

The Political Economy of Fiscal Resilience: Evidence from Best Practices in Local Government Liquidity Management

Danang Indrajaya¹, Anak Agung Ngurah Agung Chandra Nanda Kusuma², Muhammad Fikri Al-Banna³, Windari Driyastutik⁴

^{1,2,3}School of Economics and Busines, Telkom University, Bandung, Indonesia

⁴Politeknik Negeri Bandung, Indonesia

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Abstract

Purpose – This study interrogates a critical yet underexplored phenomenon in subnational finance: the accumulation of local government funds in commercial banks. Moving beyond conventional interpretations of such balances as mere fiscal imbalances, we rigorously examine whether these reserves reflect deliberate liquidity management strategies or systemic governance failures. **Methodology/approach** – Through a systematic literature review synthesizing global references, we analyze the tension between transparency imperatives in public financial management and the realities of local political pressures. Employing a comparative analytical framework, we integrate insights from fiscal resilience theory, cost stickiness behavior, and digital transformation in the public sector. **Findings** – Our findings reveal that fund accumulation often constitutes a rational response to rigid expenditure structures and serves as a strategic fiscal buffer against macroeconomic uncertainty. However, the efficacy of this buffer is critically undermined by information asymmetries arising from political connectedness and creative accounting practices, distortions that compromise managerial decision-making and fiscal accountability. Notably, jurisdictions embracing Environmental, Social, and Governance (ESG) principles alongside Technology-Organization-Environment (TOE) frameworks demonstrate significantly higher budget absorption efficiency and public value creation. **Novelty/value** – This research contributes a nuanced political economy perspective to fiscal resilience literature, offering policymakers evidence-based pathways to transform idle balances into instruments of sustainable local development, without succumbing to political capture or fiscal opacity.

Keywords: Fiscal resilience; liquidity management; subnational government finance; political economy; ESG governance; digital transformation

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INTRODUCTION

Regional financial management is currently facing increasingly complex challenges along with demands for transparency, spending efficiency and fiscal resilience in the face of global economic uncertainty. The phenomenon of accumulation of Regional Government (Pemda) funds in banking is often the subject of public debate between indications of failure to absorb the budget or a careful liquidity management strategy. The urgency of this research lies in the need for a deep understanding of how regions balance disciplined fiscal rules, digital technology innovation, and active stakeholder involvement to achieve sustainable independence. Liu and Lee (2024) underscore that Environmental, Social, and

¹ Corresponding Author: danangi@telkomuniversity.ac.id

Governance (ESG) practices can serve as an effective external monitoring mechanism to reduce information asymmetry within government entities. Without adequate transparency, the accumulation of funds in banks can trigger negative perceptions regarding the region's inability to intervene in the economy through public spending. Therefore, it is important to carry out this research to map how global governance standards can be integrated into local practices to change the cash management paradigm from mere administrative compliance to an instrument of public value creation. This study will provide strategic insight into the importance of synchronizing fund retention policies with high information disclosure standards to maintain regional economic stability.

Fiscal uncertainty is often triggered by external shocks such as health crises or natural disasters which require strong financial preparedness from each region. Lodi et al. (2023) in their study shows that regions with high economic resilience could recover more quickly through internal budget flexibility and sufficient cash reserves. The strategy of storing funds in banking, in this context, cannot necessarily be considered wasteful if its function is as a "fiscal cushion" to face the risk of future default. Zahid et al. (2023) strengthens this argument by stating that organizations that integrate risk management into their financial cycles prove to be more resilient during times of crisis such as the COVID-19 pandemic. However, the accumulation of these funds must be accompanied by innovation in the provision of cost-efficient public services, such as the use of local waste for land restoration which has proven to be cheaper (Li et al., 2023).

One of the main obstacles to effective regional cash management is the influence of political connections which often distort financial reports and decision-making processes. Based on Positive Accounting Theory, Ababneh and Aga (2019) found that political pressure often encourages creative accounting practices aimed at manipulating information for short-term electoral interests. This creates major challenges where the accumulation of funds may be intentionally carried out or hidden to meet specific political targets, ultimately undermining the integrity of financial data governance. On the other hand, sustainable data governance and the use of technological frameworks such as Technology, Organization, Environment (TOE) are crucial in increasing bureaucratic responsiveness (Sihotang et al., 2025). Digitizing the bureaucracy through e-budgeting and e-procurement systems is a solution to minimize unaccountable human intervention in managing regional funds. This research will examine the tension between political interests and the need for data transparency to see how the interaction of the two affects cash management accuracy. Understanding these dynamics is very important so that regions can build an independent monitoring system for manipulative practices that harm the public.

