show that the decentralization ratio positively impacts the distribution of capital expenditures. Thus, the study's second hypothesis is accepted. This is evident from the fiscal decentralization ratio's coefficient value of 1,09, which has a probability value of zero,000. The ratio of fiscal decentralization exhibits a positive and significant relationship due to the higher level of local revenue relative to regional revenue, resulting in a positive and significant value. This indicates that the Central Java Province provincial government has fulfilled its obligation to carry out the regional development assigned by the national government.

If the ratio of fiscal decentralization increases, regional financial performance improves, so the allocation of regional capital expenditure increases. The increase in local revenue received is supported by a fiscal decentralization policy. Local governments seek to increase capital expenditure allocations to provide facilities and infrastructure for community needs. The increase in capital expenditure allocation can improve the community's welfare and economic growth in the area.

The findings of this study support Adolf Wagner's theory, which takes the form of a law known as The Law of Ever Increasing State Activities, or the trend toward rising state spending, to express his viewpoint. According to Wagner's law, an economy's relative government spending will grow with an increase in per capita income. This is possible because, according to the APBD, the degree of fiscal autonomy is defined as the ratio of regional own-source income (PAD) to total regional revenue. It also describes the region's independence or gives an overview of the internal area's capacity to contribute to regional revenue.

The results of this study are also by previous research by Arsa (2015), Praza (2016), and Indiyanti (2018), which state that financial performance in the form of the degree of decentralization has a positive effect on capital expenditure. The results of this study support the results of research from Arsa and Setiawian (2015), Huda (2015), and Praza (2016).

D. The Effect of Budget Ratcheting on Capital Expenditure Allocation

The results of this study identify that budget ratcheting has a negative effect on capital expenditure allocation. This can be seen from the coefficient value of -1,24 with a probability value of 0,0144. The negative coefficient value can be interpreted that if the budget ratcheting increases by 1 unit, the capital expenditure allocation will decrease by 1 unit. The negative coefficient value means that budget ratcheting in capital expenditure is smaller than zero. The fourth hypothesis is that budget ratcheting affects the allocation of capital expenditure; thus, this study supports the research of Safitri & Sari (2020) and Hidayah and Sari (2022). As well as supporting Susanto & Halim's research (2016).

Budget preparers respond to the existence of a negative variance in the previous year as a factor that determines the size of the budget in the current year. Thus, the presence of budget ratcheting in the allocation of capital expenditures is inseparable from the role of dishonest budget preparation behaviour spearheaded by agency problems and opportunistic behaviour from various parties.

Lim (2011) conducted research stating that the variance when revenue is positive will be related to the revenue budget in the future. The negative variance in income will not be related to the revenue budget the following year. Positive variances that occurred in the past reflect good performance, so the path travelled in the past is a guideline for the future. Local governments are implementing complex agency problems directly proportional to information asymmetry, so the possibility of budget ratcheting is also getting more significant.

VI. CONCLUSIONS AND SUGGESTION

Drawing from the findings of studies examining the impact of financial performance as measured by effectiveness, efficiency, fiscal decentralization, and budget ratcheting on capital expenditure allocation expenditure of the Regency / City Regional Government of Central Java Province in 2018-2021, the following conclusions can be made: 1) Financial performance at the regional level as measured by effectiveness, efficiency, fiscal decentralization, and budget ratcheting all act in concert to influence capital expenditure allocation. The effectiveness ratio, which measures financial performance, has a negative impact

The Effect of Financial Performance and Budget Ratcheting on Capital Expenditure Allocation in Districts/Cities of Central Java Province

on capital expenditure allocation to some extent. 3. financial performance, as measured by efficiency ratios, has a partial negative impact on capital expenditure allocation. 4) The distribution of capital expenditure is positively impacted, to a partially lesser extent, by financial performance as measured by the fiscal decentralization ratio. 5) Budget Ratcheting partially has a negative effect on the allocation of capital expenditure.

The limitation of this research is that this research is only based on quantitative data and has yet to include relevant qualitative aspects that determine the capital expenditure allocation policy. The sample used is very limited, only using local governments in Central Java due to constraints in finding data samples, so it cannot compare the allocation of capital expenditures of local governments in Indonesia whether it is in accordance with the minimum limit of regional expenditure allocations. The measurement of financial performance in this study is only represented by 3 financial ratios (PAD effectiveness ratio, regional financial management ratio and degree of fiscal decentralization), while there are still many financial ratios in local governments.

