

# PERSPECTIVE

RESEARCHERS AT ISEAS – YUSOF ISHAK INSTITUTE ANALYSE CURRENT EVENTS

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## **A Special Law for Archipelagic Provinces: Is it Necessary for Kepri?**

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### **EXECUTIVE SUMMARY**

- This year, the Indonesian parliament will deliberate on a bill which would give special status to “archipelagic” provinces, or those whose territorial waters are larger than their land areas.
- The bill’s most important aspect is a change in the formula of the general-purpose grant (DAU), or the central government’s main fund transfer to the regions, aimed at reducing fiscal inequalities among the regions. The current DAU formula only considers variables such as the size of land areas and of the population. With this formula, archipelagic provinces have been receiving less transfers than terrestrial provinces. The new bill seeks to include the size of provincial waters in the formula in order to increase the DAU for archipelagic provinces.
- However, increasing DAU based on territorial waters will not reduce fiscal inequalities across regions, as the increase of transfers to archipelagic regions will decrease those to non-archipelagic regions. Moreover, increasing central transfers will also perpetuate the dependence of the regions on central government resources.
- For Kepri, the province’s relative independence from central transfers means that it can opt for developing its main economic sectors on its own instead of aspiring to get more resources from Jakarta.

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## INTRODUCTION

On 29 January 2018, representatives of eight “archipelagic provinces”, led by the Riau Islands (Kepri) government, met in Batam to push for the ratification of the bill on “the governance of archipelagic regions”.<sup>1</sup> Last year, the DPR included the bill in its priority list to be deliberated in 2018. If ratified, the new law will alter the fiscal relations between the central government and archipelagic regions. Ratification will give these provinces “special region” status and, more importantly, special additional transfers from Jakarta.

Archipelagic, or aquatic-terrestrial, provinces are those with territorial waters comprising more than 75% of their total size. In concrete terms, these are Kepri (96%), Maluku (93%), North Maluku (91%), East Nusa Tenggara (88%), West Nusa Tenggara (85%), North Sulawesi (79%), Bangka-Belitung (76%) and Southeast Sulawesi (72%). Some of these are among the poorest in the country. In 2017, East Nusa Tenggara was Indonesia’s third poorest province, Maluku the fourth, and West Nusa Tenggara the eighth.<sup>2</sup>

In December 2017, the Deputy Head of the Regional Representative Council (DPD), or the Indonesian Senate – the institution that first proposed the bill in 2012 – mentioned that the President has agreed to deliberate on it with the Parliament and DPD this year.<sup>3</sup> Kepri’s governor Nurdin Basirun mentioned that his province would welcome additional fund transfers from Jakarta to boost Kepri’s local welfare and “pride”, as a province that “borders foreign countries”.<sup>4</sup> Similarly, North Maluku’s vice-governor highlighted the need to improve the maritime security of the archipelagic province,<sup>5</sup> while North Sulawesi’s vice-governor said that archipelagic regions deserved “a special treatment” due to their distinct “geo-economic and geo-political” characteristics.<sup>6</sup>

But despite the support of the archipelagic provinces’ governments for the bill, the question is being raised whether a special law on archipelagic regions is really necessary. A political observer from Kepri agrees that the central government needs to prioritise the development of archipelagic regions, but what it should do is to issue a government regulation, not create a separate law. According to him, this is because some of the bill’s important tenets, such as the scope of “provincial waters” being 0-12 miles offshore, have already been included in the existing 2014 Law on Regional Governments.

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<sup>1</sup> <https://www.antaranews.com/berita/681378/delapan-provinsi-kepulauan-sepakati-deklarasi-batam> (accessed 05/02/18).

<sup>2</sup> Poverty rate of Indonesian provinces in *Laporan Bulanan Data Sosial Ekonomi* Edisi 90 (transl. “Monthly Report of Socio-Economic Data”, edition 90). Badan Pusat Statistik, November 2017: 153.

<sup>3</sup> <http://www.dpd.go.id/artikel-513-nono-sampono-pengesahan-ruu-daerah-kepulauan-percepat-perwujudan--indonesia-poros-maritim-dunia> (accessed 22/01/18).

