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Foreign Direct Investment in Indonesia's Agriculture

by Donny Pasaribu, Arumdriya Murwani, and Indra Setiawan

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Authors:

Donny Pasaribu, Arumdriya Murwani, and Indra Setiawan

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EXECUTIVE SUMMARY

Indonesia is gearing itself to attract more trade and investment, as well as integrating further into the global economy. The country has been actively pursuing economic cooperation both through regional agreements, such as the Regional Comprehensive Economic Partnership (RCEP) and with individual countries, such as the Indonesia-Australia Economic Partnership Agreement (IA-CEPA).

Despite these integration efforts, the government has given relatively little attention to attracting FDI in Indonesia's agriculture. FDI in Indonesia's agriculture only makes up between 3-7% of the total FDI realization between 2015 and 2019. The majority of Indonesia's FDI in agriculture went to palm oil, which was seen to be more profitable than other subsectors. Through interviews with Australian investors, Australian business associations, and the Indonesia Investment Coordinating Board, this paper identifies several issues that affect investors' decision to invest in the Indonesian agricultural sector.

Land issues are very central in investment decisions in agriculture. Issues about landholding and land ownership have the potential to create agrarian conflicts, which count as an investment risk. As a result, private investment in the upstream sector of agriculture remains limited. Fixing land issues requires broad reforms that can improve clarity in land registration, especially in rural Indonesia.

Improving infrastructure availability, including road, port, and electricity outside Java are still important. The large size of land required for large scale agribusinesses is only available outside Java. Without sufficient infrastructure, investors would not find investing in agriculture profitable. While some investors are willing to build the required infrastructure to support their businesses, the modest margin in most food crops cannot justify the cost of infrastructure.

A broader change in food trade policy is also required, especially related to the openness to trade and the role of SOEs in achieving self-sufficiency goals. The cost of pursuing self-sufficiency has to be paid in terms of higher domestic food prices, less diverse food consumption, and misallocation of resources. By pushing SOEs to achieve self-sufficiency goals, the government is encouraging a reallocation of resources from other productive means into costly, and sometimes unrealistic, self-sufficiency projects.

Price distortions due to self-sufficiency policies also have misallocation effects. They direct resources into less productive but protected agriculture sub-sectors and deter investors who do not want to face political risks from investing in agriculture. Openness to trade will not only make food more affordable but also diminish the distortionary effects past policies have in the sector. Getting rid of these distortions will allow farmers and investors to allocate resources according to profitability and productivity.

Improving regulatory predictability is also important to increase investors' trust in the Indonesian regulatory environment. Regulatory uncertainty is still a major problem that hinders foreign investment in Indonesia. Despite deregulations efforts with the enactment of Law No.

11/2020 on Job Creation, implementing provisions are still subject to swift change to respond to public pressure. These changes create uncertainties in the regulatory environment which can temporarily deter foreign investments.

Institutional capacity also needs to be improved to be better prepared to accommodate FDI. This includes ministries and agencies that are involved in trade and investment in agriculture, as well as district governments at the local level. General efforts to cut bureaucratic red tape, as measured by Indonesia's ranking in the EoDB index, is still important.

Lastly, responsible government agencies should focus on programs that could foster relationship building between Indonesian and Australian businesses. The Ministry of Trade and Investment Coordinating Board can increase their engagements with Indonesian industry associations and hold events that allow them to connect with Australian businesses. Another way to foster relationship building is to negotiate a further increase in the Work Holiday Visa (WHV) quota for Indonesian to work temporarily in Australia and through cultural and language exchange programs.

Participation in the global economy has always been an important factor in Indonesia's economic development. Since long before modern Indonesia was established, migration and international trade have facilitated the spread of ideas and culture in the long process that shaped the country as it exists today. This is a process of continuous evolution, though its speed may rise or fall.

Recently, Indonesia's integration with the global economy has been strengthened by President Joko Widodo's decision to make increasing foreign investment a top priority of his second term in office (2019–2024). Indonesia has been actively pursuing more formal economic cooperation both through regional agreements, such as the Regional Comprehensive Economic Partnership (RCEP) and with individual countries, such as the Indonesia-Australia Economic Partnership Agreement (IA-CEPA). These actions signal Indonesia's openness to trade and foreign investment and its willingness to integrate further into the global economy.

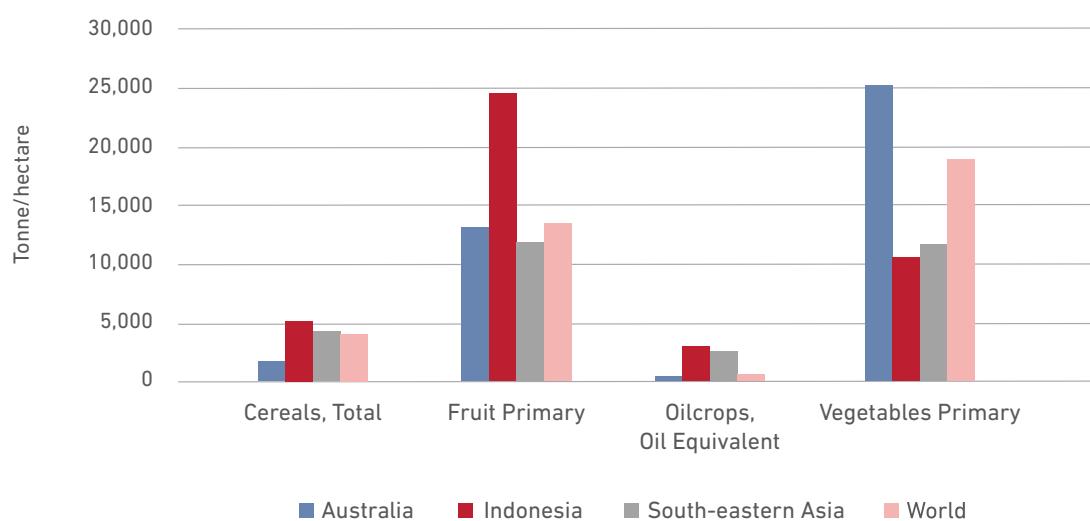
While much attention has been given to attracting investments in infrastructure, manufacturing, tourism, and the digital economy, relatively little attention has been paid to attracting FDI in Indonesian agriculture. Factors that support or hinder FDI in agriculture may be different from those in other sectors. A thorough understanding of the factors that apply to agriculture in particular are important for policymakers, investors, and to develop an academic understanding of the sector. Acting on this knowledge will help policymakers effectively support rural economic development and sustainable agriculture.

THE STATE OF INDONESIA'S AGRICULTURE SECTOR

This paper aims to identify the factors that support or hinder FDI in Indonesia's agriculture sector and to provide policy recommendations based on these factors. Indonesia urgently needs to modernise and expand its agriculture sector. As shown in Figure 1, with the exception of vegetable production, Indonesia's agricultural sector yields per hectare are high by global standards.¹ However, as Figure 2 shows, when measured per capita, Indonesia's agricultural production is low by global standards.

According to the Food and Agriculture Organization's Corporate Statistical Database (FAOSTAT), the share of agriculture sector employment is 13.6% in Indonesia compared to only 1.5% in Australia. Employment data is not given by crop, so crop production per worker cannot be compared between countries. However, when total production is compared to population, Indonesia's total production per capita in cereals, fruits, and vegetables are lower than the world average (Figure 2). Although this is not a measure of productivity per worker, it strongly suggests that agricultural labour productivity is low.

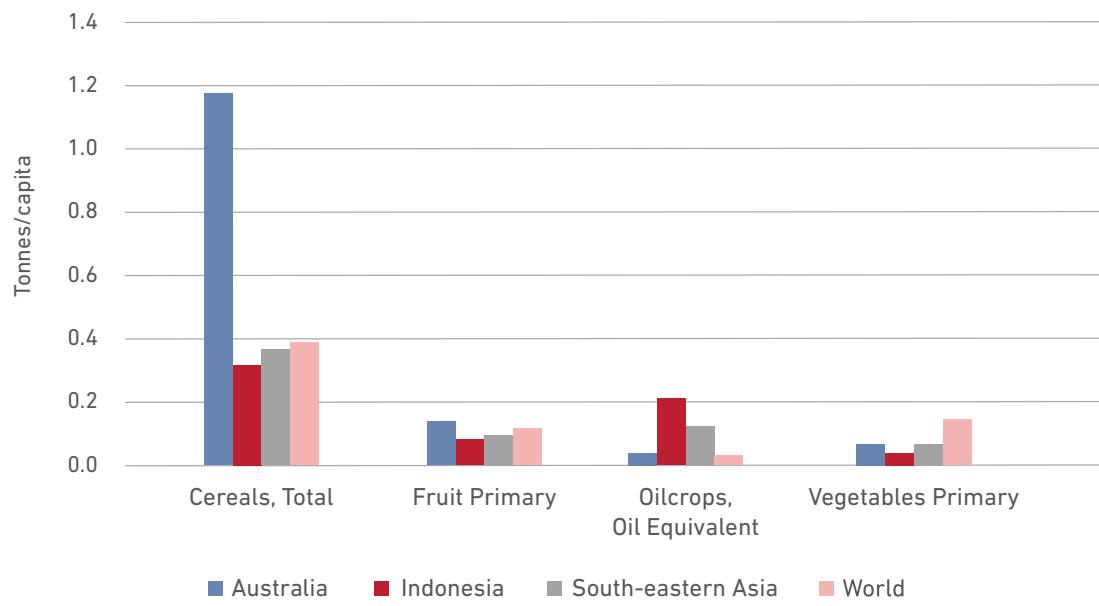
Figure 1.
Yield (tonne per hectare) of major crops in 2019



Source: FAOSTAT (FAO, 2021)

¹For simplicity, the yield figures are aggregated into agricultural product groups (cereals, fruits, oil crops, and vegetables). Because these commodities are not uniform (e.g., fruits vary in form and weight), these figures must be interpreted carefully.

