

# PERSPECTIVE

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## **Developing Poor Little Rich Natuna's Economy**

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### **EXECUTIVE SUMMARY**

- Natuna district's location in the disputed waters of the South China Sea and natural resource wealth enhances its strategic importance for Indonesia.
- Despite its significant hydrocarbon and fisheries resources, Natuna district is poor and very dependent on central government transfer payments. Revenues from energy projects off Natuna district go largely to the central government and Kepri provincial government.
- This conundrum between natural resource wealth and underdevelopment is behind the recent unsuccessful push by Natuna district to separate from Kepri province.
- Revising Indonesia's complex system of inter-governmental transfer payments, particularly for energy-producing districts, is key to improve Natuna district's economic performance and position within Kepri province.

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## INTRODUCTION

Indonesia's central government has expressed its commitment to develop the country's border regions. In March 2017, at Natuna district, Riau Islands (Kepri) province, the Coordinating Minister of Politics, Law and Security Wiranto, Home Affairs Minister Tjahjo Kumolo, Defense Minister Ryamizard Ryacudu, other ministers and top military leaders launched the "Movement for Border Regions' Integrated Development" (or *gerbangdutas*) to address the province's security and welfare issues.<sup>1</sup>

Through this programme, the government pledged IDR 1.6 trillion for Kepri, IDR 470.6 billion (USD 35.4 million) of which was allocated to Natuna district.<sup>2</sup> For Natuna, the target sectors are fisheries, tourism, gas and oil industry services, environment protection and defence.

Due to Natuna's distinctive geographical location – being one of Indonesia's northernmost islands and bordering the contested South China Sea - the emphasis on national defence is not unforeseen. In the past three years, the Natuna waters, rich with fishery resources, have attracted illegal fishing from countries such as Vietnam and China.<sup>3</sup> One incident involving a Chinese vessel led to tension between Jakarta and Beijing in 2016.<sup>4</sup> These incidents subsequently prompted the central government to revamp the military infrastructure in Natuna.<sup>5</sup>

Indonesia's renewed focus on Natuna's security is also prompted by the district's energy deposits. Natuna's waters hold the country's largest oil and gas reserves. Reports mention that the oil reserves reach 298.81 million barrels while gas reserves amount to 55.3 trillion

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<sup>1</sup> This program has been organized annually since 2011, such as in Nunukan (North Kalimantan) and Saumlaki, (Maluku) in 2015 and Alor (East Nusa Tenggara) in 2016.

<sup>2</sup> <http://bisnis.news.viva.co.id/news/read/892215-proyek-perbatasan-di-kepulauan-riau-berbiaya-rp1-61-triliun> (19/05/2017).

<sup>3</sup> <http://www.cnnindonesia.com/nasional/20170321093910-12-201610/sebanyak-17-kapal-ikan-asing-ditangkap-di-natuna-dan-sulut/> (23/05/2017).

<sup>4</sup> [http://www.bbc.com/indonesia/berita\\_indonesia/2016/06/160620\\_indonesia\\_tnial\\_bantah\\_kapalcina](http://www.bbc.com/indonesia/berita_indonesia/2016/06/160620_indonesia_tnial_bantah_kapalcina) (23/05/2017).

<sup>5</sup> The military infrastructures' improvement in Natuna and three eastern regions: Saumlaki-Selaru which borders the Australian waters, Biak (north Papua) and Morotai (north Maluku) which border the Philippines, aims at strengthening outermost islands' security. In Natuna, this would include adding the length of Ranai airport's runway to accommodate jet fighters, deployment of navy and air-force personnel, jet fighters and navy ships, and the building of barracks and hospital. Indonesia has conducted exercises in Natuna, including last April's integrated quick-hit exercise (PPRC) involving six thousand military personnel.

