



The Fiscal Capacity of The Seven New Provinces and its Implications

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Abstract

Since 2001 the regional autonomy policies have brought out seven new provinces in Indonesia. Consequently, they require the central transfer budget to finance the delegated duties and authorities and the development programs in each province. Since its establishment until today, the fiscal capacity in seven provinces except Banten has not fulfilled the increase in local expenditure needs every year. It still much depends on the central transfer because the local revenue source like PAD is very low. This research uses a descriptive method-analysis by analyzing the secondary data relevant to the discussed topic and using the concept of fiscal capacity in the framework of the fiscal decentralization theory. The results of this qualitative research explain that the high fiscal capacity index (IKF) is obtained by four provinces those are Bangka Belitung, West Papua, Riau, and North Maluku, while the intermediate index is obtained by Banten, and the low fiscal capacity index is obtained by Gorontalo and West Sulawesi. Good fiscal capacity with high index does not guarantee that the poor population in the area will be reduced as West Papua and Riau which populations are still relatively large. Besides, Banten with the very high PAD compared with six other provinces still has a large number of poor population of poor among seven provinces. But, overall the central transfer is recognized to be very helpful for the fiscal capacity of the seven new provinces above.

Keywords: autonomy, fiscal capacity, index, budget; revenue, expenditure

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INTRODUCTION

The grant of autonomous region and an extensive, real, and responsible decentralization to the region since the reform era is three strategic steps in the history of Government in Indonesia. *First*, in the political perspective the regional autonomy and decentralization is the answer to the local problems of the Indonesian nation, among others, the existence of a "threat" of the disintegration of the nation, the high levels of poverty, the uneven (disparity) interregional development, the poor quality of the public life, and the issue of the development of human resources (HR).

Second, the regional autonomy and decentralization is a strategic step for Indonesia to welcome the nation's era of economic globalization by strengthening the regional economy base (Mardiasmo, 2002:59). The essence of granting autonomy is financial (fiscal) decentralization from the central government to the local governments (sub-national governments).

Third, from the aspect of legal-formal, the era of the autonomous region is marked by the appearance of the Law No. 22 of 1999 on the Local Governance and the Law No. 25 of 1999 on the Financial Equalization between the Central and Local Government. Then the Law No. 22 of 1999 was revised by the Law No. 32 of 2004 on the Regional Governments, and the Law No. 25 of 1999 was revised by the Law No. 33 of 2004 on the Financial Equalization between the Central and Local Government, and the various rules of the organization such as the Government Regulation No. 55 of 2005 on the Equalization Funds; and the Government Regulation No. 38 of 2007 on the Divisions of Government Affairs between the govern-

ment, the provincial governance (province), and the local governance (regency/city).

Since the establishment of the autonomous region in 1999 until today, the Government has already established a new autonomous region, either the new provinces or regencies/cities. The new province areas that have already been formed since 1999 are the Riau Islands, Bangka Belitung, Banten, Gorontalo, North Maluku, West Papua, West Sulawesi, and North Kalimantan. One of many factors that encourage the establishment of new provinces in Indonesia is the economic and political factor. The domestic political condition at the start of the autonomy is very easy to establish a new autonomous region because of the euphoria of political society at that time, besides the non-political ones such as economy, poverty, and others. Besides, the policy on one unit (SKPD, autonomous region, and other government units) apparently will influence the policies on the other unit, Maggetti (2015).

The expansion or establishment of the new autonomous regions certainly brings the consequences of the financial side particularly the National Budget (APBN). At the beginning of the formation of the new autonomous region, the regional budget (APBD) of the core area is not adequate to finance the new autonomous region. Therefore, the fiscal transfer to the region was born, including to the new autonomous regions after formally passed in the legislation on the establishment of the new autonomous region respectively

In real terms, the financial ability of the new provinces is very inadequate to finance the governmental administration and development in the regions. This raises the

full dependency on the central government fiscal in APBN every year until today.

One of the purposes of the fiscal transfer is the equalization of fiscal capacity of each region. There is an increase in the central fiscal transfers every year in APBD, but it still cannot meet the demands of the increased needs of the local expenditure every year, either the province or the district/city. In 2010, for example, the fiscal transfers to the region amounted to Rp 344,613 trillions in APBN-P in the fiscal year of 2010. In 2015, the number of fiscal transfers to the region reached Rp 643,8 trillions in APBN-P of 2015, while the village fund allocation amounted Rp 20.7 trillion. From the overall allocation Transfer to the region in 2015, the General Allocation Funds (DAU) magnitude still dominates amounted Rp 352,8 trillions, followed by the Revenue Sharing (DBH) amounted Rp 110,0 trillions and the Specific Allocation Fund (DAK) amounted Rp 58.8 trillions.

Almost all of the autonomous regions, especially the new autonomous regions, have an enormous fiscal dependence on the state budget, except for DKI Jakarta which PAD source is able to finance the majority of its expenditure. But it is also a logical consequence of the political decentralization, in which there is a delegation of the partial government affairs from the center to the provinces/regencies/cities.

This means that the fiscal ability of the autonomous regions to finance various programs and activities of the regional development since the autonomy was enacted is still difficult to release from the fiscal transfer dependency. This is because the source of original regional financing, such as the original regional revenue (PAD) still hasn't been able to finance a part of the

fiscal needs (the regional expenditure) in APBD. Meanwhile the element of PAD is the most important one in measuring the regional fiscal capacity including the new autonomous regions.

Based on the Regulation of the Minister of Finance Republic of Indonesia No. 37/FMD. 07/2015 on the Regional Fiscal Capacity Map, which means that the fiscal capacity is a picture of the financial ability of each region reflected through the general receipt of the Regional Revenue and Expenditure Budget/APBD (not including the Specific Allocation Fund (DAK), emergency fund, old loan fund, and other receipt which use is restricted to finance certain expenditure) to finance the government duties after reduced by the employees' expenditure and associated with the number of poor population.

The core of the regional fiscal capacity is PAD, the general fiscal transfer, and the other formal regional revenue source. If the three variables keep increasing every year, the tendency of the regional fiscal capacity will also be increased. But it is very difficult for the new autonomous region to increase the three regional revenue sources, including PAD, because most regions whether the province or district/city is very difficult to increase the receipt of the PAD.

