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Policy Paper No. 33
**Indonesia-Australia Comprehensive
Economic Partnership Agreement:
Building the Powerhouse**

by Arianto Patunru, Andree Surianta, and Pingkan Audrine

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EXECUTIVE SUMMARY

In January 2020 the Indonesian parliament ratified the Indonesia-Australia Comprehensive Partnership Agreement (IA-CEPA), which came into force in July 2020. The seed for this agreement was planted in 2005 when former Indonesian President Susilo Bambang Yudhoyono and former Australian Prime Minister John Howard agreed to improve trade relations between the two countries. Negotiations began in 2010, and after almost a decade, the two governments signed the agreement in March 2019.

IA-CEPA came at an opportune time. As most countries recovered from the 2007–08 Global Financial Crisis, the United States and China engaged in a trade war. Tariff escalations and other trade restrictions by the two economic superpowers forced other countries to adjust their trade practices as well. Then came the COVID-19 pandemic, disrupting global trade as countries undertook restrictive measures to contain the spread of infection. Estimates suggest that international trade might have dropped by around 30% and Foreign Direct Investment (FDI) contracted by as much as 40% in 2020.

Like many other countries, Indonesia and Australia experienced economic recessions, with estimated 2020 growth rates of -1.5% and -4%, respectively. Both rely on government spending to keep the economy afloat while enforcing health protocols. Coming out of the pandemic, Indonesia and Australia will focus on re-building their economies. IA-CEPA can help facilitate this effort.

Because both economies rely heavily on natural resource exports to China, bilateral trade and investment volume has historically been low despite their geographical proximity. Global trade has proliferated, driven by production chains that are increasingly globalized. Countries that take advantage of the opportunity to participate in international production are said to take part in global value chains. The pandemic may slow the move towards global production somewhat but will not reverse it. Compared to many countries, Indonesia's and Australia's participation in global value chains are still low. Improving participation in global value chains could accelerate economic recovery and reduce reliance on China.

We therefore see the opportunity to use IA-CEPA in two ways. First, both countries should take advantage of opportunities created by the agreement to focus on their complementarities. Because at the aggregate level both countries' exports are similarly natural resources-dependent, these complementarities are likely to be found at a more disaggregated level. For example, Australia exports wheat to Indonesia as an input for Indonesia's food industry, from which Indonesia exports to third markets.

Therefore, Indonesia and Australia should prioritize cooperation in the form of a 'Powerhouse' or 'Joint Production' model by using Australian inputs in Indonesian manufacturing exports or vice versa with an aim to target regional and global markets, rather than focusing solely on bilateral trade and investment flows.

Second, both countries should take advantage of the comprehensive nature of the agreement to ensure that cooperation is not limited to trade and investment, but should push for domestic

reforms as well. Indonesia in particular can use IA-CEPA to facilitate ongoing reforms following the passing of the 2020 Job Creation Law. These reforms should include improvement of the regulatory environment, particularly in the food and beverage manufacturing and higher education sectors.

In this report we highlight important issues in and challenges for IA-CEPA using cases in two areas at the core of the agreement: trade in the food and beverage manufacturing sector and investment in higher education. Based on our analysis, we recommend the following:

1. The Ministry of Industry (MOI) should not implement an import substitution strategy in the food and beverage manufacturing industry. An import substitution strategy in this sector would hamper the ability of the Indonesia-Australia food and beverage 'powerhouse' to develop and engage with global value chains.
2. The Ministry of Agriculture (MOA) should amend Article 7 (1) of MOA Regulation No.2/2017 on Importation of Ruminant Livestock into the Territory of the Republic of Indonesia to eliminate the "1:5 breeder policy", which hinders the full use of expanded quotas in the IA-CEPA, and would hamper the development of a 'powerhouse' in the processed meat sector.
3. Ministry of Education and Culture (MOEC) should have a global higher education strategy by working with the Immigration Department to streamline the application procedures for international students. At the very least, integrating the Student Permit, entry visa (VITAS), and Limited Stay Permit (E-ITAS) into a single student visa should be considered, as well as the elimination of an exit permit requiring prior application.
4. The Indonesian government and Australian universities should use IA-CEPA as a pilot project from which lessons can be learnt about international investment in higher education. IA-CEPA initial engagements with a single source country can help policy makers identify unexpected investment roadblocks while limiting the risks of failure in preparing for further opening up of this sector to foreign investors.

IA-CEPA: BRIEF OVERVIEW

On 4 April 2005, during his visit to Australia, former Indonesian President Susilo Bambang Yudhoyono addressed the Indonesia-Australia business dialogue forum, stressing the potential benefits that would stem from expanding business relationships between the two countries, with services trade as a priority area for further growth and the health and education sectors at the forefront. He also encouraged maintaining open markets, increasing tourism, reassessing non-tariff barriers, and creating an environment conducive to investment and business (Parliament of Australia, 2005). In pursuit of an expanded economic relationship between Indonesia and Australia, President Yudhoyono and former Australian Prime Minister John Howard agreed to establish a comprehensive economic partnership (Parliament of Australia, 2005).

The drafting of a joint feasibility study to examine the benefits of a bilateral free trade agreement (FTA) followed in 2007. It took almost three years for this study to conclude (Department of Foreign Affairs and Trade of Australia [DFAT] and Ministry of Trade of the Republic of Indonesia [MOT], 2009). Finally, on 2 November 2010, Indonesian and Australian leaders agreed to begin negotiation of the Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA). After almost a decade, on 4 March 2019, both countries, represented by the Indonesian Minister for Trade Enggartiasto Lukita and the Australian Minister for Trade, Tourism and Investment Simon Birmingham, signed the agreement.

The Indonesian House of Representatives (*Dewan Perwakilan Rakyat* or DPR) Plenary Meeting on 6 January 2020 ratified the agreement, marking a new milestone for the bilateral relations between Indonesia and Australia (Parliament of Indonesia, 2020). It was legalized soon after in Law No. 1/2020 (MOT, 2020a). The Australian Parliament ratified the agreement on 26 November 2019 (Parliament of Australia, 2019). The agreement finally entered into force on 5 July 2020 (Sekretariat Kabinet, 2020).

Key Components of the Agreement

IA-CEPA creates a framework for Indonesia and Australia to reach the full potential of this bilateral economic partnership, and to build on the existing ASEAN-Australia-New Zealand FTA (AANZFTA) and the newly signed Regional Comprehensive Economic Partnership (RCEP) agreement (ASEAN, 2020). IA-CEPA also improves upon tariff reductions achieved through the AANZFTA (Neo, 2020). With 21 chapters covering trade in goods and services, investment, electronic commerce, and specific trade issues (Table 1), this bilateral agreement is expected to accelerate economic cooperation at all levels—business, communities, and individuals (DFAT, 2020b). However, its most significant use will be achieved through the adoption of a global value chain mindset, in which trade and investment between the two partners aims at forming a joint production base to supply other markets.