<http://nasional.kompas.com/read/2016/06/28/16134891/pangkalan.militer.di.natuna.dilengkapi.pesawat.tempur.hingga.pasukan.elite> (21/05/2017);

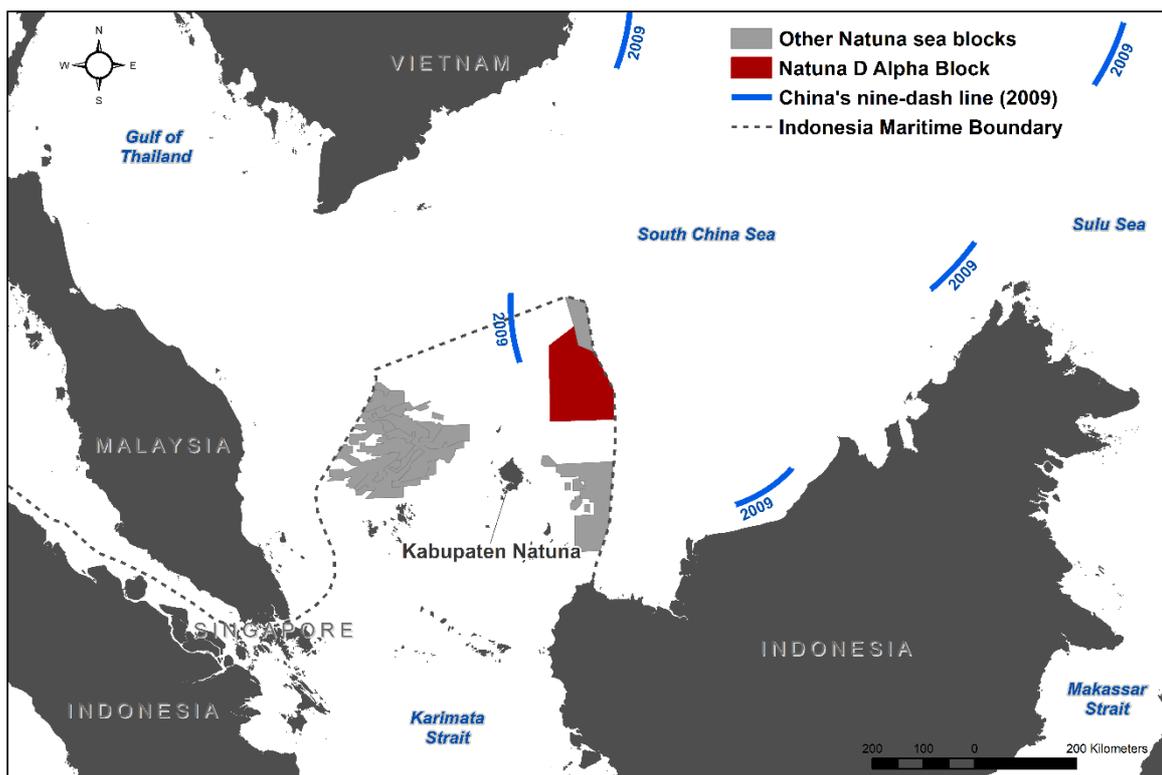
<http://www.cnnindonesia.com/nasional/20160701164757-20-142477/kemhan-prioritaskan-anggaran-untuk-pangkalan-militer-natuna/> (23/04/2017). Leo Suryadinata and Mustafa Izzuddin, "Nationalistic symbolism behind Natuna Sea", *The Straits Times*, 9 December 2016

<http://www.straitstimes.com/opinion/nationalistic-symbolism-behind-natuna-sea> (25/05/2017).

cubic feet (tcf).<sup>6</sup> More phenomenal are the gas reserves of the East Natuna Sea Block (or D-Alpha Block), which are estimated at 222 tcf, 46 tcf of which are thought to be commercially recoverable.<sup>7</sup> This accounts for about a quarter of Indonesia's total gas reserves of 182 tcf. Observers say this gas deposit should last at least thirty years.<sup>8</sup>

Indonesia's interest in safeguarding the East Natuna Sea also owes much to the fact that it overlaps with China's nine-dash-line claim in the South China Sea.

**Map of Natuna, D-Alpha Block gas field, and China's Nine-Dash Line**



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Source: *Generated from Oil and Gas Information Map of Riau Islands Province, The Office of Public Works, Mining and Energy of Riau Islands Province, 2006, and Note Verbale of the Permanent Mission of the People's Republic of China to the United Nations, 2009.*

Meanwhile, despite its fisheries and energy deposits, Natuna's revenues are surprisingly low. Its own local revenues (*PAD*) in 2014-2016 were between IDR 38 billion to IDR 62 billion (USD 2.9 million to USD 4.7 million), or 3-5% of its total revenues. This means that a large portion of Natuna's total revenues comprises of central transfers.