Figure 2.
Total production per capita of major crops (2019)



Source: FAOSTAT (FAO, 2021)

There is a strong political will to pursue food self-sufficiency, but even with the high share of the population working in the sector, Indonesia has not been able to meet its consumption demands. A third of children under the age of five in Indonesia are affected by stunted growth. In the Global Food Security Index, developed by The Economist Intelligence Unit (EIU), Indonesia ranks 62 out of 113 countries (EIU, 2019). Indonesia's ranking in affordability is 58 and its ranking in quality and safety is 84. These numbers illustrate a serious challenge faced by Indonesian consumers, in particular by poor households, who spend up to 70% of their income on food. According to UN projections, Indonesia will add another 33 million people to its population by 2035 (UN, 2019), making its ability to supply decent quality food at an affordable price ever more urgent.

Box 1. Food self-sufficiency policy

The political idea of Indonesian food self-sufficiency provides the main rationale for regulatory restrictions that create barriers for Australian agribusiness to enter the Indonesian market. The idea of self-sufficiency has a long history dating back to Soekarno's nationalistic, quasi-socialist economic policies, which included high barriers to legitimate trade (Fane & Warr, 2008). The policy of food self-sufficiency aims to encourage domestic food production (Hamilton-Hart, 2019) putting more emphasis on the quantity of domestic production, instead of quality, to fulfil domestic needs.

Under Soeharto's New Order government, the country promoted self-sufficiency in rice by subsidising input and expanding irrigation facilities using oil revenue. Rice imports were reduced gradually and halted altogether in 1985. Food imports were liberalised briefly after the Asian Financial Crisis in 1997–1998 because the IMF made liberalisation a condition for a loan package. However, protectionism quickly returned after democratisation, initially in the form of tariffs (20% tariff on imported rice in 1999), and then non-tariff barriers. The idea of food self-sufficiency culminated in Law No. 18/2012 on Food, which aimed for food self-sufficiency and sovereignty in managing the food system.

Although a country aiming for self-sufficiency focuses on quantity of production, many Australian agribusinesses prioritise quality over quantity due to higher production costs in Australia. Such a fundamental difference in the objectives of Indonesia's political governance and potential Australian investors in the agriculture sector may be a source of incompatibility for cooperation.

Comparing the price of staple food items such as chicken, shallots, and garlic in Indonesia to the prices in neighbouring countries reveals the challenge that Indonesia faces when it comes to food affordability. According to Indeks Bu RT, a food price comparison index compiled by the Center for Indonesian Policy Studies (CIPS), the average domestic prices of chicken, shallot, and garlic in November 2020 were 34%, 138%, and 68% higher, respectively, than in Malaysia (CIPS, 2020). Food affordability is not a new problem. According to Statistics Indonesia data (BPS, 2020), Indonesia's food consumer price index (CPI) inflation between January 2010 and December 2019 was a staggering 258%. Comparing this to the increase in price in Malaysia (38%) and Singapore (24%) over the same period² reveals both how severe and how longstanding the problem of food affordability is in Indonesia. While the composition of the consumer basket of goods between these countries might be different³, there is stark contrast in what happened to prices over

¹ For simplicity, the yield figures are aggregated into agricultural product groups (cereals, fruits, oil crops, and vegetables). Because these commodities are not uniform (e.g., fruits vary in form and weight), these figures must be interpreted carefully.

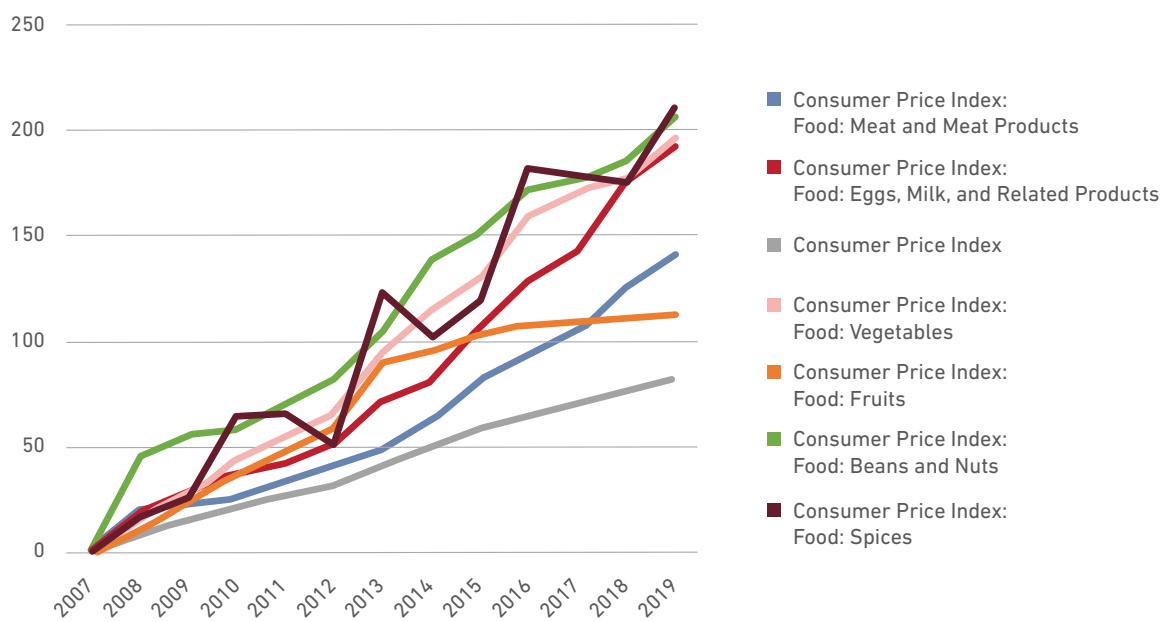
² Author's calculation based on CEIC Database

³ Consumer basket of goods are determined by domestic consumption and varies between countries. They are revised regularly by each country's statistical office. These differences may have implications when comparing inflation rate between countries.

time, with dire implications for food consumers in Indonesia compared to those in Malaysia and Singapore. More worryingly, because lower-income households spend a larger portion of their income on food than higher-income households, the burden of higher food prices is felt more harshly by poorer households.

Food prices have increased at a much higher rate than the prices of other goods in Indonesia. Figure 3 shows the change in price indices of several food items as compared to the overall consumer price index (CPI). While the overall CPI increased by 83% from 2007 to 2019, the prices of most foods have more than doubled. The highest increase was in the prices of spices, beans and nuts, vegetables, and eggs, milk, and related products, which tripled during the period.

Figure 3.
CPI inflation (%) of several food items and overall CPI inflation
(compared to 2007 price level)



Notes: Numbers denote cumulative price changes from 2007 price levels.

Source: author's calculation based on BPS data from CEIC Database.

Food quality and safety are also a concern in Indonesia. While food quality is not easy to measure, food consumption indicators can be used as a proxy. According to the Global Food Security Index (EIU, 2019), Indonesia ranked 102nd in dietary diversity, 103rd in micronutrient availability, and 97th in protein quality. These low rankings strongly suggest that poor Indonesians lack access to affordable quality food.

Food imports are necessary to meet Indonesians' demand for quality food and to bring prices back to an affordable level. However, importing food is complicated in a political environment that demands food self-sufficiency. Imports are restricted through tariffs and non-tariff barriers intended to boost domestic prices and limit domestic supply.

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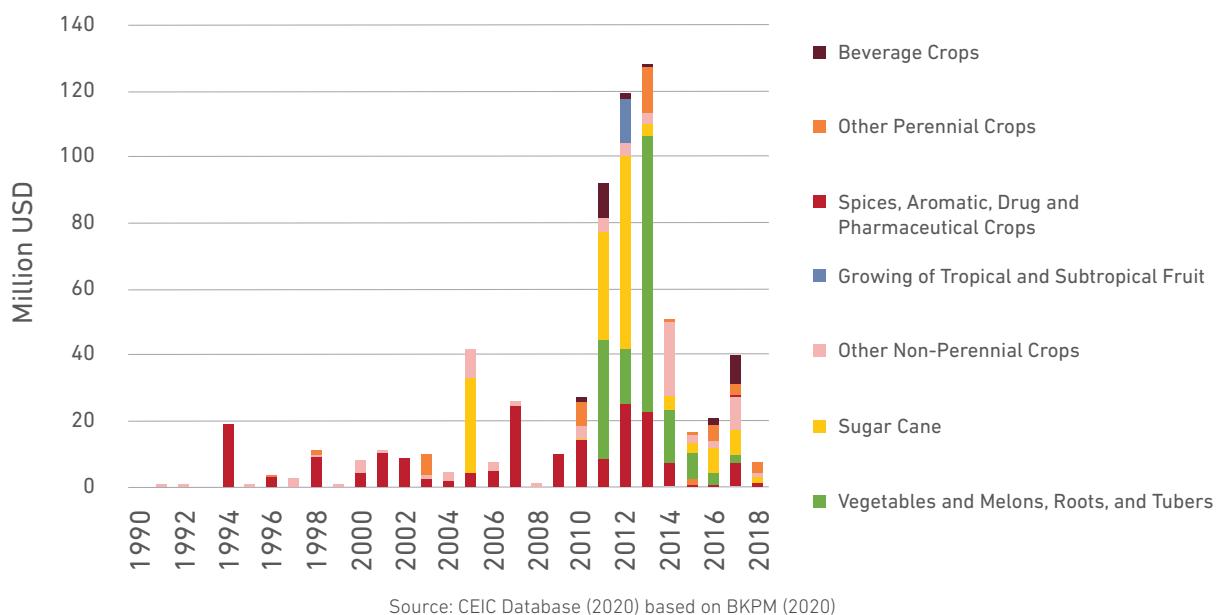
Many studies have examined the impact of trade barriers on food prices, especially rice (Basri & Patunru, 2012; Marks & Rahardja, 2012). After a brief period during which the rice market was open following the IMF structure reform package in 1998, protectionist pressure returned, and with it both tariff and non-tariff barriers (Basri & Patunru, 2012). Protectionist pressure has been the strongest in food imports, including rice, beef, soybeans, table salt, and other politically sensitive commodities. Because they increase food prices in Indonesia above those in neighbouring countries with relatively more open trade policy, food import restrictions set up to protect farmers and help the agriculture sector grow ends up hurting the poor. But these policies have not achieved their stated goal of encouraging domestic production to meet domestic consumption demand.

“ FDI can bring with it new technologies, managerial capacities, and knowledge and connections to the global market (Ramstetter, 1999), increasing the productivity of firms that receive it.