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Table 1.
The Structure of IA-CEPA

Component	Issue	Associated Documents
Chapter 1	Initial Provisions and General Definitions	
Chapter 2	Trade in Goods	Annex 2-A: Schedules of Tariff Commitments Appendix 2-A.1: Tariff Rate Quota
Chapter 3	Non-Tariff Measures	
Chapter 4	Rules of Origin	Annex 4-A: Procedures for Issuing Certificates of Origin Appendix 4-A.1: List of Data Requirements Annex 4-B: Procedures for Making Declarations of Origin
Chapter 5	Customs Procedures	
Chapter 6	Trade Facilitation	
Chapter 7	Sanitary and Phytosanitary Measures	
Chapter 8	Technical Barriers to Trade	
Chapter 9	Trade in Services	Annex 9-A: Professional Services
Chapter 10	Financial Services	Annex 10-A: Authorities Responsible for Financial Services
Chapter 11	Telecommunications	
Chapter 12	Movement of Natural Persons (MNP)	Annex 12-A: Australia's Schedule of MNP Commitments Annex 12-B: Indonesia's Schedule of MNP Commitments
Chapter 13	Electronic Commerce	
Chapter 14	Investment	Annex 14-A: Code of Conduct of Arbitrators Annex 14-B: Expropriation and Compensation Annex 14-C: Foreign Investment Policy Annex 14-D: Public Debt
Chapter 15	Economic Cooperation	
Chapter 16	Competition	
Chapter 17	General Provisions and Exceptions	
Chapter 18	Institutional Provisions	
Chapter 19	Transparency	
Chapter 20	Consultations and Dispute Settlements	Annex 20-A: Rules of Procedures Annex 20-B: Code of Conduct
Chapter 21	Final Provisions	

Source: DFAT (2020b)

Trade in Goods and Services Provisions

IA-CEPA envisions an ‘economic powerhouse’ model, in which Indonesia and Australia join forces in accessing the global value chains (Consulate General of the Republic of Indonesia in Melbourne-Victoria, Australia, 2020). The model seeks to identify complementary industries in Australia and Indonesia and strengthen their linkages in order to access third country-markets. While a free

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trade agreement traditionally aims at increasing exports of final consumption goods between the two partners, the powerhouse concept seeks to establish a value chain comprising the two partner countries which supplies other countries outside the agreement. IA-CEPA would be particularly suitable for establishing this concept in the food and beverage manufacturing sector, as it could leverage both Indonesia’s substantial food and beverage manufacturing capacity with Australian agricultural capabilities.

The trade provisions in this agreement are outlined in Chapter 2 (Trade in Goods) and Chapter 9 (Trade in Services). Chapter 2 consists of 15 sections, each of which contain various technical specifications for streamlining trade activities, including the reduction or elimination of customs duties, tariff rate quotas, acceleration or improvement of tariff commitments, and a trade remedies dialogue. Technical notes on the schedules of tariff commitments for both Indonesia and Australia are outlined in Annex 2-A. In terms of non-tariff measures, IA-CEPA provides specific rules on tariff rate quotas in eight sectors, namely (1) live cattle; (2) potatoes; (3) carrots; (4) oranges; (5) mandarins, clementines, wilkins, and similar citrus hybrid; (6) lemons and limes; (7) feed grains (e.g., wheat and muslin, barley, and grain sorghum); and (8) hot/cold rolled steel coil.

Chapter 9, on trade in services, contains 14 sections and one annex that covers standard General Agreement on Trade in Services (GATS) items including national and most-favored-nation treatment, market access, local presences, non-conforming measures, and the establishment of Committee on Trade in Services. The annex document of this chapter focuses on achieving common recognition on professional services which will be managed by the Professional Services Working Group.

Investment Provisions

The investment provisions in IA-CEPA are outlined in Chapter 14 of the agreement. It consists of two sections and four annexes specifying treatment and protection of investors. With investment largely focused on the services sector, Section A of this chapter again follows the GATS standards, such as equal treatment with domestic investors (national treatment), equally favorable treatment with other countries (most-favored-nation), and no restrictions on operations (prohibition of performance requirements) and senior executive appointments (senior management and board of directors). Section B contains the Investor-State Dispute Settlement (ISDS) mechanism, which lays out the procedures for arbitration between investors and host states. This chapter is reviewed by a Committee on Investment that meets every two years.

Although the provisions above discourage discriminative practice to foreign corporations—something Indonesia is well-known for—section 14.14 still allows both countries to specify non-

conforming measures which can be understood as the 'right to restrict'. Even the ISDS provisions and the prohibition of expropriation contain exclusions that make it less robust than the now-lapsed Bilateral Investment Treaty between Indonesia and Australia (Thresher, 2020).

These non-conforming measures are listed in Annex I and II. Through them, both countries essentially maintain existing investment restrictions. This includes the Australian FDI review threshold for agriculture investment and the Indonesian Negative Investment List (*Daftar Negatif Investasi* or DNI) which specifies foreign shareholding limits in various business sectors. The recently passed Omnibus Law on Job Creation (Job Creation Law) is expected to replace DNI with an Investment Priority List. Although this new list is still being drafted, depending on its contents, Australian investors may be better off following the common investment path than utilizing investment provisions in IA-CEPA.

Economic Cooperation Program

A unique feature of the IA-CEPA is the inclusion of an Economic Cooperation Program (ECP), which ties in official development assistance (ODA/aid) with this FTA. The ECP seeks to increase the likelihood of success of IA-CEPA implementation by supporting regulatory reforms through technical assistance, resourcing industry-to-industry engagement, and developing common standards and skills frameworks. It will be located in Jakarta with an initial budget of USD 40 million over five years. The program was intended to start in 2020 but the pandemic has pushed it back to 2021.

ECP activities will be overseen by the Economic Cooperation Committee (ECC), a joint committee between Indonesian and Australian governments. The day-to-day operation will be run by a Collaborative Hub that reports to and assists the ECC in designing and implementing programs. The Hub will also leverage existing Australian ODA in Indonesia to deliver new activities. The Hub is expected to collaborate with existing Australian programs and agencies such as PROSPERA, PRISMA, Australia Awards, PAIR, Australia-Indonesia Centre, and Austrade. In Indonesia, the National Development Planning Agency (Bappenas) has been proposed as its representative in the ECC. Bappenas would be tasked with monitoring and evaluation as well as coordinating the activities with other Indonesian government agencies. The ECP will foster collaboration with the private sector through business dialogues, workshops, and seminars.

The ECP aims to achieve three outcomes when it concludes in 2025: greater market access, better market integration, and enhanced labour market skills in Indonesia. The ECP will focus on driving activities in pursuit of these three outcomes across three economic sectors: agrifood, advanced manufacturing, and services. Each will have its own multi-year activities under Agrifood Innovation Partnerships, Powering Advanced Manufacturing, and Co-Investing in Skills and Training.

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The AUD 7.5 million (approximately USD 5.6 million) Agrifood Innovation Partnerships will begin with a 'Grains Partnership' that will support industry engagement on grains for food and feed. It seeks to increase the grain and food processing product trade between Australia and Indonesia and to increase support for and investment in Indonesian food processing as a value-added

industry. Indonesia was the second largest exporter of instant noodles in the world in 2018, supported by its robust wheat flour industry, which is a major customer for Australian wheat. One of the goals of the Grains Partnership is to extend this successful global value chain model into Indonesia's other flour-based products, such as baked goods. There may also be interest in a halal food global value chain model.