Besides, most budgets absorbed by the share of employees' expenditure every year is increasing, not only by the employees in the provinces but also those in the regencies/cities. The increase in the share of employees' expenditure in APBD will affect the minimum portion of capital expenditure for the infrastructure development and will reduce the allocation for the goods expenditure in the effort to increase the regional assets.

The element of deduction from the fiscal capacity is the employees' expenditure in APBD. If the employees' expenditure is increasing every the fiscal year, the fiscal capacity will also be reduced. The number of poor population is an element to indicate the magnitude of the fiscal capacity index (IKF). The influx of poor population elements in measuring the IKF is because it is the responsibility of each local government to abolish the poor population, besides it is also the responsibility of the central government through the countermeasure program of poor reduction nationally.

According to Ahmad Yani, (2008; 39-43), the relationship of the central and regional finance is performed in line with the principle of financial equalization between the center and regions in the Law Number 33 of 2004. The financial equalization between the center and regions is the state financial sub-system as the consequence of the division of tasks and affairs between the center and regions. The granting of financial resources of the state to the region is undertaken in the implementation of decentralization with regard for the stability of the national economy and the fiscal balance between the center and regions. The financial granting in the implementation of decentralization is the core of the fiscal decentralization policy.

According to Andres Rodriquex Poses and Roberto Ezcurra (2010), most of the theoretical literature on fiscal decentralization has tended to dwell on the supposedly positive impact of granting greater financial autonomy/transferring resources to subnational tiers of government for both allocative and production efficiency and, eventually, economic growth. The arguments behind this potential positive

association between fiscal decentralization and economic performance are based on a series of simple premises. An important, but often forgotten, the initial premise is that fiscal decentralization implies a mobilization of resources. Subnational governments, by the simple fact of being granted greater autonomy and funds, are compelled into mobilizing the resources in their own territory, rather than wait for solutions or for the provision of public goods and services to come from a central government. This leads to a greater emphasis on economic efficiency across regions and localities within any given country and to tapping into what otherwise may have been untapped potential.

According to Joko Try Harianto (2016), the fiscal decentralization from the expenditure side is defined as the authority to allocate the expenditure in accordance with the discretion of each region. The function of the Central Government is just giving advice and monitoring of implementation. Unfortunately, this pattern makes the implementation of fiscal decentralization and regional autonomy in Indonesia felt getting away from what was aspired previously. The regions thus increasingly depend on the Central Government; there is the practice of dynastic rulers in the regions the rampant corruption behavior of the public officials. The idiom arises telling that the fiscal decentralization and the regional autonomy are only moving the negative externalities of the Central Government in the New Order era towards the local government in the reform era.

The early implementation of the fiscal decentralization in Indonesia aims at creating the aspects of independence in the regions. As a consequence, the regions receive the delegation of authority in all

areas, except for the authority in the field of foreign policy, defence, security, justice, monetary and fiscal, and religious. The delegation of authority is also followed by the submission of funding sources in the form of the submission of the tax bases as well as funding assistance through the mechanism of the Transfer to the regions in accordance with the money follows function principle. The existence of a mechanism of Transfer to the regions is based on the consideration of reducing the fiscal imbalances that may occur both among the regions (*horizontal imbalances*) and between the central government and the regions (*vertical imbalances*) and improving the fiscal capacity of the autonomous regions. Although considered too rush, many parties appreciate the implementation of the fiscal decentralization and the autonomous regions in Indonesia. With all the existing limitations and constraints, the implementation of the fiscal decentralization and the regional autonomy in Indonesia can be one of the best practices in the world, given the vastness of the territory and the magnitude of the population with a wide variety of characteristics. One thing to keep in mind is that the implementation of the fiscal decentralization in Indonesia is the decentralization of the expenditure side instead of the revenue (Joko Try Harianto; 2016).

In the concept of fiscal decentralization, the fiscal capacity is a picture of the financial ability of each region of the province/district/city that is reflected through the general receipt of the Local Revenue and Expenditure Budget/APBD, (not including the specific allocation fund (DAK), emergency fund, loan fund, and other acceptance which use is restricted to finance the certain expenditure) to cover the governmental tasks, after reduced by the

employees' expenditure and associated (divided) by the number of poor population in the concerned region (the Regulation of the Minister of Finance; 2015).

Surtikanti (2013; 26) and Graham (2013) explained that this moment in practice almost no countries in the world that all of the administration is held in centralization or otherwise held entirely in decentralization. Therefore, in the federal state system, there is always a balancing between the authority held in centralization by the central government and the authority held in decentralization by the autonomous regional government units. This also establishes a concept of the local state government and the local self-government. If the local state government establishes the area of administration of the central government in a region represented by the governor as the representative of central government in the region and the vertical agency in the region; the local self-government establishes the regions or autonomous regions represented by the existence of DPRD. The fiscal transfer to the regions shows the commitment of the central government towards the decentralization to increase the regional fiscal capacity.

RESEARCH METHODS

This research is quantitative using the secondary data. Some analyses used in this research are the fiscal capacity formula, both in the provinces or regencies/cities based on the following formula:

$$KF = \frac{\{(PAD + DAU + DBH + LPDS) - BP\}}{(VPN)}$$

Description:

KF = Fiscal Capacity

PAD = Original Local Revenue

DBH = Sharing Fund SDA and Non-SDA

DAU = Public Allocation Funds

LPDS = other legitimate Local Revenues

BP = Employees' Expenditures

VPN = Total Poor Population

The map of local fiscal capacity describing the condition of the fiscal capacity of each region is grouped based on the fiscal capacity index (IKpF). The grouping based on the index is used to measure not only the sources of the local revenue but also to measure the ability of the region to finance the local expenditure needs and the local government efforts in addressing the poverty in the regions through the regional fiscal policy in APBD because the local fiscal capacity index is very concerned or is one a mirror of image of the local poverty.