<sup>6</sup> <http://www.cnnindonesia.com/nasional/20160623134311-20-140387/laut-natuna-jadi-sumber-migas-asia/> (23/05/2017).

<sup>7</sup> <http://www.reuters.com/article/indonesia-natuna-exxon-idUSJAK16825020070105> (23/05/2017).

<sup>8</sup> A new contract between the government and a consortium of oil companies to develop this sea block is still pending <http://www.republika.co.id/berita/koran/industri/17/01/07/ojep8621-exxonmobil-laporkan-kemajuan-east-natuna> (29/05/2017).

In March 2016, elite groups of Natuna and the neighbouring oil-and-gas district Anambas aspired to separate from Kepri to create their own province. Their aim was to secure more fiscal transfers from Jakarta.<sup>9</sup> Among these people was Natuna's former district-head Daeng Rusnadi, who was once imprisoned for corruption concerning oil-and-gas revenues.<sup>10</sup> The plan was supported by Natuna's current district-head Hamid Rizal, whose deputy is Rusnadi's wife. In January 2017, the discourse was adopted by local parliamentarians, who subsequently tried to exploit Jakarta's security interest to push for a "special defence province". Unsurprisingly, Kepri's governor Nurdin Basirun did not support the separation<sup>11</sup> as Kepri would then lose its only oil-and-gas districts. Eventually this spark of separation was doused by the recent *gerbangdutas*' pledge of funds and the moratorium on the creation of new provinces.<sup>12</sup>

On the surface, Jakarta's development funds for Natuna seem to be what the region needs. However, further dependency on the central government's resources may not be helpful in boosting the local economy in the long run. By focusing on the dependence of regions to central government transfers, this article aims to highlight the causes of Natuna's lack of income despite its natural wealth.

## **NATUNA, A POOR LITTLE RICH PLACE**

Natuna district was established in 1999 after its separation (*pemekaran*) from Riau-Islands district under Riau Province. Shortly thereafter, a discussion began about separating Riau province's six archipelagic districts (Batam, Bintan, Karimun, Lingga, Tanjung Pinang and Natuna) to create a new "Riau Islands" (Kepri) province. Natuna did not support this idea at first, because being part of Kepri would reduce its share of oil and gas revenues. As Kepri's only oil-and-gas producing district, Natuna would have to share its revenues with the province's non-producing districts. Should it remain part of Riau Province – which has nine other oil-and-gas districts – Natuna would continue to benefit from these regions' revenues. However, as it is geographically tied to Kepri, Natuna was included as part of the new province in 2002.

Natuna comprises 154 islands spanning 262,197 km<sup>2</sup> of water. It lies about 580,000 m northeast of Singapore. According to the 2010 census, the district had 69,000 inhabitants. However, the 1.4% population growth rate there indicates the current population to be

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<sup>9</sup> Deasy Simandjuntak, "Natuna and Anambas intend to separate from Riau Islands province." *ISEAS Commentary*, 6 February 2017. <https://www.iseas.edu.sg/medias/commentaries/item/4858-natuna-and-anambas-intend-to-separate-from-riau-islands-province-a-commentary-by-deasy-simandjuntak>

<sup>10</sup> <http://batam.tribunnews.com/2016/03/06/tim-perjuangan-pemekaran-provinsi-pulau-tujuh-terbentuk> (08/06/2017).

<sup>11</sup> <http://tanjungpinangpos.id/gubernur-provinsi-pulau-tujuh-jangan-dulu/> (30/05/2017).

<sup>12</sup> <http://haluankepri.com/natuna/100582-mendagri-bentuk-provinsi-tidak-mudah.html> (23/05/2017).

