

Beyond Budget Allocation: Understanding Fiscal Trade-Offs and Spending Structure in Decentralized Governments

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Abstract

This study aims to examine fiscal trade-offs and spending structures within the context of decentralized local governments. The primary focus is to analyze how expenditure composition and fiscal behavior influence budget allocation decisions, particularly the trade-off between operational spending and capital expenditure. This research employs a quantitative approach with descriptive and explanatory design, utilizing panel data from local government financial reports across regencies and municipalities in Aceh Province over the period 2019–2023. Panel data regression analysis is applied to investigate the relationship between spending structure, fiscal behavior, and budget allocation trade-offs. The findings reveal that local government expenditure structures are predominantly driven by operational spending, especially personnel expenditures, while capital expenditure remains relatively low and shows a declining trend. This condition reflects increasing fiscal trade-offs, where short-term expenditure priorities tend to crowd out long-term investment. Furthermore, fiscal behavior demonstrates high expenditure elasticity relative to revenue, indicating a strong dependence on central government transfers, commonly associated with the flypaper effect. Empirical results confirm that both spending structure and fiscal behavior have a significant impact on budget allocation trade-offs. This study contributes to the literature on public financial management by providing insights into the implications of fiscal decentralization on expenditure quality. Policy implications highlight the need for budget reorientation toward more productive spending and strengthening local fiscal independence to support sustainable regional development.

Keywords: *Spending Structure; Fiscal Behavior; Budget Trade-Off; Fiscal Decentralization.*

Introduction

Public financial management is one of the government's main instruments in achieving economic and social development goals. The fiscal decentralization policy in Indonesia through laws (Indonesia, n.d.) and (Indonesia, 2004) that provide broad authority to regional governments to manage finances independently. The main instrument in this policy is the Regional Revenue and Expenditure Budget (APBD), which functions as an

instrument for resource allocation, distribution, and stabilization of the regional economy. Through fiscal policy, the government determines the direction of development by allocating the budget to priority sectors. However, the implementation of fiscal decentralization in various regions still faces serious challenges. Many local governments exhibit inefficient fiscal behavior (Toyyib, n.d.), with a dominance of operational spending and low allocation (Afryansyah, n.d.) for capital spending. This phenomenon has implications for limited fiscal space and weak long-term development capacity.

The structure of public expenditure, which encompasses both routine and development spending, directly reflects the government's preference for meeting public needs. However, the reality is that the government budget is never sufficient to simultaneously finance all public needs. Limited fiscal resources, both in terms of tax revenue and financing, force the government to face a dilemma in determining spending priorities. This situation gives rise to what is known as a fiscal trade-off, namely the need to choose between various public spending alternatives that are equally important but cannot be fully funded.

Trade-offs in budget allocation often create policy dilemmas. For example, increased infrastructure spending aimed at boosting long-term economic growth can reduce fiscal space for health or education spending, which are crucial for short-term public welfare. Conversely, populist increases in social spending can suppress fiscal capacity to finance productive investments in the future. This phenomenon demonstrates that every budget allocation decision always has consequences, both positive and negative, depending on the time perspective and underlying political interests. On the other hand, the government's fiscal behavior in facing trade-offs is also influenced by political (Saravistha, D. B., Widnyana, I. M. A., & Sancaya, 2021), economic, and institutional factors. The literature on fiscal behavior highlights various phenomena, such as the political budget cycle, where the government tends to increase spending before elections to gain political support; the flypaper effect (Parwati. Sayu Made, 2014), where transfer funds from the central government tend to be spent more than funds originating from internal sources; and fiscal illusion, where the public finds it difficult to objectively assess the efficiency of public spending due to limited information. These factors often make budget allocation decisions not fully reflect the real needs of the community, but rather short-term political interests or institutional weaknesses in fiscal management.

Aceh Province has had special fiscal characteristics through the Special Autonomy Fund (DOK) since 2008. However, since 2023, this fund has significantly decreased, limiting fiscal capacity. At the same time, regional spending in Aceh remains dominated by routine expenditures, while capital expenditures are relatively low. This situation creates a trade-off dilemma in budget allocation, particularly between personnel spending and public investment. The problem is further complicated by the lack of studies that specifically examine the relationship between expenditure structure, fiscal behavior, and budget allocation trade-offs at the regional level, particularly in regions with special fiscal characteristics such as Aceh.