Apart from political factors, the behavior of costs in the public sector which tends to be rigid (cost stickiness) provides a new dimension in the analysis of regional fund accumulation. Fabre and Borgert (2022) explain that costs are often more difficult to reduce when income decreases due to bureaucratic commitments and inflexible long-term contracts. This cost rigidity forces local governments to be more conservative in spending and keep more funds in banks as a hedge against liquidity risks. This condition is complicated by cyclical spending behavior, where spending on public goods often fluctuates sharply following the political cycle or voter preferences (Abbott and Jones, 2024). If not managed well, this unstable spending pattern will result in the buildup of unproductive cash balances at the end of the fiscal year. Therefore, this research aims to prove conceptually whether the accumulation of funds is a passive defense mechanism against stiff costs or whether it is an error in financial planning. Understanding cost flexibility will help regions develop liquidity strategies that are more adaptive to changes in local economic conditions.

This research positions itself as a synthesis of various global literature linking financial management with resilience, innovation and government legitimacy. Jing Zhang (2016) emphasized that effective financial management is the main key to building government legitimacy through the provision of high-quality public services. The relationship between the availability of funds in banking and the quality of public services must be positive, where existing funds are used strategically for investments that have a broad impact. For example, regions that have saved funds can leverage public finances to attract private investment for the development of smart city infrastructure (Hadfield and Cook, 2019). This is in line with

global best practices where regions do not just focus on revenue extraction, but act as catalysts for economic development through non-conventional financing schemes.

Based on the background description above, the problem formulation in this research is determined as follows. RQ1: How does the interaction between local political pressure and financial data governance structure affect the accuracy of cash management decision making in the public sector? RQ2: To what extent do the phenomena of cost stickiness and cyclical spending behavior contribute to the formation of cash reserves as a financial resilience strategy? RQ3: How does the integration of Environmental, Social, and Governance (ESG) principles and global governance standards change the liquidity management paradigm from mere administrative compliance to an instrument of public value creation? By answering these questions, it is hoped that this research can close the gap between financial resilience theory and the real practice of cash management in regional government, as well as provide guidance for financial governance reform that is more accountable and effective.

LITERATURE REVIEW

Sustainability Governance and Quality of Financial Reporting

Data from global literature shows that there is a strong correlation between the implementation of Environmental, Social, and Governance (ESG) practices and the quality of financial information transparency in various sectors. Liu and Lee (2024) found that in entities that have government involvement or state ownership structures, ESG practices significantly improve the quality of financial reports through reducing information asymmetry. This is supported by the findings of Jan et al. (2019) who noted that the integration of ethical values and sustainable governance contributes positively to long-term financial performance, especially in financial institutions. On the other hand, Ababneh and Aga (2019) present data that without sustainable financial data governance, political connections become the main driver for the emergence of creative accounting practices that distort the validity of cash reports. This political influence was found to be the main inhibiting factor in achieving full transparency in public organizations in developing countries. The literature consistently shows that high reporting standards are often the result of regulatory pressure and strict stakeholder oversight. The quality of financial data thus depends heavily on the integrity of the governance structure implemented by the management of the organization.

Cost Behavior and Regional Financial Resilience

The main findings of previous research regarding the structure of government spending show an anomaly known as cost stickiness or cost stickiness in response to income fluctuations. Fabre and Borgert (2022) present evidence that operating costs in the public sector tend to decrease by a smaller proportion when revenues decrease compared to costs increasing when revenues increase. This rigid condition has an impact on fund accumulation strategies, where the government tends to keep larger cash reserves in anticipation of inflexible obligations. Regarding recovery ability, Lodi et al. (2023) report that regions that have high economic resilience are characterized by budget flexibility and the availability of sufficient emergency funds. Data shows that the integration of disaster risk management into the budget planning cycle is very effective in maintaining fiscal stability when external shocks occur (Zahid et al., 2023). Additionally, spending on public goods has been found to often be cyclical and significantly influenced by election cycles (Abbott & Jones, 2024). This uneven spending pattern directly contributes to fluctuations in cash balances held in banking institutions throughout the fiscal year.