Advanced manufacturing and services activities also has the food processing industry as its secondary target. While the AUD 5 million (USD 3.7 million) Powering Advanced Manufacturing activity will initially focus on electric batteries and power inputs for electric vehicles, there are plans to expand this to processed food. The AUD 8.9 million (USD 6.7 million) Co-investing in Skills and Training activity aims to build a more significant partnership between Indonesian and Australian technical vocational education and training providers. One of the areas of focus is agriculture. The Co-investing in Skills and Training activity specifically mentions training programs for Indonesian flour mills covered in Grains Partnerships. Multiple program focus illustrates that the complementarity between Australian agriculture business and the Indonesian food and beverage manufacturing industry makes this area a good candidate for the powerhouse approach.

EMERGING TRENDS AND CHALLENGES

The effectiveness of IA-CEPA implementation will be influenced by economic trends and challenges external to the agreement. These include the economic relationship between Indonesia and Australia and international trade trends including the proliferation of FTAs, increasingly international production networks, and global shocks caused by the U.S.-China trade war and the COVID-19 pandemic. We briefly discuss each of these trends and challenges below.

Indonesia-Australia Economic Relationship

The year 2019 marked the 70th anniversary of diplomatic relations between Indonesia and Australia. The two neighbors have committed significant diplomatic resources to strengthening relations. The Australian Embassy in Jakarta is the nation's largest overseas diplomatic mission, employing more than 500 staff, including 150 Australian diplomats (Wibawa, 2020). There are also three Australian consulates in other cities: Bali (Australia Consulate-General in Bali, 2020), Makassar (Australian Consulate-General in Makassar, 2020) and Surabaya (Australian Consulate-General in Surabaya, 2020). Similarly, Indonesia has its embassy in Canberra and consulate offices in Australia's major capital cities, Sydney, Melbourne, Perth (SGS Economics and Planning Pty Ltd., 2018), and Darwin (Indonesian Embassy in Canberra, 2020).

However, these close diplomatic ties do not reflect the depth of economic relations. Trade and investment flows between the two countries are low. The total two-way trade in goods and services was worth AUD 17.8 billion or approximately USD 12.4 billion in 2018–2019.¹ Compare this to Australia-China trade, which stood at AUD 252 billion or USD 175 billion in 2019 (DFAT, n.d.). Trade between Indonesia and China trade was valued at USD 72.6 billion in 2018 (Pinandita, 2019). Indonesia-Australia trade is also declining—export growth from Indonesia to Australia between 2011 and 2015 was -7.9% per year, while import was -0.8% (MOT, 2020b).

The low trade volume between Australia and Indonesia runs counter to the gravity model in international trade, which predicts higher trade flows with geographic proximity (Chaney, 2011). This may be because Indonesia and Australia have similar export commodities. Both countries rely on natural resources exports to China (DFAT, 2020c; Statistics Indonesia, 2019). To optimize the potential areas of economic cooperation, it is important to identify and exploit economic complementarities between the two countries.

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¹ Based on BI Foreign Exchange Rate in December 2019, USD 1 equals IDR 13,901 and AUD 1 equals IDR 9,739. Retrieved from <https://www.bi.go.id/en/moneter/informasi-kurs/transaksi-bi/Default.aspx>

Indonesia's Export to Australia

In 2018, Indonesian exports mostly went to China, Japan, and United States. Australia ranked 13th as Indonesian export destination (see Table 2). The rankings were similar in 2017.

Indonesia's worldwide goods exports are dominated by natural resources, especially palm oil, coal, and oil and gas, which account for about 30% of total goods exported. Indonesia's exports to Australia are similar—dominated by crude petroleum (USD 724 million in 2018), refined petroleum (USD 248 million), and shaped wood (USD 144 million) (Observatory of Economic Complexity, 2020). Indonesia also exports services, with travel and tourism as the leading service sectors, worth IDR 35 trillion or USD 2.4 million in 2018–2019 (Australian Embassy Jakarta, 2019).

Table 2.
Indonesia Top Merchandise Export Destinations 2018

No.	Country	Values (USD)	Share (%)
1	China	27,126,932,415	15.05
2	Japan	19,479,892,015	10.81
3	USA	18,471,771,383	10.25
4	India	13,725,675,911	7.62
5	Singapore	12,991,592,744	7.21
6	Korea	9,532,500,322	5.29
7	Malaysia	9,436,721,366	5.24
8	Philippines	6,825,460,227	3.79
9	Thailand	6,818,948,867	3.78
10	Other Asia	4,700,894,117	2.61
11	Vietnam	4,583,936,595	2.54
12	Netherlands	3,898,165,830	2.16
13	Australia	2,800,076,351	1.55
	WORLD	180,215,034,325	

Source: CEIC Database

Indonesia's Import from Australia

China was the main source of Indonesian goods imports in 2018, followed by Singapore and Japan. In contrast with its low ratings as a destination for Indonesian exports, Australia is at #8 as shown in Table 3. Again, this is similar to the ranking in 2017.

About 90% of Indonesia's imports are raw materials and capital goods. This implies that domestic production is heavily dependent on imports. From Australia, Indonesia mainly imports crude petroleum, coal briquettes, and wheat, which were valued at USD 616 million, USD 590 million, and USD 547 million respectively in 2018.

Service imports in 2018 included large shares from transport, travel, and tourism. Total service imports were worth USD 1.23 billion, of which USD 1.04 billion was travel, followed by transportation (USD 111 million), and other business services (USD 55.3 million) (Observatory of Economic Complexity, 2019).

Table 3.
Indonesia Top Merchandise Import Origins in 2018

No.	Country	Values (USD)	Share (%)
1	China	45,537,814,908	24.13
2	Singapore	21,439,514,466	11.36
3	Japan	17,976,711,408	9.53
4	Thailand	10,952,798,159	5.80
5	USA	10,212,388,449	5.41
6	Korea	9,088,875,758	4.82
7	Malaysia	8,602,839,083	4.56
8	Australia	5,825,541,411	3.09
9	India	5,016,912,125	2.66
10	Saudi Arabia	4,910,728,137	2.60
	WORLD	188,711,171,618	

Source: CEIC Database

Australia and Indonesia FDI Relationship

As with trade, investment flows between these neighbors are low. In 2019, Indonesia Investment Coordination Board (*Badan Koordinasi Penanaman Modal* or BKPM) recorded Australia's investment flow of nearly USD 350 million (AUD 500 million) in all sectors excluding oil and gas and financial services (Jayani, 2020). This is approximately a third of U.S. investment in Indonesia and twenty times smaller than China and Hong Kong combined. Indonesian holdings in Australia are also marginal, accounting for just 0.002% of the total stock of foreign direct investment in Australia in 2019 (Australian Bureau of Statistics, 2020).²

The similarities between Australian investment in Indonesia with its trade activities illustrates that trade often acts as an introduction to FDI, especially in the global value chain context.

According to BKPM data, nearly half of Australian investment in Indonesia since 2015 is in the mining sector. Metal non-machinery industry follows next at 10%, with hospitality and agriculture tied at 8%. The similarities between Australian investment in Indonesia with its trade activities illustrates that trade often acts as an introduction to FDI, especially in the global value chain context. If corporations find it easy to import and export materials, intermediaries, and final products from a country, they are more likely to choose that location as part of their supply chain. Understanding this relationship is critical for the economic powerhouse model.