<sup>4</sup> <http://batam.tribunnews.com/2017/12/08/gubernur-nurdin-basirun-ingin-uu-daerah-kepulauan-segera-disahkan-ini-kebaikannya-bagi-kepri?page=all> (accessed 22/01/18)

<sup>5</sup> <https://centralbatam.co.id/dukung-uu-daerah-kepulauan-dibahas-bks-provinsi-kepulauan/> (accessed 22/01/18).

<sup>6</sup> <https://trensulut.com/eksekutif/wagub-sulut-dukung-penuh-ruu-daerah-kepulauan/> (accessed 19/01/18).

This article aims to shed light on how an ‘asymmetrical’ decentralization (or a special status system) based on several regions’ distinct socio-political characteristics has been implemented in Indonesia so far, and how a new regulation on archipelagic provinces will affect Kepri’s governance and welfare.

## **ARCHIPELAGIC PROVINCES AND FISCAL TRANSFERS**

In 2005, recognizing their geographic and socio-economic similarities, Indonesian archipelagic provinces established a forum to discuss policies to boost their local economies. By 2012, the Indonesian senate had proposed a bill on the governance of archipelagic regions. The Law on Regional Governments from 2014 acknowledged the size of provincial waters in the formula of the general purpose grant or DAU<sup>7</sup> which theretofore took into account only the factors of land areas and population.

Archipelagic provinces’ populations tend to be smaller than those of terrestrial provinces. For example, of Kepri’s total size of 251,810 km<sup>2</sup>, 241,215 km<sup>2</sup> is water, and its scattered islands – around 2,408 of them – only have 2 million inhabitants. This starkly differs for example from the neighbouring terrestrial province of Riau, from which Kepri separated in 2002, whose total size is only 88,672.67 km<sup>2</sup>, but it has a population of more than 6 million. These characteristics resulted in smaller sums of DAU being transferred to archipelagic provinces compared to terrestrial provinces, and in turn constrained the former’s revenues and development.

Despite the 2014 Law’s inclusion of provincial waters’ size in the DAU’s formula, the above provinces nevertheless deem it necessary to have the bill ratified into a separate Law, especially to increase the amount of central transfers from Jakarta. The bill is also said to alter the management of natural resources (for example fisheries and off-shore mining) within provincial waters, since there would be a difference in the scope of “provincial waters” between archipelagic and terrestrial provinces.

## **THE ‘SYMMETRICAL’ DECENTRALIZATION**

The Indonesian 1999 decentralization reforms were enacted upon the collapse of the highly centralized New Order regime, to appease anti-Jakarta sentiments in the outer regions and satisfy the demands of international lending agencies. Despite its many weaknesses<sup>8</sup>, decentralization has been relatively successful in deterring secessionist sentiments. However, the hasty manner in which it was implemented meant that there was a lack of preparation for the large-scale changes it implied.<sup>9</sup>

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<sup>7</sup> DAU is transferred annually, with the aim to reduce fiscal inequality across regions.

<sup>8</sup> Edmund J. Malesky, and Francis E. Hutchinson. "Varieties of disappointment: why has decentralization not delivered on its promises in Southeast Asia?" *Journal of Southeast Asian Economies (JSEAE)* 33.2 (2016): 125-138.

<sup>9</sup> Kai Ostwald, Yuki Tajima & Krislert Samphantharak. "Indonesia’s Decentralization Experiment: Motivations, Successes, and Unintended Consequences." *Journal of Southeast Asian Economies (JSEAE)*, vol. 33 no. 2, 2016, pp. 139-156.

The initial ‘big bang’ decentralization, regulated by Law No. 22/1999, transferred substantial policy-making authority to the districts, or sub-provincial units. Districts were given power to manage all sectors previously controlled by the central government, including education, health, and natural resource management, except for strategic sectors such as defence/security, foreign policy, judiciary, monetary, and religion. District heads were no longer appointed by the Minister of Home Affairs upon consultation with provincial governors, but elected by district parliaments. Provinces were thus significantly weakened, as they functioned only as mediators of the districts.

On the fiscal side, Law No. 25/1999 obliged the central government to transfer funds to the now ‘autonomous’ districts. Two major ones were the general-purpose grant (DAU) to assist local governance, and the special funds (DAK) for local health, education, irrigation and reforestation.