Based on this research, local governments can consider that in making regional expenditures, not solely through direct allocation of capital expenditures, but can consider spending on intensification and extensification in the context of optimizing PAD. For further research, it is hoped that it can develop research by using questionnaire instruments, making direct observations of local governments and conducting interviews with related parties. A more comprehensive sample was added to compare which local governments in Indonesia have met the minimum limit for capital expenditure allocations. Researchers suggest looking for other references such as from the Central Statistics Agency (BPS) website (www.bps.go.id) or the website of the Information and Documentation Management Officer (PPID) for each province sampled and adding variables and research periods to provide a broader picture and research results.

Furthermore, it is anticipated that the study's findings will give the public information and a summary of the government's financial performance, enabling the community to support development and the region's efficient administration. With this information, the public will be able to know how the government manages and maintains the continuity of development in the area.

REFERENCES

- 1) Abdul Halim dan Theresia Damayanti. 2007. *Pengelolaan Keuangan Daerah*. Edisi Kedua. Yogyakarta: UPP STIM YKPN.
- 2) Abdullah, S. & Junita. A. (2016). "Bukti empiris pengaruh budget ratcheting terhadap hubungan antara pendapatan sendiri dan belanja daerah pada kabupaten/kota di aceh". *Journal Modus*, 28, pp. 185–201.
- 3) Annisa Ayu Safitri dan Vita Fitria Sari. (2020). Efek Budget Ratcheting Pada Anggaran Pemerintah Kabupaten Kota Provinsi Sumatera Barat (Studi Empiris Pada Pemerintah Daerah Kabupaten Kota Provinsi Sumatera Barat Tahun 2014-2018). *Jurnal Eksplorasi Akuntansi*, 2(ISSN: 2656-3649), 2992–3011.
- 4) Aranda, C., Arellano, J., & Davila, A. (2014). Ratcheting and the Role of Relative Target Setting. *The Accounting Review*, 89, 1197–1226. <https://doi.org/10.2308/accr-50733>.
- 5) Ardhini dan S. Handayani. 2011. Pengaruh rasio keuangan daerah terhadap belanja modal untuk pelayanan publik dalam prespektif terhadap teori keagenan: Studi pada Kabupaten dan Kota di Jawa Tengah.
- 6) Arif, Muhammad dan Arza, Indra, M. 2018. Pengaruh Kinerja Keuangan Terhadap Alokasi Belanja Modal Pemerintah Daerah di Kabupaten dan Kota Provinsi Sumatera Barat Tahun 2013-2017. *Jurnal Riset Manajemen & Akuntansi* Vol.9 No 2 November 2018.
- 7) Arsa, I. K dan Setiawina Nyoman Djinar. 2015. Pengaruh Kinerja Keuangan Terhadap Alokasi Belanja Modal dan Pertumbuhan Ekonomi Pemerintah Kabupaten/Kota se-Provinsi Bali Tahun 2006 s.d. 2013. Tesis S-2 Pascasarjana Universitas Udayana.
- 8) Basuki, A. T., and Pratowo, N. (2016). Analisis Regresi Dalam Penelitian Ekonomi and Bisnis. PT Rajagrafindo Persada, Depok.
- 9) Daling, M. (2013). Analisis Kinerja Realisasi Anggaran Pendapatan Dan Belanja Pemerintah Kabupaten Minahasa Tenggara. *Jurnal EMBA*, 1(3), 82-89 ISSN: 2303-1174.
- 10) Darmastuti, W. Y., Susilowati, E., & Tannar, O. (2022). Pengaruh Kinerja Keuangan Pemerintah Daerah Terhadap Alokasi Belanja Modal di Kabupaten/Kota Provinsi Jawa Timur. *Jurnal Proaksi*, 9(1), 1–13. <https://doi.org/10.32534/jpk.v9i1.1913>.
- 11) Dinarossi, Utami dan Yanti Darma. 2016. Pengaruh Efisiensi dan Kemandirian Keuangan Daerah terhadap Belanja Modal. *Jurnal Adminika*, Vol. 2 (2): 61-77.