Given the political desire to improve domestic production, FDI should be explored as another channel through which economic openness can improve food affordability and quality. FDI can bring with it new technologies, managerial capacities, and knowledge and connections to the global market (Ramstetter, 1999), increasing the productivity of firms that receive it. Studies in Indonesia have found that FDI has positive productivity spillover effects for sectors related to the ones benefitting from FDI and positive wage spillover effects in geographic areas that host the recipient firm (Lipsey & Sjöholm, 2005, 2011). Although these findings are mainly based on studies of the manufacturing sector similar effects can be expected in agriculture. FDI may help to develop Indonesia's agricultural sector and improve access to high-quality food for Indonesians.

However, there has been little FDI in Indonesian agriculture, especially in food crops and horticulture. FDI in agriculture was only 3%–7% of total FDI realisation between 2015 and 2019 (BKPM, 2020). Moreover, since 2003, FDI in Indonesian agriculture has been concentrated in the palm oil sector, the result of a global commodity boom in palm oil. Between 2003 and 2018, FDI in the palm oil sector reached USD 13.9 billion, while FDI in the rest of the food crop, horticulture, and plantation sector amounted to only USD 441 million. At its peak in 2014, FDI realisation in palm oil alone was more than forty times FDI in the rest of the agriculture sector combined. Figure 4 shows the composition of FDI realisation in food crops, horticulture, and plantations excluding palm oil. Food crops include rice, corn, soybean, peanut, green bean, cassava, and sweet potato. Horticulture includes vegetables, fruits, spices, pharmaceutical crops, and decorative plants. Plantation crops include rubber, coconut, oil palm, beverage crops (coffee, tea, cocoa, hops, and yerba mate), clove, kapok, quinine, and non-perennial crops (sugar cane, tobacco).

Figure 4.
FDI Realisation in agriculture by type of crops, excluding palm oil

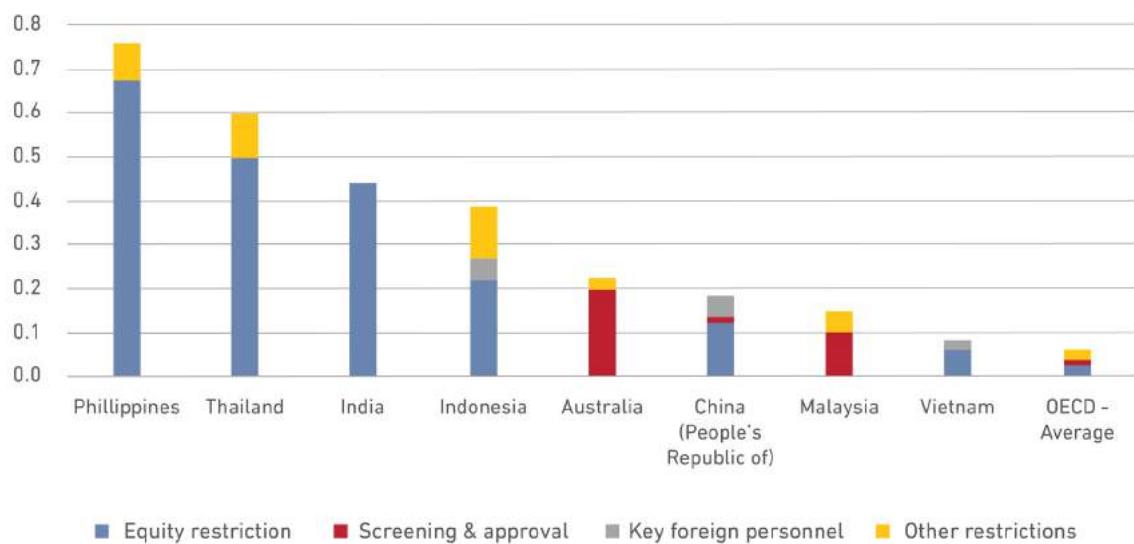


Source: CEIC Database (2020) based on BKPM (2020)

Historically, compared to its neighbours Indonesia has not been the most welcoming to foreign investment, especially in agriculture. Figure 5 shows the investment restrictiveness index scores for the agricultural sectors in Indonesia and other countries in the region. The index is prepared by the OECD. Zero denotes complete openness to foreign investments and one signifies a foreign investment environment that is completely closed. In 2019, Indonesia was more restrictive to foreign investments than Australia, China, Malaysia, and Vietnam. These restrictions are mainly equity restrictions (a maximum proportion of foreign ownership in a firm), key foreign personnel, and other restrictions.

Foreign investment in agriculture was most restrictive in the horticulture sector, regulated under Law No. 13/2010 on Horticulture and Presidential Regulation No. 44/2016 on the Negative Investment List. These regulations put horticulture in the negative investment list, a list of sectors that are closed or restricted to foreign investment, which until 2020 only allowed 30% foreign ownership in horticulture and strictly limited the number of foreign personnel allowed in foreign-owned firms. This changed with the implementation of Law No. 11/2020 on Job Creation and its implementing regulations, which eliminated the foreign ownership cap in the sector.

Figure 5.
Investment restrictiveness index in agriculture



Source: OECD (2020)

Even if the country's leadership signals openness to foreign investments, impediments to investing may persist. It is essential for policymakers to understand how investors make decisions about where to invest and why FDI in food crops has been so rare. This study tries to answer these questions by collecting data through in-depth interviews with Australian investors and would-be investors in the agriculture sector.

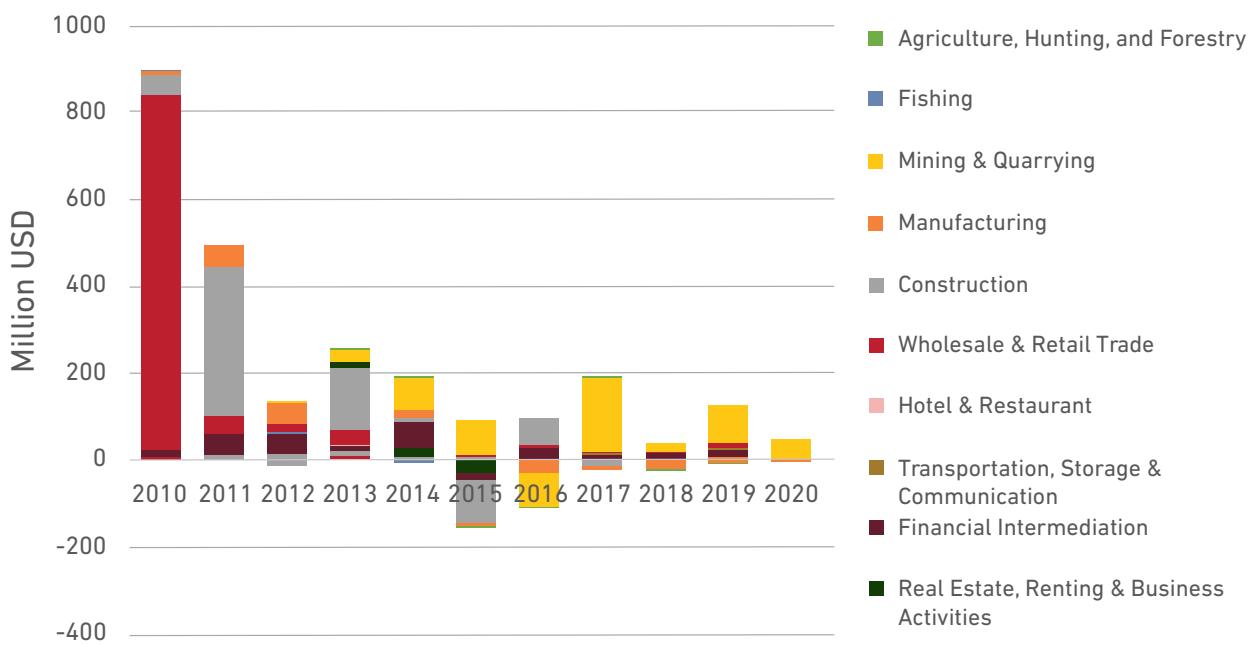
Australian investors were selected because Indonesia and Australia are neighbouring countries with a long history of cooperation. Although neither is a top-five (and only occasionally a top-ten) merchandise trading partner with the other, trade relations between the countries have been consistent. In services trade, tourism and education have been increasingly important sectors connecting the countries. With the comprehensive partnership agreement (IA-CEPA) signed in 2020, further economic integration and a closer economic relationship are expected. According to the UN Comtrade (2020) database, 32% of Indonesia's imports from Australia in 2019 were food and live animals, while 66% of Indonesia's exports to Australia was manufactured merchandise. This suggests a trade relationship in which each country benefits from traditional comparative advantages.

Australia's reputation as an exporter of high-quality food products is widely known. According to UNCTAD's (2019) Revealed Comparative Advantage (RCA) radar, Australian agriculture has comparative advantages in food and live-animals exports, especially in barley, wheat, meat, live animals, and fruits and nuts exports. Indonesia's agriculture has comparative advantages in vegetable oil and its products (mainly palm oil), spices, seafood, cocoa, coffee, and tea exports. At the same time, Australia's agriculture sector has better access to technology and capital which Indonesia's agriculture does not. These differences mean that the two countries have an

opportunity for a traditionally complementary trade relationship that could be reinforced through stronger trade and investment ties. With its technical and capital advantage in agriculture, Australia's FDI in Indonesian agriculture may be part of the solution to increase productivity and help the country to provide affordable high-quality food.

However, Australia's FDI in Indonesia has been relatively small. While the average annual total FDI inflow to Indonesia between 2010 and 2019 was USD 17.8 billion, annual FDI from Australia only represents an average of USD 217 million (BI, 2020). Australia is a net recipient of FDI (Productivity Commission, 2020) so low outflows may not be surprising. But unlike Malaysia, Singapore, and China, Indonesia is not one of Australia's top ten FDI destinations. Moreover, Australia's investment abroad tends to be in non-agricultural sectors such as manufacturing, mining and quarrying, financial and insurance activities, and real estate. Some of Australia's FDI may have entered Indonesia through a third country, such as Singapore, for financial reasons. If so, this would result in an undercounting of Australian FDI in Indonesia by Bank Indonesia or the Investment Coordinating Board (BKPM).