In 2004, the government issued Law no. 32/2004, ruling that district heads were to be directly elected by local residents. This began a new era in local politics, where local administrators became politicians, as local patrons vied to secure power by running in elections.<sup>10</sup>

Meanwhile, Indonesia’s administrative units proliferated, as regional splitting (*pemekaran*) was believed to be the solution for problems of efficiency and distributive policies. Between 1998 and 2014, the number of provinces and districts/municipalities increased from 341 to 542. In many cases, *pemekaran* were instigated by local elites who aimed at gaining access to central government resources.<sup>11</sup> Meanwhile the majority of new administrative units failed to improve local welfare.<sup>12</sup> Failing to generate more income from their own sources, these regions became dependent on central government transfers to finance basic needs such as the salaries of local civil servants.<sup>13</sup>

On the fiscal side, starting in 2005<sup>14</sup> a symmetrical allocation of DAU to each administrative unit was determined by adding the sum of local civil service salary (dubbed ‘basic

<sup>10</sup> See Deasy Simandjuntak, "Gifts and promises: Patronage democracy in a decentralised Indonesia." *European Journal of East Asian Studies* 11.1 (2012): 99-126; Maribeth Erb and Priyambudi Sulistiyanto, eds., *Deepening democracy in Indonesia? Direct elections for local leaders (Pilkada)*. Institute of Southeast Asian Studies, 2009; Henk Schulte Nordholt and Gerry Van Klinken, eds. *Renegotiating Boundaries: Local politics in post-Suharto Indonesia*. Leiden: Brill, 2007.

<sup>11</sup> Fitria Fitriani, Bert Hofman, and Kai Kaiser. "Unity in diversity? The creation of new local governments in a decentralising Indonesia." *Bulletin of Indonesian Economic Studies* 41.1 (2005): 57-79. Deasy Simandjuntak, "Bringing the (Central) State Back In: Governing *Pemekaran* in Indonesia." *ISEAS Perspective* 22 (2015).

<sup>12</sup>

<http://nasional.kompas.com/read/2015/07/11/16491141/Kemendagri.Perketat.Pemekaran.Daerah.Baru> (accessed 22/01/18)

<sup>13</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>14</sup> *Peraturan Pemerintah No. 55/2005 tentang Dana Perimbangan* (Government Regulation 55/2005 on Balance Funds).

allocation’) and the fiscal gap. The fiscal gap is the difference between local government (fiscal) needs and capacity (see Appendix 1, DAU Formula). Fiscal capacity is the sum of a province’s or district’s own-income revenues and the amount of revenue-sharing fund (DBH) from the central government. Fiscal needs consist of the total expenditures of the province/district, population size index, regional gross domestic product (RGDP) per capita index, human development index, construction price index, and the size of land area index. Each variable has different weights ( $\alpha$ ) which shows their significance in the calculation (see Appendix 2, Variables’ weightage in the calculation of fiscal needs- Kbf).

The fact that the DAU formula depends on the size of population and the size of land area, and not provincial waters, means that archipelagic regions tend to receive a smaller DAU than land-based regions.

On the governance side, despite its ‘symmetrical’ nature, Law No. 32/2004 acknowledged an ‘asymmetrical’ treatment for some regions, taking into account their unique socio-political, economic and cultural characteristics. Such special status results in a special calculation of central transfers.

## TOWARDS AN ‘ASYMMETRICAL’ DECENTRALIZATION

The debate of ‘symmetry’ vs ‘asymmetry’ in the discourse of federalism is not new. Charles Tarlton, a leading scholar of this subject, highlights their differences in terms of *conformity* and *commonality*. A symmetrical system is suitable for countries comprised of units with “equal territory and population, similar economic features, climatic conditions, cultural patterns, social groupings, and political institutions” while an asymmetrical model has units with “a unique feature or set of features which would separate in important ways, [their] interests from those of any other state or the system considered as a whole”.<sup>15</sup>

Indonesia has enacted asymmetrical decentralization in Jakarta, Yogyakarta, Papua (and West Papua) and Aceh. Jakarta’s function as capital city gives it a special provincial status despite having non-elected mayors for its administrative ‘towns’. Yogyakarta’s special status derives from its history as the seat of the Yogyakarta Sultanate prior to Indonesia’s independence and the role of its former king, Sultan Hamengkubuwono IX, in the struggle against colonialism. In 2012, this status was strengthened by a Law recognizing Yogyakarta’s hereditary sultans as de jure governors of the province.