Digitalization and Operational Transformation of Financial Management

Data regarding digital transformation shows that the effectiveness of financial management in the modern era is highly dependent on technological readiness and organizational commitment. Based on the TOE (Technology, Organization, Environment) framework, Sihotang et al. (2025) found that successful integration of digital systems in bureaucracy requires strong regulatory support and adequate technological

capabilities. This transformation has proven capable of speeding up the budget absorption process and minimizing administrative delays which often cause unproductive accumulation of funds. At the operational level, the use of an integrated financial information system enables real-time cash monitoring which supports accurate managerial decision making. Findings from Li et al. (2023) provides an overview of the cost efficiencies that can be achieved through operational innovation, such as the use of local resources for land restoration which is much more cost effective than conventional methods. This data indicates that technological innovation and new work methods are key components in achieving budget optimization at the regional level. The role of leadership in encouraging technology adoption was also found to be a determining variable in the success of financial bureaucratic reform.

METHOD

This study conducted a systematic literature review (SLR), a methodological approach well aligned with the research aims. SLRs offer a rigorous framework for synthesizing existing evidence, uncovering critical knowledge gaps, and establishing a robust foundation for future inquiry in the field. By applying explicit, reproducible criteria, this technique enables the systematic identification, critical appraisal, and integrative interpretation of relevant empirical studies. Literature was sourced from the Watase UAKE database and Scopus using targeted keyword searches.

The PRISMA SLR diagram depicts the study selection process systematically through three stages: Identification, Screening, and Included Studies. Starting from the initial 123 track records from the database (Scopus), 50 track records were eliminated (31 due to the 2015–2025 criteria and 19 for other reasons), so that 73 track records passed the filtering stage. Of the 73 records, 5 were excluded during title/abstract screening, then 37 reports were not found, resulting in 31 reports being assessed for eligibility and 1 excluded, resulting in 30 studies from the database. An additional 8 studies from other sources that met the criteria resulted in a total of 38 studies included in the review. This diagram guarantees transparency, reduces bias, and ensures credibility through detailed documentation of each exclusion as well as a clear selection path.