74,520.<sup>13</sup> The unemployment rate has been rising as well. It was 10.54% in 2015, an increase from 7.60% in 2014.<sup>14</sup>

Natuna is one of Indonesia's top ten oil-and-gas regions. In 2015 and 2016, it produced 5.9 million and 5.6 million barrels of oil, and 86 million mmbtu and 51 mmbtu of gas respectively.<sup>15</sup> The region's contribution to Indonesia's export revenue is significant, even with the international oil price ranging between USD 50-52 per barrel. Gas from West Natuna Sea Block (Premiere, ConocoPhilips, and Star Energy) reached 491 million standard-cubic-feet-per-day (mmscfd),<sup>16</sup> 325 mmscfd of which is exported to Singapore.<sup>17</sup>

Due to Indonesia's fiscal structure however, the main contributor to Natuna's economy is not its oil and gas sector. Figure 1 indicates that the agricultural sector (including forestry and fisheries) is the main contributor, followed by construction, large trade and retail, and government administration. The remaining sectors contribute less than 5%. Meanwhile, 74% of the agricultural sector consists of fisheries<sup>18</sup>, and absorbs 25% of the workforce.<sup>19</sup> Aside from fisheries, tourism (indicated by the hotel and restaurant sector) could be the next important sector. Recently, Natuna's government indicated 11 locations to be developed for tourism.<sup>20</sup>

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<sup>13</sup> *Statistik Daerah Kabupaten Natuna (DKN) 2016*

[https://natunakab.bps.go.id/website/pdf\\_publicasi/Statistik-Daerah-Kabupaten-Natuna-2016.pdf](https://natunakab.bps.go.id/website/pdf_publicasi/Statistik-Daerah-Kabupaten-Natuna-2016.pdf)

<sup>14</sup> Statistik DKN 2016.

<sup>15</sup> Ministry of Energy and Mineral Resources.

<http://lifting.migas.esdm.go.id/lifting/laporan/perdpmkkks>

<sup>16</sup> <https://finance.detik.com/wawancara/3255500/natuna-daerah-kaya-sumber-daya-yang-diincar-china> (29/05/2017)

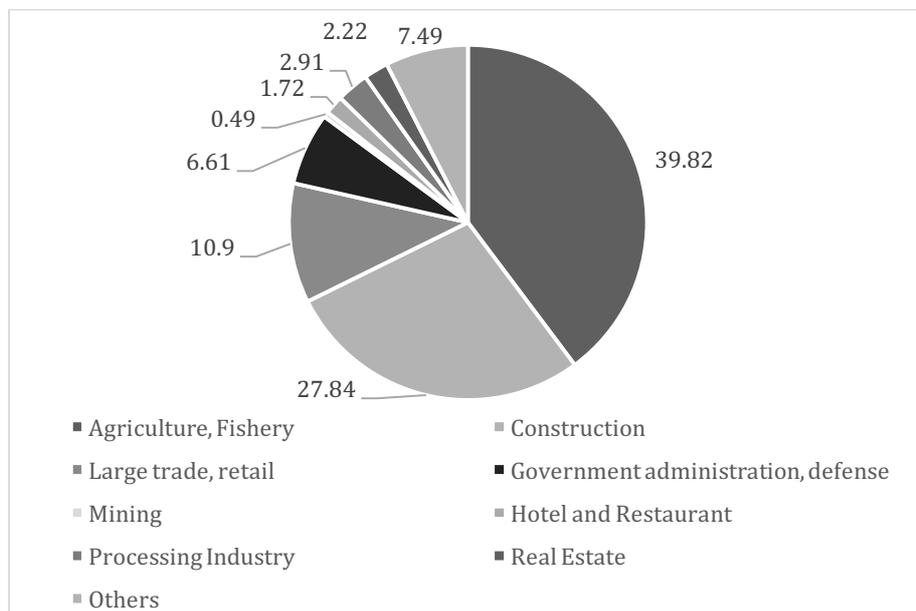
<sup>17</sup> Natuna's pipeline is one of four supplying gas to Singapore. It carries 325 mmscfd, the second largest after the South Sumatra's pipeline carrying 350 mmscfd. <http://www.eiwatch.org/country-profile/singapore/> (31/05/2017)

<sup>18</sup> Natuna's RGDP 2011-2015, p.83. [https://natunakab.bps.go.id/website/pdf\\_publicasi/Produk-Domestik-Regional-Bruto-Kabupaten-Natuna-Menurut-Lapangan-Usaha-2011-2015.pdf](https://natunakab.bps.go.id/website/pdf_publicasi/Produk-Domestik-Regional-Bruto-Kabupaten-Natuna-Menurut-Lapangan-Usaha-2011-2015.pdf) (31/05/2017).

