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**AN ANALYSIS OF THE
EMERGING AGRIBUSINESS
SUB-SECTOR IN INDONESIA**

A Report Prepared for
The Agency for International Development

Office of Agriculture and Rural Development
USAID Mission/Indonesia

by

InterAmerican Management Consulting Corporation
Key Biscayne, Florida

Contract No. DHR-4053-C-00-8027

Jakarta, Indonesia

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GLOSSARY AND ABBREVIATIONS

| | |
|-----------|--|
| ACA | Agribusiness Constraints Analysis |
| ADB | Asian Development Bank |
| ARSSP | Agricultural and Rural Sector Support Project |
| ASG | Agribusiness Support Group |
| ASP | Agribusiness Support Project |
| BAI | Bureau of Agriculture and Irrigation in BAPPENAS |
| BAPPENAS | Badan Perencanaan Pembangunan Nasional - National Development Planning Agency |
| BAPPEDA | as above - at the provincial and kabupaten levels |
| BIMAS | Bimbingan Massal - Mass Guidance Supervised Credit Programme for Food Production |
| BKPM | Badan Koordinasi Perencanaan Modal - Investment Coordination Agency |
| BOP | Bureau of Planning |
| BPH | Bank Umum Koperasi Indonesia - Indonesian Cooperative Bank |
| BULOG | Badan Urusan Logistik - National Logistics Agency |
| DEPTAN | Departemen Pertanian - Ministry of Agriculture |
| EEZ | Exclusive Economic Zone |
| GATT | General Agreement on Tariffs and Trade (Indonesia is a member of the Cairns Group of agricultural exporting countries) |
| GBHN | Garis-garis Besar Haluan Negara (Broad Guidelines of State Policy) |
| GDP | Gross Domestic Product |
| IBRD | International Bank for Reconstruction and Development (World Bank) |
| ICO | International Coffee Organization |
| IGGI | Inter-Governmental Group on Indonesia |
| IFAD | International Fund for Agricultural Development |
| IFPRI | International Food Policy Research Institute |
| IKOPIN | Institut Koperasi Indonesia - Institute of Cooperative Management |
| INKUD | Induk KUD - National Federation of Cooperatives |
| INMAS | Intensified BIMAS |
| INPRES | Instruksi Presiden - Presidential Instruction |
| INSUS | Intensifikasi Khusus - Special Intensification Scheme |
| IPB | Institut Pertanian Bogor - Bogor Agricultural University |
| IPEDA | Iuran Pembangunan Daerah - regional development tax |
| ITC | International Trade Center |
| JAC | Joint Agribusiness Committee; short version for the Permanent Agricultural-Industrial Working Commission |
| JMB | Joint Marketing Board |
| Kabupaten | Administrative district |
| Kecamatan | Administrative sub-district |

| | |
|--------------|--|
| KUPEDES | Kredit Usaha Pedesaan - village working credit |
| KUD | Koperasi Unit Desa - village unit cooperative |
| KUT | Kredit Usaha Tani (farmers working credit) |
| L/C | Letter of Credit |
| MOA | Ministry of Agriculture |
| MOC | Ministry of Cooperatives |
| MOF | Ministry of Finance |
| MOI | Ministry of Industry |
| MOT | Ministry of Trade |
| NAFED | National Agency for Export Development |
| NES | Nucleus Estate Smallholder Scheme (see also PIR) |
| Pancasila | Five principles of the state philosophy |
| PBSN | Large National Private State Enterprises |
| PEFP | Pre-shipment Export Financing Program |
| PELITA | Pembangunan Lima Tahun - Five-Year Development Period |
| P.T. PERTANI | State-owned agricultural inputs distribution company |
| P.T. PUSRI | State-owned fertilizer production company |
| PIR | Perusahaan Inti Rakyat - Nucleus Estate Smallholder Scheme |
| PIR Susu | as above for dairying |
| PPL | Penyuluh Pertanian Lapangan - agricultural extension worker |
| PPM | Penyuluh Pertanian Madya - agricultural extension coordinator |
| PPS | Penyuluh Pertanian Spesialis - agricultural subject matter specialist |
| REPELITA | Rencana Pembangunan Lima Tahun - Five-Year Development Plan |
| TFAPA | Task Force for Agricultural Policy Analysis, Junior Minister's Office, MOA |
| USAID | U.S. Agency for International Development |

EXECUTIVE SUMMARY

The Economic Policy Setting

The agricultural sector is still a predominant part of the Indonesian economy. It is not only the largest employer but it is also becoming a major earner of foreign exchange through the export of its products. Traditionally, however, Government policy has focused on achieving self-sufficiency in agricultural production, almost to the exclusion of promoting the foreign exchange earning aspects. This self-sufficiency emphasis was to promote a source of employment for the rural population and to save foreign exchange that had been used to import food products. Through a concerted and successful effort to expand rice production, the self-sufficiency goal was largely achieved by the mid-1980's. The effort was financed primarily by petroleum revenues which increased substantially in the 1970's and early 1980's.

As soon as self-sufficiency was achieved, the agricultural sector became less of a focus of Government policy. Even when petroleum revenues fell in the mid 1980's, and new sources of foreign exchange were needed, emphasis was put on increasing manufactured exports rather than agricultural exports. To help stimulate the development of an export oriented manufacturing sector, an agenda of policy reform was begun in 1985 which ultimately resulted in the deregulation of many aspects of the economy. These included the deregulation of the banking sector and financial markets, the removal of many restrictive trade licensing requirements, and the reform of investment laws. These reform measures were geared to the manufacturing sector, for the most part, and not toward agriculture.

Exports of non-petroleum products grew substantially during most of the 1980's, including both agricultural commodities and non-agricultural products. Although deregulation had helped stimulate this growth, the major devaluation of the Indonesian currency in 1986 was a much more important factor in increasing exports of all products. By the late 1980's, the growth in exports had slowed somewhat, however, as the effects of devaluation began to fade. Weak agricultural commodity prices in the world market further contributed to the lack of rapid growth. Oil prices did not strengthen as much as had been hoped. As a result, in formulating REPELITA-V, Government planners had to identify a new area of growth to help stimulate foreign exchange earnings. They have targeted the agribusiness sub-sector, particularly agroprocessing, as the major area for growth.

Agribusiness in Indonesia

Agribusiness is generally considered a sub-sector of the agricultural sector, but it also has components in other sectors such as manufacturing, trade, transport and services. Agribusiness, as defined for the purposes of this study, incorporates those enterprises which provide inputs to the agricultural sector, and those enterprises which process, elaborate, store or market the products produced by the agricultural sector.

Indonesia's agribusiness sub-sector is large and still growing rapidly. It is the largest single contributor to Gross Domestic Product. In 1987, this contribution was over 25 percent of the total or over US\$ 16 billion.

Agribusiness is not a homogeneous sub-sector. On one side it supplies the purchased inputs to production. On the other side it deals with the output of production. On the output side, some products are changed substantially through value-adding activity while others are simply transported to the consumer. The agribusiness sub-sector consists of three very distinct components: (i) agricultural input services; (ii) bulk commodities; and, (iii) the agroprocessing industry.

Study Purpose

Given the large size of the agribusiness sub-sector and its importance to the Indonesian economy, it is no wonder that it plays prominently in REPELITA-V. To respond to the interest on the part of the Government and to encourage the development of this sub-sector, the US Agency for International Development (USAID) commissioned an agribusiness sub-sector profile and constraints analysis study. The objectives were to examine the impacts of constraints to agribusiness development and identify areas in which USAID could help to alleviate these constraints.

Study Focus

Although agribusiness incorporates the three components of input supply services, bulk commodities and the agroprocessing industry, the Indonesian Government's emphasis is clearly on the agroprocessing industry. During PELITA-V it is hoping to develop a large, modern agroprocessing industry which can take advantage of Indonesia's agronomic advantages and its cheap labor. The primary objectives are to provide a growing source of foreign

exchange and to capture the value added from processing in-country rather than outside.

This Government emphasis on agroprocessing is well suited to USAID's purposes. USAID does not have a comparative advantage in formulating an agribusiness support project that addresses the constraints of the input supply or the bulk commodity components. Both of these are too heavily regulated to permit a successful agribusiness project. The constraints for inputs and bulk commodities relate primarily to regulatory questions. Most of these issues are already being addressed by USAID's Agriculture and Rural Sector Support Project (ARSSP). Therefore, the preliminary agribusiness constraints study concentrated on the agroprocessing sector. Constraints to the growth of the sector were identified and recommendations for addressing those constraints are presented in this report.

The Agroprocessing Industry

Most agricultural products are processed in one way or another before they enter into distribution channels. For many products, the first stage of processing is very minor, however, and mainly involves putting a product in the form in which it is normally traded. This would include milling rice, producing crude vegetable oils, or raw sugar from cane. These products are classified as bulk products. Other processing adds significantly to the value of the product, however, and puts it in a form where it is ready to be sold to a consumer at the retail level. This study focuses primarily on the consumer end of the industry.