The Effect of Financial Performance and Budget Ratcheting on Capital Expenditure Allocation in Districts/Cities of Central Java Province

- 12) Fahd, Y., & Rasyid, S. (2017). Pengaruh Kinerja Keuangan Daerah Terhadap Alokasi Belanja Modal Dan Implikasinya Pada Tingkat Kemiskinan Dan Pengangguran. *Jurnal Analisis*, 6(2), 194–201 ISSN: 2303–100X.
- 13) Fees, Warren Reeve. 2008. Pengantar Akuntansi Edisi 21. Salemba Empat. Jakarta.
- 14) Gerungan Sylvia Febriany, Saerang David P.E. dan Pontoh Winston. 2015. Pengaruh Kinerja Keuangan Kabupaten / Kota Terhadap Alokasi Belanja Modal di Provinsi Sulawesi Utara. Skripsi Dipublikasikan. Universitas Sam Ratulangi.
- 15) Halim, Abdul. 2008. Analisis Investasi (Belanja Modal) Sektor Publik Pemerintah Daerah. Yogyakarta: UPP STIM YKPN.
- 16) Hercowitz, Zhi & Strawczynski. (2004). Cyclical Ratcheting In Government Spending: Evidence From The OECD. *The Review of Economics and Statistics*, 86(1): 353-361.
- 17) Hidayah, A.N. & Sari, V.F. (2022). Pengaruh Pendapatan Asli Daerah Terhadap Alokasi Belanja Modal Dengan Budget Ratcheting Sebagai Variabel Moderating. *Jurnal Eksplorasi Akuntansi (JEA)*, 4 (1), 165-177.
- 18) Huda, Syahrul, dkk.(2015). Pengaruh Kinerja Keuangan, Fiscal Stress, dan Kepadatan Penduduk terhadap Alokasi Belanja Modal di Nusa Tenggara Barat. *Jurnal ASSETS*. Volume 5 Nomor 2: 1-12.
- 19) Hygi Prihastuti, A., Taufik, T., & Agusti, R. (2015). Pengaruh Kinerja Keuangan terhadap Alokasi Belanja Modal dan Pertumbuhan Ekonomi di Kabupaten/Kota Riau. *Sorot*, 10(2), 143. <https://doi.org/10.31258/sorot.10.2.3211>.
- 20) Indiyanti, N. M. D., & Rahyuda, H. (2018). Pengaruh Kinerja Keuangan Daerah Terhadap Alokasi Belanja Modal Di Provinsi Bali. *E-Journal Manajemen Unud*, 7(9), 4713-4746 ISSN: 2302- 8912.
- 21) Iswahyudin. 2016. "Pengaruh Belanja Modal, Belanja Barang Dan Jasa Terhadap Sisa Lebih Pembiayaan Anggaran (Silpa) Kabupaten/Kota Di Sulawesi Tengah". *E Jurnal Katalogis*, Volume 4 Nomor 6.
- 22) Kelola, T., Akuntabilitas, D. A. N., Negara, K., & Misra, F. (2020). Budget Ratcheting In Governmental Budgeting: An Empirical Investigation. 6(1), 73–86. <https://doi.org/10.28986/jtaken.v6i1.400>.
- 23) Keuangan, A. K., Provinsi, P., & Timur, K. (2018). *Indonesian Treasury Review*. 43–59.
- 24) Lee, T., & Plummer, E. (2007). Budget Adjustments in Response to Spending Variances: Evidence of Ratcheting of Local Government Expenditures. *Journal of Management Accounting Research*, 1, 137–167.
- 25) Lim, Dongkuk. (2011). Budget Ratcheting and Agency problem. Dissertation. The University of Texas at Dallas.
- 26) Mahmudi. 2007. Analisis Laporan Keuangan Pemerintah Daerah. Yogyakarta: Unit Penerbit dan Percetakan STIM YKPN.
- 27) Mardiasmo, 2004. Otonomi Dan Manajemen Keuangan Daerah. Yogyakarta: Andi.
- 28) Marlina, L. (2018). Pengaruh Kinerja Keuangan Daerah dan Budget Ratcheting Terhadap Alokasi Belanja Modal. *Jurnal Akbis*, 2, 34–44.
- 29) Marlina.L, Indriani.M, Fahlevi.H.(2017). Kinerja Keuangan dan Alokasi Belanja Modal (Studi pada Kabupaten dan Kota di Provinsi Aceh. *Jurnal Akuntansi Pascasarjana Universitas Syiah*. Volume 6, No.1.Februari 2017.pp21-30
- 30) Martini, Kadek dan Dwirandra, A.A.N.B. 2015. Pengaruh Kinerja Keuangan Daerah pada alokasi belanja modal di Provinsi Bali. ISSN: 2302-8556.
- 31) Muhammad Fauzan. (2006). Hukum Pemerintahan Daerah: Kajian tentang Hubungan Keuangan antara Pusat dan Daerah. UII Press.
- 32) Nurena, Salsabila Shiffa (2023) Pengaruh Kinerja Keuangan Daerah Terhadap Belanja Modal (Studi Kasus Kabupaten/Kota di Jawa Tengah tahun 2018 – 2021). Undergraduate thesis, Universitas Diponegoro.
- 33) Nuryanto, and Pambuko, Z. B. (2018). Eviews untuk Analisis Ekonometrika Dasar: Aplikasi dan Interpretasi (M. Setiyo (ed.)). UNIMMA PRESS.
- 34) Oktavianti, Y. A. (2020). Pengaruh Kinerja Keuangan Daerah Terhadap Belanja Modal Pada Kabupaten/Kota Di Provinsi Jawa Timur. *Jurnal Ilmu Dan Riset Akuntansi*, 9(11), 1–20.
- 35) Patarai, M. I. (2017). Kinerja Keuangan Daerah. Makasar: De La Macca.
- 36) Prihastuti, Asepma Hygi, Taufik Taufeni, dan Agusti Restu. (2015). Pengaruh Kinerja Keuangan terhadap Alokasi Belanja Modal dan Pertumbuhan Ekonomi di Kabupaten/Kota Riau. *Jurnal Ilmiah*, Vol.10, No.2:143 – 154 Lembaga Penelitian dan Pengabdian kepada Masyarakat Universitas Riau.
- 37) Purwanti, E., & Noviyanti, E. (2022). Analisis Kinerja Keuangan Daerah Pemerintah Kota Salatiga Tahun 2014-2018. *Among Makarti*, 14(2), 1–12. <https://doi.org/10.52353/ama.v14i2.213>.
- 38) Putri, R.S dan Rahayu, S. 2019. Pengaruh Kinerja Keuangan Pemerintah Daerah Terhadap Belanja Modal di Provinsi Jawa Barat. *JASa (Jurnal Akuntansi, Audit dan Sistem Informasi Akuntansi)*. Vol.3 No.2 Agustus 2019. ISSN 2655-8319.
- 39) Riswan, & Affandi, A. (2014). Pengaruh Kinerja Keuangan Daerah Terhadap Belanja Modal Untuk Pelayanan Publik Dalam Perspektif Teori Keagenan. *Jurnal Akuntansi Dan Keuangan*, 5(2), 71–90.