Figure 6.
Australia's FDI flow to Indonesia by sector



Source: CEIC Database (2020), based on Bank Indonesia (2020)

Australia's recent FDI to Indonesia is concentrated in wholesale and retail trade, construction, mining and quarrying, and financial intermediation (Figure 6). Between 2010 and 2020, Bank Indonesia recorded USD 11.6 million of Australian FDI in Indonesian agriculture and Indonesian FDI outflow to Australian agriculture totalling USD 8.38 million.⁴ This two-way investment relationship indicates that there are opportunities for both sides, but this paper will focus on Australian FDI inflow into Indonesia.

Faced with high food price inflation, low food quality, and a growing population, Indonesia's agriculture sector urgently needs new FDI inflows. There are problems facing potential investors, especially in Indonesian agriculture, that limit investors' ability to take advantage of potential opportunities. If they are not identified and addressed, other policies aimed at opening Indonesia to FDI will not succeed.

Although some general issues that hamper investment—such as unmet infrastructure needs—must also be addressed, other factors are specific to the agriculture sector. This study collects information about the challenges of investing in Indonesian agriculture from the Australian point of view through interviews with experienced investors, representatives of industry bodies, potential investors, and Indonesian investment promotion officials in Australia. The next section will discuss these issues.

⁴ Aggregation is based on quarterly data, not individual investment figures.

ISSUES FACING INVESTMENT IN INDONESIAN AGRICULTURE

Despite efforts to boost investment in the country, some investment constraints remain in Indonesia. Over the past few years, Indonesia has been trying to improve its Ease of Doing Business (EoDB) index score to attract investment. In 2020, Indonesia ranked 73 out of 190 countries in the EoDB index as surveyed by the World Bank Group (World Bank Group, 2020). President Joko Widodo's target is to boost the country's ranking to 50th in the index (Investment Coordination Board, 2020). Since this target was set, Indonesia has implemented several deregulation policies and passed the sweeping Omnibus Bill on Job Creation into Law No. 11/2020. Despite these reforms, investment constraints remain, especially in the agriculture sector.

Investment decisions involve a broad range of factors, and some factors are more important than others for the agriculture sector. This section will discuss the factors that affect Indonesian agriculture in particular and how each one affects Australian investors' decisions to invest in Indonesian agriculture.

Market Size and Depth

There is no dispute about the potential of Indonesia's growing market size. It is the world's fourth most populous nation, the only Southeast Asian country in the G20, and the world's 10th largest economy in terms of purchasing power parity (World Bank, 2020). Indonesia has enjoyed consistent economic growth since the Asian financial crisis in 1998. Before the COVID-19 pandemic, Indonesia recorded annual GDP growth of 5.6% and was reclassified as upper-middle-income by the World Bank (2020). Despite the economic contraction during the pandemic in 2020, Indonesia's economy is projected to grow by 5.3% in 2021 following the recovery phase from COVID-19 (ADB, 2020).

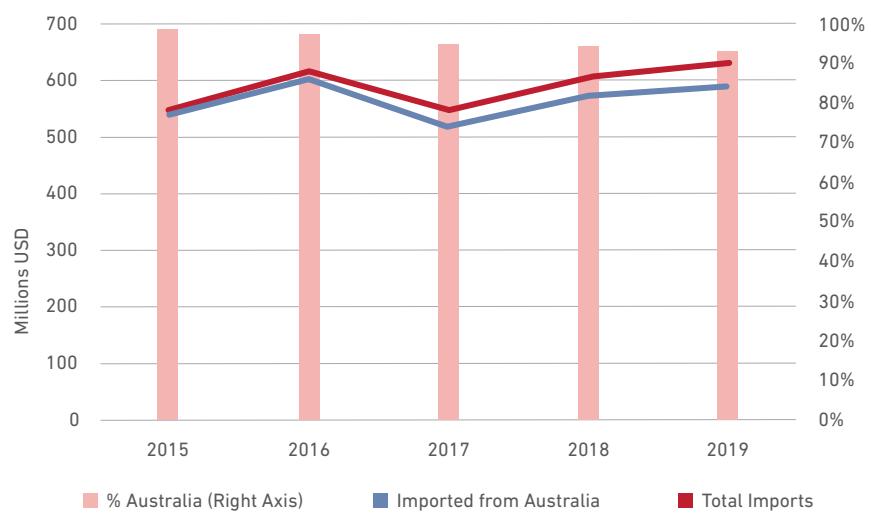
Indonesian growth has come hand-in-hand with the rapid growth of the Indonesian middle class. Approximately 52 million citizens are economically secure and categorised as middle class. As income grew higher, Indonesia's poverty rate fell to single-digits. This rapid expansion of the middle class and reduction in poverty has played a pivotal role in the Indonesian economy, with middle class consumption growing at 12% annually since 2002 (World Bank, 2019). A large middle class population means higher domestic consumption, presenting an opportunity for Australian businesses to invest in Indonesia. This is especially true because the demand for products from Australia, such as beef and dairy products, has grown significantly.

"...while everyone was focusing all their energy on China, we felt that it really opened an opportunity with a country like Indonesia, with such a very large population base, very similar and typical story about growing middle class and growing appetite for Western foods, Western products, and so on, for us to really take a different approach to what many of our contemporaries were taking in terms of focusing on China at the expense of so many other markets ..." – Garry Embleton, CEO of Ausfine

The increasing demand for beef and dairy products can be seen in the increasing import volume of both products. Statistics Indonesia (2020) recorded that beef imports grew quickly from

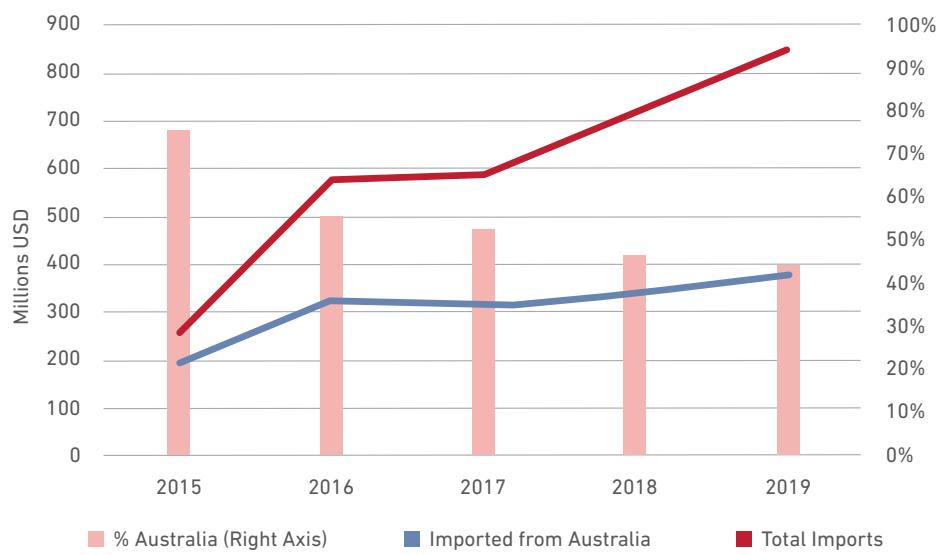
50,689.7 tonnes in 2015 to 262,251.3 tonnes in 2019. Most imported meat and live animals come from Australia. Figures 7 and 8 show the value of Indonesian imports of live animals and meat. Although the value of imports from Australia is growing, their share of total imported meat and live animals is declining. The volume of imported dairy products also grew with consumption. Dairy consumption in Indonesia grows by 4% per year (Ministry of Agriculture, 2018). Data from the Ministry of Agriculture shows that dairy product imports have consistently grown since 2010.

Figure 7.
Indonesian imports of live animals, from Australia and total imports



Source: UN Comtrade (2020)

Figure 8.
Indonesian imports of Meat, from Australia and total imports



Source: UN Comtrade (2020)

Nevertheless, some Australian businesses believe that Indonesian household income is still too low to generate demand for higher quality, and therefore more expensive, products, such as Australian premium tropical fruits. The World Bank (2019) reports that the majority of the Indonesian middle class, while economically secure, is not wealthy. Middle class household consumption is still considered low. Around 90% (47 million) of middle class spend between USD 7.70 and USD 20.00 a day, while a small proportion of middle class (5 million) spend from USD 20 to USD 38 daily (World Bank, 2019). The upper class, defined as people spending more than USD 38 per day, constitutes less than 1% of the Indonesian population (World Bank, 2019).⁵

Nevertheless, some Australian businesses believe that Indonesian household income is still too low to generate demand for higher quality, and therefore more expensive, products, such as Australian premium tropical fruits.

However, lower Indonesian household income is not a barrier to investing in Indonesia. Rather, it is an indicator of the characteristics and limits of trade and investment compatibility between Indonesia and Australia. At the moment, Australian agricultural businesses exploring trade and investment opportunities in Indonesia are in cattle related sectors or bulkier products such as wheat and maize. This trade and investment pattern is also a sign of sectoral compatibility between these countries. For example, our interviews revealed a high interest in cattle trade and investments in Indonesia, but a relatively limited interest in horticulture products, which tend to have a more modest price margin (Interview 2, 3).

However, lower Indonesian household income is not a barrier to investing in Indonesia. Rather, it is an indicator of the characteristics and limits of trade and investment compatibility between Indonesia and Australia.

Land Issues

Another crucial factor affecting investors' decisions regarding Indonesian agricultural investments is land. Agriculture requires access to sufficient and suitable land. Three important issues in Indonesia make accessing suitable land difficult for investors: land conflict, availability, and profitability.

Land conflict between local communities and private investors is common in Indonesia, and along with the complexity of landholding in Indonesia, has discouraged investors from involvement in the food production system (Asian Development Bank et al., 2019; Dahlan et al., 2019). The Consortium for Agrarian Reform (CAR), a non-governmental organisation that works in agrarian reform, reported that in 2019 there were 279 incidences of land conflict covering about 734,293 ha of land and affecting as many as 109,042 families (Konsorsium Pembaruan Agraria, 2020).

Land conflicts are especially common in plantation sectors such as palm oil and rubber plantation. CAR received reports of 87 incidences of land conflict in the plantation sector alone—effectively making the plantation sector the most problematic sub-sector in the agriculture industry in land

⁵ These numbers are based on the National Household Survey (Susenas), released by Statistics Indonesia (BPS). The World Bank believes the survey excludes many richer Indonesians and that the upper class is much larger and richer than the survey data suggest (World Bank, 2019).

conflict occurred in cash crop plantations including but not limited to palm oil (29 incidences), rubber (6 incidences), sugarcane (5 incidences), and horticulture (3 incidences) (Konsorsium Pembaruan Agraria, 2020).

