

Financial Performance of Local Governments Before and After Refocusing and Budget Reallocation Policy for Handling Covid-19 In Indonesia

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Abstract

The pandemic of COVID-19 requires all levels of government to take action under a broad context of economic uncertainty and social pressures. In Indonesia, a policy of refocusing and reallocating the budget is implemented as a regional government action to overcome the impact of Covid-19. The purpose of this research is to examine the impact of refocusing and budget reallocation policies on the fiscal health of Indonesian municipalities in the wake of the Covid-19 outbreak. The sample in this study uses districts and cities in Indonesia. The Regional Government Financial Reports for 2018 and 2019 represent the pre-refocusing and budget reallocation years, then 2020 and 2021 as the years and post-refocusing and budget reallocation. Using the independence and effectiveness ratios, the results demonstrate that pre- and post-refocusing and budget reallocation regional governments differed significantly in their financial performance. The efficiency ratio, however, shows no change between the pre- and post-refocusing and budget reallocation.

Keywords: *Covid-19 pandemic, financial performance, refocusing, and budget reallocation.*

Abstrak

Pandemi COVID-19 mengharuskan semua tingkat pemerintahan untuk bertindak dalam konteks ketidakpastian ekonomi yang meluas dan tekanan sosial. Di Indonesia, kebijakan refocusing dan realokasi anggaran sedang diterapkan sebagai tindakan pemerintah daerah untuk mengatasi dampak Covid-19. Tujuan dari penelitian ini adalah untuk mengkaji dampak kebijakan refocusing dan realokasi anggaran terhadap kesehatan fiskal pemerintah daerah di Indonesia pasca merebaknya wabah Covid-19. Sampel dalam penelitian ini menggunakan kabupaten dan kota di Indonesia. Laporan Keuangan Pemerintah Daerah Tahun 2018 dan 2019 adalah tahun sebelum refokus dan realokasi anggaran, kemudian tahun 2020 dan 2021 sebagai tahun dan setelah refokus dan realokasi anggaran. Dengan menggunakan rasio independensi dan efektivitas, hasilnya menunjukkan bahwa sebelum dan sesudah refocusing dan realokasi anggaran pemerintah daerah berbeda secara signifikan dalam kinerja keuangannya. Namun, rasio efisiensi menunjukkan tidak ada perubahan antara sebelum dan sesudah refocusing dan realokasi anggaran.

Kata Kunci: *Kinerja keuangan, pandemi covid-19, refocusing and budget reallocation.*

1. INTRODUCTION

Covid-19 has spread across nearly all of the world's land masses. The President of Indonesia announced the official Covid-19 on March 2, 2020. In an article titled "The Effect of the Covid-19 Epidemic on Subnational Finances, Emergency Governance for Cities and Regions," United Cities and Local Government (UCLG) explains how the spread of the virus

has strained local and national budgets, especially for public health. As a result of the closure of borders inside countries, Covid-19 has hurt national economies (UCLG, 2021). Foreign trade, foreign direct investment, and unemployment have all increased significantly in developed and developing countries, and each is a vital indicator of the success of the national economy. In addition, it has been noted that the level of poverty has risen dramatically in developing nations (Heald and Hodges, 2020). The pandemic of COVID-19 requires all levels of government to take action under a broad context of uncertainty and below significant economic, financial, and social pressures.

As the number of COVID-19 cases reported in Indonesia continues to rise, there is a pressing need for the central and regional governments to work together to respond to the outbreak and lessen its impact, as well as to follow up on the implementation of Government Regulation in place of Law (PERPU) Number 1 of 2020. Due to the Joint Decree No. 119/2813/SJ and 117/KMK.07/2020 of the Ministers of Home Affairs and Finance on the Acceleration of Adjustment of the local government budget in the Context of Handling the COVID-19 Pandemic, as well as Safeguarding the People's Purchasing Power and the National Economy, the Regional Government must quickly revise the local government budget. This Joint Order describes the steps taken by Regional Heads to reallocate and refocus the local government budget.