The Indonesian government is hopeful that IA-CEPA will boost investment. The MOT claims that IA-CEPA improves the investment environment in service sectors about which Australia has stated an interest: vocational education and training, higher education, tourism, construction, mining, energy, hospitals, wastewater management, aged care, transportation, telecommunication, and professional services (Bilateral Negotiation Directorate, 2020). DFAT also claims that IA-CEPA represents the strongest commitments the Indonesian government has ever extended to foreign (Australian) investment compared to its other FTAs (DFAT, 2019a). Nevertheless, analysis of the agreement shows that out of the 12 sectors above, only higher education and healthcare have eliminated equity restrictions. Higher education has a clearer pathway for implementing the powerhouse approach and will be the focus of further analysis.

International Trade and Investment Dynamics

International trade and investment have gained momentum over the past three decades. The realization of trade benefits prompted the proliferation of trade agreements, from only 22 in

1990 to 305 in 2019 (World Trade Organization, 2020a). The rise of global value chains, in which production for a single product occurs across many borders, have made trade agreements that secure international trade and investment flows the more important. In spite of the increase in international trade and investment, policies crafted today must take into account two recent challenges, namely the U.S.-China trade war and the COVID-19 pandemic.

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² Total foreign direct investment stock in Australia in 2019 reached AU\$ 1.019 billion.

Proliferation of Trade Agreements

The 1947 General Agreement on Tariffs and Trade (GATT) became the World Trade Organization (WTO) in 1995 and has formed the foundation of broader trade agreements that contribute to increasing global trade and investment. Trade has become a crucial element for growth in developing countries, generating employment and fulfilling needs in food, health, education, and other goods and services (Watanabe, 2001). The WTO framework emphasizes reduction in tariff and non-tariff measures while addressing other issues in international trade³ (Jensen & Gibbon, 2007).

Under the WTO, multilateral trade negotiations were the dominant approach to international trade. As the WTO has grown, achieving consensus among the members has proven difficult. This led to the indefinite suspension of the WTO's Doha Round of negotiations, which began in 2001. Deadlock in multilateral trade has led countries to pursue bilateral and regional trade agreements.

Bilateral negotiations are typically faster than multilateral trade negotiations and provide more flexibility since two parties can agree on a broader range of issues than in a multilateral setting (Baucus, 1989). Regional trade agreements cover a group of countries within a geographic region. Most bilateral agreements and many regional agreements have adopted a preferential approach. In other words, the agreements are exclusive to the members and often become barriers to non-members.

Trade economists have warned that the proliferation of preferential trade agreements may lead to a 'spaghetti bowl' effect, whereby many rules across different trade agreements conflict with one another, resulting in higher transaction costs for business (Bhagwati, 2008). Recent bilateral and regional trade agreements seem to take this concern to heart and set targets and commitments in a way that resembles the non-discriminatory principle of the WTO. Indonesia's former trade minister once said that, "without adherence to WTO principles, regionalism is in danger of becoming a stumbling block and not a complement to the multilateral trading system." (Pangestu, 2011). Some recent agreements also take the form of expanded or 'comprehensive' trade agreements that include investment reforms, human capital development and institutional improvement.

Global Value Chains

As global trade has proliferated, so has international production. Countries that participate in such international production are said to take part in global value chains. Global value chains account for almost half of global trade. Parts and components crisscross the globe as firms search for the most efficient production process. International supply chains have led to a rise in productivity and incomes in many countries. Over the past 30 years, they have helped underdeveloped and developing countries grow faster, lifting many out of poverty. Global value chains can further boost inclusive and sustainable growth, create more jobs, and reduce poverty

³ WTO Principles are the foundation of multilateral trading system that covers five aspects in which the trading system should be: without discrimination, freer, predictable, more competitive, and more beneficial for less developed countries (World Trade Organization, n.d.).

poverty if developing countries tap into them by speeding up trade and investment reforms along with improving bilateral and multilateral connectivity. To do this, these countries need to pursue open and more predictable policies (World Bank, 2020b).

According to the OECD (2013), Indonesia and Australia are relatively less integrated in global value chains. Participation by both countries in these value chains is mainly driven by downstream links—that is, other countries use natural resources from Australia and Indonesia as inputs. Indeed, mining is the top sector through which these two countries are involved in global value chains. A successful trade agreement between Indonesia and Australia should create new opportunities for both countries to engage more broadly with global value chains by focusing not on their competing similarities but on complementarities instead.

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U.S.-China Trade War and COVID-19

Even as countries look to increase their integration into international supply chains, the U.S.-China trade war and the COVID-19 pandemic have presented serious challenges to global trade. The tension between the United States and China has hurt both countries as well as their trading partners. A report examining the U.S.-China trade war from 2018 to the first half of 2019 confirms that retaliatory tariffs economically harm both countries in the dispute and multilateral trade (UNCTAD, 2019). The conflict has led to a trade redirection where Vietnam, Taiwan, Europe, and Mexico increasing their exports to the United States to fill the gap left by China, while China has responded similarly with ASEAN countries (Huang & Smith, 2020). Another side effect of this trade war is heightened investment uncertainty. A JP Morgan (Ward & Juvyns, 2019) study finds that companies are scaling back their investment plans in response to the trade war.

Just as the conflict between the United States and China began to settle down, with China granting tariff exclusion for the United States' food and agricultural commodities (Office of the US Trade Representative, 2020), the global economy was rocked by the COVID-19 pandemic and widespread lockdowns, which sent supply and demand tumbling. The WTO has predicted that international trade will contract by 13–32% in 2020 and this will have a knock on effect on FDI, which is expected to fall as much as 40% in 2020 (UNCTAD, 2020; World Trade Organization, 2020). The pandemic has also affected global trade and investment policies as some governments have turned inwards and pushed for self-sufficiency (Baldwin & Evenett, 2020). However, relying only on domestic sources will make countries even more vulnerable since this reduces diversification of supply during a crisis and domestic industries are unlikely fully insulated from a global crisis either (EAF Editorial Board, 2020). The pandemic should, therefore, be used as an opportunity for countries to engage deeper with international trade and global value chains instead of withdrawing from them.

Indonesia and Australia have not escaped COVID-19 economic distress. Indonesia went into recession for the first time since 1998, with negative GDP growth in Q2 and Q3 2020. Fixed investments fell from 4.1% in Q4 2019 to 1.7% in Q1 2020 due to heightened uncertainty and lower commodity prices (World Bank, 2020a). Australia also sunk into its first recession in 30 years, recording negative growth in Q1 and Q2 2020. On the investment side, private capital expenditure in Australia fell by 1.6% in Q1 2020 from Q4 2019 (Trading Economics, 2020).

MAXIMIZING THE BENEFITS FROM IA-CEPA

Indonesia and Australia can use IA-CEPA not only to improve their bilateral economic relationship but also to help navigate these recent and emerging challenges. In particular, both countries can use this agreement to accelerate economic recovery through increased participation in the global value chains. We illustrate this possibility by presenting two cases: trade in food and beverage manufacturing and investment in higher education.