The frequency of land conflicts, especially in leading investment destination commodities, has made land issues one of the most fundamental disincentives to investing in Indonesian agriculture.

Land issues can turn into investment risks by (but not exclusively by), (1) creating a 'reputational risk' for the investor—especially when the reputational damage can be translated into financial losses, (2) inability of investors to access locations accessible only to the local community, (3) increased vulnerability to conflict with the local population, such as sabotage or theft, that can increase business cost to investors (Rutten et al., 2017). Land issues can also arise when local government changes their land usage plan (Interview 9) or when the plan lacks sufficient clarity and coherence. The frequency of land conflicts, especially in leading investment destination commodities, has made land issues one of the most fundamental disincentives to investing in Indonesian agriculture.

"... we've had an issue, where we've had industrial land that they [the government] took back because they wanted to build a toll road. And then they decided that they didn't want to build the toll road there. So, they gave it back to us as residential land, which was then useless to us for a cold store. And that took us nearly two years to solve that issue with the government..." – Daniel McNicol

Land availability poses another problem. Agricultural land decline has been in the spotlight in recent years, with increasing urbanization of rural Indonesia cited as one of the main drivers of conversion (Rondhi et al., 2018). In developing urban areas, where demand for housing is high, the land economic value increased rapidly and added the incentives to convert agricultural land for non-agriculture use. As a result, the rate of agricultural land conversion in Indonesia is 187,720 ha/year, with most of the land converted for housing and industrial site development (Rondhi et al., 2018). Mulyani et al. (2016) predicted that with that rate, land available for agricultural use would be reduced from 8.1 million hectares in 2016 to 5.1 million hectares in 2045. This high conversion rate indicates that landowners, especially those in developing urban areas, is driven by the incentives to convert land for non-agriculture use and might show that farming may not be the most profitable activity in many developing parts of the country.

Even when land is available, Indonesian agricultural land often suffers from a lack of supporting infrastructure.

Even when land is available, Indonesian agricultural land often suffers from a lack of supporting infrastructure. This is especially true outside Java, where suitable land for agriculture is available but supporting infrastructure is limited. This substantially drives up the price of arable land that has access to infrastructure.

"... It's easy to buy little pieces of land here and there but at a scale, it's something else. If you do go to scale, invariably you'll go to outer island areas and then you're faced with very big infrastructure challenges. Everything from electricity, especially electricity, roads, shipping, is challenging..."

– Richard Slaney

The main investors in infrastructure on agricultural land are individual farmers and the government. When it comes to water management, the individual farmers, farmers' associations, and the local community invest mainly in small-scale infrastructures such as water catchment and small-scale irrigation, while the government invests mainly in large-scale infrastructure such as dams (Asian Development Bank et al., 2019).

Land conflict and a lack of land availability mean that investing in agricultural land in Indonesia involves high costs with significant risks. The difficulty of acquiring suitable land and the risk of potential conflicts reduce the attractiveness of investing in agriculture, especially in food crops that yield lower profit compared to cash crops. When investors decide to engage, they prefer subsectors with higher productivity and profitability, such as palm oil or cash crops. They receive government assistance for investments in cash crop plantations and industrial forest plantations for pulp and paper. As shown above, there is little investment in areas of agriculture where productivity levels are low. This is part of a vicious cycle in which a lack of investment perpetuates low levels of productivity and profitability in these agricultural subsectors which, in turn, makes investment less attractive for investors.

Land conflict and a lack of land availability mean that investing in agricultural land in Indonesia involves high costs with significant risks.

Regulation and Policies

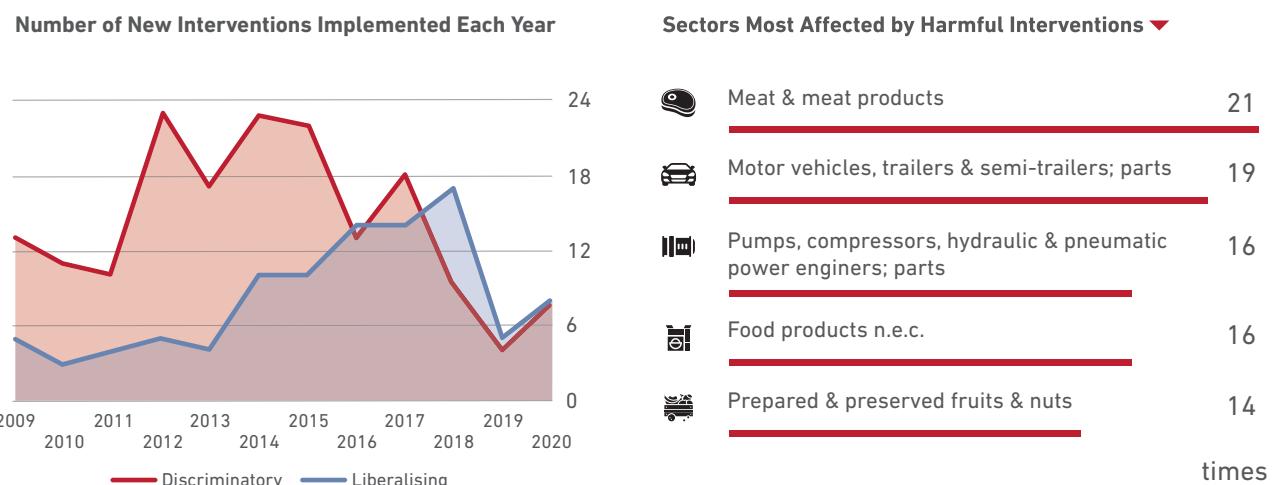
There are at least three forms of regulatory challenges to investing in Indonesia, particularly in agriculture: regulatory restrictions, regulatory complexity, and legal certainty or policy consistency.

Prior to the ratification of the Omnibus Bill into Law No. 11/2020 on Job Creation, Indonesia had one of the highest levels of FDI restrictiveness according to the OECD's Foreign Direct Investment Regulatory Restrictiveness Index (FDI RRI). The FDI RRI measures four areas of FDI restrictions among OECD members and several of its partners: (1) foreign equity restrictions, (2) screening and prior approval requirements, (3) rules for key personnel, and (4) other restrictions on the operation of foreign enterprises. The index takes a value between 0 and 1, with one being the most restrictive. In 2019, Indonesia scored 0.34 on the total restrictiveness index, the highest (most restrictive) among major economies (OECD, n.d.).

Setting aside restrictive FDI policy, Indonesian trade interventions also negatively affect its trade relationship with Australia. According to Global Trade Alert, there are 171 trade interventions that impede commercial relations with Australia. As shown in Figure 9, meat and meat products rank first as the sector that is most affected by harmful intervention with 21 state interventions. The government of Indonesia applies a strict import quota and technical barriers to meat and meat products from Australia. Such state interventions not only hamper Indonesians' access to Australian meat products but, because of the importance of Australia as the source of meat for Indonesia, Indonesian access to meat products generally.

Prior to the ratification of the Omnibus Bill into Law No. 11/2020 on Job Creation, Indonesia had one of the highest levels of FDI restrictiveness according to the OECD's Foreign Direct Investment Regulatory Restrictiveness Index (FDI RRI).

Figure 9.
State interventions by Indonesia that affect Australia



Source: <https://www.globaltradealert.org/>

As the government tried to attract investment, deregulation policies aimed to make the agriculture sector more attractive to investors. Law No. 11/2020 on Job Creation introduced sweeping deregulation to some of the more restrictive sectors, such as horticulture. One of the most significant changes in the law is the removal of the 30% cap on foreign ownership in horticulture businesses. The government also eliminated its negative investment list, further liberalising the 14 other sectors on the list.

While the removal of ownership caps and other deregulation have the potential to make investing in agriculture more attractive, the risk of new regulation that could hamper investment in Indonesia remains. In the horticulture sector, for example, the investment cap is now regulated using presidential regulations as opposed to laws.⁶ A change in Law (*Undang-Undang*) would require parliamentary approval, but presidential regulations can be changed without the approval of parliament. Therefore, foreign ownership caps can be reintroduced without parliamentary consultation and there is no certainty that future administrations will not introduce new ownership caps.

Another issue is regulatory complexity, which has been among the primary complaints of investors in Indonesia. In 2020, Indonesia ranked 72 out of 190 in the World Bank's Ease of Doing Business (EoDB) index but ranked 146 in enforcing contracts, 139 in starting a business, 117 in trading across borders, 111 in dealing with construction permits, and 107 in registering property. To address these problems, the Indonesian government has been trying to deregulate parts of the country's economy to attract investors through Law No.11/2020 on Job Creation. However, our interview reveals that some investors remain sceptical of the lengthy and complicated process and requirements to obtain investment licensing, transparency and consistency of the policy enforcement.

⁶Previously, foreign ownership cap for Horticulture was regulated in Law No.13/2010 on Horticulture, but now investment caps and restrictions in all sectors are regulated in Presidential Regulation No. 5/2021 on Business Sectors for Investment.

The government is also trying to simplify the requirements to obtain an investment license by giving the Investment Coordinating Board (BKPM) more autonomy when issuing business licenses. Previously, FDI requirements in Indonesia required investors not only to coordinate with different ministries in the central government but also with regional governments and bodies. This complex investment licensing process was inefficient and bureaucratic.

In addition to pursuing deregulation, the government also tried to attract more investment by ratifying trade and investment deals, including the 2020 Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA). Because of its recent ratification, the success of IA-CEPA in attracting more investment in the agriculture sector cannot yet be assessed, but Australian businesses express high hopes that it will open trade links.

The third issue is regulatory certainty and policy consistency. Despite slowly moving towards an environment conducive to investment, there is still some scepticism among investors about transparency, consistency, and policy enforcement (Interview 4, 5, 6, 8, 11).

“... we did everything in our power to make sure we did conduct a very squeaky clean, ‘to the book,’ to the requirements, to the regulations in Indonesia. And again, that was difficult, especially with the change in policy. So, you know, the changes in policy were the major problems which we encountered...” – Greg Pankhurst.