The local fiscal needs are the local needs to finance all the local expenditures in order to implement the local function/ authority in the provision of public services and development. In the context of macro-economic theory, the government fiscal expenditure (APBD) is one of the factors/ variables in the economic growth (GDP). The more increasing the local fiscal capacity is, the greater the capital to build the region that in turns will drive the economic growth of the region.

In the computation of the public allocation fund (DAU), the region needs are reflected from the fiscal needs of the variables as follows: a) Total Population; b) Width of Area; c) Construction Cost Index (IKK); and d) Relative Poverty Index (IKR), while fiscal capacity is the ability of local government to compile the local revenue based on its potential. The potential regional receipt is the sum of the potential of the original local revenue (PAD) with the receipt of the sharing funds (DBH Tax and DBH

SDA) and other legitimate original local revenues.

The current fiscal needs criteria is already wider, by adding several indexes such as GDP Index, the Human Development Index (HDI) and the total average expenditure of APBD, and the weighted index. The fiscal needs formula can be seen in the following:

$$\text{KBF TBR} = (\partial_1 \text{IP} + \partial_2 \text{IW} + \partial_3 \text{HDI} + \partial_4 \text{IKK} + \partial_5 \text{IPDRB/capita})$$

in which:

KBF = fiscal needs

TBR = Total average expenditures

IP = Population Index

IW = Width of Area Index

HDI = Human Development Index

IKK = Construction Cost Index

IPDRB/kap = GDP per capita Index

∂ = Weights of the index.

RESULTS AND DISCUSSION

According to Masita Machmud, et al (2014:4), the ideal financial equalization between the center and the regions is when each level of the government can be independent in the finance to fund the implementation of tasks and authorities of each. This means that the subsidy and assistance from the center as the major source of receipt of APBD has begun to diminish, and the main source of revenue is from the region itself particularly PAD. But most of the regions have not been able to increase their own regional source of revenues. The low PAD in six new provinces except Banten Province after the extraction as illustrated in Figure 1 is not the simple problem. The problem of the low PAD is not only due to the regulation of local taxation but also the pace of economic growth in the six provinces is relatively slow. The main

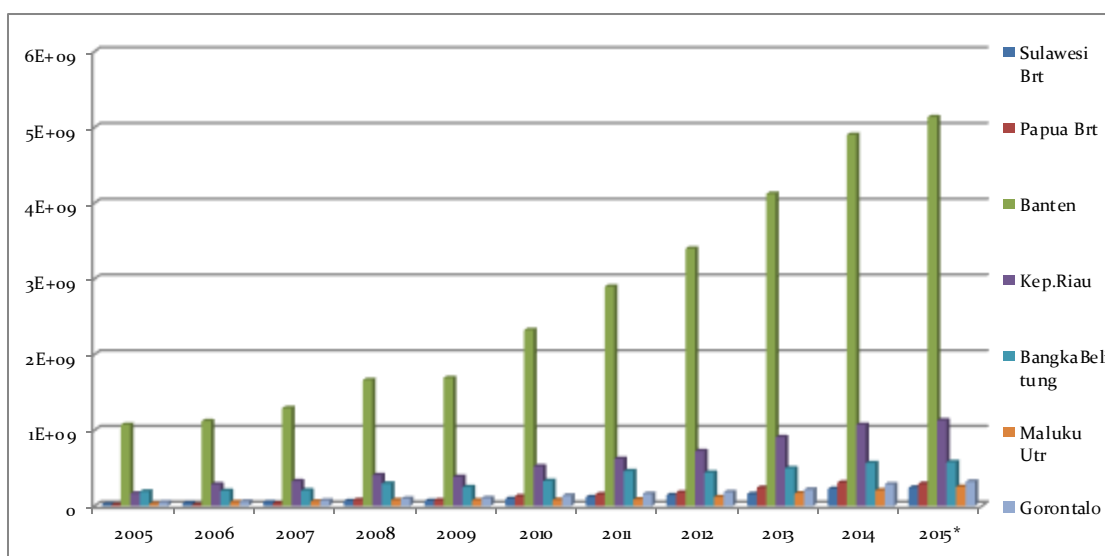
source of PAD is the local tax and the local levy. The Law No.28 of 2009 explains that the provincial tax consists of: motor vehicle tax (PKB); Exchange of Ownership of Vehicle Tax (BBN-KB); Vehicle Fuel Tax (PBB-KB); Water Surface Tax (PAP); and Cigarette Tax.

It is approximately 80 to 90% of the provincial PAD in Indonesia averagely donated by the local tax and levies while the advantages of BUMD are still relatively minimal. Currently the local tax and levies either province or regency/city embraces the principle of a closed list, unlike the previous local tax regulation that was open-list in the Law No. 34 of 2000). This means that the region can collect the new local tax and levy outside the laws through the local regulation as long as it is potential and there is no need to get approval from the center.

In Figure 1 above it can be seen that each province's ability to dig up the receipt of PAD is different. Banten Province, as a new autonomous region, an extraction from West Java is able to improve PAD and much outperform other six new provinces. The ability of Banten Province is evaluated as

reasonable and logical because the geographical location of Banten is bordered by DKI Jakarta and it is on the island of Java, which is the biggest contributor towards the national economy (GDP).

The portion of PAD revenue towards the total revenue of APBD Banten in 2005 reached 67%, the remaining is the central fiscal transfer and other legitimate income. In 2010, its contribution reached 73.95% and in 2015 reached 67,15%. Compare with PAD portion of West Sulawesi in 2010 that was only 14.78% of the total local revenues in APBD, while the portion of fiscal transfers reached 74,76%. In 2015 the portion of PAD is still relatively small, only 16.67%, and the contribution of central fiscal transfer reached 68,98%, (BPS; 2015:59). North Maluku Province, West Sulawesi, West Papua, and Gorontalo are the new provinces with relatively small PAD compared to the receipt of the central fiscal transfers while the other provinces which PAD are still high enough are Bangka Belitung, Banten, and Riau Islands (see Figure 1.).