“Joining forces with Australia, a prominent agricultural supplier, can secure raw materials to increase Indonesia’s involvement in the processed food global value chain.”

Food and beverage manufacturing is the second largest category of Indonesian exports after mining, but it has relatively low foreign content (OECD, 2018). Even though it is an export driver, the industry is heavily oriented to the domestic market—consumption abroad accounts for only about 20% of domestic value-added activities. This means that Indonesia has an opportunity to increase its exports. Joining forces with Australia, a prominent agricultural supplier, can secure raw materials to increase Indonesia’s involvement in the processed food global value chain. A precedent already exists: Australian wheat is milled into flour in Indonesia and used as an input into instant noodles that are exported worldwide (Greenville, 2019; DFAT, 2020a).

On the investment front, IA-CEPA can help Indonesia achieve its human capital development goals. Indonesia’s President Joko Widodo put forth human capital development as the top priority for his second term (Sekretariat Kabinet RI, 2020a). Australia is known for its high-quality training institutions and universities. Inviting Australian universities to set up facilities in Indonesia can help improve education quality in Indonesia. By inviting international students into the country, Indonesia can enhance its market size and increase its investment attractiveness to Australian education providers. Indonesia should use IA-CEPA to transform its education sector and become, in partnership with Australia, a world-class provider rather than merely being a consumer of international education.

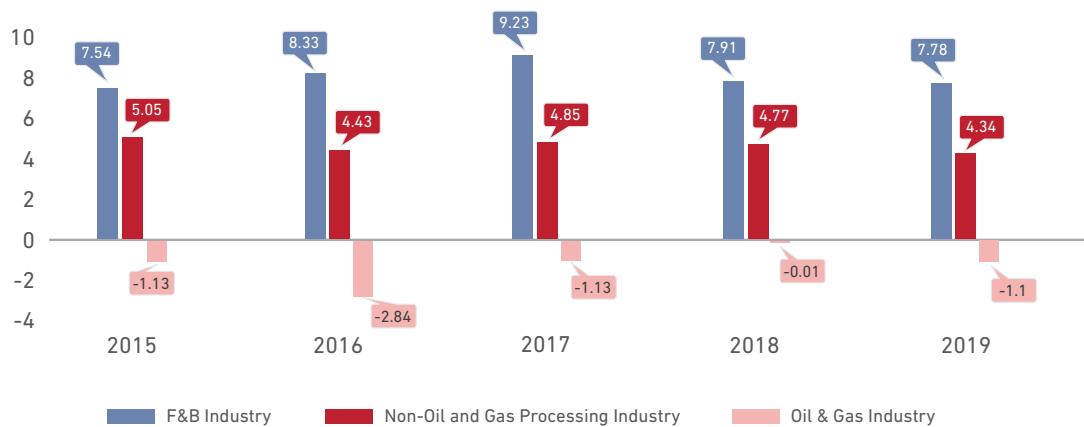
The Indonesia-Australia Food and Beverage Manufacturing Powerhouse: Challenges and Opportunities

The food and beverage manufacturing sector plays an important role in the Indonesian economy. Production of raw materials for the food and beverage industry in the primary sector (agriculture, plantations and fisheries) amounted to USD 142 billion, while the manufacturing of food and beverage products is valued at USD 71.4 billion, and food and beverage services generates USD 24 billion (Central Bank of Indonesia, 2017). The Indonesian Ministry of Industry (MOI) has stated that the food and beverage industry is an important pillar supporting growth of both the manufacturing industry and the national economy.

The importance of the food and beverage sector is evident. It represents 36.4% of the GDP of the non-oil and gas processing industry. In the first quarter of 2020, food and beverage manufacturing contributed nearly 20% of Indonesia’s total GDP (MOT, 2020c). This sector also

realized higher levels of investment over the last five years compared to other leading sectors, such as base metals and pharmaceuticals, accumulating up to IDR 293 trillion or nearly USD 21 million (Deloitte Indonesia, 2020). Despite the major role of natural resources in Indonesia's economy, food and beverage are growing more quickly than the oil and gas industry in Indonesia (Figure 1). The food and beverage sector grew by more than 7% from 2015 to 2019, outpacing both the oil and gas and the non-oil and gas sectors.

Figure 1.
Food and Beverage Industry Growth Rate, 2015–2019 (percent)



Source: Extracted and processed from Statistics Indonesia, 2015–2019

Table 4 illustrates that there were over 1.3 million micro, small, medium and large food and beverage processing businesses in 2015 (Statistics Indonesia , 2017). Although there are more micro enterprises employing more Indonesians than small and medium and large enterprises, the industry is dominated by several large companies. These include local companies Indofood, Wings, Mayora and GarudaFood, and foreign multinationals Nestle, Heinz, Kraft, Unilever, and Danone (EIBN, 2017).

Table 4.
Food and Beverage Processing Industry in Indonesia

	Micro	Small	Medium and Large
Number of enterprises	1,247,414	108,510	6,074
Number of workers	2,483,810	865,276	882,375
Gross Output (in billion USD)	9.16	8.25	74.90
Value Added in Market Prices (in billion USD)	2.56	2.32	27.19

Source: Retrieved and processed from Statistics Indonesia (2017)

The strong growth of the food and beverage industry in Indonesia is supported by an increase in domestic purchasing power, population growth, and realization of new investment (Ragimin & Widodo, 2019). The World Bank estimates that there are 52 million economically secure (middle-class) Indonesian households, representing 20% of the total population. Their consumption has

A robust domestic food and beverage market provides a solid foundation for the industry to build up a comparative advantage in the global market.

grown by 12% annually since 2002 and represents nearly half of all household consumption in Indonesia (World Bank, 2020). Middle-class consumption has also shifted away from rice as a staple food to more processed food such as bread and noodles (DFAT, 2020a). A robust domestic food and beverage market provides a solid foundation for the industry to build up a comparative advantage in the global market. Indomie is a prime example of this, growing to be the tenth most powerful brand in the world on the success of supplying a domestic market which happens to be the second largest instant noodle market in the world (Thomas, 2019). The MOI designated food and beverage manufacturing as one the five priority sectors in the 'Making Indonesia 4.0' initiative (MOI, 2018).

This initiative aims to accelerate advanced manufacturing adoption, with the goal of turning Indonesia into a major regional food and beverage producer in ASEAN. The plan includes improving upstream agricultural productivity by adopting technology, empowering micro, small, and medium enterprises through funding and technology support, enhancing modern packaged food production, and expanding food and beverage exports (MOI, 2018). The MOI also identifies the need for more innovation in the food and beverage industry to ensure that Indonesian products can compete in the global market. To this end, MOI has established an Indonesian Food Innovation Center (IFIC) in partnership with the Indonesian Food and Beverage Association (GAPMMI) (MOI, 2020). In fact, the IFIC has been identified as one of the partner institutions in the Agrifood Innovation Partnership activities to be implemented through the IA-CEPA.