The number of Covid-19 cases reported in Indonesia has skyrocketed in 2021. In July 2021, thousands of people died, especially in Indonesia, after a new strain of the Covid-19 variant of the delta virus was found in India (Puspita and Pangastuti, 2022). Therefore, on August 9, 2021, the Minister of Home Affairs and the Minister of Finance issued Circular No. 903/4253/SJ and SE-2MK.07/2021 concerning the Acceleration of the Implementation of Refocusing and Reallocation of the local government budget for the 2021 Fiscal Year in the Context of Funding for Handling the Covid-19 Pandemic and its Impact. This circular letter aims to guide local governments in budgeting and implementing local government budget refocusing and reallocation to manage Covid-19 and accelerate economic recovery in 2021. So, we can say that the policy of refocusing and reallocating the budget toward regional revenues and expenses to deal with the bad effects of Covid-19 was put into place in 2020 and 2021.

The Central Statistical Agency (BPS) reported that in 2021, Indonesia's Economy increased by 3.96%, up from the -2.07% growth seen in 2020. One indicator of this is that the Health Services and Social Activities Business Field saw the highest rate of expansion in terms of output (10.46%) among all other sectors. Java provinces dominated the Indonesian economy in 2021. Regional economic performance on the island of Java grew by 3.66%, and regional groups on the island of Java contributed 57.89% to the economy (bps.go.id). To ascertain whether government policies designed to mitigate the impact of Covid-19 on regional financial performance have been successful, an analysis of regional government financial performance is carried out. The results of this analysis are crucial for gauging the efficacy of local governments and guiding decisions on regional financial management. Quality financial reporting is essential if the government accomplishes its goal of transparent and responsible corporate governance (Dharma, 2022). Information that is helpful to its users, will be generated via high-quality financial reporting (Gamayuni, 2012).

According to Wang et al. (2022), the Covid-19 epidemic has affected the Chinese economy. According to Hu et al. (2022), the economic crisis hit China's significant cities particularly hard since they were more exposed to Covid-19. Wu and Lin (2020) found that the Chinese government has re-budgeted to deal with the Covid-19 epidemic, with the goal of economic recovery and specific support for small and medium enterprises and tax reductions for all companies in China. Economic slump as a negative influence of Covid-19 is also felt in Central and Eastern European Countries, Nigeria, and Russia, as evidenced by the work of Brada et al. (2021), Ozili (2021), and Klimanov et al. (2021).

Research by Aldila and Estiningrum (2022) on the implementation of budget refocusing and reallocation policies at the Blitar City Cooperatives and Micro Business Service found that the strategies implemented, such as budget revisions, program delays, or budget absorption activities, were quite successful. Okfitasari et al. (2021) study found that localities with less exposure to Covid-19 have prioritized and reallocated their funds more heavily, and vice versa. Local government budget refocusing in Indonesia was shown to be affected by factors such as recovery speed and economic impact, according to research by Rachmadani et al. (2022).

Based on the results of the study above, there has not been much research on local governments in Indonesia that discusses the impact of policy refocusing and budget reallocation on their budgets and financial conditions. As a result, the researcher wants to examine the impact of refocusing and budget reallocation policies in response to Covid-19 on the financial performance of local governments by including additional research years, namely 2018 and 2019, as the years before the refocusing policy and budget reallocation, and 2020 and 2021 as the years after the refocusing policy and budget reallocation. The purpose of this research is to compare the fiscal health of district and city administrations in Indonesia before and after implementing policy refocusing and budget reallocation. Cities and municipalities throughout Indonesia are the focus of this study.

2. LITERATURE REVIEW AND HYPOTHESES

Agency Theory

According to Jensen and Meckling (1976), an agency relationship is a contractual arrangement in which one or more parties (principal) involve or employ another party (agent) to carry out an activity that requires the principal to provide the agent discretion over relevant matters. For this to work, the principal must delegate authority to the agent. Concerns like moral hazard and adverse selection surface when thinking about agency theory. There is a risk of a moral hazard developing if the agent fails to fulfill the duties specified in the employment contract. When it is not apparent whether the agent's choice was influenced by the data gathered or resulted from a breach of duty on the agent's side, the principal is said to have been subjected to adverse selection. For agency theory to work, it is assumed that the principal and the agent have different levels of knowledge about the situation. According to agency theory, it is vital to keep tabs on local governments to ensure they follow the rules. This could reduce information disparity and boost the transparency of municipal governments.