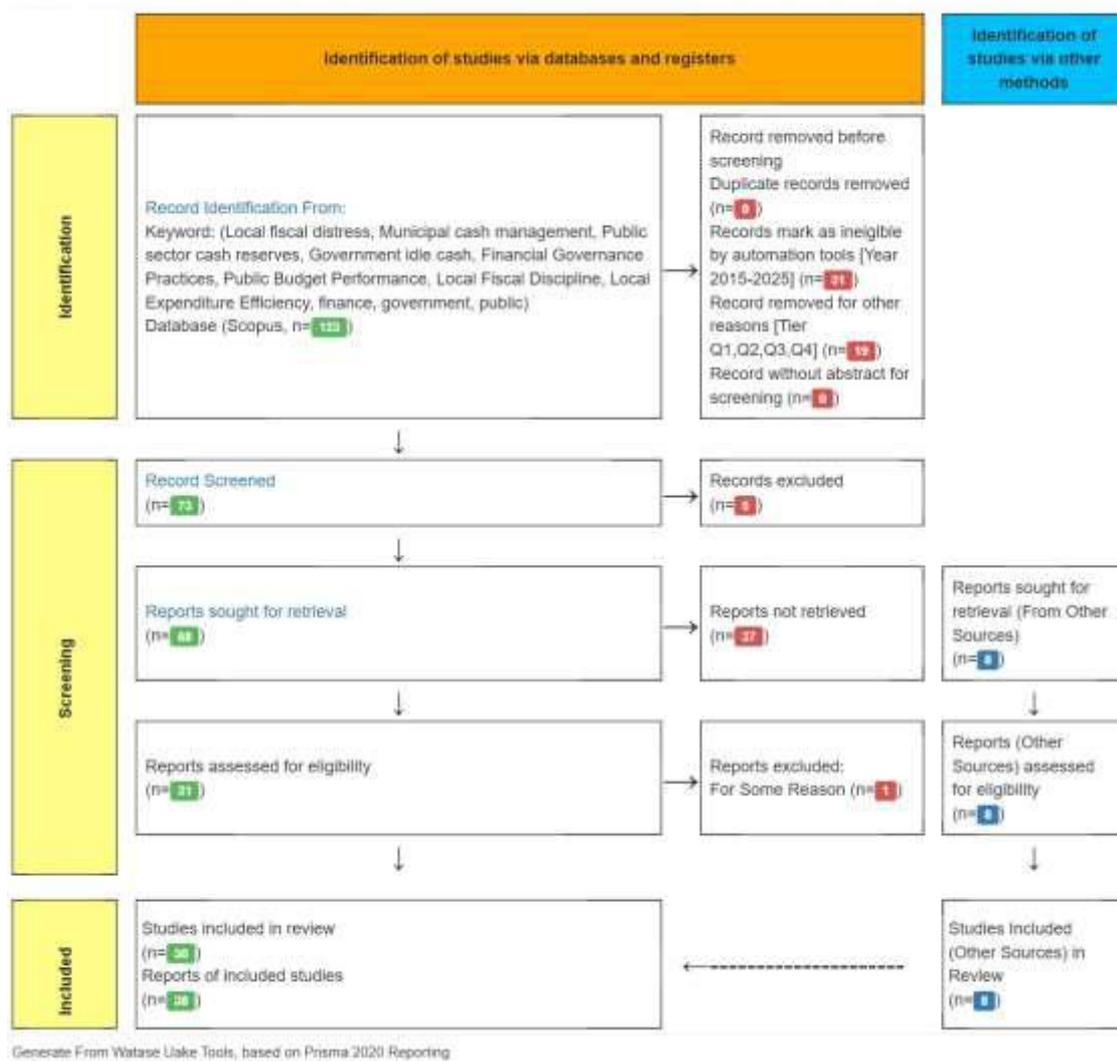


figure 1. PRISMA flow diagram of study selection process for this systematic review

RESULT AND DISCUSSION

This segment offers a critical appraisal of the selected scholarly works, articulating for each entry the author(s) (year), complete title, and substantive insights & findings, thereby mapping the intellectual terrain and identifying transferable lessons relevant to the present investigation.

No	Author (year)	Title	Insight & Findings
1	Liu & Lee (2024)	The Role of Ownership Structure in the Relationship Between ESG Practices and Financial Reporting Quality	ESG practices significantly improve the quality of financial reports in state-owned companies, but not in private companies.
2	Qi, et al. (2023)	What Determines the Digital Transformation of SRDI Enterprises? A Study of the TOE Framework-Based Configuration.	The study of SRDI enterprises provides a powerful configurational lens for understanding fiscal resilience: there is no silver bullet, but multiple pathways that depend on complex interactions between organizational

Husnayain Business Review

Vol.6 No.1 (2026)

No	Author (year)	Title	Insight & Findings
			capacity, strategy, and environmental pressures. SRDI's finding of "organization-deficient" as a failure pathway is also a warning: without governance reform and regional financial bureaucratic capacity, even the most sophisticated liquidity strategies will fail.
3	Ababneh & Aga (2019)	Impact of Sustainable Financial Data Governance, Political Connections, and Creative Accounting	Political connections encourage creative accounting (manipulation), while continuous data governance increases decision effectiveness.
4	Hadfield & Cook (2019)	Financing the Low-Carbon City: Can Local Government Leverage Public Finance?	Local governments can use special property tax instruments to stimulate private investment in infrastructure projects.
5	Lodi, et al. (2023)	The public finance response to floods of local governments in Italy	Municipalities with high resilience are able to manage their own budgets after a disaster more quickly than those that rely on the center.
6	Adu et al. (2025)	Green Banking Practices, BSHED and Bank Financial Performance	Green banking practices and social/health disclosures improve financial performance if supported by strong governance.
7	Abbott & Jones (2024)	Are government expenditures more cyclical the more they finance public goods?	Spending on public (non-rival) goods is more cyclical (fluctuating) than private goods (education/medical) due to voter preferences.
8	Jing Zhang (2016)	Government finances and public interests: perspectives on state-building	Government finance evolved from mere tax extraction into a complex means of fulfilling public interests.
9	Zahid et al. (2023)	The nexus of ESG practices with the financial performance of banks	ESG serves as an effective risk management tool; its performance has a more positive influence during times of crisis (pandemic).