While domestic food and beverage demand has been strong, the industry faces domestic supply challenges. Rising income has brought with it a shift in household consumption, increasing demand for beef, dairy products, grains, and processed food. Increasingly affluent households are not only increasing their direct consumption of beef, dairy products, and grains but also of

food products derived from these. Local agricultural production cannot meet the rising demand from both consumer and industry and so imports are needed. This makes Australia an especially important trading partner. Australia mostly exports raw materials and semi-processed food commodities to Indonesia, while Indonesia mostly exports more highly processed food products to Australia. In 2018, Australia exported an estimated USD 2.8 billion of agricultural goods, approximately 40% of its total goods exports to Indonesia. Two top imported commodities from Australia are live animals and grains (DFAT, 2019).

Powerhouse through Partnerships

The enactment of IA-CEPA should go beyond the traditional FTA approach of tariff reduction for bilateral consumption of goods in pursuit of a partnership that brings these countries into the global value chain. This will ensure that the benefits of the agreement go beyond ensuring cheaper products for end consumers to invigorating industries in both countries. Considering third country-markets during implementation will enlarge the market covered by the agreement, accelerating economic recovery in both countries from the pandemic and beyond.

Grains are among of the biggest commodities imported from Australia. In 2018, grain imports were valued at USD 639 million (Statistics Indonesia, 2020), while ABARES (2015) projected that in 2050 Indonesian consumption of wheat would grow by 113%. Indonesia's land is largely unsuitable to produce grains, especially wheat, in a significant quantity. Demand for grains in Indonesia is increasing, driven by shifts in dietary consumption, the need for feed grains, and production of grain-based foods such as bread, biscuits, pastries, and instant noodles. According to the Indonesian Flour Milling Association (APTINDO), there are 28 flour mills in Indonesia with a total milling capacity of 11.8 million metric tons/year in 2019. Feed mill capacity is even larger, producing 25 million metric tons/year. Production of grain-based foods not only meets the national demand but the demand for exports to Asian and African countries. APTINDO estimated that in 2018, Indonesia's export of wheat flour-based products was worth USD 871 million. Wafers, instant noodles, and sweet biscuits dominate this category (APTINDO , 2019).

Production of grain-based foods not only meets the national demand but the demand for exports to Asian and African countries.

Indonesia has been the biggest wheat importer in the world since 2018 (Grain Central, 2018). It is the largest market for Australian wheat exports, with an annual trade volume of around 4.2 million tonnes, valued at around AUD 1.3 billion or nearly USD 1 billion (Grain Growers, 2020). As one of the biggest wheat-producing countries, Australia supplies close to half of wheat grain imports that are milled into flour in Indonesia (APTINDO , 2019). Much of this flour goes into making instant noodles, a substantial Indonesian export to Nigeria and South Africa (Sapiie, 2016). IA-CEPA can provide the foundation to emulate and expand these success stories, combining Australian milling wheat with Indonesian wheat flour-based food industry to serve other markets.

IA-CEPA provides preferential access for more than 99% of Australian agricultural products imported by Indonesia, so businesses that use feed grains and beef as inputs can now do so at a lower price (DFAT, 2019). For feed grain, the tariff will be eliminated for 500,000 tons in the first year and this amount will be progressively increased to 775,664 tons by the tenth year

(MOT, 2020). For food grain, IA-CEPA provides an industrial training program through its Grains Partnership. Among the beneficiaries will be flour mills, baked goods, and noodle producers. The partnership also seeks to improve Indonesian food quality and safety standards to enable export access to broader third-country markets (DFAT, 2020a).

Aside from supporting food grain, the Grains Partnership will provide training on the use of feed grains for the Indonesian livestock industry. Chicken is the most consumed locally-produced protein in Indonesia. This has supported the development of a strong feed mill industry, which exceeds the flour mill industry both in size and growth. However, the cost of poultry feed is still high due to raw material import restrictions, making Indonesian poultry-based food exports uncompetitive (Ferlito & Respatiadi, 2018). The combination of tariff elimination and training programs for feed mills can contribute to cost reduction and improve export competitiveness (DFAT, 2020a).

Beef is the third most consumed meat after chicken and fish in Indonesia.

The opening up of feed grain imports by IA-CEPA reflects that live cattle also play a significant role in bilateral trade. Beef is the third most consumed meat after chicken and fish in Indonesia. In 2018, Indonesians consumed 514,800 tons of beef⁴, while national production was 497,971 tons. To close the consumption gap and also fulfill food and beverage industry needs, Indonesia imported 510,937 heads of live cattle (Austrade, 2020).

Growing beef consumption has also led to growth of the meat processing industry. MOI reports that the meat processing sector grew by nearly 30% in 2019, with a production volume of 242,791 tons, increased from 188,391 tons in 2016 (MOI, 2020a). It is no surprise, then, that tariff reductions and elimination on various red meat imports are considered key outcomes of IA-CEPA (Table 5).

⁴The consumption figure is based on Hirschmann (2020) and production figure is based on Statistics Indonesia, accessed via CEIC Database.

Table 5.
IA-CEPA's Grain and Red Meat Outcomes

Product	Treatment at entry into force	Longer term outcome
Live feeder cattle	Duty free (from 5% tariff) access for 575,000 cattle in year one	4% annual growth in volume reaching 700,000 by year 6. A review for subsequent increases
Frozen beef	Tariff cut to 2.5% (from 5%) and access for unlimited volume	Elimination of tariff after 5 years
Sheep meat	Tariff cut to 2.5% (from 5%) and guaranteed access for unlimited volume	Elimination of tariff after 5 years
Feed grains	Duty free access for 500,000 tonnes in year one	5% annual growth in volume thereafter

Source: DFAT (2019)

Indonesia and Australia have explored the 'powerhouse' concept for red meat under the Red Meat and Cattle Partnership since 2013. Divided into two five-years phases, it began with a focus on breeding, processing, transport/logistics, and skills development. The last phase, which began in 2019, seeks to streamline the cooperation for investment, supply chain, capacity building, innovation and export, and communication (Australia Government and Indonesian Investment Coordinating Board, 2020). As such, this partnership already envisioned cooperation in livestock global value chains a few years before IA-CEPA materialize. With the agreement poised to eliminate the bulk of red meat tariffs within the next five years, the lessons learnt from this partnership would be valuable in ensuring a successful powerhouse program in the meat-based processed food sector.

The Red Meat and Livestock feasibility study (ProAnd Associates Australia Pty Ltd., 2018) examines the viability of setting up a beef feedlot and processing plant in a bonded zone in Indonesia. A bonded zone usually exempts imported products from duties and taxes as long as the products are used for exports. A beef bonded zone would thus create the potential for Indonesian enterprises to re-export processed meat from imported Australian live cattle to third-country markets. While IA-CEPA eliminates the need to establish such special duty-free zones, this feasibility study provides important insights on other non-tariff factors that may hinder an effective powerhouse formation.