Law No. 1/2001 rules that Papua is governed by the Papuan People Assembly in addition to the customary executive, legislative and judiciary branches. It also regulates special fiscal transfers from Jakarta. Aceh’s special status was reinforced by the 2016 Law of Aceh Governance (UUPA) as an effort to maintain peace after decades of struggle against the central government. UUPA recognizes Islamic (*sharia*) principles as the basis of local

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<sup>15</sup> Charles D. Tarlton, "Symmetry and asymmetry as elements of federalism: A theoretical speculation." *The Journal of Politics* 27.4 (1965): 861-874

governance, Aceh's local parties and a special calculation of revenue-sharing funds (*DBH*) for its natural gas production.

There are opposing arguments with regard to the above special statuses because they have not improved local welfare and have instead complicated governance.<sup>16</sup> Papua, for example, receives 80% of the revenues from its forestry, fishery and mining sectors, and 70% of its oil and gas income until 2026, and 50% thereafter.<sup>17</sup> This is much more than what other provinces receive. Total additional special autonomy and infrastructure funds to Papua in 2002-2016 amounted to IDR 59 trillion (USD 4.4 billion).<sup>18</sup> However, the special treatment has not significantly improved local welfare. Papua's poverty rate since 2014 stays stagnant at around 28%, the highest in Indonesia.<sup>19</sup>

Although Aceh's local economy is slightly better, its 2016 poverty rate was 16.43%, making it the seventh poorest province in the country.<sup>20</sup> Some observers believe that the total of IDR 57 trillion (USD 4.2 billion) of 'special autonomy funds' it received from Jakarta in 2008-2016 was not managed well.<sup>21</sup> Reports mention that the provincial government seems to control the funds' allocation with little consultation with the districts.<sup>22</sup> Moreover, because the provincial government is controlled by former *Gerakan Aceh Merdeka* (Freedom of Aceh Movement - GAM) combatants, these funds are mostly channelled to villages inhabited by former GAM sympathizers.<sup>23</sup>

The experience of Aceh and Papua poses a question about whether a special status is the best way forward in terms of improving local welfare.

<sup>16</sup> Robert Endi Jaweng, "Kritik Terhadap Desentralisasi Asimetris Di Indonesia." *Analisis CSIS* (2011): 160-176.

<sup>17</sup> Budy P. Resosudarmo, et al. "Development in Papua after special autonomy." In Hal Hill, eds. *Regional dynamics in a decentralized Indonesia*, Institute of Southeast Asian Studies (2014): 433-459.

<sup>18</sup> *Penerimaan Dalam Rangka Pelaksanaan Otonomi Khusus Bagi Papua* (Revenues for the implementation of special autonomy of Papua), Papua Provincial Finance and Asset Management Board, <https://bpkad.papua.go.id/dana-otsus/18/penerimaan-dalam-rangka-pelaksanaan-otonomi-khusus-bagi-provinsi-papua.htm> (accessed 22/22/2017).

<sup>19</sup> *Indikator Kesejahteraan Rakyat Provinsi Papua* (Welfare Indicators of Papua Province) 2016, Badan Pusat Statistik Provinsi Papua, 2017.

<sup>20</sup> *Indikator Kesejahteraan Rakyat Provinsi Aceh* (Welfare Indicators of Aceh Province) 2016, Badan Pusat Statistik Provinsi Aceh, 2017.

<sup>21</sup> <http://harian.analisdaily.com/aceh/news/aceh-terima-dana-otsus-rp5667-triliun/337813/2017/04/04> (accessed 24/11/2017).

<sup>22</sup> <http://aceh.tribunnews.com/2017/03/14/menyoal-qanun-tata-kelola-dana-otsus?page=2> (accessed 24/11/2017).

<sup>23</sup> This is according to a researcher of the Indonesian Institute of Sciences (LIPI), see <https://www.cnnindonesia.com/nasional/20171024123235-20-250590/dana-otsus-tak-efektif-kikis-kesenjangan-di-aceh-diy-papua/> (accessed 24/11/2017).