Source: the Central Agency for Statistic of Indonesia

Figure 1. Comparison of PAD in 7 New Provinces period 2005-2015 (in Thousand Rupiahs)

Although the number of PAD of Banten Province is very high and is increasing every year, the fiscal capacity index never rises to the high or very high position. The index ranks the intermediate position since 2009 to 2015. This is because the number of poor population in Banten Province is still very high and due to the burden of the employees' expenditure in APBD, even the number of poor population in September 2015 was increasing from September 2014 (see Figure 2).

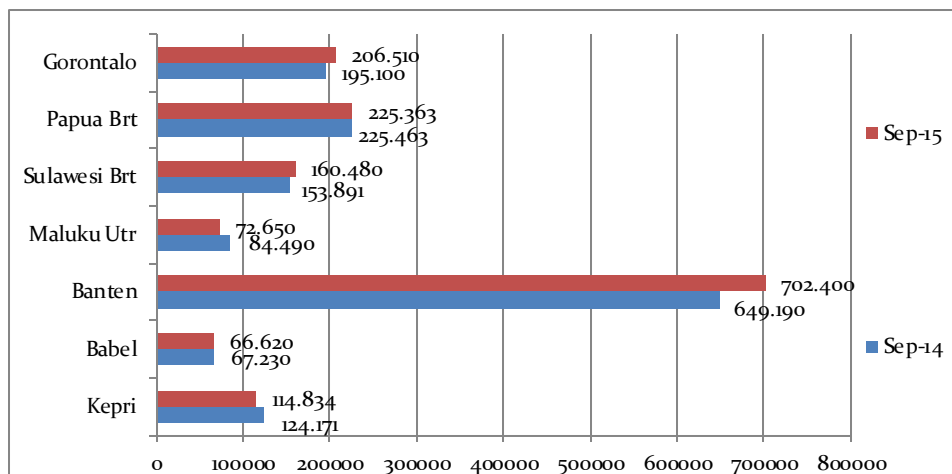
The intermediate fiscal capacity index obtained by Banten Province illustrates that its fiscal capacity still hasn't been able to reduce the number of poor population. It is not including the burden of employees' expenditure each year in APBD that drains the local revenue. When compared with the number of the Indonesian poor population in 2015 amounted 28.5 million, the contribution of the poor population of Banten reached 2.46%. It becomes paradoxical in viewing the structure of APBD with its fiscal capacity. This means that the relatively large PAD of Banten does not guarantee that the poor population will be decreased in Banten.

The provinces of West Sulawesi and Gorontalo are also the new two provinces with the low fiscal capacity index since 2011 to 2015. The causes are: *first*, the two regions are still lack of ability to dig into the source of PAD. *Second*, the allocation of employees' expenditure in APBD is still high. The expenditure budget of the officers of Gorontalo Province reached 20.60% of the total regional expenditure in APBD of the province in 2015. In comparison, the portion of capital expenditure amounts 24.78%. Consequently, these two provinces are still

very dependent on the central fiscal transfers due to the inability of PAD. The contribution of Gorontalo PAD 2010 amounted to 22.43% while the central fiscal transfer amounted 73.88% of the total income of the region. In 2015 it achieved 22.40%, while the portion of the central fiscal transfer amounted 66%. When the local government of of Gorontalo cannot resist the rate of increase in the employees' expenditure in APBD, the portions may reach 25% of the regional revenue. this becomes a burden in APBD in the future, whereas the local government should increase the portion of capital expenditures/infrastructure in APBD every year to support the alleviation of poverty in the regions.

Third, the number of poor population in the provinces of Gorontalo and West Sulawesi is still high enough that is above 150,000 people, as seen in Figure 2. Even the poor population increased in September 2015 from September 2014. This causes the fiscal capacity index of Gorontalo and West Sulawesi remains in a low position in the last five years (2011-2015), whereas in 2009 and 2010 the index was ever intermediate (see Table 1).

Fourth, the structure of APBD of both provinces is too weak where the number of PAD is also still low compared to other provinces such as Banten, Riau Islands, and Bangka Belitung. Although it has been established since December 2000 under the Law No. 38 in 2000, the PAD capabilities are still minimal since 2005-2015 to support the development finance. This obviously makes Gorontalo and West Sulawesi still depend a lot on the central fiscal transfers.



Source: the Central Agency for Statistic in Kepri; Babel; Banten; North Maluku, Sulawesi West; West Papua; Gorontalo Provinces.

Figure 2. The Poor Population in 7 Provinces, in September 2014, and 2015.

According to Robert A. Simanjuntak, (2003:15), the main issues of PAD associated with the implementation of regional autonomy is that PAD is a reflection of the local taxing power that should have the quite significant magnitude, moreover, with the increasing duties/functions of the local government in the era of autonomy. However, the experience so far shows that PAD from the province or regency/city in

general has only a marginal role towards the budgets. The issuance of the Law No.18 of 1997 limited the amount of the levy that can be taxed by the region, but it turned out to reducing the role of local taxes and levies in APBD. Therefore there are a lot of hope towards the implementation of the Law of the Local Tax and Levies that is strengthening the capacity of PAD.

Table 1. Fiscal Capacity Index in Seven New Provinces, 2009-2015

IKpF	2009	2010	2011	2012	2013	2014	2015
Very High (≥ 2)	Riau.Islands BANGKA Belitung	Riau. Islands West Papua	Riau Islands	Bangka Belitung	-	West Papua	West Papua
High (1 - 1.90)	North Maluku West Papua	Bangka Belitung	Bangka Belitung West Papua	Riau Islands	North Maluku BangkaBelitung Riau Islands West Papua	Bangka Belitung Riau Islands Maluku Utrara	Riau islands Bangka Belitung North Maluku
Intermediate (0.50-1)	Banten Gorontalo Sulawesi West	North Maluku Bantam West Sulawesi Gorontalo	North Maluku Banten	North Maluku Banten West Papua	Banten	Banten	Banten
Low (0.09 - 0.49)	-	-	Gorontalo, West Sulawesi	West Sulawesi Gorontalo	West Sulawesi Gorontalo	West Sulawesi Gorontalo	West Sulawesi Gorontalo
Very Low (< 0.10)	-	-	-	-	-	-	-

Source: Appendix a regulation of Finance Minister RI in 2009-2015.