Husnayain Business Review

Vol.6 No.1 (2026)

No	Author (year)	Title	Insight & Findings
10	Loan T. Le (2024)	Impact of ESG practices on financial performance: evidence from Southeast Asia	Consistent implementation of ESG in ASEAN increases company value and long-term profitability.
11	Oyerogba et al. (2024)	Corporate governance practices and sustainability reporting quality: evidence from the Nigerian listed financial institution	Board size and gender diversity improve the quality of sustainability reports, but board independence has a negative impact.
12	Oyarce et al. (2023)	Index to degree of adhesion to good practices of corporate governance	Higher compliance with governance standards (index) is directly correlated with improved financial performance (ROA/ROE).
13	Arthur & Owen (2019)	A Micro-ethnographic Study of Big Data-Based Innovation	Data innovation requires multilevel ethical governance to maintain trust; focus on mutual benefits between stakeholders.
14	Dunbar & Middleton (2022)	UEFA's financial fair play regulations: a good example of best practice?	UEFA's FFP regulations are an example of best practice in monitoring financial stability, although they require more transparency in law enforcement.
15	Klaus J. Hopt (2021)	Corporate Governance of Banks and Financial Institutions	The governance of financial institutions is special; Creditor protection and strict supervision are more crucial than just the owner's interests.
16	Shaban & Omoush (2025)	AI-Driven Financial Transparency and Corporate Governance	AI adoption significantly improves financial transparency, risk management and stakeholder engagement.
17	Laura Južnik Rotar (2025)	Testing Wagner's Law Based on Government Functions	Fiscal interventions such as the RRF have succeeded in changing the composition of government spending to be more productive and sustainable.
18	Athari et al. (2024)	Examining the Quadratic Impact of Sovereign ESG Practices	There is an inverted U-shaped relationship between country-level ESG and profitability; A country's ESG supports performance up to a certain optimal point.

Husnayain Business Review

Vol.6 No.1 (2026)

No	Author (year)	Title	Insight & Findings
19	Onofrei et al. (2021)	Impact of Governments' Fiscal Behaviors on Public Finance Sustainability	Budget discipline and compliance with fiscal rules determine the long-term sustainability of public finances.
20	Myriam et al. (2025)	More Money, More Ethical Commitment?	Strong financial performance (excess resources) provides room for organizations to be more committed to ethical and ESG practices.
21	Kumari & Pattanayak (2016)	Linking earnings management practices and corporate governance	Strong governance (board independence) can significantly mitigate earnings manipulation practices.
22	Fiandrino et al. (2019)	Corporate governance and financial performance for CSR	CSR is not just a result, but an integrated process that strengthens governance and financial performance at the same time.
23	Usman & Yakubu (2019)	Investigation of post-privatization firms' financial performance	The transition from state to private ownership (privatization) improves performance if accompanied by improvements to the board structure.
24	Mensah et al. (2023)	Enhancing cash flow management through corporate governance	Board attributes (size and gender diversity) have a positive effect on the effectiveness of operational cash flow management.
25	Tan et al. (2023)	A gendered discourse on truthful disclosure of financial fraud	Individual integrity and a supportive governance environment increase intent to disclose financial fraud.
26	Fabre & Borgert (2022)	Cost Behavior in Local Governments from the theory of public finance perspective	Costs in local government are asymmetrical (sticky); spending does not fall as quickly as income during a fiscal contraction.
27	Saygili et al. (2021)	The Effects of Corporate Governance on Financial Performance	Stakeholder-oriented governance improves financial performance and public trust.

Husnayain Business Review

Vol.6 No.1 (2026)