In pursuit of profit, investors weigh the cost of meeting regulatory requirements against the potential profit from investing in Indonesia and accessing its market. Stringent regulatory requirements are not unique to Indonesia, and exporters and investors expect to encounter them. After all, every sovereign country has its own regulatory setting and it is the responsibility of investors to monitor their changes. However, long term business decisions, such as FDI, require a degree of predictability so that risks can be assessed appropriately.

However, long term business decisions, such as FDI, require a degree of predictability so that risks can be assessed appropriately.

Predictability is not always the reality in Indonesia. Ironically, the ratification process of Law No.11/2020 on Job Creation provides an example. There was a lack of public participation in drafting the bill, and its deliberation and ratification process were also shrouded in secrecy. The public received sudden notification of the bill along with five different drafts before its ratification in October 2020 (Ghaliya & Gorbiano, 2020). The process created uncertainty about which of the drafts would be ratified and raised questions about the drafting process.

Indonesia has a history of vast policy changes each time a new administration was sworn in. This reduces predictability and increases the risk associated with investing. One example is the aforementioned Law No. 13/2010 on Horticulture, ratified during President Yudhoyono’s administration. Prior to the ratification of the Horticulture Law, Indonesia allowed up to 95% foreign ownership in the horticulture sector in its Negative Investment List (*Daftar Negatif Investasi* – DNI). The Horticulture Law suddenly imposed a 30% cap on foreign ownership and its implementing regulations imposed a temporary ban on the imports of 15 horticulture products, contributing to rapid price increases for the affected commodities (World Bank, 2014). Foreign investors in horticulture with ownership above the new cap were given four years to divest. President Widodo’s

Indonesia has a history of vast policy changes each time a new administration was sworn in. This reduces predictability and increases the risk associated with investing.

administration in Presidential Regulation No. 44/2016 on the Negative Investment List reinforced the hostile investment climate. Five years later, Law No. 11/2020 on Job Creation reversed these changes by removing the foreign ownership cap in horticulture. Presidential Regulation No. 10/2021, which is the implementing regulations for FDI associated with the Job Creation Law, removed horticulture from the list of business sectors that are open for investment “with Specific Requirements”. While these changes are positive, the removal of the foreign ownership cap in the horticulture sector is regulated under a Presidential Regulation and so further sweeping changes are possible without parliamentary consultations.

Another example of swift regulatory change has affected investment openness in the alcoholic beverages industry. Presidential Regulation No.10/2021 initially included alcoholic beverages in the list of business sectors that are open for investment “with Specific Requirements”. However, after backlash from the public—especially from religious groups—President Joko Widodo suddenly decided to remove alcoholic beverages from the list (Sekretariat Presiden, 2021). This case illustrates that even when leadership-led deregulation aims to improve the investment environment, public pressure can swiftly change the direction of policy.

Food Self-Sufficiency Policies

Beyond the challenges created by regulatory certainty and complexity, is the overall regulatory environment of the agricultural sector. Indonesian agricultural policy is heavily controlled by the state and driven by the mandate of Law No. 18/2012 on Food, which aims for self-sufficiency. Food self-sufficiency has been a heavily politicised issue since democratisation in 1998 and contributes to uncertainty for investors in the sector. The government maintains significant control over supply chain management of strategic food commodities, especially but not exclusively rice, beef, chili, and maize.

Import and export barriers on food products are implemented with minimal public consultation when prices are either too high or too low or when the government deems domestic supply inadequate. Interventions are especially common in politically sensitive food commodities. While tariffs on imported good are relatively low and have been declining for the last thirty years, import restrictions on food crops and food products persist in the form of non-tariff measures (Marks & Rahardja, 2012). Before even shipping their product to Indonesia, food exporters must obtain halal certification from the Indonesian Halal Product Assurance Agency (BPJPH), register the product with the National Agency of Drug and Food Control (BPOM), and obtain an import permit, recommendation, and entry permit from the Ministry of Agriculture (Australian Food & Grocery Council, 2020). In 2018, more than 95% of animals, vegetables, and food product imports in Indonesia are subject to non-tariff measures (Munadi, 2019).

These interventions not only fail to achieve their objective of price stability, as demonstrated by high food price inflation, but also distort prices as market signals for investors. Distorted prices and policy uncertainty make investing in agriculture risky business with uncertain returns. Long term investment decisions in agriculture can hardly be based on artificially and temporarily high food prices. Moreover, government interventions create political rents that incentivise corruption. Multiple politicians have been indicted for corruption and bribery for the importation of beef, rice, and garlic.

Protectionist policy also discourages investors by creating a political risk associated with investing in agriculture. Trade openness will not only lower food prices, it will diminish the distortionary effects past policies have had in the sector, allowing investors to better assess potential opportunities. Allowing prices to be set by the market will also allow both farmers and investors to understand where their resources can be used most productively, as indicated through profitability—further lowering food prices. Beef production, in which Australia has a comparative advantage, is a prime example.⁷ Our interviews confirm that producing beef is more expensive in Indonesia than in Australia (Interview 1, 8), while Indonesia's comparative advantage lies in the fisheries and poultry sectors. Protectionist policies in beef production not only make beef prices higher to Indonesian consumers, but they may also divert private investment away from sectors in which Indonesia has a comparative advantage, such as the fisheries and poultry sectors.

Trade policy matters for investment decisions in part because trade allows future investors to acquire local knowledge. Some investors interviewed for this study were first understood the potential of investing in the Indonesian market through exporting to Indonesia (Interview 4, 9). Investing requires a larger commitment than exporting and so requires deeper knowledge. The firm heterogeneity model, outlined by Helpman, Melitz, and Yeaple (2004), argues that only the most productive firms export and only the most productive exporters will invest abroad. Exporting as a prelude to investing is a common pattern in many sectors. The pattern of successful exporters elevating their involvement to investment fits the prediction of the firm heterogeneity model in FDI. This supports the claim that trade openness is an important channel by which investors can learn about the Indonesian market.

Furthermore, Dunning's (1973) standard OLI (ownership, location, and internalisation) model argues that for a multinational firm to profitably engage in FDI, it must be able to combine its competitive advantage with the local advantages in the investment destination and internalise both advantages in its production process. In many cases, internalising these advantages requires a production network that combines imported inputs from the firm's origin country with the production process in the FDI destination country. An example that fits the OLI model is importing live cattle from Australia to joint-venture feedlots in Indonesia, which then use local inputs to feed the imported cattle for approximately 100 days before they are sent to abattoirs (Interview 1, 6, 8). This process combines Australia's comparative advantage in cattle breeding with Indonesia's advantage in feeding. This process depends largely on trade openness.

⁷ Comparative advantage is measured using Revealed Comparative Advantage index, released by UNCTAD (2019). Accessible at: <https://unctadstat.unctad.org/en/RcaRadar.html>

Institutional Weakness and Inaccurate Data

In addition to inconsistent regulatory policy, Indonesia lacks strong legal institutions to enforce the law and provide legal certainty for investors. One Australian investor mentioned low contract enforcement capacity in Indonesia, and there is little faith that the Indonesian court system will treat foreigners fairly (Interview 1). This matters because a secure business environment is necessary for the ease of doing business in an economy. The EoDB index assesses whether the judiciary can handle complex commercial cases efficiently with specialised judicial bodies, which would improve investment conditions in Indonesia. Indonesia is currently ranked 146 out of 190 countries and regions in terms of contract enforcement and 36 out of 190 in resolving insolvency (World Bank Group, 2020).

Australian investors shared that differences in the implementation of trade and investment policies between ministries can create problems for their investments (Interview 2, 6, 7).

Consistency between ministries across the government is important for FDI in agriculture. Australian investors shared that differences in the implementation of trade and investment policies between ministries can create problems for their investments (Interview 2, 6, 7). This points to the need for better coordination between ministries and agencies and improvement in institutional capacity in the relevant agencies, such as the Ministry of Agriculture, the Ministry of Trade, and the Investment Coordinating Board. An interviewee also mentioned the need to improve communication between investors and the government (Interview 6).

“... Probably the biggest issue of all across the government is that different ministries have different approaches to these issues and therefore, you don’t get a whole, consistent policy across the government (...) I’m not talking about corruption here, I’m talking about the ability to sit down in a table and have a conversation whenever there’s a problem...” – Richard Slaney

Institutional capacity at the subnational level, such as the district and provincial levels, is also important for FDI in agriculture. Agricultural investments tend to require large parcels of land, only available outside Java. Local governments outside Java have lower institutional capacity, which can result in costly and lengthy bureaucratic and legal processes. The problems stemming from land issues discussed in the previous section are in many ways related to local government capacity.

Indonesia also suffers from data accuracy problems, especially regarding statistics related to food commodities (Ruslan, 2019). Accurate data are needed by the Indonesian Ministry of Agriculture, which is responsible for issuing licenses, import recommendations, and entry permits to allow

Inaccurate data can create a misplaced sense of confidence in policies and lead to unintended consequences. Inaccurate data also undermines the trust of both the government and the private sector in official statistics.

the importation of various food products. Inaccurate data can create a misplaced sense of confidence in policies and lead to unintended consequences. Inaccurate data also undermines the trust of both the government and the private sector in official statistics. In 2018, for instance, domestic rice prices remained high and Indonesia imported 2.25 million tons of rice despite official figures that showed a surplus of national rice production surpassing 10 million tons. In the same year, Indonesia imported 731,000 tons of corn while statistics about domestic corn production recorded a surplus of 14.6 million tons (Ruslan, 2019). The inability of the government to determine the actual output of harvested commodities reflects the institutional weakness of governing agencies in the agriculture sector.

Cultural Differences and Finding a Local Business Partner

As neighbouring countries, people in Indonesia and Australia have surprisingly limited awareness of their neighbours' cultural characteristics. Cultural, historical, and linguistic differences act as barriers that separate these countries much more than the narrow sea between them. In a report released by the Australia-Indonesia Centre in 2016, only 22% of Australians agreed that Indonesians are trustworthy people and 13% agreed that Indonesia is a trustworthy country. At the same time, 44% of Indonesians agree that Australians are trustworthy people and 53% agreed that Australia is a trustworthy country (EY Sweeney, 2016). A lack of understanding and a negative perception was also demonstrated by a poll from the Lowy Institute in 2019 which found only 50% of Australian respondents personally agree that Indonesia is a democracy and 1% of Australians felt Indonesia was "Australia's best friend in the world", lower than China or Japan, let alone the United States or the UK (Lowy Institute, 2019).