Budget Refocusing and Reallocation

Presidential Directive Number 4 of 2020, titled "Activity Refocusing, Budget Reallocation, and Acquisition of Products and Services in the Context of Accelerated

Processing of Covid-19," the term "budget reallocation" refers to shifting resources around to meet a different set of objectives, whereas "refocusing" refers to shifting one's attention from one activity to another that one believes would yield better results (Rachmadani et al., 2022). To maintain national economic stability, refocusing and reallocating the budget is one option to reduce the likelihood of a recession. In the face of global economic shocks that cause the economic system to collapse owing to inadequate conditions or a crisis, a country may choose to refocus its efforts to ensure financial stability (Okfitasari et al., 2021). To keep a country's economy from collapsing during a recession or other financial crisis, it's essential to apply the principle of refocusing. The Refocusing and Reallocation of Budget Expenditures, as stated in SE Number S30/MK.02/2021, aims to facilitate activity planning, coordination of implementation, and monitoring and evaluation of activities, including shifting between organizational units, between functions, and/or between programs, in response to the Covid-19. The Directorate General of Budget stresses the importance of understanding and sharing the same enthusiasm in implementing this change.

According to Government Regulation (PP) Number 71 of 2010, financial reports are structured reports on the reporting entity's financial status and the transactions that occurred during the reporting period. The primary purposes for which financial reports are utilized are to assess the efficacy and efficiency of reporting organizations, look at the current financial position, and determine the value of the economic resources employed by the government to carry out its operations.

Wang et al. (2022) the best way to gauge the efficacy of local government management is to compare it to financial results. For an implementation to be successful, it must lead to the expected results within the allocated resources. Regional financial performance refers to a region's independence from the federal government regarding its ability to fund its operations, provide for the welfare of its citizens, and promote growth.

Regional Financial Independence

The pandemic caused by the COVID-19 virus and which began in 2020, had various repercussions, including an impact on the economy (Heald and Hodges, 2020). As a direct consequence, the authorities took action to stop the spread of Covid-19 (Mennini et al., 2022). Through the Joint Decree of the Minister of Home Affairs and the Minister of Finance Number 119/2813/SJ and 117/KMK.07/2020 and the Joint Circular of the Minister of Home Affairs and the Minister of Finance Number 903/4253/SJ and SE-2MK.07/2021, there is a statement for the regional government to be able to restore the regional economy which had declined due to the impact of Covid-19. The government's new measures are designed to enhance people's health so they can return to work and boost the economy.

According to the Regulation of the Minister of Home Affairs Number 19 of 2020, the independence ratio describes the dependence of the region on external funding sources. The higher the ratio of independence means that the level of regional dependence on external assistance (especially the central and provincial governments) is lower, and vice versa. Increased prosperity allows local governments to maximize taxation and other revenue sources toward achieving their Goals. The government's measures, which aim to restore normalcy and get people back to work, will have a good effect on the economy. Boosting Local Own-source Revenue (PAD) in the regions has the potential to promote regional independence and lessen

regional dependence on the central government. And hence, the hypothesis for this investigation is as follows:

H1: The independence ratio is higher after the refocusing policy and budget reallocation.

Regional Financial Effectiveness

Economics was affected when the Covid-19 pandemic broke out in early 2020, which prompted the government to create some rules and policies to restrict the spread of the disease and break the chain of transmission (Mennini et al., 2022). According to the Joint Decree of the Minister of Home Affairs and the Minister of Finance Number 119/2813/SJ and 117/KMK.07/2020 and the Joint Circular of the Minister of Home Affairs and the Minister of Finance Number 903/4253/SJ and SE-2MK.07/2021, there is a statement for local governments to make adjustments to regional revenue targets and rationalization of Local Own-source Revenue.