Several barriers to participation by Indonesia in the processed meat global value chain were identified by the Red Meat and Livestock feasibility study. First, there are limited cold chain facilities available for transportation and storage. Next is the "1:5 breeder policy" set out by Ministry of Agriculture (MOA), which forces Indonesian importers to import at least one breeding cattle for every five feeder cattle imported (MOA, 2017). This policy burdens importers because breeding requires specialized skills that are virtually non-existent in Indonesia. This skill scarcity means that importers who attempt to breed cattle experience a high failure rate, making its return-on-investment very low (Fitzgerald, 2018). Furthermore, it is illegal to re-export imported

Differences in halal standards and certification between Indonesia and other countries also act as non-tariff barriers for Indonesian halal exports.

livestock to other countries, so the importers are saddled with both unsellable and unproductive cattle. Finally, Indonesia lacks bilateral or multilateral phytosanitary agreements with potential third-country markets. While IA-CEPA removes the tariff barriers, these infrastructure and policy challenges must be addressed for the powerhouse approach to work effectively in this sector.

A niche sub-sector briefly suggested in the Economic Cooperation Program document is a halal food global value chain. However, Indonesian capacity in this sector is relatively underdeveloped, despite having the largest Muslim population in the world. In fact, Indonesia's halal food exports lag behind Brazil, Thailand, and Turkey. While MOT has begun exploring halal products export opportunities to states within the Organization of Islamic Cooperation (OIC), many local businesses do not consider halal certification as essential for their activity. Differences in halal standards and certification between Indonesia and other countries also act as non-tariff barriers for Indonesian halal exports. These are being addressed by the MOT through trade dialogues with both OIC and non-OIC countries (MOT, 2020d; MOT, 2019). To encourage the industry further, MOI is developing plans for new Halal Industrial Zones (MOI, 2020b).

Food and beverage, cosmetics, and pharmaceutical products are the three halal industry sectors that have enjoyed export success, generating trade surpluses of USD 281 million, USD 20 million, and USD 26 million, respectively (MOT, 2020d). From 2015 to 2019, halal food and beverage exports to the OIC member states increased by 5.51% (MOT, 2020d). A recent example of halal global value chain success is the signing of a memorandum of understanding (MoU) between a Saudi Arabian company with the Payakumbuh district government to export 20 tons of rendang (Rahmat, 2019). Most of the beef in this product likely originated in Australia, which highlights the potential for IA-CEPA to improve the connection between the Australian live cattle industry and the Indonesian halal food industry to supply the global halal market.

Investing in an Indonesia-Australia Higher Education Powerhouse

Both the Indonesian Ministry of Trade (MOT) and Australian Department of Foreign Affairs and Trade (DFAT) highlight a dozen sectors in which Indonesia-Australia investment interests are aligned:

The MOT further identifies three sectors through which the broader economic partnership is delivered: vocational education and training, higher education, and health.

vocational education and training, university education, tourism, construction, mining, energy, hospital, wastewater management, aged care, transportation, telecommunication, and professional services (Bilateral Negotiation Directorate, n.d.; DFAT, 2019). The MOT further identifies three sectors through which the broader economic partnership is delivered: vocational education and training, higher education, and health. However, comparing this agreement with the negative investment list which was still valid during the drafting of this paper in December 2020 (2016 DNI) reveals that only higher education and health had better terms in IA-CEPA.

Vocational education and training in IA-CEPA still faces the same restriction as 2016 DNI, limited to 67% foreign ownership. This is despite Indonesia expressing interest in increasing vocational

education and training cooperation with Australia (The Jakarta Post News Desk, 2019) and research confirming this interest (Sebastian, Rish, & Evans, 2019). The Attachment to the Side Letter for Economic Cooperation shed some light on what is meant by 'cooperation'. Vocational education and training cooperation is meant to develop Indonesian national standards and capacity, likely to be done on a government-to-government basis. Australian vocational education and training providers are only expected to develop training modules based on this national standard in consultation with Indonesian providers, in line with the joint venture model specified in IA-CEPA (Birmingham & Lukita, 2019).

In higher education and health, however, IA-CEPA improves upon the provisions in the 2016 DNI. The negative list only allows foreign hospitals in some capitals of Eastern Indonesian provinces and this restriction was eliminated in IA-CEPA. The IA-CEPA also eliminates restrictions on universities in Ministry of Research, Technology, and Higher Education Regulation No. 53/2018, which only allowed foreign universities in special economic zones. As a result of the agreement, Australian-owned hospitals and universities can be established anywhere in Indonesia. However, advantages specific to this agreement may be short-lived if the Indonesian government follows through on considerations to open up both sectors to other foreign investors as well (Rolindrawan & Muskitta, 2019).

Nevertheless, these changes have generated interest from Australian businesses. Canberra-based Aspen Medical and Sydney-based Docta have signed a joint venture agreement with PT Jaya Sarana, a West Java state-owned enterprise, to develop 650 clinics and 23 hospitals across the province (Mizen, 2020). Monash University has announced their intention to open a campus focusing on Master's and Doctoral students in Jakarta (Monash University, 2020). Central Queensland University has also begun offering a dual-degree Master's program through partnership with Bakrie University in Jakarta (Universitas Bakrie, 2020). To boost this further, Indonesia and Australia should aim to join forces in creating an education powerhouse through immigration policy reforms for international students.

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Lessons from Across the Strait

International education is Australia's fourth largest export, valued at over AUD 40 billion. Nearly half of the economic activity in this sector is the result of international students attending universities in Australia (Department of Education, Skills and Employment, 2020). As the Australian government has closed its borders to international travelers due to the pandemic, IA-CEPA provides a possible solution for Australian universities faced with international student drought that matches with the human resources development needs of Indonesia.

Over two thirds of the international students in Australia come from Asia, with nearly 10,000 university students from Indonesia in 2018 (Ferguson & Sherrell, 2019). This is relatively small compared to China and India, which send out 200,000 students combined, or even to Vietnam (15,000) and Malaysia (14,000). However, with only 16% of Indonesians aged 25–34 attending university, there is plenty of room to grow (OECD, 2019). With Australian border closure preventing international students – including Indonesian – from coming into the country,

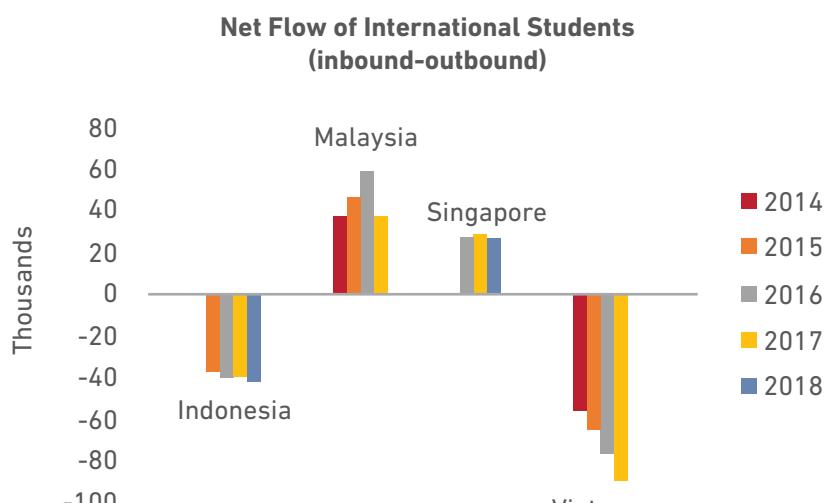
Australian universities should consider using the full ownership provision allowed in IA-CEPA as an alternative strategy to attract potential students from Indonesia. Early action by Australian universities may be the difference between success and failure as Indonesia may soon open this sector to investors from other countries as well.