## **TAKING WATERS INTO CONSIDERATION: IS IT NECESSARY FOR KEPRI?**

The current Law on Regional Government No. 23/2014 has, in fact, acknowledged the distinct characteristics of archipelagic regions. Article 29 paragraph 2 mentions that the calculation of DAU for archipelagic provinces must consider the size of provincial waters. Paragraph 6 mentions that the central government will allocate an ‘acceleration fund’ to these provinces, in addition to DAU and DAK.

Law on Maritime Affairs No. 32/2014 also strengthens the case for archipelagic regions. Its article 15 paragraph 4 stipulates that “[...] the government is obliged to include the size of sea areas as the basis for Maritime Development budget allocation”. Paragraph 5 specifies that this development budget derives from the provincial/district budget.

Moreover, since 2014, the size of regional (provincial and district) waters has de facto played a role in the DAU formula (see Appendix 2). While the weightage of the variables regarding fiscal needs stays the same, the weightage of the size of waters’ as part of the ‘area index’ has increased over the years. Recently the government revealed a plan to increase the weightage of regional waters by 100%, or double the current percentage.<sup>24</sup>

However, a simulation study done in 2012 on the DAUs of archipelagic provinces using 2011 data revealed that, although the increase of provincial waters’ weightage from 30% to 100% would boost their DAU, it would not significantly raise provincial economic growth.<sup>25</sup> The simulation also showed that an increase of more than 80% would not result in equitable financial capacity, as the increase of DAU of archipelagic regions would reduce those of non-archipelagic provinces.<sup>26</sup>

For Kepri, the rise of the provincial waters’ weightage has increased the DAU that the province received over the years, yet Kepri’s DAU is still smaller than those received by smaller-sized terrestrial provinces whose populations are bigger than Kepri’s, such as Central Kalimantan and Jambi (see charts 1 and 2).

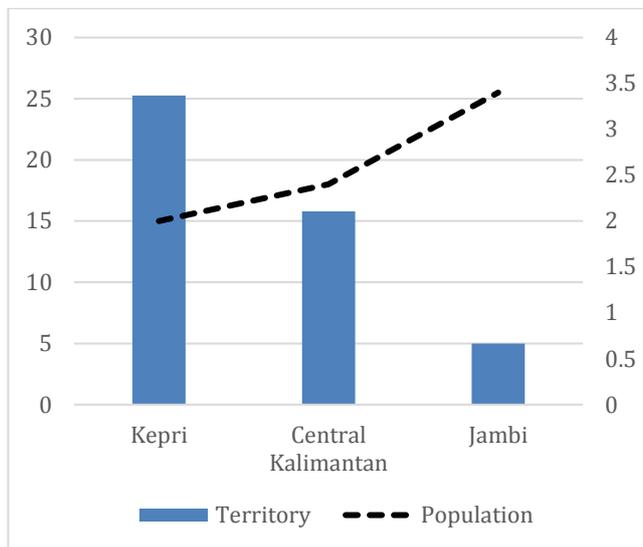
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<sup>24</sup> Kepulauan dapat tambahan: Bobot luas wilayah laut akan dinaikkan dalam dana alokasi umum <https://www.pressreader.com/indonesia/kompas/20170620/281925953008599> (accessed 28/11/2017).

<sup>25</sup> Julian Ong, *Analisa Dampak Rencana Perubahan Formulasi Dana Alokasi Umum: Studi Kasus Provinsi Berciri Kepulauan*, MA Thesis, Faculty of Economics, University of Indonesia, 2012.