The Indonesian food processing industry has been growing rapidly. In 1975, the value of output of the sector was US\$ 1.8 billion. By 1987, the value had risen to US\$ 5 billion. Most of the production of the food processing industry is marketed domestically, with exports of only US\$ 135 million in 1988. Cigarette production, vegetable oil refining, milk processing, and fish canning are the largest industries. The processing of fruits and vegetables is very small. While there are many small and medium size firms, the processing industry is dominated by a few large producers. This is especially true in the processing of the more important products for export.

Constraints

Seven constraints to the agroprocessing industry were identified. They are ranked below in order of importance to the industry. For the most part, all of the food processing industry

is affected by these constraints, although not necessarily at the same level of importance in every commodity line.

1. Technical Agroprocessing Constraints

With few exceptions, the food processing industry in Indonesia is known for consistently producing low quality, unwholesome products. This was poignantly demonstrated with the contamination of domestically produced cookies with sodium nitrite in late 1989, resulting in the deaths of 28 people in Indonesia. This contamination, as in most cases of low quality food products in Indonesia, was largely because of a lack of understanding of the basic principles of "Good Manufacturing Practices". These principles set the standards for plant design, sanitation programs, quality assurance and quality control. Both workers and management are mostly unfamiliar or unconcerned with these principles. Processors often lack or have limited access to the technologies, information or expertise which would make them more efficient manufacturers.

2. Raw Material Supply Constraints

Food manufacturers are severely constrained by a lack of steady supplies of high quality raw materials for the production process. In addition, the supply of packaging materials like tin plate are highly regulated, expensive and of poor quality.

3. Marketing Constraints

Marketing problems are a function of most of the other problems faced by the processing industry. It is hard to sell poor quality products. Unappealing packaging and labeling further limit the marketability of most products. Also, because of a lack of information on world market trends, it is difficult to design an effective marketing plan.

4. Transport and Logistic Constraints

Transporting Indonesian products is expensive, both domestically and internationally, due to the long

distances involved, lack of infrastructure on the Outer Islands and restrictive freight rates. There is also a severe shortage of refrigerated containers.

5. Credit Constraints

Interest rates on investment loans for establishing a food processing plant are approximately 19.5 percent and loan periods are short, usually only five years. The high interest rates do not seem to be a major problem any longer for the industry.

6. Regulatory Constraints

Government regulation of the food processing industry is minimal but controls in the raw products production sub-sector remain. Regulation is not considered a major problem by the industry except in some cases where it limits raw material supplies. Areas of regulation include the closing of investment in vegetable oil refining, milk processing, and cigarette manufacturing. The regulation of packaging materials and sugar raises input prices. The land tenure system discourages investment in ventures requiring their own agricultural production.

7. Institutional Constraints

Most institutional efforts are geared toward regulating the export of bulk commodities. Little is done to support the export of processed products, either through a promotional program or through the provision of timely information. There is no effective trade association to support the food processing industry. Government has research and extension organizations but these are not yet developed to service agribusiness. Areas where such services would be most useful for agroprocessing interests are in fisheries and horticulture.

Proposed USAID Project Activities

The purpose of the following suggestions is to provide USAID with a package of activities with which to address the current

constraints in the agroprocessing industry, as well as to indicate areas in which such efforts would be less helpful. These recommendations are not commodity specific but can be used to assist any type of food processor. This approach will allow USAID to have the flexibility to react to quick changes in the processing industry or to simultaneously respond to a number of different problems. Rank ordered items to consider for inclusion in the proposed project are given below. How these elements relate to actions that can be taken in advance of the project are shown in an attachment to this Executive Summary (Page xiii).

(i). Establish a training program to instruct the basics of "Good Manufacturing Practices" (GMP). Courses should be short, very applied in nature, and geared to lower level factory employees. The program should become self-supporting after a short period of time. It should be coordinated initially by a person with extensive GMP training experience. This will address Constraint 1 above.

(ii). Establish an "Agribusiness Support Group" which will be able to broker the provision of various kinds of technical assistance to food processors. This group should be managed by an individual with extensive business background in the food processing area. This will address Constraints 1, 2, and 3.

(iii). Do not attempt to address the transport or credit constraints.

(iv). Prepare a policy agenda to address the regulatory constraints. This effort should be complementary with ARSSP.

(v). For a partial response to the institutional constraints area, establish a program to support the development of a service oriented trade association. Establish a relationship between this association and the Trade Institute proposed as part of the Trade and Investment Project.

(vi). Develop support mechanisms for promotion of U.S. agribusiness products and services in cooperation with the U.S. Foreign Commercial Service and USDA Foreign Agricultural Service.

Government Coordination

Donor assistance projects in Indonesia usually require sponsorship by, and/or coordination with, a Government ministry. For the proposed Agribusiness Support Project, however, an attempt should be made to coordinate it with the new Permanent Agricultural-Industrial Working Commission, which is more commonly

known as the Joint Agribusiness Committee (JAC). Since the Commission only became operational in late April 1989, it is still in its program formulation stage. At this time, therefore, the Commission should be advised not to take regulatory type actions affecting agribusiness development like attempting to approve all investments and agroprocessing plant locations. As a new coordinating mechanism in Government, it should be more open to a private sector incentive orientation. The proposed Agribusiness Support Project, working through the Commission, can assist in developing this attitude.

There is a functional reason as well for developing a strong linkage with the GOI. As discussed in Chapter IV, there are a number of ways that Government interacts with the private sector. Basically these interactions can be classified as (i) policy direction; (ii) regulatory interventions; and, (iii) a host of service functions. Dialogue between the Government and the private sector is essential so that the respective roles of each can be carried out in a cost-effective manner. One of the primary responsibilities of the project leader for the Agribusiness support Project will be to help establish the necessary mechanisms for facilitating this Government-private sector dialogue. It is not a project function, however, to determine in advance where the interface line should be between Government and private sector interests; that point will have to emerge through discussion and negotiation between the two groups.

USAID Pre-project Activities

It will take 12 to 18 months to complete designing, funding and staffing the proposed Agribusiness Support Project. In the interim, there are a number of other activities that USAID should undertake outside the project so as not to miss current opportunities. These include:

(i). Immediately recruit a senior agribusiness specialist. This individual would: (i) help in the agribusiness project design; (ii) assist USAID staff in the coordination of this project design effort with the ARSSP and the Trade and Investment Project; and (iii) liaison with the JAC and agroprocessing interests in the private sector. Upon project activation, the person in this coordinator position could become the director of the Agribusiness Support Group.

(ii). Participate in the upcoming donor-funded and staffed agribusiness sector study. If other donors like the World Bank, Asian Development Bank or the FAO/UNDP fail to respond to Government's request for this study, consider doing it as part of ARSSP.

(iii). Provide temporary funding and technical advice to the new Permanent Agricultural-Industrial Working Commission as it could easily become the future Government coordinator for the Agribusiness Support Project.