No	Author (year)	Title	Insight & Findings
28	Karen P.Y. Lai (2017)	Unpacking financial subjectivities: Intimacies, governance and practices	Financial decisions are influenced by morality and social relationships, not just pure economic logic.
29	Bergman et al. (2016)	Promoting Sustainable Public Finances in the EU	Fiscal rules are only effective in increasing sustainability if they are accompanied by high government efficiency.
30	Tomaš-Miskin et al. (2022)	The Significance of Archiving Documentation and Assessment Quality	Digital filing systems significantly improve the quality of managerial decision making and transparency.
31	Pierson et al. (2015)	The Government Finance Database: A Common Resource for Quantitative Research	The importance of an integrated and uniform database for conducting accurate public financial analysis across regions.
32	Bocean Vărzaru, Anca & Bocean, Claudiu George. (2024)	Digital Transformation and Innovation: The Influence of Digital Technologies on Turnover from Innovation Activities and Types of Innovation	Liquidity digitalization increases transparency but reduces the discretionary power of local elites, a fundamental tension in the political economy of fiscal reform.
33	Buccaro et al. (2023)	Techno-Economic Assessment of APS-Based Poultry Feed Production	A detailed economic assessment of circular projects can ensure cost efficiency and operational sustainability.
34	Tahfim & Chen (2022)	A Cluster-Based Approach for Analysis of Injury Severity	Clustering methods are effective for grouping complex data to discover hidden patterns that are invisible to ordinary statistics.
35	Li et al. (2023)	Influence of Organic Amendments Based on Garden Waste	Using garden waste as fertilizer is a cost-effective land restoration method. Penggunaan limbah taman sebagai pupuk merupakan metode restorasi lahan yang efektif biaya (<i>cost-effective</i>).
36	AlMarzoqi et al. (2023)	Nonlinear Fiscal Multipliers in Saudi Arabia	Investment spending has a much greater multiplier impact than routine spending; Fiscal policy is more effective during the economic expansion phase.

No	Author (year)	Title	Insight & Findings
37	Zhou et al. (2023)	Spatial-Temporal Evolution and Driving Factors of Regional Green Development	Technological innovation and environmental regulations are the main drivers of green development efficiency at the regional level; there are real spatial disparities.
38	Jan et al (2019)	Sustainable Business Practices and Firm's Financial Performance in Islamic Banking: Under the Moderating Role of Islamic Corporate Governance	Governance not only influences technical performance but also influences the perceptions and beliefs of external stakeholders. Strong governance is needed to protect long-term strategies from short-term distortions.

RQ1: How does the interaction between local political pressure and financial data governance structure affect the accuracy of cash management decision making in the public sector?

The findings of this research indicate that the accumulation of funds in banking is often the result of tensions between local political interests and professional standards of data governance. Based on the answer to the first research question (RQ1), the interaction between political pressure and data governance structure has a significant influence on the accuracy of cash decision making. In line with the Positive Accounting Theory referred to by Ababneh and Aga (2019), there is strong evidence that political connections tend to encourage creative accounting practices that distort information regarding the actual cash position. This means that high cash balances in banks do not always reflect a pure fiscal surplus, but could instead be a manipulation to create an image of positive performance ahead of a particular political cycle. The literature shows that without strong sustainable data governance, public sector financial managers lose objectivity in the deployment of funds, resulting in cash management decisions becoming subject to short-term electoral interests. This reinforces the findings of Liu and Lee (2024) that the ownership structure and government involvement in entities (such as BUMN or Regional Government) require stricter external supervision through transparent disclosure standards to mitigate this information asymmetry.

The significance of these findings lies in the confirmation that data transparency is not just a technical IT problem, but rather an instrument of defense against managerial corruption and budget politicization. The significance of these results shows that regions that have an established data governance structure are able to produce cash investment decisions that are more accurate and free from political bias. The theoretical contribution of this research extends the application of Agency Theory in the context of regional finance, where the community acts as a principal who is often disadvantaged by information asymmetries created by political agents. By referring to the integration of ethical values in financial management (Jan et al., 2019), this discussion confirms that governance integrity is an absolute prerequisite for effective liquidity management. Without integrity, even sophisticated digital technology will not be able to optimize the use of regional funds if the input data is distorted by political interests. Therefore, bureaucratic reform must target the independence of the financial management function so that cash management decisions are based on real liquidity needs for public services.

RQ2: To what extent do the phenomena of cost stickiness and cyclical spending behavior contribute to the formation of cash reserves as a financial resilience strategy?

Answering the second research question (RQ2), analysis of cost behavior shows that the accumulation of funds in banking is a rational response to the cost stickiness phenomenon. Fabre and Borgert (2022) explain that costs in the public sector are often inflexible to fall when revenues decrease, which creates the risk of default on routine obligations. This finding gives new meaning to regional government cash balances;

these funds function as a "passive protection strategy" to ensure the continuity of bureaucratic operations amidst a rigid expenditure structure. In addition, cyclical spending behavior where spending on public goods tends to increase only in certain periods (Abbott & Jones, 2024) automatically creates a buildup of cash in the early periods of the fiscal year. This is significant because it proves that the accumulation of funds is often not caused by deliberate hoarding of money, but rather is the result of a lack of synchronization between income receipt patterns and expenditure schedules which are influenced by administrative regulations and political preferences of constituents.