Most of the existing studies still focus on the technical aspects of budgeting or spending efficiency (Huda, n.d.), the effects of transfers on fiscal behavior (Murniasih & Mulyadi, 2012), the diversity of budget increase patterns based on the strategic responses of local government officials in responding to the dynamics of bargaining power and pressure to justify the budget (Choi et al., 2021), political practices to form and use budgets to regulate public organizations and research results (Putri et al., 2024) examine how changes in the local revenue budget and profit sharing funds have a positive effect on changes in the capital expenditure budget, fiscal decentralization encourages improved government governance from the revenue side (Astriana, 2024). Furthermore, research (Perdana, 2017) the need for the development of a government revenue and expenditure management system, explains how budgeting moderated by organizational commitment and ethics can weaken the influence of participation on budgetary slack. These studies do not comprehensively link how local fiscal dynamics are influenced by diverse spending preferences. The limitations of studies that examine the relationship between fiscal behavior, expenditure composition and budget trade-offs at the regional level, especially in the Aceh region with its special fiscal characteristics, this problem becomes a gap to be studied through this basic research.

Research Question

The problems examined in this research are as follows:

1. What is the structure and trend of regional government spending in Aceh Province over the past five years, and what are the trends regarding operational and capital expenditures?
2. How are the characteristics of regional government fiscal behavior in Aceh reflected in the management of the Regional Revenue and Expenditure Budget (APBD), particularly in the context of fiscal decentralization and dependence on central transfer funds?
3. Is there a trade-off pattern between operational and capital expenditures in regional budget allocations?

Based on this background, it is important to conduct a baseline study in Aceh Province, which faces challenges in managing the Regional Budget (APBD) efficiently and sustainably. This challenge is particularly relevant in the context of the utilization of the Special Autonomy Fund, which has been declining since 2023. Furthermore, the dominance of operational expenditures in the budget structure indicates an imbalance in budget allocation, reflected in certain fiscal behaviors and carrying the risk of trade-offs against productive spending. Overall, this background suggests that Aceh Province requires a more rational, targeted, and evidence-based budgeting approach, minimizing detrimental trade-offs and strengthening integrity and accountability in public financial governance. Therefore, in-depth research is essential to examine how expenditure structures, fiscal behavior, and budget trade-offs are constructed in regional fiscal policy practices, so that applicable patterns, problems, and solutions can be identified to improve the quality of APBD management in Aceh Province.

This study aims to analyze the expenditure structure, fiscal behavior, and trade-offs in regional budget allocation in Aceh Province, and to examine their influence on capital expenditure allocation as an indicator of long-term development. Previous research has shown the existence of a flypaper effect (Suwanan & Sulistiani, 2009), in many regions in Indonesia where central transfers encourage spending more than PAD. However, research examining the relationship between expenditure structure, fiscal behavior, and trade-offs in Aceh is still limited, so this study fills this gap. This paper is expected to provide several benefits. First, theoretically, this article enriches the literature on public finance by linking the concepts of expenditure structure, trade-offs, and fiscal behavior in one analytical framework. Second, practically, this article provides a better understanding for policymakers about the consequences of each budget choice (Zainab, 2020) and budget implementation (Sofyani, 2018), thereby encouraging more rational and accountable decision-making.

Literature References

Fiscal Decentralization and Fiscal Behavior

Fiscal decentralization is believed to increase the efficiency of public services because local governments are considered to be more aware of community needs (Ginting et al., 2019). However, the literature also shows weaknesses, including increased bureaucratic costs and opportunities for inefficiency (Iliopoulos & De Witte, 2024). Regional autonomy and fiscal decentralization began its implementation in 2001 based on Law Number 22 of 1999 concerning Regional Government and Law Number 25 of 1999 concerning Financial Balance between the Central Government and Regional Governments. Decentralization is believed to be a policy and solution to economic and political problems (Abdullah & Fahira, 2024). The implementation of fiscal decentralization as the largest budget policy in Indonesia is characterized by the allocation of transfer funds to regions in the APBN. Until 2020, this policy has produced a lot of progress, however, the evaluation results indicate that the quality of policy implementation still needs to be improved (Widianto, 2024), nonetheless, fiscal decentralization has had a fairly good impact on the performance of governance in terms of revenue and expenditure (Zhang & Yuan, 2023).