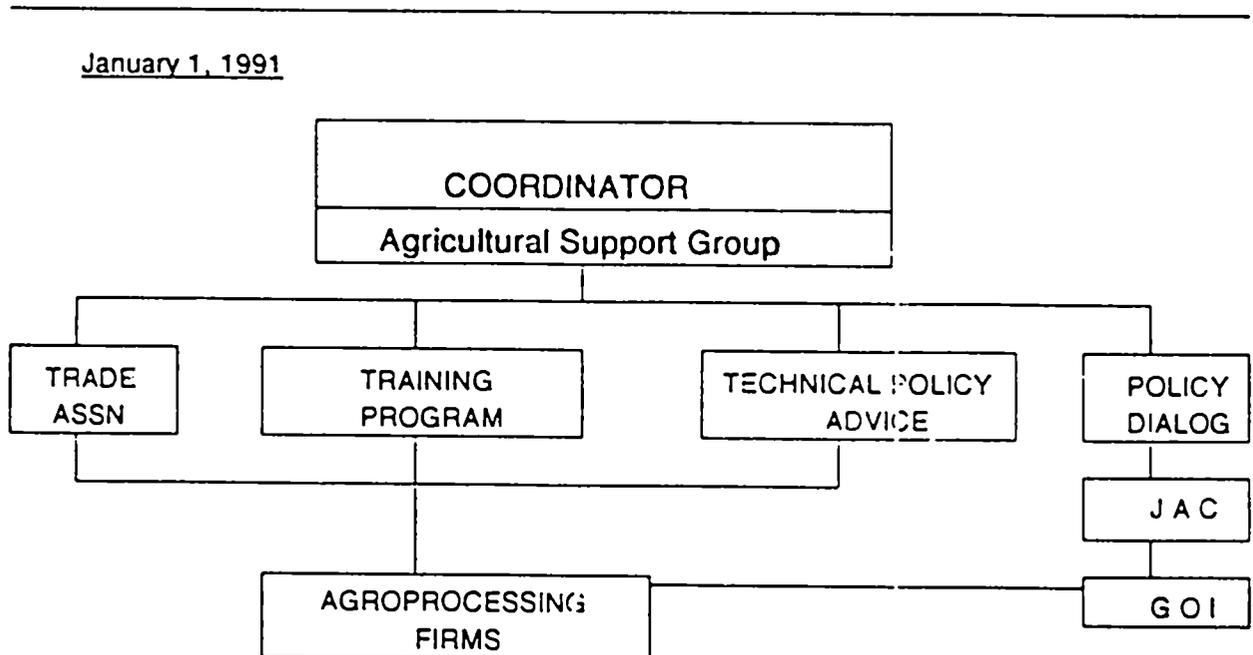
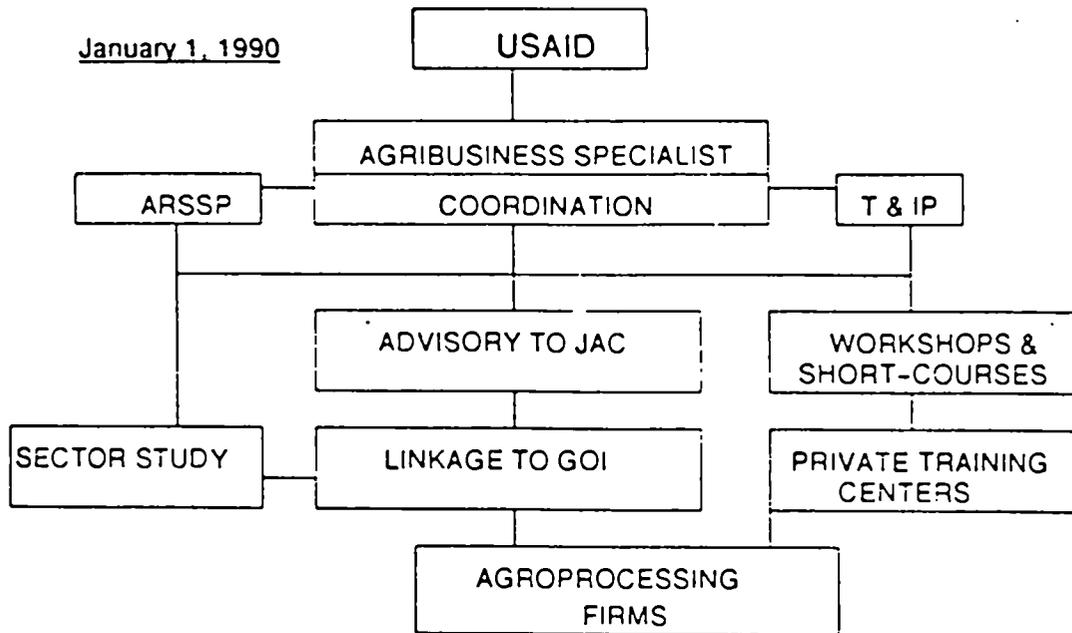
(iv). Present directly or sponsor through the Agricultural-Industrial Commission a series of agribusiness seminars and/or workshops for the GOI and the agribusiness community.

U.S. Trade Opportunities

In opening the door to the Indonesian food processing industry, the Agribusiness Support Project also presents interesting opportunities for increasing U.S. trade with Indonesia. With the Agribusiness Support Group as the vehicle, the project can be used to accomplish the following:

- (i). Promote the sale of U.S. food processing equipment.
- (ii). Promote the use of U.S. technical services.
- (iii). Promote joint ventures and licensing agreements between U.S. and Indonesian companies.
- (iv). Assist U.S. firms in obtaining supplies of high quality Indonesian processed food products.

Fig. 1. ORGANIZATIONAL CHART OF USAID AGRIBUSINESS ACTIVITIES



CHAPTER I

INTRODUCTION

Historical Background

The agricultural sector has always been a major focus of Indonesia's development policy. For over four decades the Government of Indonesia (GOI) planners have given highest priority to a self-sufficiency objective. Through a concerted and successful effort to expand rice production, food self-sufficiency was largely achieved by the mid-1980's. Rapidly expanding rice production over the past 25 years was also able to absorb most of the surplus labor force in rural areas.

Throughout this period, the Ministry of Agriculture (MOA) remained the dominant government force in the agricultural sector. In addition, however, the GOI, working primarily through its National Development Planning Agency (BAPPENAS), National Logistics Agency (BULOG) and the Ministry of Cooperatives (MOC), turned agriculture into the most regulated sector in the Indonesian economy. The GOI justified its continued heavy direct involvement in the agricultural sector, including increasing the number of government owned and operated agricultural parastatals, control of key agricultural inputs and almost total control of rice prices, marketing and distribution, so as to "insure political stability and enhance social welfare".(1) Agricultural exports, particularly of bulk commodities like tree and estate crops, continued to be important but were overshadowed by the rapid expansion oil revenues, particularly in the 1970's and early 1980's.

When an initial decline in petroleum-based revenues developed in 1982/83 and then intensified in 1985/86, however, GOI policy began shifting to include some deregulation measures designed to increase non-oil export revenues. Of particular significance to the agricultural sector were some banking and other deregulation measures during 1986-88 designed to induce increased private sector investment and participation, primarily in agroprocessing and expansion of processed agricultural exports. As a result of these policy changes, planners in BAPPENAS expected that by the start of PELITA-V in 1989, most of the revenue shortfall would be offset by increased exports of agricultural products.

While there has been increased agribusiness activity in recent years, its foreign exchange generation response has been far less than BAPPENAS planners had projected. It has become clear that the agribusiness sub-sector faces a number of constraints that must be overcome before significant growth in its contributions to international trade and foreign exchange earnings can be achieved. This is particularly true for the agroprocessing component. Nonetheless, the GOI continues to expect the

agribusiness sub-sector, and particularly its agroprocessing component, to become increasingly important during PELITA-V. Areas of greatest impact are expected in generation of employment, value-added income and foreign exchange earnings.

The Current Policy Setting

The major shift in the GOI policy focus to agricultural activities beyond the primary (production) stage became apparent in March 1988 when the People's Consultative Assembly adopted the Broad Guidelines of State Policy (GBHN) for formulation of the policy framework for REPELITA-V. The most important of these guidelines to the future structure and role of the agricultural sector were the following: (1)

1. Achieve significant expansion in international trade with major emphasis on processed agricultural products for export and diversifying domestic consumption patterns.
2. Increase private sector involvement in agriculture
3. Improve agricultural production, processing and marketing efficiency.

BAPPENAS, in turn, developed a set of macro policies for REPELITA-V. These policies addressed three major issues facing the Indonesian economy in the decade of the 90's and which will impinge directly on the agricultural sector. These are: (1)

1. Adequate employment generation outside of rice production, particularly in rural areas.
2. Sufficient foreign exchange generation to meet debt service and recurrent budget needs that is much less dependent on oil exports
3. A reliable government revenue source to offset an expected declining role of donor agency assistance for development and recurrent budgets

The present major policy concerns of the GOI, as related to the need for a rapidly expanding agribusiness sub-sector during PELITA-V, are rank ordered as follows:

1. Non-oil revenues are expected to provide over half of the export earnings, primarily from the agricultural sector (including wood pro-

ducts); agribusiness activities are expected to be the fastest growth area.

2. Agroprocessing activities are expected to replace rice production for absorbing the additional surplus rural labor force.
3. Private investment is being sought as a partial replacement for expected declining donor loan funding so as to reduce the debt service, and via taxes and fees, to contribute to GOI development and recurrent operating budgets
4. Concern with equity considerations is at least equal in priority to and perhaps even above an objective to increase per capita incomes in rural areas.

In spite of the present GOI policy concerns for growth in agribusiness, the REPELITA-V document itself has very little to say about the need for expansion of the agribusiness sub-sector or about the strategy for achieving that objective. A recent agribusiness project planning team fielded by FAO/UNDP reported that it could find only one vaguely worded policy directive in REPELITA-V, (2) as follows:

"Within the framework of boosting exports and substituting the import of agricultural produce as well as the development of domestic industry, the participation of the farmers/peasants, private interests, cooperatives and BUMNs will be further stepped up, for supporting the boosting of agricultural production, the development of the processing industry and the trade of agricultural produce."

"(Among) measures to be taken are the following ... creation of a favorable climate for the establishment of private food processing industrial undertakings throughout the country, particularly in non-rice food production centers."

While agribusiness as a topic is not very visible in REPELITA-V, the above quote nonetheless does show that the GOI intends to continue to promote value adding food processing industrial undertakings and moving more of their products into international trade channels. And, since the release of REPELITA-V in early 1989, the GOI has increasingly been sending strong signals to the donor community that it would welcome technical and capital assistance for the emerging agribusiness sub-sector. In response, most of the donor agencies who have supported development of the agricultural sector in the past are now in the process of designing agribusiness support projects. One of these ongoing efforts within

the USAID is the subject of this report. The modified Terms of Reference for this study are given in ANNEX A, attached.

Definitions

Three key definitions are set forth at the outset so as to reduce confusion and possible misinterpretation of the information, conclusions and recommendations presented in this report. These are:

The Agricultural sector consists of a primary (producing) sub-sector and an agribusiness sub-sector.

Agribusiness incorporates those enterprises which provide inputs to the agricultural sector and those enterprises which process, elaborate, store or market the products produced by the agricultural sector.

Agroindustry (or agroprocessing) includes that segment of the agribusiness sub-sector which processes and transforms raw agricultural food and fiber products into intermediate and finished consumer goods.

Since the term, agroprocessing, is often used in Indonesia for what is usually defined elsewhere as agroindustry, these two terms will be used interchangeably in this report.