Other legitimate local revenues become more important in the context of the efforts of the local government to increase the fiscal capacity. This revenue is the local receipt from other things belonging to the local government. There are at least 13 different types of local revenues in the category of other local revenues including the following objects: 1) Results of the local asset sales that are not separated; 2) Giro services; 3) Interest income; receipt of the demands as the local compensation; 4) Receipt of commissions, discounts, or other forms as a result of the sale, procurement of goods and services by the region; 5) Financial receipt from the difference between the rupiah exchange rate against the foreign currencies; 6) Fine revenues for the delay in the execution of the work; 7) Tax fine revenues; 8) Levy fine revenues; 9) Execution of warranty revenues; 10) Revenues from the refund; 11) Revenues from the social and public facilities belonging to the local government; 12) Revenues from the organization of education and training; 13) Revenues from budget/sale installment.

One of the crucial issues and classical problems in the aspect of local expenditure is

the employees' expenditure. Since the autonomy is enacted, the local government tends to be easy to add the employees that lead to an increase in the portion of the employees' expenditure every year in APBD, either in the province or regency/city. On average the portion of the employees' expenditure reached 20 to 25% of the total local expenditure.

The portion of the employees' expenditure in Western New Guinea for example, in 2005 only amounted to Rp 31.3 billions, but in 2010 increased to Rp 109.5 billions or increased 250% in the span of five years. In 2015 the allocation of the employees' expenditure of West Papua already reached Rp 322.6 billions or increased 195% from 2010. As mentioned in the formula, the employees' expenditure is a deduction from the local fiscal capacity. The more increasing the employees' expenditure is, the more reducing the local fiscal capacity will be. Although there is an increase in the local receipt such as the central fiscal transfer receipt, the increase in the employees' expenditure will affect the fiscal capacity every year. (See Table 2).

Table 2. Employees' Expenditure of the Seven New provinces in APBD in 2010-2016, (Rp thousands)

The province of	2010	2011	2012	2013	2014	2015
Bantam	280,475,124	320,486,551	384,981,221	423,141,044	481,328,441	593,556,884
BangkaBelitung	151,693,153	191,385,033	216,271,988	246,900,473	274,339,635	329,023,180
Gorontalo	165,232,594	187,796,432	209,099,424	224,332,890	239,795,987	302,669,797
Riau Islands	162,989,135	192,313,329	212,470,060	220,943,360.	252,064,813	300,000,000
North Maluku	163,837,449	154,479,487	200,362,804	215,957,878	265,437,989	339,277,975
West Papua	109,575,055	150,883,802	171,578,191	172, 542.175	178,580,573	322,629,605
West Sulawesi	77,197,534	99,184,433	127,058,283	200,211,221	210,732,942	241,369,985

Source: Provincial Government Finance Statistics 2009-2012 and 2012-2015, Publisher of BPS.

From table 2 above, it can be seen that the magnitude of the employees' expenditure in the seven new provinces is increasing every year, even Banten Province reached Rp 500 billions more in 2015 or increased 39% from 2014. In the structure of expenditure of APBD in seven provinces, the average portion of the employees' expenditure ranks the third largest one after the Sharing Expenditure and the Grant Expenditure, only the employees' expenditure in West Sulawesi that is relatively small with an increase every year relatively small and insignificant.

The disproportional expenditure policies occurred in Gorontalo where the portion of the employees' expenditure is greater than the portion of capital expenditures at the period of 2010-2014 (BPS; 2012-2015), which is different from the six other provinces. So it is difficult for Gorontalo Province to finance the regional needs particularly to build the infrastructure. The next implication is that the fiscal capacity of Gorontalo is unable to finance its development that resulted in the low index. The increase in the employees' expenditures is positive in one side in improving the welfare of the country's civil apparatus (ASN) in Gorontalo, but in other side it gives negative influence in the financial capability of the regional infrastructure development.

All provinces experienced a significant increase in the employees' expenditures in 2015 compared to 2014, one of which was affected by the increase in the central transfer to the seven provinces in 2015, especially the DAU transfer. From seven provinces, in 2015 West Papua gained the largest DAU amounted Rp 1.284 trillions (0.36% of the total DAU); North Maluku amounted Rp 1.061 trillions (0.30% of the total DAU); Bangka Belitung amounted Rp

897.887 billions (0.25% of the total DAU); West Sulawesi amounted Rp 895.580 billions (0.25% of the total DAU); Gorontalo amounted Rp 845.395 billions (0.24% of the total DAU); Riau Islands amounted Rp 695.943 billions (0.20% of the total DAU); and Banten amounted Rp 640.981 billions (0.18% of the total DAU), (Presidential Regulation; 2015).

The local expenditure structure is always based on the general policy of local expenditure in APBD. The local expenditure policy should be established and adapted to the local financial strength. It is explained that the policy direction is preferred to meet the Indirect Expenditures including the employees' expenditures, grants, social assistance, and unexpected expenditures in accordance with the applicable legislation. The Local Government can also perform efficiencies in the usage/utilizing the electricity, telephone, water, and the expenditures of building maintenance/official vehicles, and so on. The expenditure can also be directed to any activities that support the priorities of development. The Local Government can also optimize the expenditure for the deconcentration fund and the assistance duties, whereas the Indirect Expenditures such as the grant expenditure can be determined and issued to the parties participated in the implementation of development. Meanwhile, the Social Assistance Expenditures are directed, among others, to the poor family home surgery, etc., (Margono; 2015).

Fiscal capacity can also be seen from the comparison or the ratio of capital expenditures to the total of local expenditures in APBD every year. The larger the ratio of capital expenditures is, the better the fiscal capacity will be. Therefore, the growth

of capital expenditures must be greater than the growth of the employees' expenditures every year. The ratio of capital expenditure towards the local expenditure on the seven new provinces can be seen in table 3 below.

In table 3 it can be concluded that West Papua and Banten are the two new provinces which employees' expenditure ratio to the local expenditure is relatively small since 2012-2015, while Gorontalo, West Sulawesi, and North Maluku are the provinces with a great enough employees' expenditure ratio. Even Gorontalo and West Sulawesi are the provinces with an average budget of employees' expenditure beyond the capital expenditure except for 2015.