The effectiveness ratio describes the ability of local governments to realize the planned local own-source revenue compared to the targets set based on the real potential of the region Mahmudi (2016). The effectiveness of a program or activity can be seen from the greater contribution of the output to the achievement of goals. The higher the effectiveness ratio, the better the regional government's performance. As a result of the policy of refocusing and reallocating the budget for handling Covid-19, adjustments have been made to regional income targets in the local government budget. These adjustments have been made by adjusting the Local Own-source Revenue targets, which have been calculated as a result of a decline in economic activity. As a result of these adjustments, there will be an increase in the amount of Local Own-source Revenue realized in regencies and cities throughout Indonesia. So based on this, the hypothesis in this study is:

H2: The effectiveness ratio is higher after the refocusing policy and budget reallocation.

Regional Financial Efficiency

At the beginning of 2020, the Covid-19 pandemic occurred, which hampered people's economic activities. To reduce and break the chain of transmission of Covid-19, the government had to issue rules and policies (Mennini et al., 2022). According to the Joint Decree of the Minister of Home Affairs and the Minister of Finance Number 119/2813/SJ and 117/KMK.07/2020 and the Joint Circular of the Minister of Home Affairs and the Minister of Finance Number 903/4253/SJ and SE-2MK.07/2021, a statement requires local governments to reallocate budget use to focus more on recovering the health of people affected by Covid-19, including spending money on medical equipment and social assistance for communities.

The efficiency ratio describes the level of the government's ability to streamline the expense incurred by the government. To measure the level of efficiency in managing finances by looking at the comparison between the realization of revenue and the realization of expense to obtain revenue. According to Halim (2014), the local government is considered to have implemented budget efficiency if the efficiency ratio is more than 100%, otherwise, if it is less then it indicates that there has been a waste of the budget. The implementation of the policy of refocusing and reallocating the budget for handling Covid-19 has made district and city governments in Indonesia still have to focus on implementing social protection and community economic empowerment by providing financial support for spending on handling Covid-19

which has led to an increase in expenditure and has not been offset by an increase in income so that causing a decrease in the efficiency ratio. Based on this, the hypothesis in this study is:
H3: The efficiency ratio is lower after the refocusing policy and budget reallocation.

3. RESEARCH METHOD

Local government financial reports for 2018 and 2019 represent the years before the refocusing and budget reallocation policies were implemented, and reports for 2020 and 2021 represent the years after these policies were implemented as secondary data for this analysis. The information was collected from the Audit Board of the Republic of Indonesia. The sample in this research uses districts and cities in Indonesia. There are 224 samples used after using the Slovin formula:

$$n = \frac{N}{1 + N e^2}$$

Where N= population size, n = sample size, e²= degree of tolerance for inaccuracy due to decision errors. In this study, a degree of 5% was used.

Variable Measurement

Independence

According to the Regulation of the Minister of Home Affairs Number 19 of 2020, the independence ratio describes the dependence of the region on external funding sources. The higher the ratio of independence means that the level of regional dependence on external assistance (especially the central and provincial governments) is lower, and vice versa.

$$Independence = \frac{Local\ Own - source\ Revenue\ Realization}{Local\ Income\ Realization} \times 100$$

Effectiveness

The effectiveness ratio describes the ability of local governments to realize the planned local own-source revenue compared to the targets set based on the real potential of the region Mahmudi (2016). The effectiveness of a program or activity can be seen from the greater contribution of the output to the achievement of goals. The higher the effectiveness ratio, the better the regional government's performance.

$$Effectiveness = \frac{Local\ Own - source\ Revenue\ Realization}{Local\ Own - source\ Revenue\ Budget} \times 100$$

Efficiency

The efficiency ratio describes the level of the government's ability to streamline the expense incurred by the government. To measure the level of efficiency in managing finances by looking at the comparison between the realization of revenue and the realization of expense to obtain revenue. According to Halim (2014), the local government is considered to have implemented budget efficiency if the efficiency ratio is more than 100%, otherwise, if it is less then it indicates that there has been a waste of the budget.