From an economic resilience perspective, these findings are very relevant to the financial resilience theory proposed by Lodi et al. (2023). Regions that consciously build cash reserves demonstrate better adaptability to external shocks, such as natural disasters or global economic crises, because they have an adequate "fiscal cushion." Zahid et al. (2023) supports this by stating that conservative risk management, including maintaining high liquidity, is the key to performance stability during times of crisis. The theoretical significance of this finding is a shift in the assessment of sinking funds: from what was previously considered pure inefficiency, to becoming a strategic resilience instrument if the amount is measurable and has a clear risk mitigation objective. The practical implication is the need for regulations that provide flexibility for regional governments to manage reserve funds more productively, for example through safe short-term investments. In this way, regional financial management is transformed from just an absorption function to a proactive risk management function for regional sustainability.

RQ3: How does the integration of Environmental, Social, and Governance (ESG) principles and global governance standards change the liquidity management paradigm from mere administrative compliance to an instrument of public value creation?

The discussion of the third research question (RQ3) highlights how the integration of Environmental, Social, and Governance (ESG) principles changes the philosophy of liquidity management from compliance to value creation. Research findings show that global governance standards encourage regional governments to no longer view cash as a static asset, but rather as a tool to achieve sustainable development goals. In line with Jing Zhang's (2016) view, financial management must be able to build public legitimacy; This means that every rupiah deposited in the bank must be accounted for for its social benefits in the future. If regions are able to adopt ESG standards such as those that are starting to become popular in the ASEAN region, then transparency regarding the reasons for holding funds will increase, which in turn will increase investor and public confidence. This is significant because it shows that modern liquidity management must align cash policy with the promise of public services and the government's social responsibility towards the environment.

The main contribution of this research to the development of public sector financial management science is the provision of a framework that integrates technological innovation (TOE Framework) with moral financial standards (ESG). Varzaru & Bocean (2024) emphasize that successful digital transformation in bureaucracy will speed up cash flow and reduce unproductive siled funds. The theoretical implication is the emergence of the concept of "Regional Fiscal Intelligence", where efficiency is no longer measured from zero cash balances, but from the optimal impact of each expenditure on local macroeconomic indicators. In practical terms, regions are encouraged to leverage the public to use their financial capacity to attract external investment for green or digital infrastructure (Hadfield & Cook, 2019). Cash management thus becomes a bridge between annual budget needs and long-term sustainable development ambitions. This marks the end of the era of traditional financial management that only focuses on "input-output" and begins a new era that focuses on "outcomes" and real social impact.

CONCLUSION

This study has interrogated the political economy dynamics underpinning fiscal resilience in local government liquidity management, moving beyond technocratic models to expose the intricate interplay of power, institutional incentives, and governance structures that shape cash management practices. The findings reveal that fiscal resilience is neither a purely technical outcome nor a neutral administrative achievement, rather, it emerges from contested processes where political imperatives, behavioral fiscal patterns, and evolving governance norms converge, and often collide. The three core conclusions below synthesize how political distortions compromise data integrity, how seemingly inefficient fiscal behaviors may embody rational resilience strategies, and how normative shifts toward ESG-oriented governance are reconfiguring liquidity management as a domain of public value creation rather than mere compliance.

1. The interaction between local political pressure and financial data governance structures tends to reduce the accuracy of cash management decision making through creative accounting practices. Distortions in financial data reporting often occur to satisfy short-term political legitimacy, ultimately hindering true transparency of cash balances in the public sector.
2. The phenomenon of cost stickiness and cyclical spending behavior contribute significantly to the formation of high cash reserves. This accumulation is a rational financial resilience strategy to ensure the continuity of public services is maintained despite fluctuations in income or economic uncertainty.
3. The integration of Environmental, Social, and Governance (ESG) principles and global governance standards has succeeded in changing the liquidity management paradigm from mere administrative compliance to an instrument of public value creation. This approach ensures that liquidity management is carried out ethically, transparently and accountably to increase investor confidence and the welfare of the wider community.

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