Methodology

The members of the Agribusiness Constraints Analysis (ACA) Team proceeded with this study under the general hypothesis that further private sector involvement in Indonesia's emerging agribusiness sub-sector would continue to expand rapidly, even in the absence of additional GOI involvement and/or donor agency support efforts. It was further assumed that such involvement, if channelled into desired services (such as manpower training, collecting and disseminating information, developing and applying internationally accepted quality standards, etc.) will make the process more efficient and even more rapid, thus meriting consideration for donor agency support.

In most developed countries, when some of these services are provided by government, they are channelled primarily through agricultural ministries. This is because the agribusiness sub-sector is so closely linked to the primary (production), natural

resource based sub-sector. Therefore, the feasibility of encouraging adoption of the same approach in Indonesia will be carefully evaluated. But other options, including developing new support programs for Ministries such as Trade, Industry and Cooperatives will be considered. Finally, going directly to private agribusiness organizations and foundations serving individual firms will also be explored.

This study effort was focused primarily on the agroprocessing industry. This is where the greatest potential exists for achieving USAID's policy objectives of increasing employment and income opportunities in rural areas of Indonesia. This area also has latent potential for significantly increasing export earnings which is the first priority objective of the GOI.

The directives for carrying out the study, as set forth in the modified Terms of Reference in Annex A, were followed as closely as possible. Observations obtained thereby provided the raw material for the information, conclusions and recommendations set forth in this report. In the final analysis, however, the conclusions and recommendations reflect only the judgments of the members of the ACA Team¹, and therefore do not necessarily coincide with those held by members of the GOI, USAID or the donor community at large. And, of course, the ACA Team accepts full responsibility for all errors of fact or interpretation that may unintentionally have been included in this report.

¹ The ACA Team included: Kenneth C. Nobe (Team Leader), James R. Coyle and Wouter Nicolai. Local perspectives on agribusiness activity and logistical support were provided by Bruce Carrad.

CHAPTER II

THE AGRIBUSINESS SUB-SECTOR

Agribusiness, by definition, incorporates those enterprises which provide inputs to the agricultural sector, and those enterprises which process, elaborate, store or market the products produced by the agricultural sector. In Indonesia the agribusiness sub-sector is large, well developed and growing. As such, it is the largest single contributor to Gross Domestic Product. In 1987, this contribution was over 25 percent of the total or over US\$ 16 billion.

Agribusiness is not a homogeneous sector. On one side it deals with the inputs to production. On the other side it deals with the output of production. On the output side, some products are changed substantially, while others are simply transported to the consumer. For ease, therefore, the agribusiness sector can be divided into three very distinct components. These are: (i) the agricultural input supply services; (ii) the bulk commodity handling component; and, (iii) the agroprocessing industry.

The agricultural input component involves the supply of products to agricultural producers for use in the on-farm production process. Products in this category include fertilizers, pesticides, and seeds, as well as agricultural machinery.

The bulk commodity component is the largest of the three components. It includes activities related to the movement, storage and marketing of those commodities that have little or no processing before being delivered to the consumer. These products include rice, raw sugar, crude vegetable oils, coffee, tea, spices and most meat products.

The agroprocessing industry is the component that substantially changes the form of the agricultural product, or mixes it with other products and makes it ready for consumption with little or no further processing. Such products include canned foods, frozen foods, instant coffee, ground spices, and beverages. It also includes processed tobacco products.

These three components of the agribusiness sub-sector have unique aspects that allow them to be analyzed separately and treated distinctly. Each has an organization that differs substantially from the other two. For the most part, different Government agencies and business groups are involved as well. As such, each component has its own set of constraints and problems. In this chapter, those constraints will be differentiated and examined. Finally, as the intention of this report is to provide direction for USAID in designing a project for the agribusiness sub-sector, suggestions on the feasibility of working in each of the three components will also be examined.

Input Supply Services

Input supplies to the agricultural production process are highly controlled in Indonesia. Government regulations control production, importation, distribution and pricing of both fertilizers and pesticides. The provision of seeds is also, highly controlled. These regulations were established to promote self-sufficiency in rice production, and although they have been successful in achieving this goal, they have also resulted in several serious distortions. The distortions include (i.) price subsidies that encourage misuse and often overuse of fertilizer and pesticides; (ii.) strict control over entry into the sale and distribution of agricultural inputs which encourages a lack of competition in the distribution network; and, (iii.) a lack of research and extension on the application of fertilizer and pesticides in crops other than rice. Major inputs are discussed below.

1. Fertilizer

Other than the irrigation systems constructed by the GOI, the largest subsidy to the agricultural sector is for chemical fertilizers. In order to encourage agricultural production, particularly rice output, the MOA and the MOC through the BIMAS Program, have provided fertilizer, credit and other inputs to farmers at highly subsidized rates. According to Tabor, et al (1989), this program led to an annual 12 percent increase in urea consumption between 1978 and 1987, and an annual increase in triple superphosphate usage of 18 percent for the same period. This increased usage resulted in much higher Government expenditures, and by 1985, the annual fertilizer subsidy cost more than development expenditures for agriculture and irrigation.

The production, importation and distribution of fertilizer is highly controlled. The mechanisms include:

- * Control of production through Government ownership of plants, and through licensing of other operations.
- * Restricting the importation of subsidized fertilizers to state trading companies.
- * Requiring import licenses for non-subsidized fertilizers.
- * Imposing duties on fertilizer imports.
- * Restricting distribution of fertilizers to cooperatives.

Fertilizer prices were raised in October 1988 from Rp. 135 to Rp. 165 per kilo for urea, ammonium sulfate, KCL and KS, and from Rp. 135 to Rp. 165 for triple super phosphate (TSP). Prices of fertilizers were raised again in October 1989 - urea and ammonium sulfate to Rp. 185 a kilo and TSP to Rp. 210 a kilo. These new prices, however, are still below world prices so a subsidy remains.

Indonesia's fertilizer program has resulted in several serious problems beyond just the cost to the Government. The restrictions have led to the development of a large, inefficient industry that requires Government subsidies and import restrictions to survive. It has also led to a misuse of fertilizers by farmers.

2. Pesticides

Pesticides had also been highly subsidized until late 1988. Like fertilizer, the subsidy program was designed to increase rice production, but it also succeeded in creating overusage of pesticides by farmers. With the widespread adoption of an integrated pest management program, with joint support from USAID and FAO/UNDP, and the elimination of the subsidy, this problem is now being addressed.

3. Seeds

The supply of seeds is also regulated. Rice seed is controlled by the Ministry of Agriculture. Attempts to develop a viable hybrid corn seed industry in Indonesia have so far failed because of a lack of Government support through the extension service, and because of insufficient demand for high quality seeds. Importation of seed for horticultural crops is largely restricted, and controlled by monopoly importers.

4. Constraints

Compared to the other components of the agribusiness sub-sector, input supplies are among the most highly regulated. Freedom of entry into the production, importation and distribution of most inputs is greatly restricted. As a result the industry is inefficient. The Government's successful program to attain rice self-sufficiency has also had a number of undesirable side effects. These include the over subsidization of fertilizer prices and overuse of fertilizer and pesticides, while restricting entry by private firms.

Bulk Commodities

The transportation, handling, storage and marketing of bulk agricultural products constitute the largest and most important aspects of the agribusiness sub-sector, both domestically and in the export market. It has been estimated that approximately 70 percent of the food consumed in Indonesia is done so in an unprocessed form (1). In the export market, 95 percent of Indonesia's US\$ 2.6 billion of food exports were in an unprocessed form in 1988. Not surprising, this sector is the most highly regulated in the Indonesian economy.

Indonesia produces a wide variety of agricultural products. Rice, sugar, cassava and corn are major food crops while rubber, crude palm oil and copra are major tree crop products (Table II.1). The production of most major crops in Indonesia grew substantially during the 1970's and 1980's because of numerous Government production programs.

For some crops, the increase in production enabled strong growth in agricultural exports. During the later part of the 1980's especially, agricultural exports grew dramatically. Most of this growth occurred in exports of food products. In the early 1980's, food and non-food agricultural exports were equal at about US\$ 1.5 billion. However, the currency devaluation of 1986 led to a rapid growth in food exports, which by 1988 were US\$ 2.6 billion as compared with US\$ 1.9 billion for non-food agricultural products (Table II.2). Important food export items include frozen prawns, crude palm oil, coffee, tea, spices and cocoa, all of which are exported in unprocessed form or semi-processed form. Approximately 95 percent of the value of Indonesia's food exports are from products in bulk form. The most dynamic growth in the past five years has been in frozen prawn exports.

1. Domestic Sector Controls

As a large component of the agribusiness sub-sector, it is not surprising that the bulk commodity component is the most highly regulated part of the Indonesian economy. Regulation is pervasive in both the domestic market and the export market. In the domestic market, BULOG is primarily responsible for controlling the distribution of rice, wheat flour and sugar at controlled prices. BULOG is also responsible for stabilizing the corn and soybean markets. BULOG does this in cooperation with a set group of Indonesian businesses, and for the most part has closed participation to other groups. The distribution of cooking oil, both in the processed and crude stages, is also regulated by Joint Marketing Boards (KBP's) and by restricted entry into the business.