In Indonesia, there are various variations in the fiscal behavior of local governments related to fiscal decentralization, some regions show proactive fiscal behavior by increasing Regional Original Income (PAD) (Parwati. Sayu Made, 2014) and allocating budgets to productive sectors, while there are also regions that show dependence on central fund transfers (Saravistha, D. B., Widnyana, I. M. A., & Sancaya, 2021), which indicates a flypaper effect with a tendency to increase regional taxes and spending in response to central government transfers (Murniasih & Mulyadi, 2012).

The concept of elasticity applied to public financial management relates to expenditures or local governments. The concept of elasticity, associated with expenditure or burdens relative to regional revenues (often called expenditure elasticity to revenue or

fiscal burden elasticity), describes the level of sensitivity or responsiveness of regional expenditures to changes in regional revenues. The elasticity of burdens to revenues indicates the extent to which changes in regional government burdens or expenditures result from changes in regional revenues. In public financial management, this elasticity is an important indicator for assessing the efficiency and sustainability of regional fiscal management. A high elasticity value indicates responsive expenditures to increases in revenues, potentially reducing fiscal discipline and creating long-term deficits. However, a low elasticity value reflects sound budget control and mature public financial management capacity.

Expenditure Structure in the Regional Budget

The regional government budget structure is an annual financial management framework that encompasses regional revenue, expenditure, and financing. This structure is designed to ensure the allocation of financial resources aligns with development priorities and community needs. Based on Minister of Home Affairs Regulation Number 21 of 2011 concerning Guidelines for Regional Financial Management, the Regional Budget (APBD) consists of regional revenue, regional expenditure, and regional financing. Regional revenue comes from Regional Original Revenue (PAD), balancing funds, and other legitimate income. PAD reflects the level of regional fiscal independence, while balancing funds serve to reduce fiscal inequality between regions. Regional expenditure is a regional government obligation that reduces net assets within one fiscal year as stipulated in Law Number 33 of 2004, which includes operational expenditure, capital expenditure, unexpected expenditure, and transfer expenditure. Meanwhile, regional financing includes financing receipts and expenditures. Overall, the budget structure is designed to support the implementation of regional autonomy through independent, effective, and accountable financial management.

The implementation of the expenditure structure is reflected in the realization of the Regional Budget (APBD) each year. In Aceh Province, the implementation of the expenditure structure displayed in this budget realization, for example, for 2023, shows that regional spending is focused on priority sectors such as education, health, and infrastructure. Capital expenditure allocations are used for the construction and maintenance of roads, bridges, and other public facilities aimed at improving connectivity and services in the region. Meanwhile, operating expenditures are routine expenses that include employee salaries and office operations for the continuity of government functions. In this study, researchers investigated the structure of local government expenditure and the trade-offs between various expenditures. In general, researchers focused on the extent to which regencies/municipalities demonstrate a consistent pattern in allocating their budget resources to specific sectors.

H1: The Employee Expenditure/Total Expenditure Ratio has a significant influence on the Budget Allocation Trade-Off

H2: The Capital Expenditure/Total Expenditure Ratio has a significant influence on the Budget Allocation Trade-Off

Budget Allocation Trade-Off

The budget allocation carried out by the regional government by making choices between various types of competing needs with limited resource conditions. The conditions faced by the regional government are known as trade-offs which are dilemma conditions for determining difficult choices to determine the scale of priorities (Eva et al., 2020). The limitations of the government budget are known in the term public policy with this budget constraint important for regional governments to pay attention to in terms of public financial management, because the budget allocation decisions as regional government policies taken will affect the effectiveness and efficiency of public services.

Based on public economic theory (Huda, n.d.) the government must determine spending priorities based on the marginal benefits of each expenditure for activities. However, increasing budget allocations for one sector will reduce funds available for other sectors. The trade-off principle in public budgeting theory shows that fiscal policy at the regional level can meet all demands (Pranoto, 2025). Local government spending, trade-off conditions often occur between operating expenses and capital expenditures. Operating expenses such as employee salaries and administrative costs are important for maintaining the continuity of services, but on the other hand capital expenditures such as infrastructure development have long-term impacts on economic growth and public welfare. Many local governments face challenges in allocating budgets efficiently (Perdana, 2017), local governments increase spending to improve public services and various facilities, but this increase does not provide public happiness (Suharna et al., 2015). Based on this research, spending by local governments reflects conditions that are not yet efficient for public services.