Although the employees' expenditure of North Maluku is great enough in APBD every year, the allocation of capital expenditure is the largest among all the provinces based on the ratio of capital expenditure that on average is 30% per year from 2011 until 2015. All provinces in Indonesia still have the poor population. Although until today the central government and regions keep trying to combat and reduce the poor population in the regions, the number of poor population in Indonesia reached 28,513,570 people per 30 September 2015. This does not include the almost poor population that vulnerably fall into poor in case of the increase in some basic needs especially the food prices.

The level of the local fiscal ability/capacity is very concerned with the efforts to reduce the poverty rate in seven new provinces. Banten and Bangka-Belitung are the new provinces that have the largest number of the poor population from seven provinces; each has 690,670 people or 2.42% of the total poor population throughout Indonesia and 666,200 people or 2.33% of the total poor population in Indonesia. West Papua and Gorontalo also still have the third and the fourth largest of poor population with the portion of 0.80% and 0.72% of the total poor population in Indonesia.

The great amount of poor population in the four new provinces is clearly a burden both directly and indirectly for the budget of the region. This also affects the local fiscal capacity index (IKpF) in those provinces, such as Gorontalo with the low fiscal capacity index and Banten with the interediate fiscal capacity index. From Figure 2 above, it seems that the only two provinces with relatively small poor population are North Maluku and BangkaBelitung. Therefore it is reasonable when the fiscal index is also high.

Overall, the seven new autonomous regions are still facing the challenge of how to reduce the number of poor population in their territories. This is a responsibility of the center and the regions, including through the APBD policy.

Table 3. The Employees' Expenditures Ratio and The Capital Expenditures Ratio towards the Local Expenditure in APBD in seven New Provinces, in 2011 - 2015 (in percentage)

The province of	2011		2012		2013		2014		2015	
	BP	BM	BP	BM	BP	BM	BP	BM	BP	BM
Banten	23.00		7.24	17.25	8.0	15.35	7.77	11.16	20.73	6.63
BangkaBelitung	29.00		16.18	21.76	15.34	25.02	17.18	19.14	15.44	14.58
Riau Islands	23.30		9.44	11.66	8.13	14.46	7.61	21.67	17.68	8.17
North Maluku	34.10		33.23	15.90	15.56	28.08	17.91	28.88	18.60	27.24
Gorontalo	23.60		23.62	15.63	21.34	17.60	19.90	19.29	24.78	20.60
West Sulawesi	-		14.63	15.60	19.17	13.26	17.16	21.75	16.04	29.47
West Papua	26.30		4.40	21.90	3.33	16.10	3.02	20.18	6.04	28.30

Source: Prepared from Provincial Government Financial Statistics Book, 2012-2015, BPS Jakarta

Central Transfer: Helping the Local Fiscal Capacity

Recognized since the autonomy was enacted in 2001, the role of central fiscal transfer in the provincial APBD and the regency/city APBD is very significant, not only in the context of the financing of the implementation of the decentralization of governance but also in encouraging the regional development through the local expenditure. Seven new provinces experience an increase in the number of central fiscal transfer every year (see Figure 3). This is the one that helps the local fiscal capability in financing the local fiscal needs that increases every year. The largest portion is the DAU. Because it is the general transfer (block grant), the discretion of the local governments in managing their DAU is very large. But generally the DAU is allocated mostly to the apparatus (employees) expenditures.

Until today it is difficult to divert the DAU funds for the capital expenditures or the goods/services expenditure because the needs of the apparatus expenditure increase every year. This makes almost the entire local government "difficult" to manage the APBD because it is very little that is allocated to the capital expenditures for infrastructure financing.

Besides DAU, the sharing fund is also as the "saviour" of the local budget from the aspect of the income sources. The sharing funds of the natural resources/SDA of West Papua and Riau Islands as the oil and gas-producing provinces are relatively large in quantities (see Figure 3 below). It is reasonable if the fiscal capability is relatively able to finance some local expenditure in APBD. The fiscal capability of West Papua and Riau Islands has a positive effect towards the high fiscal capacity index. But ironically the poor population in West Papua is still high. This is a great question for the local government of West Papua in managing the local finance all this time to reduce the poverty of its population. This means that the regional policy of West Papua has not succeeded in reducing the poverty, whereas its fiscal capacity is quite capable with the central fiscal transfer that keeps increasing every year either the DAU fund or the sharing fund of oil and gas natural resources.

From Figure 3 there are three provinces those are Banten, Riau Islands, and West Papua that get large enough central fiscal transfers over Rp1 trillions. This increase really helps the capacity of APBD of the three provinces. While the four other provinces — although there is an increase in transfers every year, it has not reached Rp 1 trillion, except North Maluku in 2015.

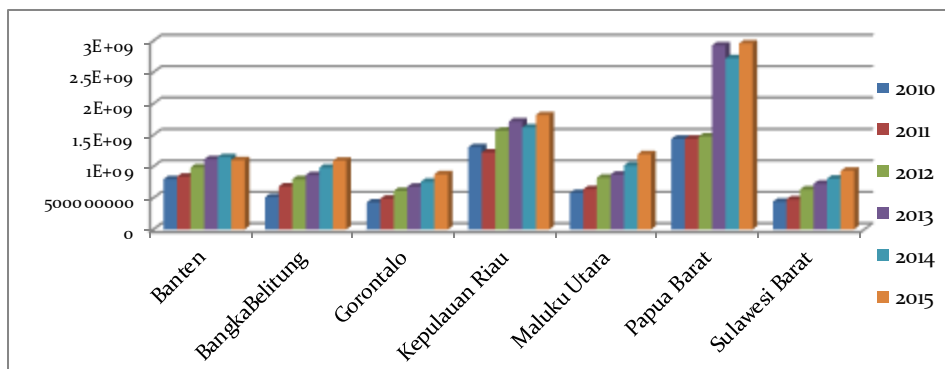


Figure 3. The Total of Fiscal Transfer (Minus DAK & Dana Otsus) to Seven New Provinces in 2010-2015 (in Thousand Rupiah)

From Figure 3 there are three provinces those are Banten, Riau Islands, and West Papua that get large enough central fiscal transfers over Rp1 trillions. This increase really helps the capacity of APBD of the three provinces. While the four other provinces — although there is an increase in transfers every year, it has not reached Rp 1 trillion, except North Maluku in 2015.