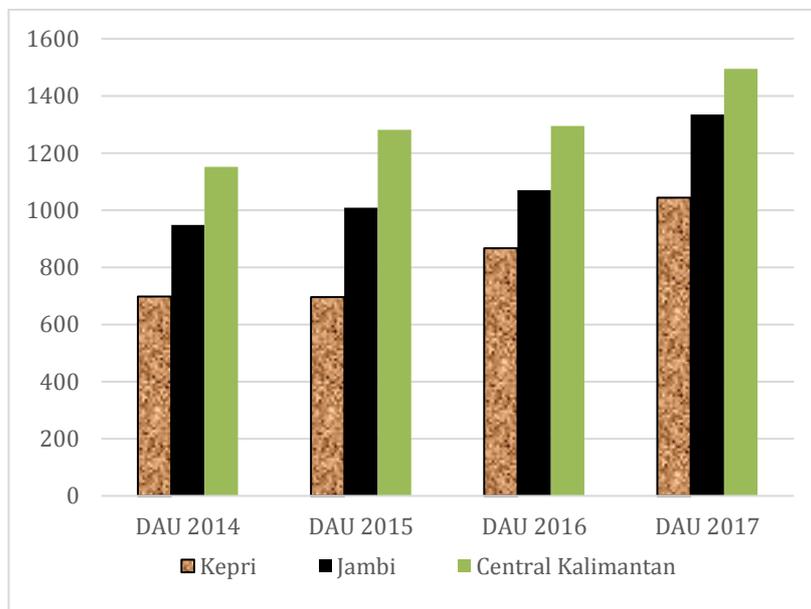
<sup>26</sup> Ong, 2012.

**Chart 1: Territorial (in 10,000 km<sup>2</sup>) and Population (in million) sizes of Riau Islands, Central Kalimantan and Jambi**



\*Sources: provincial government’s websites for territorial size; 2010 Population Census for population size, BPS.

**Chart 2: DAUs of Riau Islands, Central Kalimantan and Jambi (in IDR billion)**

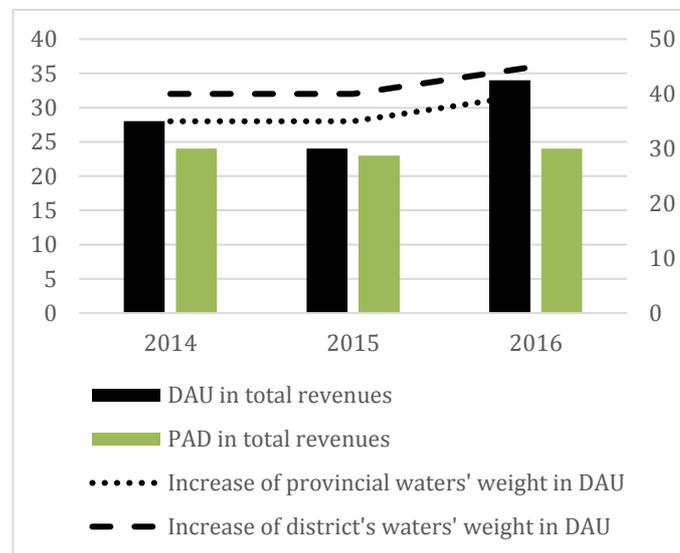


\*Sources: processed from *Anggaran Pendapatan dan Belanja Daerah* (local annual budgets) of Kepri, Jambi and Central Kalimantan provinces in 2014, 2015, 2016 and 2017.

Yet one has to ask, although the amount of Kepri’s DAU may be smaller than the two terrestrial provinces’, but has the size of the provincial water in the DAU really affected Kepri’s revenues?

Chart 3 shows the percentage of DAU and own-income revenues (PAD) in the total revenues of 8 (eight) Riau Islands regions (1 province and 7 districts/municipalities) in 2014-2016. Total revenues consist of own-income revenues (PAD), central transfers (including DAU) and other revenue sources. The chart shows that the stagnation or increase of water area weightage in the calculation of DAU did not significantly influence the percentage of DAU against Kepri’s total revenues.

**Chart 3: Percentage of DAU and PAD against Total Revenues of Kepri’s 8 administrative regions**



\*Source: processed from DJPK regional government of Kepri.

Kepri’s Regional Gross Domestic Product (RGDP) trend instead shows more independence from central transfers. Table 1 shows the percentage of Own-Income (PAD) against Kepri’s RGDP, which indicates the capacity of the region to convert income potential (RGDP) into own-source income (PAD). It shows that a quarter of Kepri’s total revenues comes from its own sources. It also shows an increase of percentage of PAD against total expenditures which indicates that there is a decrease of dependence on the central transfers (including DAU) in financing its expenditures compared to previous years. However, the sum of 24.98% here also shows that in 2016, Kepri’s own-income could only finance a quarter of its total expenditures.