Underlying cultural differences between Australia and Indonesia in communication style is a critical barrier. People in Western societies, such as Australia, tend to verbally convey their feelings and are comfortable directly criticising people (Giri, 2006). The written or spoken word matters more than the context of the communication. Meanwhile, Indonesia is generally embedded in the Asian culture, characterised by indirect ways of communicating with others. Indonesians tend to communicate indirectly to prevent conflict and to create a pleasant working environment (Panggabean, 2004). The social context of communication is often more important than written or spoken words. In both countries, the rural areas are culturally more secluded, providing them with less exposure to these differences, which makes engaging with foreign cultures, even just to do business, more daunting.

This cultural friction can represent a significant barrier to building a profitable business in a foreign country, particularly in the early stages. Cultural awareness affects how the business is operated, its products, and its interaction with employees, suppliers, consumers, the government, and the local community. The agriculture sector presents a unique problem in this aspect because the large area of land required mean it is nearly always carried out in rural areas, where local traditions are more strongly held and interaction with the local government and local community tend to be more intense. Insensitivity to cultural cues can lead to conflicts with stakeholders, and even legal problems that can jeopardise the investment.

Cultural awareness affects how the business is operated, its products, and its interaction with employees, suppliers, consumers, the government, and the local community.

As in any business decision, FDI risks have to be assessed and mitigated. In the case of cultural risks, this is done by learning the local culture and language and adapting business practices to in order to build trust and do business successfully in Indonesia. Knowing how to deal with bureaucratic hurdles, sourcing inputs and labour locally, and building a positive reputation are part of cultural awareness. Understanding taste differences, including between regions within Indonesia, also helps businesses serving the domestic market to develop suitable products. All of these factors are local knowledge that is not always easily accessible to foreign investors.

"What are the three most important things to start an investment in Indonesia? There are three things. One is the right joint venture partner. The second one is the right joint venture partner. And the third one is the right joint venture partner." – Greg Pankhurst

Interviews with multiple Australian investors who have managed to maintain profitable businesses in Indonesia confirm that finding a compatible local business partner is the single most important factor in doing business in Indonesia.

One of the ways to mitigate these risks is by finding the right business partner. Interviews with multiple Australian investors who have managed to maintain profitable businesses in Indonesia confirm that finding a compatible local business partner is the single most important factor in doing business in Indonesia. The right local business partner can bridge cultural differences and allow Australian investors to navigate the complexity of Indonesian society. This mutually beneficial relationship is a way to combine the comparative and competitive advantages of people in both countries.

“... you have to have a fantastic local partner. If you don’t, give up at the start. Don’t even try, because, without the local ability to negotiate, to sort out the red tape, I suppose, for want of a better term, you’re behind the eight ball the whole time. So I think that without the right partner, don’t even try.” – Daniel McNicol

However, these relationships are not easy to build. They also require building trust, and every case is different. Greg Pankhurst, the Queensland Livestock Exporters Association president, who has been doing business in Lampung, Indonesia for more than 20 years, found his Indonesian business partner when he worked for an Indonesian company in 1992.⁸ At the time, his business partner was his direct supervisor. Daniel McNicol, the Managing Director of Agricomm, who has been doing business in Indonesia for more than thirty years, partnered with his ex-employee from a previous business.⁹ Garry Embleton, the CEO of Ausfine Food International, who has been operating an office in Indonesia for six years, got to know the Country Manager of Ausfine in his previous trade deals in Indonesia. In each case, finding the right business partner in Indonesia required repeat interactions to establish compatibility and build trust.

Our interview with the Indonesia Investment Promotion Centre (IIPC) in Sydney revealed that IIPC uses a personalised approach to match new Australian investors with a potential local partner from a pool of members from business associations in Indonesia (Interview 11). While this personalised match-making approach has been working so far, a more general approach for investors to find a local partner is necessary.

Skills and Labour

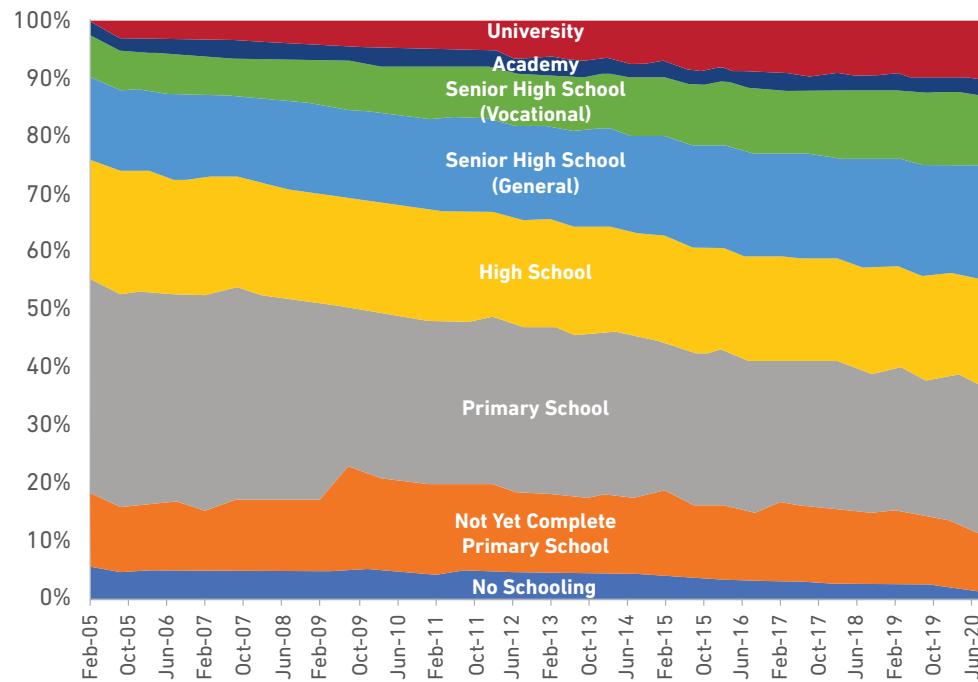
According to the National Labor Force Survey by Statistics Indonesia (BPS) in August 2020, Indonesia was home to approximately 204 million working-age people (older than 15 years old), 138 million of whom are in the labour force¹⁰ (Statistics Indonesia, 2020). The same survey finds that most Indonesian workers are low-skilled labours and only 9.7% of people in the labour force have a university degree. Figure 10 shows how these numbers are changing as more Indonesians complete their education in senior high schools, vocational schools, and universities than ever before.

⁸ Interview with Greg Pankhurst

⁹ Interview with Daniel McNicol

¹⁰ Defined as people in the working age group (15 years and older) who are working, temporarily not working, or looking for work.

Figure 10.
Labour force composition based on the highest educational attainment in Indonesia



Source: CEIC Database, based on the National Labour Force Survey (Statistics Indonesia, 2020)

Despite the growing number of people with senior secondary and tertiary education degrees in the labour market, Indonesia still lacks competent professionals. Skills mismatch is common and the labour market has a persistent talent shortage. The Asian Development Bank (ADB) estimates that 51.5% of workers are under-qualified, 40% are well-matched, and 8.5% are overqualified (Allen, 2016). A survey by Talent in Asia revealed that more than half of Indonesian employers found it hard to hire suitable candidates (RGF, 2019).

Labour market challenges also affect the agriculture sector. Agricultural work requires skilled workers to take on roles such as agricultural staff, mechanics, engineers, and farm business managers, to name just a few. Only around 2% of Indonesian university graduates work in the agriculture sector, while the majority pursue careers in the manufacturing and services industry (Nambiar, Karki, Rahardiani, Putri, & Singh, 2019). As a result, the Indonesian Rice Research Institute (BB Padi) has only four researchers studying hybrid and inbred rice varieties, while similar research centres in China involve hundreds of researchers (Krishnamurti & Biru, 2019).

The skills mismatch and talent shortage can be addressed in part through short courses and training. Most of the top ten most demanded positions, including engineers, project managers, and cybersecurity experts, need post-secondary training but not a full university degree

Agricultural work requires skilled workers to take on roles such as agricultural staff, mechanics, engineers, and farm business managers, to name just a few.

(Manpowergroup, 2018). Boston Consulting Group suggests Indonesian companies institute an accelerated training and development program to take part in reducing talent shortages (Tongg and Waltermann, 2013). The program could take various forms, including a corporate university or training centres for suppliers and customers (Tongg and Waltermann, 2013). If Indonesian companies took on this responsibility, training could be targeted to shorten the timeframe and more directly address the needs of both workers and companies.

To improve working skills in agriculture, Indonesians can also take advantage of Australia's Working and Holiday Visa (WHV). The WHV grants Indonesians the opportunity to work in Australia for up to 12 months in various sectors, including agriculture. Horticulture is one of the biggest sectors that employ WHV holders, who make up 50%–85% of total seasonal horticulture workers (Tan and Lester cited in Reilly, 2015). Until 2019, only 1,000 WHVs per year were allocated to Indonesians, but the IA-CEPA increased this to 4,000 visas beginning in 2020.

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The Dominance of State-owned Enterprises (SOEs)

The dominance of SOEs in Indonesia's economy is often cited as a reason for the lack of private sector participation and therefore as an impediment to FDI. The prevalence of SOEs began under the Soeharto administration (Innovasjon Norge, 2017). During Joko Widodo's presidency, fourteen sectors were dominated by SOEs: information and communication, professional, scientific and technical, construction, transportation and warehousing, flight navigation, trade and retail, agriculture, fisheries and forestry, energy supply, mining and excavation, financial services and insurance, water treatment, sewage and garbage, accommodation, real estate, and industrial manufacturing (Januarti, Faisal & Situmorang, 2019). However, SOEs have declined since their peak—in 2018, Indonesia had 118 SOEs, a decline from 158 SOEs in 2002 (Khatri & Ikhsan, 2020).

The government provides incentives and subsidies for SOEs, frames its tax policies to meet protectionist goals, and owns and directs SOEs to pursue self-sufficiency goals. Through all of these actions, the government encourages the reallocation of resources from other productive goals into the costly and unrealistic goal of food self-sufficiency.