The portion of the central transfer to West Papua, for example, reached 50% of the total APBD in 2015. While the portion of the central transfer to North Maluku reached 71.66% of the total APBD in 2015. The central transfer to West Sulawesi reached 69% of the total APBD in 2015. Gorontalo reached 66% of the total APBD in 2015. Banten reached 15% of the total APBD in 2015, while Riau Islands reached 57.94% of the total APBD in 2015 and BangkaBelitung reached 60.30 % of the total APBD in 2015.

Although the amount of the central transfer to Banten is lower than West Papua, the fiscal dependence of Banten on the center is very small that is 15% in 2015. As explained above, this is because the ability of the PAD is already quite high in financing

the APBD of Banten that is mostly donated by the local tax and regional levies, while the six other provinces haven't been able to excavate the potential receipt of PAD. So it could not be expected in financing the development programs in their territories. It is similar to Riau Islands that obtains a large enough central fiscal transfer, so its dependency is very large. Moreover for the provinces receive relatively small transfers from the centre coupled with the limitations of the PAD in APBD. From Figure 3, it can be concluded that West Sulawesi and Gorontalo are the two new provinces that receive relatively small number of fiscal transfers compared to others. This may have been in accordance with the policy or formula determined by the center, particularly the formula of allocating DAU as a part of the largest central transfer to the regions. But the complexity and fiscal needs may continue to increase every year because the limitation of APBD "force" the local government to make priorities of expenditure in accordance with the potential receipt and capacity of APBD.

Matrix I: Fiscal Capacity Index (TKpF) Low & Intermediate in the three Provinces

The province	The Capacity Of The PAD	The average of Central Transfer	The Allocation of Employees' Expenditures	Number of Poor Population
Banten	Very Large	Intermediate	Large	Large
Gorontalo	Small	Small	Moderate	Large
West Sulawesi	Small	Small	Small	Small

Matrix II: Fiscal Capacity Index (TKpF) high & very high in four Provinces

The province	The Capacity Of The PAD	The average of Central Transfer	The Allocation of Employees' Expenditures	Number of Poor Population
BangkaBelitung	Small	Intermediate	Large	Small
Riau Islands	Large	Large	Moderate	Large
North Maluku	Small	Large	Large	Small
West Papua	Small	Very Large	Small	Large

In Matrix I it can be concluded that Gorontalo and West Sulawesi has the problem on the low local revenues, either the PAD or the central transfer. Therefore, the allocation of expenditure is also small. West Sulawesi has relatively small poor population so the fiscal burden is relatively small. All the above factors affect the fiscal capacity and the index.

It is different from what described in Matrix II that the four provinces have different problems but the high index. Riau Islands also faces the similar problem with Banten that has the large PAD but also many poor population. West Papua, having the small PAD but large central transfer, also faces a lot poor population.

The objective necessity of the improvement of fiscal capacity, among others, is to reduce the fiscal gap — as already described above. The bigger the fiscal gap is, the low the fiscal capacity will be in covering the local fiscal needs.

Implications on the Economy

The high low of the fiscal capacity has implications in the regional economic growth acceleration (GRDP) and the national one (GDP). It is because the quantity of allocation of the local expenditure (government expenditure) in APBD contributes

towards the economic growth of the region. GRDP of Riau Islands and West Papua on the basis of prevailing prices in 2010 only contribute respectively 1.62% and 0.60% to GDP. In 2014 the GRDP of both provinces contribute respectively 1.73% and 0.55%, (BPS; 2015).

BangkaBelitung contributes 0.51% towards the GDP in 2010 and North Maluku contributes 0.22% to GDP. In 2014, North Maluku and BangkaBelitung contribute respectively 0.23% and 0.53% to GDP (BPS; 2015). Riau Islands and Banten are the two new provinces that contribute great enough to GDP at the period of 2010-2014 compared with five other new provinces. The seven new provinces experienced the positive economic growth at the period of 2010-2014 but with different contributions. In 2014, the contribution of Banten to GDP reached 4.10% , which is the highest of the seven provinces. The relative magnitude of the contribution of Banten to GDP is affected by the fast national economy development in Java. The geographical location of Banten is a driving factor in the economic development in Banten. Data from Bank Indonesia shows that the economic growth of Banten at the Fourth Quarterly/2014 reached 8% (year on year), (BI; 2016). The development of GDP of the seven new provinces can be seen in Figure 4 below.

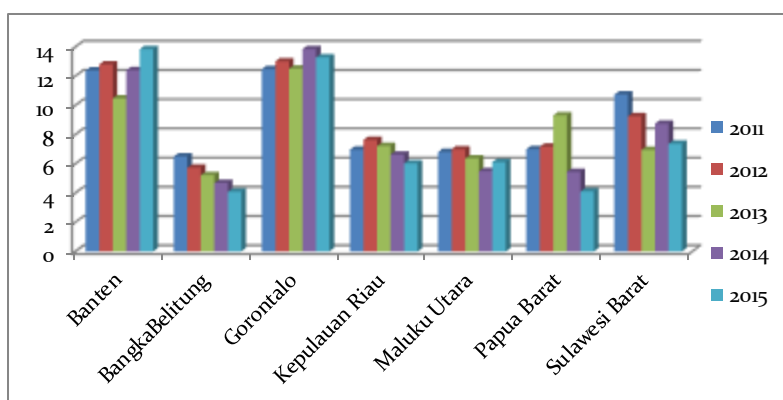


Figure 4 . Economic growth (GDP) in the seven new Provinces in 2011 until 2015, (in percentage)

From Figure 4 above, it can be seen that the highest economic growth is experienced by Banten and Gorontalo on average per year 12.37% and 13.01% over the national economic growth (GDP). The high economic growth does not directly affect positively towards the local fiscal, but it has the direct positive effect on the local tax and regional levy in the PAD. On the contrary, the total local expenditure in APBD either in the province or regency/city will directly contribute to the regional GDP from the side of expenses. When the local expenditure is high, it will affect positively towards the local economic growth. The provinces of Banten and Gorontalo with the quite high local expenditure, including the apparatus expenditure in APBD, have positive influence on the economic growth of both provinces, as can be seen from Figure 4. Bangka-Belitung, Riau Islands, and North Maluku are three provinces with the relatively low level of economic growth on average of 5 to 6% per year at the period of 2011-2015. This affects on the relatively small revenue of PAD as can be seen in Figure 1.