$$Efficiency = \frac{Realized\ Regional\ Revenue}{Realization\ Of\ Costs\ To\ Earn\ Revenue} \times 100$$

4. RESULTS AND DISCUSSION

Descriptive statistics

Based on Table 1, the mean for the independence ratio before the refocusing policy and budget reallocation is lower than the mean for the independence ratio after the budget refocusing policy and reallocation (14,32% versus 15,03%). The mean for the effectiveness ratio before the refocusing policy and budget reallocation is lower than the mean for the effectiveness ratio after the refocusing policy and budget reallocation (94,74% versus 98,15%). The mean for the efficiency ratio before the refocusing policy and budget reallocation is higher than the mean for the efficiency ratio after the refocusing policy and budget reallocation (101,41% versus 100,99%).

Table 1. Descriptive Statistics

Variables	N	Minimum	Maximum	Mean	Std. Deviation
Independence_Before_Policy	224	1,35	83,76	14,32	11,63
Independence_After_Policy	224	1,52	59,41	15,03	11,05
Effectiveness_Before_Policy	224	47,17	163,58	94,74	15,98
Effectiveness_After_Policy	224	38,91	157,28	98,15	20,11
Efficiency_Before_Policy	224	91,96	136,50	101,41	4,67
Efficiency_After_Policy	224	76,28	125,57	100,99	4,80

Normality Test

Based on Table 2, almost all Asymp. Sig. (2-tailed) < 0.05, the results obtained are that almost all the variables used are not normally distributed, so it can be concluded that all variables will be tested differently using the Wilcoxon test.

Table 2. Normality Test

Variables	Statistic	Df	Sig.
Independence_Before_Policy	0,176	224	0,000
Independence_After_Policy	0,159	224	0,000
Effectiveness_Before_Policy	0,074	224	0,004
Effectiveness_After_Policy	0,045	224	0,200*
Efficiency_Before_Policy	0,161	224	0,000
Efficiency_After_Policy	0,109	224	0,000

Independence Ratio

The test statistics for the difference in independence ratio before and after refocusing policy and budget reallocation is presented in Table 3. It shows there is an 0,71% increase in the regional financial independence ratio after the refocusing policy and budget reallocation and the increase is statistically significant (Asymp. Sig. 0,000). Thus, it can be concluded that H1 is supported.

According to the Regulation of the Minister of Home Affairs Number 19 of 2020, the independence ratio describes the dependence of the region on external funding sources. The higher the ratio of independence means that the level of regional dependence on external

assistance (especially the central and provincial governments) is lower, and vice versa. These results indicate that the government's refocusing and budget reallocation policies in handling Covid-19 affect the increase in Local Own-source Revenue by restoring and stimulating economic activity in the regions. During the Covid-19 period, the local government was more

Table 3. Independence Ratio Difference Test

Test Statistics	Mean		△
	Before Policy (2018-2019)	After Policy (2020-2021)	
Asymp. Sig. (2-tailed)	14,32 %	15,03 %	0,71 %

active in finding sources of Local Own-source Revenue to improve the economy, which had slumped due to the occurrence of Covid-19 (Rheswari and Akbar, 2022). Even though the independence ratio before and after the budget refocusing and reallocation policy is still low, the increase in the independence ratio after the budget refocuses and reallocation policy is a good thing, so efforts still need to be made to further optimize the realization of its Local Own-source Revenue, so that the role of the central government towards regional governments can be reduced.

Effectiveness Ratio

The test statistics for the difference in effectiveness ratio before and after refocusing policy and budget reallocation are presented in Table 4. It shows there is a 3,41% increase in the regional financial effectiveness ratio after the refocusing policy and budget reallocation and the increase is statistically significant (Asymp. Sig. 0,005). Thus, it can be concluded that H2 is supported.