“ Indonesia can increase the likelihood of receiving Australian education FDI further by welcoming students from other countries.”

On the other hand, Indonesia can increase the likelihood of receiving Australian education FDI further by welcoming students from other countries. The experience of Malaysia provides a useful lesson here. In 2006, Malaysia set out a plan to become the regional center for higher education by 2020 through supply and demand liberalization (Asari et al., 2017). On the supply side, foreign universities were welcomed into the country. Universities from the UK, Australia, the Netherlands, Singapore, India, and China established branch campuses all over Malaysia. This new competition prompted local universities to improve their quality in response to competition for both local and international students.

On the demand side, an easy entry process was the focus of reform. A one-stop-shop for international student applications was set up, the student visa application was simplified, and some visa applications were even subsidized during the early liberalization stage. These supply-demand strategies have largely been successful. Malaysia became the ninth-largest higher education exporter in the world in 2014, attracting over 100,000 international students. This grew to 120,000 by 2016 and is on track to reach 250,000 by 2025 (Asari et al., 2017; Chin, 2019; Yeoh, 2016). Malaysia has become a regional education hub, recording the highest net inflow of international students⁵ compared to its near neighbors (Figure 2).

Figure 2.
Malaysia the Regional Education Hub



Source: UIS Statistics

⁵ Net inflow of international students can be understood as the difference between foreign nationals studying in a host country and the host country nationals studying abroad.

In contrast with Malaysia's strategy of boosting demand by simplifying student visa application, the Indonesian system requires foreign students to go through multiple applications involving the Ministry of Education and Culture (MOEC) and the Immigration Department (Universitas Pelita Harapan, n.d.). It begins with applying for a Student Permit from MOEC, needed to apply for an entry visa (VITAS) with the Immigration Department. However, VITAS does not automatically confer the right to stay in the country, so students must also obtain a Limited Stay Permit (E-ITAS) upon arrival. Finally, upon completion of their studies, students must apply for an exit permit to cancel their ITAS. Failure to do so may result in visa difficulties in the future.

While some of these processes are now online, multiple trips to the embassy or the immigration office are still required. Such a complicated process makes Indonesia unattractive to international students. Potential student cohort size is certainly a critical factor in the FDI decisions of foreign universities. Although the local student population is substantial, relying on it alone limits future growth potential. Furthermore, welcoming more international students will benefit local universities, as the presence of international education providers will also encourage those local universities to improve their standards. Reforms to enlarge the international student pipeline should be considered an integral component to building an Indonesia-Australia education powerhouse.

IA-CEPA POWERHOUSES: SOME DOMESTIC ROADBLOCKS

Despite the potential benefits of IA-CEPA for both Indonesia and Australia, ratifying the agreement does not automatically ensure that its liberalizing measures are implemented. Indonesia's complex regulatory environment for trade and investment, coupled with limited experience of the Australian and Indonesian private sectors in working together will continue to present challenges to trade and investment (DFAT, 2020a). In addition to acknowledging external challenges that may hinder the agreement's effectiveness, Indonesian policymakers need to address two potential domestic policy barriers to a successful adoption of the powerhouse model.

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Indonesia's complex regulatory environment for trade and investment, coupled with limited experience of the Australian and Indonesian private sectors in working together will continue to present challenges to trade and investment.

First, the agreement's implementation may be affected by the Omnibus Law on Job Creation. This law is a major reform effort that revises various provisions in laws across sectors. The resources required to implement the Law on Job Creation may divert Indonesian government attention away from IA-CEPA. The revised laws may also include sectors covered by the IA-CEPA, such as the Law No. 33/2014 on Halal Product Assurance, which supposedly simplifies the halal certification process and thus may work well for the halal food powerhouse under IA-CEPA. However, the details will depend on its implementing regulations - many of which are yet to be issued as of the drafting of this paper in December 2020, so it is difficult to assess the omnibus law's potential impact to the agreement (SSEK, 2020).

Another policy that may clash with the powerhouse model is the import substitution strategy advocated by the MOI. The ministry has been preparing a road map for substituting up to 35% of imports by 2022 (MOI, 2020c). The ministry has also developed import control instruments, including a limited ban, the application of pre-shipment inspections, and the regulation of ports in Eastern Indonesia as entry points for priority commodities. Without careful consideration, these import management policies will pose a threat to the powerhouse model especially in the food and beverage manufacturing. As alignment between MOI policies and IA-CEPA is key to implementation success, the ministry should be directly involved in the Economic Cooperation Committee instead of indirectly through its IFIC.

POLICY RECOMMENDATIONS

We recommend a focus on bilateral complementarities in IA-CEPA implementation. This is best achieved through a 'powerhouse' model, which uses Australian inputs in Indonesian exports to other markets or vice versa. Both countries should take advantage of the comprehensive nature of the agreement and push for improvements beyond trade and investment policies into broader domestic economic policy reforms.

This paper considers two cases with the highest potential for success in the global value chain in order to illustrate the powerhouse prospects of IA-CEPA's trade and investment provisions: trade through a food and beverage powerhouse and investment in a higher education powerhouse. These are the sectors where Indonesia either has an existing comparative advantage that can be built upon or an urgent need for improvement that Australia is well-placed to support. Our specific recommendations in these sectors are:

- i. Given the risk posed by the import substitution program, the Economic Cooperation Program should ensure that import substitution does not affect the sectors covered by IA-CEPA. Since Indonesia is unable to produce wheat but has strong capability in wheat-based food manufacturing, raw material imports will be necessary to ensure a successful food and beverage powerhouse here. The Economic Cooperation Program should engage MOI more directly by including it in the Economic Cooperation Committee. Including the MOI in the Economic Cooperation Committee would ensure that industrial policy changes required to ensure effective implementation of the powerhouse can be quickly addressed.
- ii. The MOA should amend Article 7 (1) of the MOA Regulation No.2/2017 on Importation of Ruminant Livestock into the Territory of the Republic of Indonesia. The "1:5 breeder policy" increases importers' costs and may deter them from fully utilizing the larger import quotas provided by the IA-CEPA. This will slow down active participation by Indonesia in the meat-based food global value chains and undermine the powerhouse potential.
- iii. Indonesia should have a global strategy for higher education. With international students barred from entry, Australian universities will need to find alternatives to accommodate its largest market: Asia. The large, young population of Indonesia provides an attractive customer base, but more students can also be welcomed from other countries. Attracting international students will require streamlining the application process. Integrating the student permit, entry visa (VITAS), and limited stay permit (E-ITAS) should be considered, as well as the elimination of an exit permit requiring prior application.
- iv. Indonesia should use investment liberalization through IA-CEPA as a learning experience while developing its higher education sector. IA-CEPA provides a learning opportunity for both Indonesian policy makers and Australian education providers.

Initial engagements with a single source country can help Indonesian policymakers identify unexpected investment roadblocks while limiting the pitfalls before opening the sector more broadly. Australian investors will likely receive more attention from authorities that are keen for a success story, and will benefit from a head start over competitors from other countries. The lessons learned will be useful to inform future reforms in the Indonesian higher education sector.

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