Related to the efforts of the local government in seven provinces in order to reduce the poverty in their regions, the portion of non-employees' expenditure should be enlarged to provide the public goods or infrastructure required by the public especially the poor population. It is the duty of the local government through the fiscal instruments in each region to provide the public goods such as health facilities, roads, bridges, educational facilities, markets, electricity, and others. Therefore, although the increase in employees' expenditure is unavoidable in APBD, the increase in the budget for non-employees'

expenditure such as capital expenditure must be extended.

The large capacity of PAD of Banten Province, for example, does not have a significant effect on the reduction of poor population in Banten, whereas the local budget generally has three main functions: the function of redistribution of income; the function of distribution of resources; and the function of allocation. The budget policy in the context of autonomy is the discretion of the regional government official completely. It means that the extraction of areas aiming to prosper the people is not achieved although most of the new provinces have been established since 15 years ago except West Sulawesi that was formed later.

Fadzil and Nyoto (2011) analyzed the relationship between the local fiscal capacity and the inter-governmental transfer with the realization of the budget. The research result indicates that there is a high dependence of the local governments on the funding (grants) from the central government. Although there is a close relationship between the fiscal capacity with the performance of the regional budget, the inter-governmental fiscal transfers cannot fully mediate the relationship.

Furthermore Fadzil and Nyoto (2011) explained, public budget have an influence on economic activity. In terms of revenues, public budget can be used to build a conducive of business climate, and to invigorate the economic sector grow. However, the consequences of local revenue may also be obstacles to business and economic climate. Public budgets have an influence on economic activity. In terms of revenues, public budget can be used to build a conducive of business climate, and to

invigorate the economic sector to grow. From the expenditure side, spending for the provision of public goods, especially infrastructure will build a huge opportunity movement of people's economic sectors. Public services such as facilitating, regulatory, and development of the business sector strongly supports the creation of a good business climate.

Moreover, the local budget (fiscal) also directly affects the economic activity in the effort to encourage the growth (GDP). From the income side, the local budget serves to make the business climate conducive to improve the regional/local income, whereas from the expenditure side, the local budget can drive the economic sectors through the local expenditure for the public goods and a range of infrastructure.

CONCLUSION

Policy of the autonomous region in the Law No. 32 of 2004 on the New Local Governance is one of the focuses in the new autonomous region arrangement including the new province, which becomes one of the important issues that until today has remained the focus of the central government. The arrangement of the new autonomous regions until today is still synonymous with the area expansion. When arranging the new autonomous region, it is very possible to do the deletion and/or merging the new autonomous region as provided for in the Government Regulation No. 78 of 2007 on the Requirements and Procedures for the Establishment, Criteria of Expansion, Deletion, and Merging of the Regions. Considering one of the autonomous region goals is to improve the welfare of the public, get closed to the public service, and strengthen the competitiveness of regions,

the establishment of seven new provinces should be able to speed up the improvement of public welfare and public services. The results of the performance evaluation of the new autonomous regions performed by the Ministry of Home Affairs mentioned that only 58.71% having the high-performing, the remaining 34.19% having intermediate-performing, and 4.16% having low-performing. Even President Susilo Bambang Yudhoyono stated that 80% of the new autonomous regions failed to improve the welfare of its people (Fadzil, Faudziah Hanim, and Harryanto Nyoto: 2011).

The above conclusions can also be seen among others by the lack of the fiscal capacity on seven new provinces, as discussed above. The growth of its own revenue sources such as PAD and business performance of BUMD is slow. Such is one of the magnitudes of the great dependence of the new provinces on the central transfer in the structure of the local revenue in APBD. It is very difficult for the new province to finance the needs of the local expenditure every year without the central transfer. Banten Province that has a quite high PAD is still dependent on the central transfer to increase its local fiscal capacity to be able to finance the local expense in its APBD.

Moreover, the fiscal capacity also describes the space owned by the local government to perform the discretion of policy. But the adequate fiscal capacity without the APBD policy particularly the effective APBD expense policy will cause the value added of the APBD to the local economy not optimal. It is a mistake of policy in APBD if the local government does not take advantage of the discretion and the large space of the fiscal capacity to encourage the economic growth in the region. Until

today the expense policy of APBD is still one of the regional main leadings to finance the development and move the economy especially the new autonomous region that has the relatively high PAD and the natural resources (SDA). It becomes one of the local fiscal challenges at this time. Besides, the local fiscal challenge today and in the future is the issue of the poor population that are still a lot especially in the provinces of Banten, Gorontalo, West Papua, and West Sulawesi. This is clearly becoming a burden and the fiscal challenges in the future. The ratio of high employees' expenditures compared to the ratio of capital expenditures also will lower the fiscal capacity on seven new provinces. The comparison of the allocation of employees' expenditure and the capital expenditure are the two factors that always affect the local financial performance in APBD every year. This ratio also affects the success rate of the local government in the development of infrastructure. It is a dilemma for the local government, including those at seven new provinces. On one side the policy of employees' expenditure is important to improve the public welfare, but on the other side the capital expenditure can also encourage the economy of the region with the development of the infrastructure that is financed entirely by APBD that is primarily sourced from its own revenues.

The high and very high fiscal capacity index is not automatic and does not guarantee to reduce the poverty rate in the regions significantly. The local governments in the seven new provinces need to make the program priorities and the policies of development every year that really can directly improve the public welfare in their regions. The pro-poor fiscal policy and the equitable one will encourage the economy of the region, including the efforts in the real

and informal sectors such as the micro, small and medium enterprises. The multiplier effect is to improve the public welfare.

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