TABLE II.1

PRINCIPAL AGRICULTURAL PRODUCTS BY SUBSECTORS, 1974 - 1987
('000 TONS)

| PRODUCT | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 /a |
|-----------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------|
| <u>Food Crops</u> | | | | | | | | | | | | | | |
| Rice | 15,276 | 15,195 | 15,815 | 15,276 | 17,525 | 17,872 | 20,163 | 22,226 | 22,237 | 24,006 | 25,932 | 26,542 | 27,104 | 27,453 |
| Corn | 3,011 | 2,529 | 2,572 | 3,143 | 4,029 | 3,606 | 3,991 | 4,509 | 3,235 | 5,097 | 5,228 | 4,330 | 5,920 | 5,093 |
| Cassava | 13,031 | 12,516 | 12,191 | 12,428 | 12,902 | 13,751 | 13,726 | 13,301 | 12,988 | 12,103 | 14,167 | 14,037 | 13,312 | 14,479 |
| Sweet potato | 2,469 | 2,433 | 2,381 | 2,460 | 2,023 | 2,194 | 2,079 | 2,444 | 1,676 | 2,213 | 2,156 | 2,121 | 2,091 | 1,905 |
| Soya beans (shelled) | 589 | 590 | 522 | 523 | 617 | 680 | 653 | 704 | 521 | 536 | 769 | 870 | 1,227 | 1,151 |
| Groundnuts (shelled) | 307 | 390 | 311 | 409 | 416 | 424 | 470 | 475 | 437 | 460 | 535 | 528 | 642 | 524 |
| <u>Fisheries</u> | | | | | | | | | | | | | | |
| Saltwater fish | 949 | 957 | 1,022 | 1,158 | 1,227 | 1,318 | 1,395 | 1,408 | 1,490 | 1,622 | 1,713 | 1,622 | 1,923 | 2,029 |
| Freshwater fish | 388 | 353 | 461 | 414 | 420 | 430 | 455 | 506 | 524 | 533 | 549 | 573 | 607 | 638 |
| <u>Meat and dairy</u> | | | | | | | | | | | | | | |
| Meat | 403 | 455 | 449 | 468 | 475 | 486 | 571 | 596 | 629 | 650 | 742 | 808 | 860 | 927 |
| Eggs | 58 | 112 | 116 | 131 | 151 | 164 | 259 | 275 | 297 | 319 | 355 | 370 | 432 | 495 |
| Milk /b | 57 | 51 | 57 | 61 | 62 | 72 | 78 | 86 | 117 | 143 | 179 | 152 | 220 | 227 |
| <u>Cash crops</u> | | | | | | | | | | | | | | |
| Rubber | 817 | 722 | 857 | 844 | 884 | 898 | 1,020 | 963 | 900 | 1,007 | 1,033 | 1,055 | 1,109 | 1,132 |
| Palm oil | 348 | 357 | 431 | 473 | 532 | 642 | 701 | 748 | 884 | 979 | 1,147 | 1,243 | 1,350 | 1,411 |
| Coconut/copra | 1,341 | 1,375 | 1,532 | 1,518 | 1,575 | 1,582 | 1,759 | 1,812 | 1,718 | 1,604 | 1,750 | 1,520 | 2,114 | 2,002 |
| Coffee | 149 | 160 | 193 | 194 | 223 | 228 | 285 | 295 | 281 | 305 | 315 | 311 | 339 | 357 |
| Tea | 64 | 69 | 73 | 79 | 91 | 125 | 106 | 110 | 94 | 110 | 126 | 127 | 136 | 157 |
| Cloves | 15 | 15 | 20 | 41 | 22 | 35 | 39 | 40 | 32 | 41 | 49 | 42 | 55 | 57 |
| Pepper | 27 | 23 | 37 | 43 | 46 | 47 | 37 | 39 | 34 | 46 | 41 | 41 | 40 | 49 |
| Tobacco | 79 | 82 | 89 | 84 | 81 | 27 | 116 | 118 | 106 | 109 | 108 | 161 | 164 | 115 |
| Cane sugar | 1,237 | 1,227 | 1,321 | 1,438 | 1,516 | 1,601 | 1,831 | 1,700 | 1,627 | 1,628 | 1,810 | 1,859 | 1,894 | 2,128 |
| Cotton | 3 | 2 | 1 | 1 | 1 | 1 | 6 | 10 | 13 | 14 | 12 | 45 | 53 | 23 |
| <u>Forestry /c</u> | | | | | | | | | | | | | | |
| Teakwood | 620 | 595 | 460 | 573 | 475 | 495 | 613 | 578 | 692 | 718 | 758 | 777 | 798 | 689 |
| Other timber | 22,660 | 15,701 | 20,947 | 22,366 | 26,256 | 25,520 | 21,702 | 14,024 | 13,236 | 24,180 | 27,716 | 24,277 | 27,403 | 31,029 |

/a Preliminary figures.

/b In liters million.

/c In '000 cubic meters.

Source : Supplement to the President's Report to Parliament, August 16, 1988.

TABLE II.1

TABLE II.2
 FOOD AND AGRICULTURAL EXPORTS OF INDONESIA
 BY COMMODITY
 (MILLIONS OF US DOLLARS)

| <u>PRODUCT</u> | <u>1983</u> | <u>1984</u> | <u>1985</u> | <u>1986</u> | <u>1987</u> | <u>1988</u> |
|------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|
| FOOD & BEVERAGES: | | | | | | |
| FISH, FRESH/FROZEN | 20 | 15 | 19 | 24 | 45 | 84 |
| CRUSTACEANS, FRESH/FROZEN | 204 | 202 | 207 | 297 | 369 | 528 |
| CEREAL PREPARATIONS | 6 | 6 | 4 | 6 | 8 | 13 |
| VEGETABLES, FRESH/DRIED | 34 | 39 | 52 | 56 | 97 | 141 |
| VEGETABLES, PRESERVED | 1 | 1 | 1 | 4 | 4 | 10 |
| FRUIT, FRESH | 5 | 12 | 16 | 14 | 14 | 20 |
| FRUIT, PREPARED | 2 | 1 | 6 | 9 | 15 | 17 |
| SUGAR AND HONEY | 23 | 27 | 22 | 40 | 37 | 28 |
| COFFEE | 430 | 568 | 562 | 822 | 539 | 552 |
| COCOA | 42 | 53 | 64 | 61 | 66 | 82 |
| TEA | 120 | 226 | 149 | 99 | 119 | 125 |
| SPICES | 94 | 112 | 126 | 209 | 240 | 222 |
| FEEDSTUFFS | 86 | 65 | 65 | 72 | 74 | 89 |
| TOBACCO | 47 | 43 | 49 | 68 | 71 | 65 |
| OILSEEDS | 14 | 5 | 7 | 3 | 8 | 3 |
| VEGETABLE OIL | 148 | 175 | 414 | 166 | 290 | 539 |
| OTHER | 28 | 42 | 88 | 61 | 58 | 95 |
| SUBTOTAL: | 1,304 | 1,592 | 1,851 | 2,011 | 2,054 | 2,613 |
| NON-FOOD: | | | | | | |
| RUBBER | 848 | 952 | 718 | 713 | 961 | 1,246 |
| WOOD, LUMBER | 348 | 366 | 244 | 281 | 416 | 534 |
| CRUDE VEGETABLE FIBER | 122 | 110 | 112 | 118 | 192 | 124 |
| OTHER | 37 | 35 | 28 | 10 | 10 | |
| SUBTOTAL: | 1,335 | 1,465 | 1,109 | 1,140 | 1,579 | 1,914 |
| TOTAL: | 2,639 | 3,057 | 2,960 | 3,151 | 3,633 | 4,527 |

Source: Central Bureau of Statistics

2. Export Controls

The export of bulk agricultural products is even more highly controlled. Exports of these products, both food and non-food, are highly regulated. The Government uses a system of export licensing and export bans to control the flow of exports. This control is not intended to dampen exports but rather to achieve the maximum return possible through maintaining high export prices. The system is also used to bestow favors to certain business groups, however, who have often gained tremendously from export control. Not surprisingly, these groups strongly support the regulation of their commodities. As a result, little deregulation has occurred in recent years. In fact, the opposite has actually occurred, where exports have become more highly controlled. While this control extends to both food and non-food agricultural products, the concern in this study was only with the export framework for food products. In terms of value, 50 percent of food exports and 44 percent of all agricultural exports were regulated by this export system in 1988.

Nearly 95 percent of all Indonesian food exports are in a bulk form. The most important food exports include coffee, spices, crude vegetable oil and fishery products. Exports of coffee, spices and vegetable oil are all highly regulated. Recently, requests have been made to regulate fishery exports as well. The GOI uses a system of export licensing as its primary means for regulating food and other agricultural exports. Under this system, an exporter must be approved by the MOT as a bona fide exporter. The number of approvals that the MOT will issue is severely limited so it is very difficult for new companies to obtain approval to export the controlled products. It is also difficult to lose "approved exporter" status once it is obtained. Usually, these licensing procedures include a provision that an exporter belong to the commodity trade association for the product. These trade associations usually are the strongest supporters of the system, and serve as the regulators of it.