**Table 1**  
**Kepri's Financial Capacity Indicators**

Year	RGDP in trillion	Own-income (PAD) in trillion	Percentage of Own-income (PAD) against RGDP	Percentage of Own-income (PAD) against total revenues	Percentage of Own-income (PAD) against total expenditures
2014	143.36	2.56	1.79	24.17	22.44
2015	155.16	1.68	1.09	23.00	17.80
2016	169.92	2.62	1.54	23.96	24.98

\*Sources: processed from Muhamad Ameer Noor and Didi Setyopurwanto, *Kajian Fiskal Regional Provinsi Kepulauan Riau*, 2015 and 2016 editions, Kanwil Ditjen Perbendaharaan Provinsi Kepulauan Riau.

Kepri also has better financial capacity than some archipelagic provinces, for example North Maluku. In 2016, North Maluku's own-income (IDR 245 billion) made up only 11.3% of its total revenues (IDR 2.17 trillion)<sup>27</sup>, indicating that the province is highly dependent on central transfers. Its own-income's percentage against RGDP (IDR 21.56 trillion) was only 1.13%,<sup>28</sup> indicating that it has less capacity to convert its income potential into own-source income, compared to Kepri. Moreover, North Maluku's own-income made up only 9.2% of its total expenditures (IDR 2.65 trillion)<sup>29</sup>, indicating that its own income can finance only 9.2% of its total expenditures. This is significantly lower than Kepri which can finance a quarter of its expenditures by its own-income.

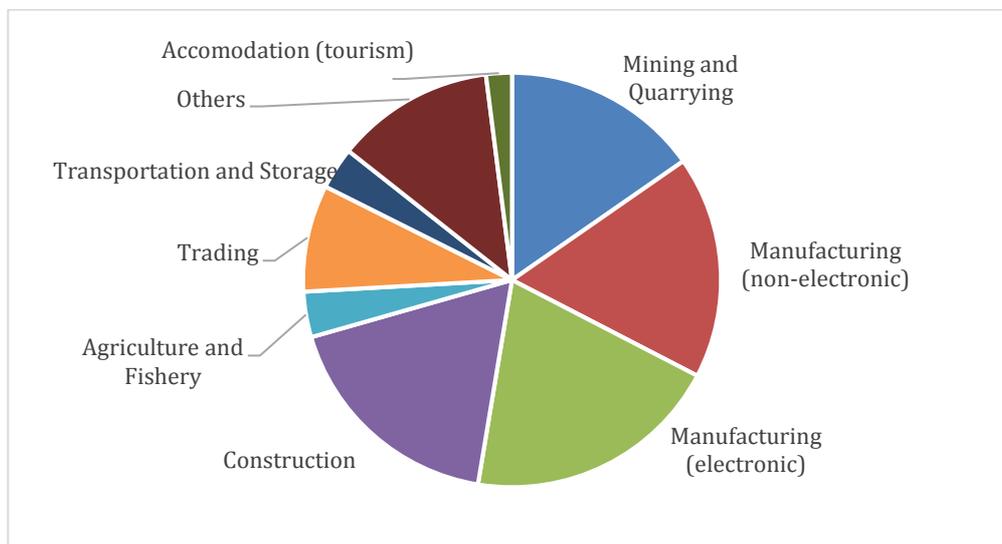
Kepri's gradual independence from central transfers means that the province can opt for developing its main resources to boost its economy. The contributors to the province's economy are manufacturing (38%), construction (18%) and mining and quarrying (16%). Considering the province's proximity to Singapore and Malaysia, tourism will likely contribute to its economy in the future. It would be more useful to focus on developing these main sectors than to aspire for more fiscal sources from Jakarta.

<sup>27</sup> *Kajian Ekonomi dan Keuangan Regional Provinsi Maluku Utara*, Bank Indonesia 2017.

<sup>28</sup> Processed from *Kajian Ekonomi dan Keuangan Regional Provinsi Maluku Utara*, Bank Indonesia 2017 and *Tabel-tabel Pokok PDRB Menurut Lapangan Usaha Provinsi Maluku Utara 2016*, BPS Maluku Utara.

<sup>29</sup> *Kajian Ekonomi dan Keuangan Regional Provinsi Maluku Utara*, Bank Indonesia 2017.