<sup>19</sup> Statistik DKN 2016.

<sup>20</sup> <http://marwahkepri.com/2017/05/20/genjot-sektor-pariwisata-pemda-natuna-bentuk-tp3n/> (30/05/2017).

**Figure 1: Percentage of RGDP by Industry in Natuna, 2015**



Source: *Produk Domestik Regional Bruto Kabupaten Natuna Menurut Lapangan Usaha 2011-2015*, modified:

[https://natunakab.bps.go.id/website/pdf\\_publicasi/Produk-Domestik-Regional-Bruto-Kabupaten-Natuna-Menurut-Lapangan-Usaha-2011-2015.pdf](https://natunakab.bps.go.id/website/pdf_publicasi/Produk-Domestik-Regional-Bruto-Kabupaten-Natuna-Menurut-Lapangan-Usaha-2011-2015.pdf)

Table 1 shows a positive trend in Natuna’s RGDP at constant prices, going from IDR 2.88 trillion to IDR 3.47 trillion. However, RGDP’s growth rate is slowing down.

**Table 1: Natuna’s RGDP Without Oil and Gas 2012-2015 (in million IDR)**

Year	RGDP Current Prices	RGDP Constant Prices	Growth
2012	3,211,538.70	2,878,080.56	6.81
2013	3,635,638.80	3,071,659.64	6.71
2014	4,030,543.10	3,274,436.18	6.60
2015	4,421,470.40	3,467,118.60	5.88

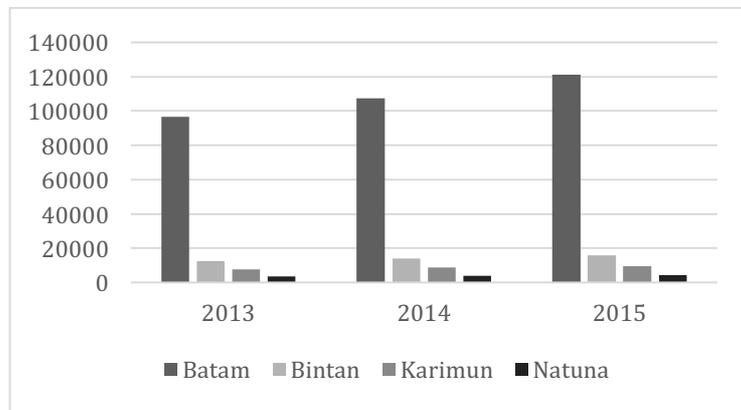
Source: *Indeks Pembangunan Manusia Kabupaten Natuna 2016*, modified.

[https://natunakab.bps.go.id/website/pdf\\_publicasi/Indeks-Pembangunan-Manusia-Kabupaten-Natuna-Tahun-2015.pdf](https://natunakab.bps.go.id/website/pdf_publicasi/Indeks-Pembangunan-Manusia-Kabupaten-Natuna-Tahun-2015.pdf)

A comparison with other Kepri districts indicates that Natuna’s local economy is not doing well. Figure 2 shows the RGDPs of Natuna, Batam, Bintan and Karimun in 2013-2015. The

three other districts used to form a free trade zone to take advantage of their proximity to Singapore.<sup>21</sup> Natuna has the lowest RGDP compared to these non-oil-and-gas districts.