3. The Approved Exporter System

The greatest number of products covered by approved exporter regulations are in the agricultural field. Exports of textiles, some mineral products and petroleum products are also restricted by the same regulations. For agricultural products, when a commodity is to be classified under these regulations, usually all current exporters are given approved exporter status. State trading firms are also usually made approved exporters, as are the companies of select present and former Government officials, and other companies with political influence. After this initial group

is formed, it is difficult for new companies to obtain approval, unless they are able to exert special influence.

Approved exporter regulations are applied to coffee, cassia vera (cinnamon), nutmeg and mace, vegetables from Sumatra and vanilla in the food categories. They also apply to sawn wood, plywood and processed wood products in the non-food categories. For coffee there are 330 approved exporters. For nutmeg and mace there are 43 approved exporters. For white and black pepper there are 38 and 45 approved exporters, respectively. For cassia vera there are 50 approved exporters. The state trading firms are also approved exporters for all these commodities.

To maintain status as an approved exporter, a company must show that it is exporting. Some commodities have export quotas as part of the package, whereby an exporter can export only a predetermined amount of product. These quotas are usually determined in large part by past export performance. These quotas have applied to coffee and to cassia vera, until recently. This has led to a system of quota trading where exporters with insufficient quota buy additional allocations from other exporters. Exports are physically handled by the exporters with insufficient quota but in the name of the actual quota holder. In the extreme, this has led to the creation of a class of exporters, often referred to as "briefcase exporters", who never actually export any of their own allocations. Yet, they are able to maintain their approved exporter status year after year. Almost two-thirds of the approved coffee exporters conduct their operations in this way. There are less than 100 physical exporters out of over three hundred "approved exporters" in this industry. Most exports by the state trading firms are also conducted on a briefcase basis.

Exports of agricultural products are regulated by the Director of Exports for Agricultural and Forestry Products, Directorate General for Foreign Trade, Ministry of Trade. This body issues exporter approvals, and sets quota allocations. For certain products, it also establishes joint marketing boards (Kantor Pemasaran Bersama - KPB), which conduct the marketing operations for the products. Most products produced on state controlled plantations are marketed through joint marketing boards. These products include coffee, cocoa, rubber, tea and crude palm oil. In addition, joint marketing boards have been established in the food area for nutmeg and cassia vera.

For all approved exporter products, the role of the trade association is central. To obtain Government approval to export, the exporter must be a member of the commodity trade association. These associations work with the GOI to administer the program and to determine who receives or loses approved exporter status. They also lobby the GOI in an effort to direct the allocation of quotas among their members. This has especially been the case for the coffee exporter association, AEKI. Until the recent collapse of

the International Coffee Agreement, AEKI advised the MOT on how to divide Indonesia's overall quota among the exporting members. Even after the collapse of the international agreement, AEKI continued to lobby for the maintenance of a domestic quota that maintains market share for all of its members. Only pressure from the MOF on the MOT led to the elimination of the domestic quota.

Two justifications exist for the establishment of the approved exporter system. For certain commodities, like coffee, Indonesia has traditionally been allocated an export quota under the International Coffee Agreement. In order to assure that it does not export more than this quota, some type of export control is needed. By limiting exporters to a few in number, and then by assigning them individual quotas, the MOT is better able to regulate compliance to the international quota. In the case of coffee, where the international quota only applies to exports to certain countries, the domestic quota can also be used to encourage exports to non-quota countries. Since exports to quota countries are more profitable than those to non-quota countries, exporters can be enticed to sell to non-quota countries with the promise of larger quota allocations to quota countries. The MOT has used this system to allocate part of its coffee quota. It does not use an auction of quotas for any agricultural products.

The second justification for the establishment of the approved exporter system is to maintain market position. For commodities where Indonesia controls a major portion of the world's supply, the GOI has taken to organizing its exporters into de facto monopolies so as to capture monopoly rents. The Government and the industry have used this system to stifle competition among Indonesian industry members in order to present a united front to international buyers. Price setting is the main feature of this system. Indonesia has used this system to increase the export price of nutmeg from US\$ 2.02 per kg. in 1985 to US\$ 7.02 per kg. in 1987. In the case of cassia vera, the price was increased from US\$ 0.90 per lip to US\$ 1.47 per lip between 1988 and 1989.

The approved exporter regulations have greatly benefited those who have received approved status. Not surprisingly, most approved exporters favor the system and wish to maintain it. Also not surprisingly, other commodity groups have an interest in repeating it for their product groups as well. This is proving to be the case for frozen prawn exporters (the major fishery exporting group) and for tapioca exporters. The trade associations of both groups are lobbying the Government to have their industries regulated. Their justification is that "controlling harmful competition will benefit all the members."

4. Export Bans

While the use of approved exporter regulations is the main method used to control exports, it is not the only one. The Government uses a number of other means to regulate exports as well. Export bans have been instituted over the last ten years for select unprocessed agricultural products in order to encourage the development of a processing industry within Indonesia. For example, a ban on the export of unprocessed logs was instituted in 1980. This led to the development of a much larger saw milling and plywood industry. In July 1988, a complete ban on the export on raw and semifinished rattan was also instituted. The Government hopes that this will lead to the development of a large scale rattan furniture making industry.

5. Export Quotas

The GOI also controls exports through a system of export quotas. Under this system the export of numerous food and agricultural products is limited by Government decree in order to assure domestic supplies. The export of 24 products are controlled in this manner. These include rice, crude vegetable oils, soybeans and live animals. In the December 1986 reform package, the export quotas were removed on refined palm and coconut oil, and on processed meat products. All of the deregulated products, however, are of very minor importance.

Crude palm oil is the most important product facing export quotas. Palm oil is the most widely produced vegetable oil in Indonesia. It is grown primarily on Government estates, but also on an increasing number of private plantations. Most refining is done by private companies, the Sinar Mas Group being the largest. The domestic price of fully refined palm oil is US\$ 0.71 per kg., about 20 percent higher than the Malaysia export price. Because of this, all privately produced crude palm oil is consumed domestically even though exports are not officially regulated. In fact, Indonesia imports a substantial amount of refined palm oil from Malaysia and Singapore (US\$ 122 million in 1988). While importing refined palm oil, crude palm oil is exported, even though there is excess refining capacity in Indonesia.

Clearly, all of these restrictions, both on domestic and international marketing of bulk agricultural products limit initiative. When market share and profits are guaranteed, there is little reason to be aggressive in improving product quality or in introducing new technologies or improved management methods.

Agroprocessing

The processing of agricultural products in Indonesia is also a large and growing part of the agribusiness sub-sector. Unlike the bulk product area though, it is not subject to the same sort of intense regulation and Government control. Because of this lack of control, growth within this sector in the last five years has been substantial. Businesses have been able to be innovative and responsive to market forces and opportunities rather than being restrained. As such, the output of this sector grew from US\$ 1.8 billion in 1975 to US\$ 5 billion in 1987. Exports of processed food products grew from US\$ 26 million in 1983 to over US\$ 135 million in 1988 (Table II.3). Rapid growth is expected to continue in the future.

The agroprocessing sector is not without problems, however. In fact, numerous constraints exist that, if not addressed, will inhibit the efficiency of the sector's growth in the coming decade: First and foremost among these are numerous technical production problems that prevent the manufacture of high quality, wholesome products. A lack of steady supplies of high quality raw materials also often prevents an expansion of output, or discourages new processing ventures. The marketing of processed food products is inhibited by poor packaging and high transport costs.

Obtaining credit at reasonable prices also constrains expansion of the processing industry, as do many government regulations. Finally, there is very little institutional support for the food processing industry either from the Government or from trade associations. As a result, most of the agroprocessing industry works in a vacuum, not knowing what the rest of the world is doing, and having a hard time entering that world market.

The agroprocessing industry will undoubtedly grow during the next decade. But, the rate and direction of its growth will be largely determined by whether these constraints can be solved. It will also depend on the future direction of Government intervention. The agroprocessing component is almost classified as the future savior of the Indonesian economy in REPELITA V. While this is probably wishful thinking, it has led to increased Government interest in the component. It may also lead to increased Government control. This could in turn result in the formulation of restrictive policies like those in the other two agribusiness sub-sector components.