Heavy-handed state control over the management of food commodities make this sector an obvious one for SOE dominance. The government provides incentives and subsidies for SOEs, frames its tax policies to meet protectionist goals, and owns and directs SOEs to pursue self-sufficiency goals. Through all of these actions, the government encourages the reallocation of resources from other productive goals into the costly and unrealistic goal of food self-sufficiency.

With state backing that makes them less vulnerable to market forces and government subsidies to SOEs in particular, SOEs can crowd out potential private sector investments and reduce competition. For this reason, SOE dominance affects not only potential foreign investors but also domestic investors (Interview 6). The private sector has called for more public-private partnerships and greater participation by the private sector in key development projects in Indonesia (PwC, 2016).

There have been attempts to privatise SOEs in order to encourage more competition in the

Indonesian economy, but these have fallen by the wayside. One of the most common arguments for privatisation of SOEs is their financial losses and low productivity (BPHN, 2005). Under President Widodo's administration, the government shifted its focus away from privatisation and towards developing infrastructure (Khatri & Ikhsan, 2020), including through expanding the role of SOEs in order to further national development goals. Unfortunately, this strategy has come at the expense of profitability or productivity (Kim, 2019).

An important example of SOE dominance in agriculture is in sugar. President Suharto's New Order regime forced smallholder sugar cane farmers to supply their produce to state-owned mills (Fane & Warr, 2008). Although this practice was eliminated during democratisation in 1998, investment restrictions have continued, leaving old sugar mills badly in need up updating, and import controls have been tightened. This caused sugar shortages and high domestic prices.

The dominance of SOE in agriculture, especially food, is exemplified by Bulog, a state-owned logistics enterprise in the food sector. Bulog has a long history of controlling the food supply, especially rice, with a stated primary objective of maintaining food availability¹¹. Currently, Bulog is tasked with maintaining the availability of and price stabilisation in 11 commodities: rice, maize, soybeans, sugar, cooking oil, wheat flour, onions, chilies, beef, chicken, and eggs. This mandate is set by Presidential Regulation No. 16/2016 on the role of Bulog in national food security. In spite of Bulog's activities, food prices in Indonesia have increased much more than other goods in the last decade, especially when compared to neighbouring countries. It is fair to say that Bulog has not been able to achieve its objective of price stabilisation. This leaves the private sector and foreign investors with the unappealing options of investing in the shadow of Bulog or not investing at all.

SOE dominance in the food sector is likely to increase as the Ministry of State-Owned Enterprises plans to create a state-owned food industry holding company and merge some SOEs. A letter from the Minister of State-Owned Enterprises Number S-1131/MBU/12/2020 dated 1 December 2020 mandated PT Perinus and Perindo, two state-owned companies focusing on fisheries, to merge. SOEs in Indonesia are divided into Persero whose capitals are shared between the government and other parties, and Perum (public company) whose capitals are wholly owned by the government without a shareholder structure and usually has a public service obligation. The merged entity is set to control the upstream and downstream business of fisheries, from the port business to fish auctions and aqua tourism (MoSOE, 2021). Besides the merging of fisheries SOEs, media report that PT Pertani (Persero) will merge with PT Sang Hyang Sri (Persero) because they both produce seeds (Tempo, 2020). Additionally, warehousing will be run by PT Banda Ghara Reksa (Persero), while the international and domestic trade will be carried out by PT Perusahaan Perdagangan Indonesia (Persero). PT Banda Ghara Reksa (Persero) and PT Perusahaan Perdagangan Indonesia will have a role in distributing state-owned food products up to buyers or retailers. Those previously mentioned companies will join a state-owned food industry holding company led by PT RNI. The creation of a holding company and mergers of SOEs can potentially decrease competition and shows the government's intent to keep its dominance in the agriculture and food sector.

¹¹ For more detailed discussion, see Arshad, Arifin, & Tey (2019).

POLICY OPTIONS FOR THE FUTURE AND CONCLUDING REMARKS

We are faced with the challenge of providing affordable high-quality food for its growing population, Indonesia must consider all available options. Food prices in Indonesia have increased much faster than in neighbouring countries, and foreign investment in agriculture, especially food crops, have been meagre. The combination of high and rising food prices and low food quality cannot be allowed to continue. Despite government overtures toward integration into the global economy and encouraging FDI, Indonesia's relatively protectionist trade policy in food and its ambivalence towards foreign investments are largely to blame. Addressing the challenge of providing affordable, high-quality food to Indonesians requires commitment to trade openness and willingness to undertake policy changes to improve the investment climate in Indonesian agriculture.

This paper has discussed some of the relevant issues that influence potential investors in Indonesian agriculture. FDI in agriculture is important because it can bring with it new technologies, managerial capacities, and knowledge and connections to the global market. FDI decisions are based on more than macro-economic indicators and ease of doing business indices. Although those indicators are important, investing in agriculture involves attention to the unique challenges facing investment in agriculture—it requires a different approach.

Land issues are central to investment decisions in agriculture. Finding a suitable location is important in any businesses, but indispensable in agriculture. Addressing the issues surrounding securing suitable land requires improving clarity in land registration, especially in rural Indonesia. In addition, the potential for agrarian conflict between rural communities and investors is a significant risk for investors, which count as investment risks.

Traditional solutions to improving the investment climate, such as infrastructure improvements, including road, port, and electricity access outside Java are also important for agricultural investment. The available land required for large scale agribusinesses is only available outside Java, but outside Java infrastructure is also much less developed. Sufficient infrastructure is crucial for profitable agriculture investments. Some investors are willing to build the required infrastructure to support their businesses, but the modest margin in most food crops cannot justify the cost of enough infrastructure to solve the problem.

Even if self-sufficiency were a realistic goal, it would be an extremely expensive one, paid through higher domestic food prices, less diverse food consumption, and misallocation of scarce resources.

A broader change to food policy is also required. Self-sufficiency narratives have resulted in protectionism that hurts both the food sector and consumers. Even if self-sufficiency were a realistic goal, it would be an extremely expensive one, paid through higher domestic food prices, less diverse food consumption, and misallocation of scarce resources. Furthermore, the dominance of SOE in the agriculture sector needs to be reduced if the private sector and investors are expected to contribute to the development of the agriculture sector. Protectionist policies in agriculture, which distort prices and discourage investments, needs to be abolished. Import process for agricultural products can and should be simplified.

Because importers gain local knowledge that can enable them to invest in Indonesia, lowering the effective rate of protection can improve both the affordability of food and the investment climate in agriculture.

Improving regulatory predictability is also crucial for encouraging investment. Although policy changes such as the passage of Law No. 11/2020 on Job Creation, which aims at deregulation, are moving in the right direction, implementation can change swiftly in response to public pressure. This means that even when good laws are passed, the regulatory environment remains risky for potential investors. Investors need to believe not only that policy improvements will happen, but that improvements will be predictable and lasting and policies costly to investors will be implemented reasonably.

Institutional capacity needs to be improved across the board. Governments, from the central government ministries to the local level, need to be able to reliably, predictably, and fairly handle the issues that come with foreign investment. This is a long-term challenge with no obvious solution, but efforts to cut bureaucratic red tape and many other policies aimed at improving the ease of doing business in Indonesia may help to lower the demands on governments struggling with capacity issues as well as improve the overall investment climate.

Finally, recognising the importance of cultural understanding and the need for domestic business partners in Indonesia, the government should focus on programs to foster relationship-building between Indonesian and Australian businesses. The Ministry of Trade and the Investment Coordinating Board should increase their engagement with Indonesian industry associations and hold events to connect these associations with Australian businesses. Although such short events are unlikely to be sufficient to develop the trust needed to form the foundation of a business partnership, these relationships have to start somewhere. Another way to foster relationship-building and experience and skills development is to negotiate a further increase in the WHV quota for Indonesians to work temporarily in Australia. Other avenues, such as cultural and language exchange programs, are also worth considering.

Governments, from the central government ministries to the local level, need to be able to reliably, predictably, and fairly handle the issues that come with foreign investment.

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Interview

Interview 1 – Peter Fennel, Principal at International New Business Advisory (2020, November 10). Personal communication.

Interview 2 – Michael Coote, National Manager – Export Development of AUSVEG (2020, November 13). Personal communication.

Interview 3 – Michael Rogers, CEO of The Australian Fresh Produce Alliance (2020, November 13). Personal communication.

Interview 4 – Garry Embleton, CEO of Ausfine Food International (2020, November 18). Personal communication.

Interview 5 – An executive at a food import company in Indonesia (2020, November 22). Personal communication.

Interview 6 – Richard Slaney, General Manager of Farms Indonesia (2020, December 11). Personal communication.

Interview 7 – Valeska Valeska, Indonesia Country Manager at Meat & Livestock Australia (2021, January 8). Personal Communication.

Interview 8 – Greg Pankhurst, President of Queensland Livestock Exporters Association (2021, January 19). Personal communication.

Interview 9 – Daniel McNicol, Managing Director of Agricomm Group (2021, January 20). Personal communication.

Interview 10 – Geoffrey Annison, Deputy Chief Executive at Australian Food and Grocery Council (2021, February 5). Personal communication.

Interview 11 – Henry Rombe, Director of Indonesia Investment Promotion Centre Sydney (2021, February 17). Personal communication.

ABOUT THE AUTHORS

Donny Pasaribu has a Ph.D. in Economics and a master's degree in International Trade and Economic Relations, both from the Australian National University. His research interests include development economics, international trade, natural resource economics, public policy, and competition policy. Before pursuing his doctoral degree, he worked as a researcher at the Institute for Economic and Social Research, Universitas Indonesia.

Arumdriya Murwani specializes on the topics of food security and international trade in CIPS. Prior to joining CIPS, she worked in a research team at Universitas Gadjah Mada that studied the political economy of the transition to renewable energies in Indonesia and development cooperation in the Global South. She graduated with a Bachelor's degree from the Faculty of Social and Political Sciences at the Universitas Gadjah Mada in Yogyakarta and she is an alumnus of the CIPS Emerging Policy Leaders Program (EPLP) 2020.

Indra Setiawan specializes on the topics of agriculture and the digital economy in CIPS. Previously, he worked in a consulting firm as a research analyst on infrastructure development and the energy and natural resources policy. He graduated with a Bachelor's degree in International Relations at Universitas Diponegoro in 2018 and he is an alumnus of the CIPS Emerging Policy Leaders Program (EPLP) 2020.

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