

## Political Budget Cycles: Controllable or Uncontrollable?

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### ABSTRACT

*This research synthesizes several literatures about Political Budget Cycles practice (PBC). PBC practice is a universal phenomenon that is possible to happen in political cycle. PBC depicts changing pattern in economic policy that inclines to the increasing budget spending in years before the election which will return to its normal spending after the election year by managing macroeconomic policy. This study aims to further develop PBC practice determinants based on some empirical studies in various countries. Another objective is to provide reasoning whether PBC practice controllable or uncontrollable. This research provides explanation that PBC is uncontrollable if a direct election is held in developing country, there is asymmetry of budget information and incumbent that manages the discretionary fund. Finally, this study shows that there is an important area for further research that PBC size depends on the institutional context in a country.*

*Keywords: Political Budget Cycles; discretionary fund; election year.*

### INTRODUCTION

Budget is a statement of intended performance estimation for a certain period of time, stated in financial measurement (Purwanto, 2016). In a public sector organization, budget is a rather complicated step that is highly affected by political nuance (Mardiasmo, 2009). Public sector budget is often viewed as a moment to fight for public resources of various group interests, both from actors in political system and other group interests who have influence on political budget decision (Farhan, 2013).

Shi & Svensson, (2006) stated that budget option is affected by political election cycle. More specifically, literature finding shows that the upcoming political election encourages the rise of deficit and prevents fiscal reformation and those two trends will often happen in years after the political election (Purwanto, 2016).

Therefore, after the last election, a change of budget can be predicted as the impact of the preparation of political election. The change of budget is done by cutting the spending or other costs that are increased as the effect of political election preparation, especially for incumbents who want to continue his electability on the next period. One of the strategies of the incumbent is by managing the discretionary fund spending to boost the prospect of his re-electability. This indicates the budget to be controllable or uncontrollable.

Previous study which synthesized several literatures about Political Budget Cycles (PBC) were hardly ever done. Coming from a literature review by de Haan & Klomp, (2013) about PBC, the author intends to study by linking whether PBC practice is controlled or uncontrolled. Thus, this research contributes to PBC, whether it is controlled or uncontrolled, as the background and literature review for further researches. Literature review by de Haan & Klomp, (2013) stated that factors behind PBC practice in a country come from the level of development, quality of agencies, age and level of democracy, rules of the election and the government form, transparency of political process, presence of checks and balances, as well as fiscal policies.

Later, after PBC practice is entering its fourth decade, the need to synthesize this practice will be necessary. This article intends to provide a synthesis by dividing it to two parts. The first part is to explain the literature reviews and define PBC as well further develop PBC practice based on empirical study in several countries. The second part will provide an explanation whether PBC practice is controllable or uncontrollable.

### **LITERATURE REVIEW**

**Definition of PBC.** Budget is a political document as an executive commitment and legislative agreement on public fund using for certain purpose, making budget is no longer a technical problem (Mardiasmo, 2009), but more a political tool (Halim & Kusufi, 2012; Mardiasmo, 2009). The implementation of budget in a country is not separated from its affecting policies; one of them is economic macro policy. Studies of political economy that relate the political election cycle with macroeconomic policy have been done in recent 40 years. It is generally known that the incumbents often expand the economic policy before the election year to boost their re-electability.

In literatures about political economy, this view is called Political Budget Cycles (PBC). PBC is defined as the macroeconomic probable cycle that is affected by a political cycle (Setiawan & Rizkiah, 2017). Previously, Nordhaus, (1975) presented that theory by Political Business Cycle. Afterwards, Nordhaus, (1975) questioned how politician decide on the upcoming election, for government will decided between current welfare and future welfare. The macroeconomy policy encouraged by Nordhaus, (1975) pioneering work about PBC hypotheses that government will manage the economical policy before the election years to maximum their probability to be re-elected.

Nordhaus, (1975) suggest a model for incumbent to manage the macroeconomic policy to get electoral benefit, assuming that the voters will choose retrospectively, so the incumbent will put an effort to set the economical decision that is desired the most by expanding fiscal policy to encourage the economy so it will create a “favorable” condition that will finally lead to electoral benefit. As the impact, these models imply that government, apart from ideology orientation, adopt an expansive fiscal policy before election year to stimulate economy activity.