Table 4. Effectiveness Ratio Different Test

Test Statistics	Mean		△
	Before Policy (2018-2019)	After Policy (2020-2021)	
Asymp. Sig. (2-tailed)	94,74%	98,15%	3,41 %

The effectiveness ratio describes the ability of local governments to realize the planned local own-source revenue compared to the targets set based on the real potential of the region Mahmudi (2016). The effectiveness of a program or activity can be seen from the greater contribution of the output to the achievement of goals. The higher the effectiveness ratio, the better the regional government's performance. From the results of this test, it is found that the ratio of regional financial effectiveness after the refocusing policy and budget reallocation is higher than before. It can be said that this has happened because the regional government has adjusted the target of original regional income so that the realization made after the refocusing and reallocation of the budget policy can be more optimal and has an impact on increasing the effectiveness of regional, regional financial Local Own-source Revenue.

Efficiency Ratio

The test statistics for the difference in Efficiency ratio before and after refocusing policy and budget reallocation are presented in Table 5. It shows there is an -0,42% decrease in the regional financial effectiveness ratio after the refocusing policy and budget reallocation but the decrease is not statistically significant (Asymp. Sig. 0,475). Thus, it can be concluded that H3 is not supported.

The efficiency ratio describes the level of the government's ability to streamline the expense incurred by the government. To measure the level of efficiency in managing finances by looking at the comparison between the realization of revenue and the realization of expense to obtain revenue. According to Halim (2014), the local government is considered to have implemented budget efficiency if the efficiency ratio is more than 100%, otherwise, if it is less

Table 5. Efficiency Ratio Difference Test

Test Statistics	Mean		△
	Before Policy (2018-2019)	After Policy (2020-2021)	
Asymp. Sig. (2-tailed)	101,41%	100,99%	-0,42 %

then it indicates that there has been a waste of the budget. The results of the study show that there has been a decrease in the regional financial efficiency ratio, which can be interpreted after the refocusing policy and reallocation of the expenditure budget is more than the income received. It can be said that this is happening because the implementation of the policy of refocusing and reallocating the budget for handling Covid-19 has made district and city governments in Indonesia still have to focus on implementing social protection and community economic empowerment by providing financial support for spending on handling Covid-19 which has led to an increase in expenditure and has not been offset by an increase in income so that causing a decrease in the efficiency ratio.

5. CONCLUSION AND SUGGESTIONS

The purpose of this research is to compare the financial outcomes of local governments before and after they refocused their policies and reallocated their budgets using the independence ratio, effectiveness ratio, and efficiency ratio. The sample in this study uses districts and cities in Indonesia. This study uses the 2018 and 2019 Regional Government Financial Reports as the years before the refocusing and budget reallocation policies, then 2020 and 2021 as the years after the refocusing and budget reallocation policies.

Based on the research results, there is a difference in the ratio of independence before and after implementing the refocusing and reallocation budget. This study provides conclusive evidence that the government's refocusing and funding reallocation policies launched in response to Covid-19 mitigate the increase of Local Own-source Revenue by reviving regional economies.

In the effectiveness ratio, there are differences before and after implementing the refocusing and reallocation budget. This study provides empirical evidence that changes in regional income targets in the local government budget have been made due to the policy of refocusing and reallocating the budget for handling Covid-19. These changes have been made by recalculating Local Own-source Revenue targets, which were calculated in light of the slowdown in economic activity.

The efficiency ratio is unchanged before and after the refocusing policy and budget reallocation, but results on average reveal a deterioration. As this study demonstrates, district and city governments in Indonesia still have to prioritize social protection and economic empowerment for their communities by providing financial support for spending on handling Covid-19. However, doing so would increase regional spending and reduce efficiency ratios.

The limitation of this research is that not all of the cities and municipalities in Indonesia are used as examples in this research, and then this study only uses the independence ratio, efficiency ratio, and effectiveness ratio to assess regional economic performance. Suggestion for future research is if we learn more about Indonesia, we need to add all the districts and cities for future research, and further research can reveal another ratio for gauging regional financial performance in Indonesia.

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