The Effect of Financial Performance and Budget Ratcheting on Capital Expenditure Allocation in Districts/Cities of Central Java Province

- 40) Sari, A. A. dan V. F. (2020) „Pengaruh Pendapatan Asli Daerah Terhadap Belanja Daerah dan Budget Ratcheting Sebagai Variabel Moderasi“, *Jurnal Eksplorasi Akuntansi*, 2(ISSN: 2656-3649), pp. 1984–2000.
- 41) Susanto, Anindyo Aji & Halim, Abdul. (2016). Efek Ratchet pada Anggaran Pemerintah Daerah: Studi pada Satuan Kerja Perangkat Daerah Pemerintah Provinsi Daerah Istimewa Yogyakarta. *Jurnal Akuntansi & Akuntabilitas Publik*, 1(1): 88-96.
- 42) Suyono. 2010. Analisis Kinerja Keuangan Pemerintah Daerah di Indonesia. Tesis. UNS.
- 43) Utari, L. P. S., & Palguna, I. G. R. (2020). Implementasi Penilaian Kinerja Karyawan Pada PT. GAE. *Jurnal Syntax Transformation*, 1(5), 5–24.
- 44) Weitzman, M. L. (1980). The Ratchet Principle and Performances Incentives. *The Bell Journal of Economics*, 11: 302-308.



There is an Open Access article, distributed under the term of the Creative Commons Attribution – Non Commercial 4.0 International (CC BY-NC 4.0 (<https://creativecommons.org/licenses/by-nc/4.0/>)), which permits remixing, adapting and building upon the work for non-commercial use, provided the original work is properly cited.