To describe the relationship between fiscal policy expansion and election year, Rogoff, (1990) introduced PBC term which explains that the politicians of the electoral year will influence the potential voters using financial instruments. In this article, the author includes a wide-based PBC inclusive definition that combines the macroeconomic policy dimension with political election cycle which explicitly agreeing the role of the incumbents in their re-electability dynamic

(Nordhaus, 1975; Rogoff, 1990; Setiawan & Rizkiah, 2017).

*PBC depicts the changing pattern of the macroeconomic policy that inclines to the increasing of budget spending in years before the election year which will return to its normal spending after the election year by the current politician in electoral period by managing the macroeconomic policy to stimulate the economic activity leads to the gaining of voters' sympathy.*

**Empirical study about PBC in various countries.** PBC model comes from the assumption that a good macroeconomic condition before the election year will help the incumbents to be re-elected (Brender & Drazen, 2005). In recent models, signaling is the driving force behind PBC practice. The stakeholders will use the government spending to boost macroeconomic performance on period before the election years in efforts to signal their competency.

Rogoff, (1990) offer a balance theory that maintains some insights from previous model, emphasizing fiscal policy rather than output and inflation. Rogoff, (1990) also explained that the emphasis on fiscal policy, rather than output and inflation, comes from multi dimension signaling process. Study by Rogoff & Sibert, (1988) and Shi & Svensson, (2006) explained that the signaling is the power behind PBC practice. Both studies emphasize the temporary role of information asymmetry of politician competency to explain election cycle in fiscal policies.

Empirical studies have proven that PBC is practiced in several countries; some of which are developed countries and developing countries. A study by Shi & Svensson, (2006) for 21 years from 1975 to 1995 found that there was PBC practice and there was system difference in developed country and developing country. Shi & Svensson, (2006) also marked that PBC has higher chance in developing country and lower or even no chance in developed country. Further research was done by Brender & Drazen, (2005) who studied PBC using panel data in 68 countries from 1960 until 2001. Brender & Drazen, (2005) agreed Shi & Svensson, (2006), that PBC phenomenon is happened in developing country which may reflect the low level democracy of those countries.

Argument built that PBC is not happened in all countries, but influenced by the experience newly democratic countries and developing countries. A country is a newly democratic country when there had been four competitive elections on the country (Farhan, 2013). Study finding by Brender & Drazen, (2005) showed that when those newly democratic countries were eliminated from sample study, PBC practice was automatically eliminated too. There was no evidence that PBC is practiced in countries that have practiced democracy for a long time, including (Organisation for Economic Cooperation and Development (OECD) countries and countries with high level of democracy.

Next study was done in Sudan for 1956 – 1992 time period (Abdel-Rahman, 1997). Study finding Abdel-Rahman, (1997) showed that Sudan has been through big politic and economic turbulences and after four decades, there was an evidence of PBC

practice. That finding indicates that it is easy to manipulate political instruments and it is harder to control the result of the policy (Abdel-Rahman, 1997).

The next study was done in London Metropolitan Boroughs from 1902 until 1937. Study finding by Aidt & Mooney (2014) showed that PBC is opportunistic in London Metropolitan Boroughs between 1902 – 1937 time periods under two different suffrage regimes. The taxpayer's suffrage from 1902 to 1914 in which the right to vote and its linkage with the obligation to pay local tax encourages the saving and PBC manifested itself in tax cut and save in election year, while the universal vote rights in 1921 to 1937, in which all the adults had the right to vote regardless their taxpayer status that encouraged demand for productive public services and PBC manifested itself in the election year in a form of modal spending increase and reduction of spending (Aidt & Mooney, 2014). Next is Portuguese state between 1979 and 1983 and 1986 to 2006 showed that the politicians systematically manipulated the economic and fiscal policies in the year before the election to higher their chance to be re-elected (Aidt, Veiga, & Veiga, 2011). That result is followed by the governments of ten provinces in Canada in 1951 to 1984 which showed that the politicians manipulated the government output to uphold their re-electability chances (Blais & Nadeau, 1992). Furthermore, the major fiscal performance of Israel in 1988 period was substantially influenced by the re-electability probability (Brender, 2003).

Studies to evaluate the PBC on local government have provided various findings (Klomp & de Haan, 2013). In local government in Indonesia, Ritonga & Alam, (2010) found that allocation of grant funds and people's support to uphold the area of the incumbents in 96 regions in election years is higher than the year before the district head election year in 2009 until 2010. The local governments used their authority to higher their probabilities to win the election (Setiawan & Rizkiah, 2017).