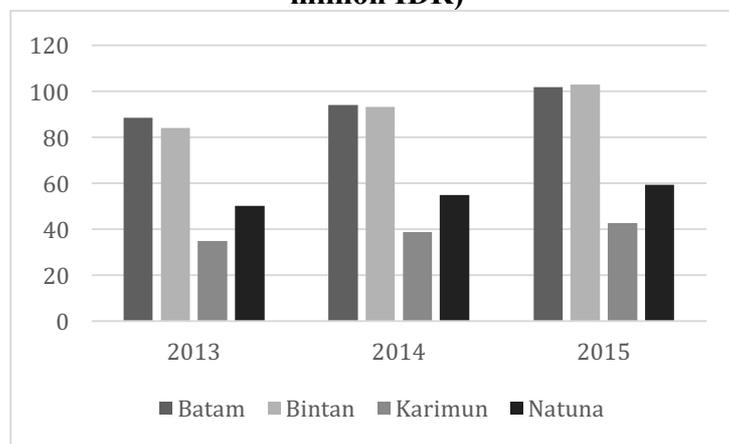
**Figure 2: RGDP of Natuna, Batam, Bintan and Karimun 2013-2015 (in million IDR)**



Source: *Statistik Daerah Kota Tanjung Pinang 2016*, modified. [https://tanjungpinangkota.bps.go.id/website/pdf\\_publicasi/Statistik-Daerah-Kota-Tanjungpinang-2016.pdf](https://tanjungpinangkota.bps.go.id/website/pdf_publicasi/Statistik-Daerah-Kota-Tanjungpinang-2016.pdf)

A region’s welfare level can be seen from its RGDP per capita. Figure 3 shows that in 2013-2015, Batam and Bintan had the highest RGDP per capita while Natuna, despite the increase of 9.5% in 2014 and 8.15% in 2015, is only slightly better than Karimun.

**Figure 3: RGDP per capita of Natuna, Batam, Bintan and Karimun 2013-2015 (in million IDR)**



Source: *Statistik Daerah Kota Tanjung Pinang 2016*, modified.

<sup>21</sup> For Batam, Bintan and Karimun, see Mulya Amri, "A periphery serving three cores." *The SIJORI Cross-Border Region: Transnational Politics, Economics, and Culture* (ISEAS Publishing 2016): 154.

## DEPENDENCE ON CENTRAL GOVERNMENT TRANSFERS

In a decentralized system, transfers from the central government to sub-national units aim to fund the activities of local governments as well as reduce imbalances in resource distribution and public services.

However, transfer dependency occurs when a region lacks its own revenue sources, or when there is a gap between its spending and its own revenues (total revenues minus transfers received).<sup>22</sup> This pushes local governments to use central government grants for unproductive spending such as salaries; lowers the accountability of local authorities; and decreases their tax effort – all due to the anticipation that the gap would be covered by additional transfers. Transfer dependency creates inefficient revenue mobilization, as any increase (e.g. in local tax collection) begets a decrease in central transfers.<sup>23</sup> Despite these negative effects, transfers are still necessary because they allow the central government to control sub-national spending. Equalization grants are also needed to assist poorer regions and amend horizontal imbalances and disparities in revenue-raising capacity.

Indonesia's intergovernmental transfers consist of General-Purpose Grant (*DAU*), Specific-Purpose Grant (*DAK*) and Revenue Sharing (*DBH*). In 15 years, total transfers increased from IDR 81.1 trillion in 2001 to IDR 770 trillion in 2016<sup>24</sup> or 38% of total central government's expenditures. Such a burden on the national budget made the government introduce a moratorium on *pemekaran* in 2009.<sup>25</sup> Furthermore, most of these transfers are used for salary and wages, and not capital expenditures.<sup>26</sup> In 2016, when the government postponed the transfers of DAU of IDR 19.4 trillion to 196 regions, many of these regions claimed they could not pay their civil servants' salaries.<sup>27</sup>

For Natuna, its dependence on central transfers, especially revenue sharing for oil-and-gas producing regions (*DBH migas*), is reflected in its annual budget. Figure 4 shows that Natuna's own revenues constitute less than 6% of its total revenue. Moreover, *DBH migas*, which constitutes a significant portion of the transfers, fluctuates with oil prices. *DBH*'s

<sup>22</sup> Luc Eyraud and Lusine Lusinyan. "Decentralizing Spending More than Revenue: Does It Hurt Fiscal Performance?" *IMF Working Paper*, WP 11/226, 2011.

<sup>23</sup> Anwar Shah, Riatu Qibthiyah, and Astrid Dita. "General purpose central-provincial-local transfers (DAU) in Indonesia: From gap filling to ensuring fair access to essential public services for all." *World Bank Policy Research Working Paper* 6075, 2012.