TABLE II.3

PROCESSED FOOD EXPORTS OF INDONESIA
(THOUSANDS OF US DOLLARS)

| PRODUCT | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 |
|-------------------------|---------------|---------------|---------------|---------------|---------------|----------------|
| PREPARED MEATS | 2 | 14 | 1 | 28 | 51 | 63 |
| CANNED MILK | 0 | 0 | 0 | 0 | 504 | 3,361 |
| OTHER MILK | 4 | 0 | 1 | 2 | 998 | 1,315 |
| CANNED BUTTER | 0 | 0 | 0 | 61 | 13 | 88 |
| CANNED FISH | 4,532 | 4,485 | 2,572 | 4,763 | 12,349 | 26,963 |
| CEREAL PREPARATIONS | 6,390 | 6,011 | 4,482 | 5,677 | 7,630 | 13,055 |
| CANNED MUSHROOMS | 0 | 0 | 0 | 3,540 | 3,352 | 3,078 |
| OTHER CANNED VEGETABLES | 0 | 0 | 0 | 0 | 395 | 6,582 |
| CANNED PINEAPPLE | 0 | 345 | 5,315 | 8,533 | 13,757 | 14,322 |
| OTHER CANNED FRUIT | 1,627 | 754 | 700 | 876 | 1,668 | 2,407 |
| SUGAR PREPARATIONS | 193 | 573 | 183 | 131 | 901 | 2,049 |
| INSTANT COFFEE | 0 | 21 | 0 | 107 | 252 | 598 |
| CHOCOLATE PREPARATIONS | 1,844 | 294 | 132 | 59 | 83 | 448 |
| GROUND PEPPER | 0 | 0 | 0 | 0 | 0 | 403 |
| MARGARINE | 6 | 0 | 28 | 1,481 | 3,772 | 223 |
| OTHER PREPARED FOOD | 2,222 | 2,718 | 2,613 | 3,528 | 3,870 | 4,700 |
| BEVERAGES | 261 | 459 | 160 | 398 | 695 | 3,908 |
| TOBACCO, MANUFACTURED | 9,294 | 10,123 | 5,464 | 5,761 | 13,910 | 22,502 |
| REFINED PALM OIL | 0 | 0 | 0 | 0 | 15,799 | 28,306 |
| REFINED COCONUT OIL | 0 | 16,310 | 15,654 | 0 | 2,981 | 869 |
| TOTAL | 26,375 | 42,107 | 37,305 | 34,943 | 82,980 | 135,240 |

Source: Central Bureau for Statistics

Alternative Project Opportunities

As has been demonstrated above, the three agribusiness components are quite distinct in their structure and problems. They all clearly have constraints which prevent them from becoming more efficient in their operations. For the most part, these problems are quite variable, so they cannot efficiently be addressed within one program. The political reality of Indonesia prevents many of the problems from even being addressed. It is in this environment that USAID is attempting to design a new Agribusiness Support Project.

USAID is undertaking this project within a relatively limited budget. As such, there is a definite necessity in clearly defining

what areas can be influenced with this limited budget. It may be that the biggest or most important problems cannot even be addressed. This also means that only one sub-sector component should be addressed within the project.

Because of the high level of Government control in the input and bulk product areas, designing a project to increase business opportunities or to increase business efficiency would be difficult in these components. The concentration of business in the hands of a few Government agencies and a few large business groups further complicates matters. Finally, given the size of business that occurs in these two components, the amount of money that USAID could budget to this project is relatively insignificant.

The third sub-sector component, the agroprocessing industry, is more open to influence to a USAID type of project. The industry is not as concentrated or as controlled as the other two components. It does have problems, however, ones that a USAID project could address with high hope for success.

The rest of this report will focus on the agroprocessing industry. In the next chapter, the constraints to growth in agroprocessing will be more fully examined. Finally, in Chapter VI, recommendations will be given on how a USAID technical assistance project can address the constraints which were identified.

CHAPTER III

THE AGROPROCESSING INDUSTRY

Most agricultural products are processed in one way or another before they enter into distribution channels. For many products the first stage of processing is very minor, however, and mainly involves putting it in the form in which it is normally traded. This would include milling rice, producing crude vegetable oils, or raw sugar from cane. These products are classified as bulk products. Other processing adds significantly to the value of the product, however, and puts it in a form where it is ready to be sold to a consumer at the retail level. This study includes a concern with the quality of the products offered to consumers, as well as other constraints faced within the agroprocessing industry.

The manufacture of processed food products is still quite a young industry in Indonesia. In the last decade, a large and fairly modern processing industry has been created but this industry still accounts for only a small part of the of the food consumed by the Indonesian people. Most food in Indonesia is purchased in either a raw form, or with only minimal processing, as in the case of rice. What processing is done is directed largely toward the domestic market.

The Indonesian agroprocessing industry is growing rapidly. In 1975, the firms in the food, beverage and tobacco categories employed over 385,000 people and produced products valued at approximately US\$ 1.8 billion. In 1987, the number of people employed in processing operations had increased to 600,000. They produced products valued at US\$ 5.0 billion. Thus, while processed food products may not yet have become overly important from a domestic consumption perspective, they are already a very important part of the manufacturing sector.

Little of this production is exported. While Indonesia is a large agricultural exporter, most of these products are exported in an unprocessed form. Total food exports in 1988 were US\$ 2.6 billion. Processed food exports were valued at only US\$ 135 million or 5 percent of the total. In comparison, Singapore exported US\$ 451 million of processed food products in 1988.

Though the volume of processed agricultural exports may still be small, it is growing at a rapid rate. Between 1983 and 1988, for example, exports of processed products grew by over 400 percent. Exports and production for the domestic market are expected to continue increasing rapidly in the 1990's as more operations are being set up all the time. The speed and efficiency of this growth is not assured, however, as the industry is faced with numerous constraints. The purpose of this

chapter is to give more information on the organization of the agroprocessing industry and to identify the primary constraints to increased output.

Agroprocessing Activity Areas

The agroprocessing industry of Indonesia comprises some thirty-four different categories. After excluding some bulk commodity categories, the remaining 28 categories are given below in descending order of value of production. These are:

1. Clove cigarettes
2. Sugar (factories only)
3. Vegetable and animal oil and fat
4. Coconut oil
5. Canning & processing fish, crustacea & foods
6. Condensed and dried milk, butter, and cream
7. Cigarettes (excluding clove type)
8. Drying and processing tobacco
9. Other tobacco products
10. Soft drinks and carbonated waters
11. Malt liquors and malt
12. Bakery products
13. Seasoning
14. Tapioca flour, sago, cassava flour & others
15. Chocolate powder and sugar confectioneries
16. Other products not elsewhere specified
17. Noodle and other kinds of noodle
18. Processing and preserving meat
19. Krupuk, emping, karak
20. Coffee, powdered and dried
21. Canning and processing fruits and vegetables
22. Wine
23. Ice
24. Soya sauce
25. Tahu, tempe, oncom, karak
26. Ice Cream and similar products
27. Slaughtering
28. Alcoholic liquors

The total output of the agroprocessing industry, in current US dollars, was reported to be \$5.087 billion for 1987. For detailed information on the relative importance and export trends of the categories, refer to TABLE III-1.

TABLE III.1
PRODUCTION VALUE OF PROCESSED FOOD PRODUCT
VALUE IN CURRENT US DOLLAR

| ISIC | DESCRIPTION | OUTPUT 1975 | OUTPUT 1980 | OUTPUT 1985 | OUTPUT 1986 | OUTPUT 1987 |
|-------|--|-------------|-------------|-------------|-------------|-------------|
| 31112 | Processing : Preserving of meat | 4,722 | 16,202 | 23,663 | 24,117 | 25,289 |
| 31121 | Condensed and dried milk, butter, and cream | 69,559 | 190,518 | 216,310 | 228,610 | 222,660 |
| 31122 | Ice cream and similar products | 2,891 | 4,076 | 6,813 | 6,601 | 7,229 |
| 31130 | Canning and processing of fruits & vegetable | 2,096 | 5,317 | 10,863 | 20,133 | 20,868 |
| 31140 | Canning and processing fish, crustacea & foods | 39,820 | 89,666 | 217,866 | 200,608 | 256,774 |
| 31161 | Coconut oil | 130,424 | 286,208 | 476,056 | 269,765 | 266,929 |
| 31169 | Vegetable and animal oil and fat | 124,691 | 418,165 | 447,181 | 442,612 | 613,036 |
| 31171 | Noodle and other kind of noodle | 9,317 | 25,917 | 44,241 | 44,662 | 44,533 |
| 31179 | Bakery products | 16,480 | 37,864 | 72,919 | 83,186 | 77,131 |
| 31181 | Sugar factories | 363,412 | 577,192 | 752,233 | 803,726 | 725,871 |
| 31190 | Chocolate powder and sugar confectioneries | 15,340 | 41,840 | 48,916 | 62,130 | 55,109 |
| 31210 | Tapiooa flour, sago, cassava flour & others | 17,970 | 36,691 | 51,612 | 69,676 | 62,280 |
| 31230 | Ice | 8,601 | 19,694 | 22,146 | 22,473 | 18,699 |
| 31241 | Soya sauce | 1,799 | 7,776 | 18,344 | 21,449 | 16,261 |
| 31242 | Tempe, tempe, oncom, karak & other chips | 2,169 | 6,957 | 9,819 | 13,257 | 9,373 |
| 31260 | Krupuk, emping, karak & other chips | 4,171 | 12,520 | 21,880 | 26,604 | 23,813 |
| 31260 | Coffee, powder and fried | 1,705 | 6,330 | 15,129 | 21,467 | 21,366 |
| 31270 | Seasoning | 26,086 | 65,641 | 93,224 | 95,803 | 73,417 |
| 31290 | Other products not elsewhere classified | 9,565 | 22,994 | 40,097 | 60,496 | 47,705 |
| 31310 | Alcoholic liquors | 1,501 | 1,422 | 544 | 801 | 887 |
| 31320 | Wine | 762 | 2,395 | 11,260 | 21,706 | 18,898 |
| 31330 | Malt liquors and malt | 39,727 | 81,016 | 81,130 | 89,544 | 79,384 |
| 31340 | Soft drinks & carbonated waters | 23,538 | 44,538 | 116,422 | 110,943 | 108,673 |
| 31410 | Drying and processing tobacco | 59,737 | 123,347 | 137,081 | 111,227 | 120,474 |
| 31420 | Clove cigarettes | 633,476 | 1,609,166 | 2,463,352 | 2,173,313 | 2,021,419 |
| 31430 | Cigarettes | 167,519 | 293,844 | 186,920 | 171,426 | 146,694 |
| 31490 | Other tobacco products | 15,380 | 25,769 | 186,784 | 146,041 | 113,931 |
| | TOTAL US Dollar | 1,790,487 | 4,043,999 | 6,796,725 | 6,311,098 | 6,087,696 |

TABLE III.1

The ACA study did not review all of the agroprocessing areas in detail; rather it focused on commodity lines that show the most potential for growth. Therefore, the analysis was concentrated primarily on three areas: (i) marine products (especially shrimp and prawns); (ii) fruit and vegetables; and, (iii) spices.