Because the voters are expected to evaluate the candidate based on past track records, the executives who have complete authorities on fiscal policies may intentionally allocate the discretionary fund strategically on important point of time on their period to give a good impression on people to increase their re-electability chances (Setiawan & Rizkiah, 2017; Sjahrir, Kis-katos, & Schulze, 2013). This discretionary fund is usually budgeted for a grant, social aid related fund, or other financial aid to lower level of regions (districts or villages) (Setiawan & Rizkiah, 2017).

Study finding by Setiawan & Rizkiah, (2017) in 451 regencies and cities in Indonesia that held direct local election in 2010-2014 showed an opportunistic PBC pattern in budget balance, total spending, grant spending, and financial aid spending. There was an increase in local budget deficit in years of election with the spending which also increases in years of election, followed by donation and spending for financial aid (Setiawan & Rizkiah, 2017). Study by Arifin & Purnomowati, (2017) from 2008 to 2013 in 492 regencies and cities in Indonesia that held direct local election found that the budget allocation for social aid and grant are more possible to increase in two years before the election years. This increase gets higher on years before the election years and they found weak evidence of PBC between incumbents in the election year (Arifin & Purnomowati, 2017).

On the other hand, Winoto & Falikhaturun, (2015) found no indication of the misuse of grant funds and social aids before the local election in 2015 in 143 regencies and cities in Indonesia. The heads of those districts tend to use discretionary fund to gain sympathies of their potential voters to re-elect them on the Head of District

election in 2015 compared to other heads of districts who were not an incumbent. Bottom line assumption on theoretical framework of PBC is the re-electability chances can be escalated through general expansive fiscal policy and in certain election years (Brender & Drazen, 2008). A good economy performance may increase the re-electability chance as long as expansive fiscal policy can be used to manage macroeconomic policy result and encourage the higher growth which signals competency and in turn gains voters for stakeholders (Setiawan & Rizkiah, 2017).

## RESULT AND DISCUSSION

**PBC practice: for whom?** The incumbents will get favorable condition and gain electoral benefit with PBC practice. So do the people. PBC practice determines the welfare of the people in both before and after the election year. The incumbent who allocates the discretionary fund to gain sympathy of the potential voters, the people, will most probably increase the welfare of the people compared to the period before.

**Controllable.** Related to the countries that have experienced democracy, the developed country as well as the strong and effective check and balances so the budget is most probably controllable in the Figure 1. Study finding by (Brender, 2003) showed that the effect of fiscal performance of elected local government in Israel in 1989 and 1993 which revealed that PBC did not occur. As the explanation, there was changing in political environment, audit enforcement, requirements in financial report, more tightens in budget which is more difficult, as well as the development of local media. It proves that there is low chance or even no chance of PBC practice if the check and balance activity is strong and effective in a country.

**Uncontrollable.** Related to the direct election in developing country, there is asymmetry of information and incumbents who manage the discretionary fund that are possible to have uncontrollable budget in the Figure 1. **Direct Election in Developing Country.** Sjahrir et al., (2013) analyzed the PBC effect on direct and indirect election in Indonesia and found that political budget cycle is significant only in regions that held direct election, not those who did not hold direct election, and PBC significantly occurs when the incumbents run for re-election. **Asymmetry of Budget Information.** Further, Rogoff & Sibert, (1988) assumed that the voters have rational expectation but undergo asymmetry information about available level of competencies. Rogoff, (1990) explained that in the election year there is drastic changing in budget posture, in which there is tax cut, transfer increase and unusual spend through various project. Politicians in electoral period want to show the potential voters that the incumbents have the competency by performing

the government task efficiently (Farhan, 2013). Theoretical model developed by Rogoff & Sibert, (1988) expounded PBC practice with rational voters who undergo asymmetrical information about the elected official competency. To encourage the growth before the election year, the incumbent may increase the spending and employment, which further will be responded positively by potential voters without

knowing that inflation will rise again, and the result of the spending and employment will return to the previous level (Farhan, 2013). **Incumbents Who Manage Discretionary Fund.** Winoto & Falikhatun, (2015) investigated the possibility of misuse of discretionary fund in local government budget, but found no indication of grant fund and social aids misuse before the local election in 2015. So did Sjahrir et al., (2013) who found significant increase of discretionary fund in year of election, and PBC is significantly stronger when the incumbent runs for re-election. On discretionary spending category, Ritonga & Alam, (2010) investigated allocation of grant fund and social aids (social aid fund) between the incumbents and non incumbents and revealed that the allocation of grant fund and social aids in incumbents region is higher in election year compared to the year before the election.