H3: Fiscal Behavior of Regional Governments has a significant influence on Budget Allocation Trade-Off

H4: The Expenditure Structure and Fiscal Behavior of Regional Governments simultaneously have a significant influence on the Budget Allocation Trade-Off

Research Methods

The study was conducted using a descriptive quantitative research design. Through this research design, researchers gain an understanding of the expenditure structure, fiscal behavior, and budget allocation trade-offs. This study analyzes how the expenditure structure and fiscal behavior influence budget trade-offs for regional development performance in Aceh Province. The research variables consist of the dependent variable, namely the budget trade-off for regional government budget allocation. This variable reflects how regional governments allocate budgets in the Regional Budget (APBD), specifically for capital expenditure and operational expenditure items (Iliopoulos & De Witte, 2024). Measurements are carried out on the proportion of budget allocations for each item, namely by determining the percentage of capital expenditure and operational expenditure allocations in the total APBD. The independent variables in this study are the structure of local government expenditure, namely the composition of expenditure in the district/municipality (Iliopoulos & De Witte, 2024) (APBD), which is obtained through the data of the local government Budget Realization Report, this variable is measured by the proportion of each type of expenditure in total expenditure. The variable of local government fiscal behavior, namely aspects of the government's tendency in allocating the budget, this variable uses the concept of expenditure elasticity to regional income. So it will be possible to measure the responsiveness of expenditure or budget allocation from year to year to regional income.

Data analysis was performed using multiple linear regression using Eviews with panel data. The panel data technique combines cross-section and time series data types. The statistical tests used consisted of descriptive tests that describe the characteristics of the data. Next, classical assumption tests and inferential tests were used to draw conclusions from the data using t-tests and multiple linear regression tests. Data analysis was performed

using panel regression (CEM, FEM, REM). The Chow, Hausman, and Lagrange Multiplier tests were used to select the best model. The panel data model equation is as follows:

$$TO_{it} = \alpha + \beta_1 SE_{it} + \beta_2 FB_{it} + \varepsilon_{it} \quad (1)$$

TO_{it} = Trade-off of budget allocation i in year t

SE_{it} = Expenditure Structure or Expenditure Composition i in year t

FB_{it} = Fiscal behavior of local governments i in year t

$\beta_{1,2}$ = Regression coefficient

α = Constanta

ε_{it} = Error term.

Results and Discussion

The results of this study's descriptive analysis include the mean, maximum, minimum, and standard deviation. A summary of the analysis results is presented in the following table:

Table 1. Descriptive Analysis

Variable	N	Mean	Maximum	Minimum	SD
ES1	115	0,728	6,659	0,519	0,564
ES2	115	0,181	1,224	0,056	0,115
FB	115	0,408	39,439	-50,548	7,516
TO	115	2,493	6,362	0,794	1,081

Source: Data processing results (2025)

Research results from 115 observations conducted in 23 regencies/cities in Aceh Province for the 2019–2023 period revealed an average ratio of employee expenditures to total expenditures of 0.728 with a standard deviation of 0.564. The maximum value of 6.659 was found in Simeulue Regency in 2020, while the minimum value of 0.519 was found in Aceh Besar Regency in 2020. Furthermore, the average ratio of capital expenditures to total expenditures was recorded at 0.181 with a standard deviation of 0.115. The maximum value of 1.224 was found in Simeulue Regency in 2020, while the minimum value of 0.056 was found in Aceh Besar Regency in 2023.

The structure of local government expenditure in Aceh for this period was dominated by employee expenditures, with an average of 72.8%, while capital expenditures

accounted for only 18.1%. From the observed trends, employee spending is relatively high and shows an increasing trend, especially in 2020, while capital spending experiences a continuous decline from 23.1% in 2019 to 10.6% in 2023. Based on this trend, it can be concluded that the budget orientation is more directed towards operational spending than capital spending.