<sup>24</sup> *Nota Keuangan APBN* (National Budget Statement) 2016, Indonesian Ministry of Finance. <http://www.kemenkeu.go.id/Data/nota-keuangan-apbn-2016>.

<sup>25</sup> The moratorium was introduced after a rampage by the supporters of Tapanuli region's separation from North Sumatra province killed the latter's parliament speaker. *Pemekaran* has been rampant, leaving the country with a total of 542 regions, all of which receive fund transfers from Jakarta, while only 7% have an income higher than 20% of total revenue.

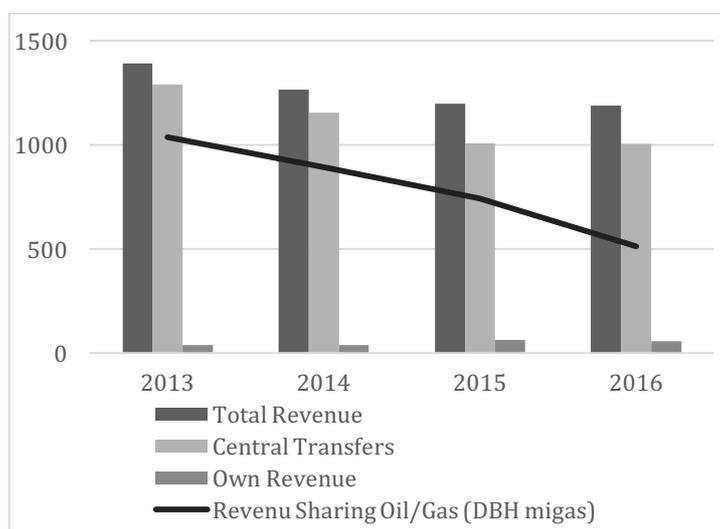
<sup>26</sup> Deasy Simandjuntak, "Bringing the (Central) State Back In: Governing *Pemekaran* in Indonesia." *ISEAS Perspective* 22, 2015.

[https://www.iseas.edu.sg/images/pdf/ISEAS\\_Perspective\\_2015\\_22.pdf](https://www.iseas.edu.sg/images/pdf/ISEAS_Perspective_2015_22.pdf)

<sup>27</sup> <http://www.hukumonline.com/berita/baca/lt57bfe6282c0db/ini-alasan-pemerintah-tentukan-daerah-terkena-penundaan-penyaluran-dau> (26/05/2017).

sharp decline in 2014-2016 was due to the decrease in international oil prices.<sup>28</sup> This decline roused protests from oil-and-gas regions, which called for greater transparency in the central state’s handling of this sector’s revenues.<sup>29</sup>

**Figure 4: Natuna’s Regional Budget 2013-2016 (in million IDR)**



Source: *Natuna’s Regional Budgets 2013-2016*, modified.

The decline draws attention to Jakarta’s calculation on DBH allocation. During *pemekaran*, some districts were created based on the myth of their oil-and-gas “wealth”. In practice, depending on their location, some oil and gas wells might not fall within the districts and thus most of the revenues might not be going to the districts. Table 2 shows that the district is considered a producing region only for wells which are 0-4 miles offshore. For wells 4-12 miles out, the province is the producing region. For wells located further away than 12 miles, 100% of the revenues go to the central government. The table also shows that even for wells within 0-4 miles, the producing district has to share its revenues with the province and other non-producing districts. Depending on the number of districts, the province might end up receiving more revenue than the producing district itself.

<sup>28</sup> Natuna’s 2016 DBH was only IDR 11 billion. <http://wartakepri.co.id/2016/03/24/pembagian-dbh-berkurang-rp589-miliar-ini-sikap-ketua-dewan-natuna/> (29/05/2017).

<sup>29</sup> <http://www.republika.co.id/berita/ekonomi/makro/16/05/27/o7tt1f382-pemda-minta-pemerintah-pusat-transparan-soal-dana-bagi-hasil-migas> (29/05/2017).