**Chart 4: 2016 Distribution of Kepri’s Gross Domestic Product according to sectors**



\*Source: *Kajian Pertumbuhan Ekonomi Provinsi Kepulauan Riau 2012-2016*, BPS Kepulauan Riau.

Doubling the weightage of territorial waters in the 2018 DAU will no doubt increase the amount of transfers, however, it also raises the concern of how the local government(s) will manage the additional sum. The experience with Aceh and Papua shows that local politics might unfavourably influence the management of local budgets.

Attention should also be given to the governance of archipelagic regions. For example, the fact that the authority on secondary education is now held by the province can restrain the development in this sector because the provincial government is geographically too far away from the districts, where the schools are physically located.

## CONCLUSION

While it is true that archipelagic provinces have so far received smaller general-purpose grants (DAU) compared to terrestrial provinces, to have a separate law adopting the size of territorial waters in the DAU formula may not be necessary, since the same provision was included in the 2014 Law on Regional Governments. Since then, the weightage of water area has steadily risen, and will reach 100% in the 2018 DAU allocation.

Furthermore, while some archipelagic provinces are among the poorest and are thus largely dependent on central transfers, some others, such as Kepri, may not be as dependent. Kepri’s financial capacity indicators show an increase in percentage of own-income against expenditure and in the capacity to convert its gross domestic product into own-income revenues. These show that the province is becoming less dependent on central transfers. Thirdly, the rise in the significance of territorial waters (beyond 80%) in DAU may run counter to the aim of DAU which is to reduce fiscal inequality across regions, since the

DAU increase for archipelagic regions will decrease the DAU for terrestrial regions. Including the size of water areas in the DAU formula may be inevitable due to the high costs of transportation in archipelagic regions, yet it may be more important to revisit their decentralized governance.

Fourthly, the experience of bestowing “special status” to certain regions, such as Papua and Aceh, and sending them extra funding shows that it has not optimally increased local welfare in these areas. Local politics seems to influence the management of their budgets. While the central government’s budget is burdened by these transfers, Jakarta cannot intervene in their management due to the “autonomy” of these regions.

Last but not least, the increase of DAU in general may be counterproductive to decentralization’s aim of increasing the financial capacity of autonomous regions, as it has a tendency to perpetuate the regions’ dependence on central transfers. Instead of increasing DAU, it is better to seek ways to maximize own-income by developing sectors that contribute to RGDP. An asymmetrical decentralization with archipelagic regions can thus be helpful for their economy in the short-run, yet will not encourage their independence from central transfers.

#### APPENDIX 1: DAU FORMULA

DAU = local civil service salary + fiscal gap (CF)

CF = fiscal needs (Kbf) – fiscal capacity (Kpf)

KbF = TBR ( $\alpha_1IP + \alpha_2IW + \alpha_3IKK + \alpha_4IPM + \alpha_5IPDRB/Kap$ )

KpF = PAD + DBH natural resources + DBH tax

DAU = General purpose grant transferred from the central government to the regions

TBR = total expenditures of the province/district

IP = population index

IW = size of area index

IKK = construction price index

IPM = human development index

IPDRB = regional gross domestic product per capita index

$\alpha$  = index weight

PAD = own-income revenues

DBH = revenue sharing funds from natural resources and taxes

**APPENDIX 2: Variables' weightage in Fiscal Needs (KbF) 2014-2016 (percentage)**

KbF variables	2014		2015		2016		2017	
	Province	District	Province	District	Province	District	Province	District
• IP	30	30	30	30	30	30	30	30
• IW	14	13	14	13	15	13	15	13
waters	(35)	(40)	(35)	(40)	(40)	(45)	(45)	(50)
• IKK	27	28	27	28	27	28	27	28
• IPM	15	15	17	17	17	17	17	17
• IPDRB/Kap	14	14	12	12	11	12	11	12

\*Sources: *Kebijakan Keuangan Daerah dan Transfer ke Daerah, Dana Desa, Dana Dekonsentrasi dan Tugas Pembantuan TA 2016*, Indonesian Ministry of Finance, 2016 (for 2014-2015); *Kebijakan Perhitungan Dana Alokasi Umum TA 2017*, Indonesian Ministry of Finance, 2015, (for 2016-2017).

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