The average elasticity was 0.408 with a standard deviation of 7.516, indicating quite varied distribution of elasticity data across regencies/cities in Aceh Province. The maximum value obtained was 39.439 for Central Aceh Regency in 2020, while the minimum value was -50.548 for East Aceh Regency in 2021. The average budget allocation trade-off across regencies/cities in Aceh Province during this study period was 2.493 with a standard deviation of 1.081. The maximum value was 6.362 for East Aceh Regency in 2023, and the minimum value was 0.794 for Subulussalam City in 2022. The ratio of employee expenditures to capital expenditures is used as an indicator to identify trade-offs in regional budget allocation. Based on the calculation results, the ratio shows an increasing trend from 1,812 in 2019 to 3,777 in 2023. This indicates that the proportion of employee spending is increasing compared to capital spending, so that budget allocation tends to be directed more towards operational spending.

Based on the Chow test results, it was concluded that the model was more suitable for estimation using fixed effects rather than the common effects model, because the probability value obtained was less than 0.05. Therefore, further testing was carried out using the Hausman test. The Hausman test was conducted to determine the model choice between the fixed effects model and the random effects model. The test results showed that the research data was more suitable for estimation using the random effects model (REM), as the probability value obtained was greater than 0.05.

The results of the Classical assumption test consist of normality testing showing a probability value (p) greater than 0.05 which means the residuals in both regression models are normally distributed. Thus, the normality assumption has been met. For the Multicollinearity Assumption Test Results, the model is free from multicollinearity, because all independent variables included in the model have a VIF value smaller than 10. The

results of the Heteroscedasticity Assumption Test using the Glejser test, obtained results that the model does not contain symptoms of heteroscedasticity. The results of the autocorrelation test with the Durbin - Watson (dW) value, the dW value is between the dU and 4-dU values which indicate there are no autocorrelation problems in the two models to be formed, so the model has met the assumptions for regression testing.

Based on the results of the model selection test using the Chow test and the Hausman test, it can be concluded that the most appropriate model for use in this study is the Random Effect (REM) model. The selection of this model indicates that differences in budget allocation trade-off values are likely caused by the unique characteristics of each Regency/City which are random and cannot be observed directly. By using this model, the following regression equation is obtained:

$$TO = 1,404 + 0,763 \text{ ES1} - 4,156 \text{ ES2} + 0,003 \text{ FB} \quad (2)$$

The regression coefficient test results for the Employee Expenditure/Total Expenditure Ratio (SP1) variable are 0.763 and have a positive value, meaning that every increase in the Employee Expenditure/Total Expenditure Ratio (SP1) assuming that other independent variables are in constant condition, is predicted to increase the Budget Allocation Trade-Off value by 0.763. Meanwhile, the regression coefficient for the Capital Expenditure/Total Expenditure Ratio (SP2) variable is -4.156 and has a negative value, meaning that every increase in the Capital Expenditure/Total Expenditure Ratio (SP2) assuming that other independent variables are in constant condition, is predicted to decrease the Budget Allocation Trade-Off value by 4.156. The regression coefficient for the Regional Government Fiscal Behavior (FB) variable is 0.003 and has a positive value, meaning that every time there is an increase in the value of Regional Government Fiscal Behavior (FB) with the assumption that other independent variables are in constant condition, it is predicted that the Budget Allocation Trade-Off value will increase by 0.003.

Table 2. T-Test

Model	t	t _{table}	α	P	Decision	Conclusion
SP1 → TO	24,193	1,982	0,05	0,000	H1 Accept	Significant
SP2 → TO	-27,237	-1,982	0,05	0,000	H2 Accept	Significant

PF → TO	2,852	1,982	0,05	0,005	H3 Accept	Significant
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Source: Data processing results (2025)

Based on table 2, the results of the t-test, it was concluded that the Employee Expenditure/Total Expenditure Ratio has a significant influence on the Budget Allocation Trade-Off, with a confidence level of 95% it can be decided to support H1. Hypothesis testing (t-test) shown in table 2 for Capital Expenditure/Total Expenditure has a significant influence on Budget Allocation Trade-Off, which means that the decision to support H2. Based on the results of the t-test, it was concluded that the Fiscal Behavior of Regional Governments has a significant influence on the Budget Allocation Trade-Off. Hereafter, the results of the t-test for the Regional Government Fiscal Behavior variable have a significant influence on the Budget Allocation Trade-Off.