**Table 2: Oil and gas region zoning and DBH allocation**

		District as producer 0-4 miles	Province as producer 4-12 miles	Centre as producer >12 miles
Oil	Centre	84.50%	84.50%	100%
	Province	3.10%	5.17%	0
	District (origin)	6.20%	0	0
	Districts (all/other)	6.20%	10.33%	0
Gas	Centre	69.50%	69.50%	100%
	Province	6.10%	10.17%	0
	District (origin)	12.20%	0	0
	Districts (all/other)	12.20%	20.33%	0

Source: Law 33/2004 on “Fiscal balance between central government and regional governments” (*Perimbangan Keuangan Antara Pemerintah Pusat dan Pemerintah Daerah*), art.14e-f, 19, 20.

Most wells in Natuna are located further than 12 miles out, and so the revenues go to the central government. Moreover, for wells found within 4-12 miles of the coast,<sup>30</sup> more revenues go to the province than to the district.

The drive to secure more DBH also explains Natuna’s local government’s recent push to make the district, and the neighbouring oil and gas district Anambas, their own province. It would however be difficult to pursue this, due to the moratorium on *pemekaran*, the population and district/cities threshold which Natuna-Anambas does not fulfill, and Kepri province’s opposition to the idea. Kepri would lose its only DBH migas source.<sup>31</sup>

## **SOLVING THE CONUNDRUM?**

The article highlights the following:

Firstly, as one of Indonesia’s largest oil-and-gas regions, Natuna is one of Singapore’s main gas suppliers.

Secondly, due to Indonesia’s fiscal structure, Natuna cannot fully benefit from its oil and gas. This makes it dependent on central transfers, especially the revenue sharing for oil-and-

<sup>30</sup> <http://lifting.migas.esdm.go.id/lifting/informasi/profildpm/1340300> (30/05/2017).

<sup>31</sup> Among oil regions, in 2013, Kutai-Kertanegara district also wanted to create a province. Offshore of this district is the “Mahakam Block”, the third largest oil deposit in Indonesia. Due to its location, the block “belongs” to East Kalimantan province. The discourse fizzled out due to the *pemekaran* moratorium.

gas regions. In recent years, Natuna's budget underwent severe cuts due to drops in international oil prices.

Thirdly, the recent push to create Natuna-Anambas province was aimed at securing more central transfers. However, Jakarta declined and allocated development funds through the *gerbangdutas* program instead. While this gives Natuna the much-needed funds, it also means that the district continues to be dependent on centrally-provided resources. Since central transfers have burdened the national budget, it is crucial for Jakarta to focus on developing local revenue-raising capacity instead of continuing with the top-down grant transfers approach.

Lastly, the drive to get central transfers has stimulated the demands for new provinces and districts. Jakarta should revisit its fiscal structure to put a hold on the proliferation of sub-national units.

The following aspects are important to consider where Natuna's economic future is concerned:

First, oil and gas revenues may not contribute to Natuna's own income. However, unlike other *gerbangdutas* regions such as Alor, which lacks resources, Natuna has sectors worth developing, such as fisheries and tourism. In Natuna, however, some development projects have been neglected after being launched. In 2014, the government began building an integrated fish harbour in Natuna's Lampa Strait, but this remains uncompleted despite IDR 200 billion already spent.<sup>32</sup> A Natuna parliamentarian has thus expressed concern that the *gerbangdutas* would only focus on security and neglect economic sectors.<sup>33</sup> It is crucial that, through good monitoring, the central government remains committed to developing Natuna's local economy.

Second, a recent provinces' competitiveness index indicated that, especially for Kepri, there is a lack of governing capacity and coordination of local governments.<sup>34</sup> In general, regional autonomy has created multiple layers of licensing authorities, which begets confusion and discourage investment. More clarity in this area is thus crucial to boost investment in Natuna.

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<sup>32</sup> <http://batampos.co.id/2016/08/20/pembangunan-pelabuhan-perikanan-selat-lampa-sudah-habiskan-anggaran-rp-200-miliar/> (29/05/2017).

<sup>33</sup> <http://www.metrokepri.com/marzuki-nilai-pemerintah-pusat-tidak-komitmen-bangun-natuna/> (29/05/2017).

<sup>34</sup> Tan Khee Giap et al. *2015 Annual Competitiveness Analysis and Development Strategies for Indonesian provinces* (World Scientific Publishing, 2017): 136.

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