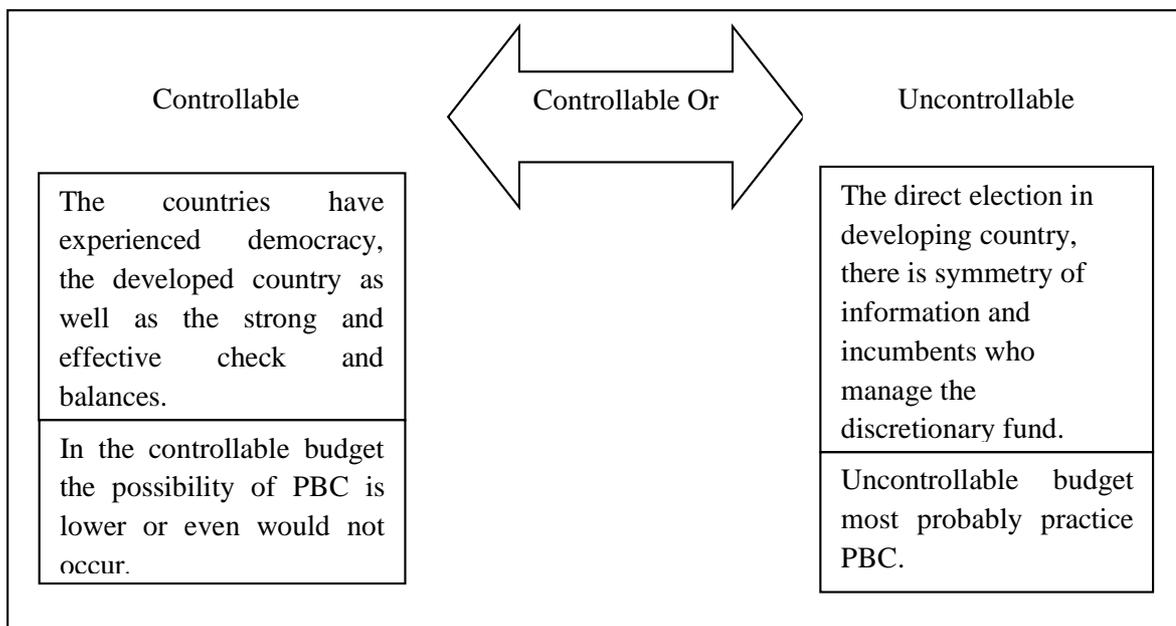


Figure 1. Political Budget Cycles: Controllable or Uncontrollable?

**Upcoming Research.** Lastly, this study showed that there are important areas for further research that PBC size may depend on the institutional context in a country. This contrast leads to several questions, especially in researches about PBC.

- ❖ Based on previous researches which found that the allocation of grant fund and people support in year of election is higher than the year before the election year of the regional head, is it possible the allocation of grant fund and people support is also higher in local election in 2018 and 2019 compared to the year before the election, considering there are more total samples of regencies/cities?
- ❖ Based on previous research that found no indication of grant fund and social aid misuse in year before the local election in 2015; is there any indication of

grant fund and social aid misuse in the local election in 2018, considering there are more total samples of regencies/cities?

- ❖ Based on empirical studies about democratic countries that do not practice PBC, is there any possibility to not practice PBC from 2014 to 2018 considering Indonesia has held direct election more than four times competitively?
- ❖ Based on the implementation of budget reporting transparency through publications by each related party, is there any possibility that PBC would not occur from 2014 to 2018 in Indonesia?
- ❖ Based on previous empirical studies that had not included other countries, such as Brunei Darussalam and Singapore as samples, is there any possibility for both countries to practice PBC?
- ❖ Related to the countries that have experienced democracy, the developed country as well as the strong and effective check and balances so the budget is most probably controllable, would PBC still not occur in the coming period through empirical evidence?
- ❖ Related to the direct election in developing country, there is asymmetry of information and incumbents who manage the discretionary fund that are possible to have uncontrollable budget, does PBC continue to occur in the coming period through empirical evidence?

This study synthesizes several literatures about PBC practice which provides understanding whether PBC is possible to be controllable or uncontrollable. In the controllable budget the possibility of PBC is lower or even would not occur. In countries which are experienced the democracy, developed country and the effective check and balance possibly have controllable budget. Uncontrollable budget most probably practice PBC. Direct election in developing country there is asymmetry of budget information and incumbents that manage the discretionary fund which more possibly have uncontrolled budget.

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