Table 3. F-Test

Model	F	F _{table}	α	P	Decision	Conclusion
SP1, SP2, PF → TO	262,48 7	2,686	0,05	0,000 0	H4 Accept	Significant

Source: Data processing results (2025)

Based on Table 3, the results of the simultaneous hypothesis test (F test) in the Random Effect model (REM), it can be decided to accept H4 that the Expenditure Structure and Fiscal Behavior of Regional Governments simultaneously have a significant influence on the Budget Allocation Trade-Off.

The results of a panel regression test using a random effects model indicate that simultaneously, the variables of expenditure structure, fiscal behavior, and trade-off significantly influence regional government budget allocation. This indicates that these three variables interact with each other in influencing regional spending allocation patterns in Aceh. These results are consistent with the literature on regional fiscal behavior in developing countries, which shows that fiscal constraints often force regional governments to make compromises in the form of trade-offs. In the case of Aceh, the dominance of routine spending reinforces a pattern of trade-offs that is detrimental to long-term development.

The analysis shows that the structure of regional government expenditure in Aceh Province for the 2019–2023 period is dominated by personnel expenditures, averaging 72.8% of total regional expenditures, while capital expenditures account for only 18.1%. This reflects a short-term fiscal orientation, as consumptive operational expenditures are prioritized over long-term productive investments. Furthermore, there was a significant decline in the share of capital expenditures, from 23.1% in 2019 to 10.6% in 2023, while personnel expenditures continued to increase, particularly during the COVID-19 pandemic. This phenomenon indicates a trade-off and crowding out, where increased routine spending suppresses fiscal space for development. These findings align with previous research suggesting that the dominance of operational expenditures is influenced by political factors, bureaucracy, and government administrative needs. In Aceh, this situation has been further exacerbated by the reduction in the Special Autonomy Fund since 2023, which has reduced regional fiscal capacity for investment and infrastructure development.

The analysis shows that the fiscal behavior of local governments in Aceh is still characterized by the flypaper effect, where regional spending is more influenced by central transfers than by Regional Original Revenue (PAD). This condition reflects high fiscal dependence on the central government and low regional incentives to optimize PAD. The average fiscal elasticity value of 0.408, with high variation between regions, indicates that fiscal behavior in Aceh is not homogeneous. Central Aceh shows more proactive fiscal behavior, while East Aceh reflects weak fiscal capacity. These differences are influenced by local economic, governance, and political factors. High dependence on central transfers has the potential to weaken regional fiscal independence and sustainability, especially amidst the decline in Special Autonomy Funds, so it is necessary to optimize PAD and reorient spending to more productive sectors.

The research results show an increase in the ratio of employee spending to capital spending from 1,812 in 2019 to 3,777 in 2023, indicating a growing trade-off in regional budget allocation. Increased employee spending tends to suppress capital spending, thereby limiting fiscal space for development investment. This situation hampers infrastructure development and long-term economic growth. This phenomenon aligns with

the budgetary trade-off theory, which explains that fiscal constraints force the government to reduce allocations to one sector to increase others. Furthermore, indications of budgetary slack were found, namely the tendency to over-allocate operational budgets, creating the illusion of budget limitations for productive spending.

Conclusion

1. The structure of regional government expenditure in Aceh for the 2019–2023 period was dominated by personnel expenditures, while capital expenditures continued to decline, resulting in a budget orientation that tended to focus on short-term operational expenditures.
2. A trade-off occurs in budget allocation, where increases in personnel expenditures are accompanied by decreases in capital expenditures, resulting in reduced fiscal space for regional development investment.
3. The fiscal behavior of regional governments in Aceh still exhibits a high dependence on central transfers (flypaper effect), resulting in a relatively low level of regional fiscal independence.
4. Expenditure structure and fiscal behavior significantly influence budget allocation trade-offs, both simultaneously and partially. Increases in personnel expenditures and fiscal elasticity tend to increase trade-offs, while increases in capital expenditures can decrease them.
5. Panel data regression results indicate that expenditure structure, fiscal behavior, and trade-offs significantly influence regional government budget allocation in Aceh.
6. Regional government fiscal policy in Aceh still faces a dilemma between meeting short-term needs and long-term development, necessitating a reorientation of regional financial management to be more productive and sustainable.

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