Types of Agroprocessing Enterprises

The enterprises which process agricultural products in Indonesia vary tremendously in terms of size and sophistication. There were nearly 4,000 Indonesian food processing firms in 1986. These firms employ anywhere from a couple of workers to thousands of workers. They use procedures that range from the traditional methods to the most modern technology available to produce their products. For the most part, these firms are geared to supplying the domestic market as their primary function. Few agroprocessing firms are geared toward the export market.

Even the largest food processing companies produce primarily for the domestic market. The operations of these companies are for the most part modern and integrated. While all of these companies produce primarily for the domestic market, they have become interested in entering the export markets as well. There is a class of large to medium size companies that produce almost exclusively for the export market. The P.T. Great Giant Pineapple Company, a subsidiary of the Gunung Sewu Group, is a notable example.

A group of medium size companies which are active in both the domestic and export markets includes P.T. Nutrifood Indonesia, San Maru, P.T. Sekar, P.T. Native Prima, and others. There are many small companies producing Indonesian specialty products such as shrimp crackers (krupuk), chile paste (sambal) and chips for the domestic market. Some of these are also interested in exploring export opportunities. There are also a number of cooperatives that are interested in entering or expanding into the export market with such products as fresh vegetables, fruits, spices and fish products

Major Constraints on Growth

The analysis of major constraints to growth was industry driven. That is, based on interviews with present and prospective agroprocessing firm operators, the various constraints were reduced to seven major categories. These are discussed below in perceived rank order of importance at the present time.

1. Technical Agroprocessing Constraints

There is a nucleus of highly capable and well informed industrialists in the agroprocessing industry in Indonesia. These few operators have a proven ability to compete internationally with products such as tuna, frozen shrimp, processed pineapple, mushrooms, shrimp crackers and flower seeds. The industry as a whole, however, lacks the technology, the quality control and the in-plant sanitation expertise to successfully compete in international markets.

The main technical constraints which impede the progress of agroprocessing growth and development include:

- * Lack of understanding of the basic principles of Good Manufacturing Practices (GMP). Most industrial nations publish the standards for GMP in the forms of manuals, and cover subjects as simple as the need for washing hands after the use of toilet facilities, and as technical as the need for installing non-porous walls to enable thorough cleaning.
- * Limited access to technology and information. Appropriate technologies may be available locally or in other countries but the entrepreneur cannot gain access to them because of a lack of information or the absence of commercial connections to the sources of the technologies
- * Lack of management expertise in critical areas such as personnel development and training, financial planning and analysis, and marketing strategies. The growth and diversification of private firms requires management personnel with the ability to organize the productive and administrative work of the company in a cost-effective manner. Local managers tend to have a short term perspective, which must be overcome if their firms are to be competitive and profitable in the long term.
- * Failure to understand the critical importance of quality control. There is often a failure to understand, or a lack of knowledge of, the quality standards required in the potential export markets of Europe, Japan and the United States. The inclination seems to be to find ways to circumvent the requirements rather than to try to meet the standards.
- * Failure to understand the need and importance of in-plant sanitation and good "housekeeping". Numerous

instances were observed where, although sanitation procedures had been established, plant personnel allowed workers to circumvent the regulations. Proper in-plant sanitation requires a high level of discipline by both management and workers. As an example, in one small factory the boiling and cooking facilities for the fruit preserves were not separated from the storage area for the packing materials; every time the packing materials were disturbed clouds of dust would contaminate the product to be bottled.

Although there are many privately owned Indonesian consulting companies, their expertise in undertaking feasibility studies and developing bankable business plans for the diversified and mostly new agroprocessing firms is very limited. Companies interested in entering into new ventures in the agroprocessing field must often turn to foreign expertise, which only the stronger financial companies are able to do. The smaller companies are usually forced by financial constraints to learn by a system of trial and error.

In developed countries, an entrepreneur starting an agribusiness firm benefits from the availability of skilled labor, specialized support services, inexpensive transport and communication services, and well established networks of firms providing inputs. Occasionally, there also exists an efficient government organization to assist with specific problems, as in still developing agribusiness extension services in the U.S. Business-specific organizations are often available to assist their members. Training in and exposure to improved practices would help alleviate the above listed constraints.

2. Raw Material Supply

Dr. Rusdian Lubis, in a technical annex to the FAO/UNDP agricultural policy options report, (1989), states in part:

In all cases analyzed, there were strong indications that large quantity and quality losses exist in the production, harvesting and post-harvest handling of agricultural products. Horticulture products, due to their perishability, are the most damaged, with the percentage of post-harvest losses estimated at 20 to 30%, not to mention the losses of nutritional content and quality degradation. The post-harvest losses and seasonality of several agriculture products, e.g. horticultural crops and marine fish, are of prime concern since the key to success of any

agro-industry (primarily the agro-food industry) is a stable supply of the right quality agricultural raw material.

In the present review by the ACA Team, it was observed, again and again, that the fundamental constraint is the lack of an available good quality raw material in adequate quantities. Supplies are limited for many potentially exportable products, which restricts the development of the agribusiness sub-sector. Some of the larger successful companies have implemented a vertical integration system so that they can control their own primary production. This seems to be one of the keys to their success. Many of the smaller agro-processing company managers expressed great hesitation about the strategy of vertical integration, however, as they lack both the agricultural expertise to manage such operations and access to sufficient land.

In many cases, an insufficient supply of raw materials was the main reason why facilities were not operating at full capacity. One mechanism to obtain appropriate supplies of raw material in such instances is through contract farming. It can be applied in a number of ways such as for a central processing unit, cooperative or marketing firm. Contract farming also supplies a vehicle for providing appropriate technology, credit, extension advice, control over the quality of the product, supervision of insect and pest control and compliance with insecticide and pesticide restrictions.

Based on experience with smallholders in other contract farming projects, several points which have led to success or failure can be pointed out. These include:

- * If possible, farmers should be organized into groups holding contiguous land parcels in order to have adequate large enough areas for mechanization.
- * To support the project, farmers may need help to clarify land claims and obtain clear land titles.
- * The farmer groups would need to receive considerable support in terms of training and extension services to help them with such important matters as scheduling equipment use, etc. Initially at least, it may not be useful to rely on Government extension services since they are still geared to traditional farming systems.
- * The farmers will be dealing with new farming systems which are very different from their previous experiences. The need for rotational cropping systems, for example, must be explained and their importance made totally clear. Initially it will be necessary to

provide consultants from other countries or areas where the systems have been well developed.

- * The processing entity will need to arrange for the timely provision of adequate quantities of appropriate fertilizers, pesticides, and other supplies.
- * Many farmers will need access to credit on favorable terms, in cash or in kind, if they are to join the project voluntarily. They will also need to know that their land holdings are protected under the project, and that there is little or no risk of losing their land due to an unfavorable credit system.
- * In order to avoid the problems of farmers selling their produce outside the project on their own, they would need a guarantee of a fair market price for their crops, or the promise of season-end bonuses.

Many countries are now trying to find the right set of incentives and local institutional arrangements to attract foreign and domestic investors to participate in agro-processing enterprises. But, for a variety of reasons, integrating farmers into agro-processing activities has been difficult. A World Bank Agricultural Policy Assessment for Indonesia (3) points out that licensing, restrictions on foreign investors, short-term land leases, quality control, and other problems in marketing and transportation have inhibited the development of secondary food crops and horticultural products.

A central concern is how to get farmers to respond to crop diversification initiatives, keeping in mind that risk avoidance often takes precedence over the potential for increased rewards. For farmers at or near the subsistence level, the fear of the possibility of losing their land usually is the overriding factor. Assuming that the economics for diversification are positive, information channels, prices, access to new crop technology, and cultivation practices have to be established and expanded in order to elicit an appropriate response from farmers. It is often said: "Farmers may be uneducated, but they are not stupid". Any crop diversification program has to deal with this reality.

Several approaches would seem to be open. One of these, as discussed previously, is to package the entire deal into a contract farming system and selling to a single agroprocessing unit. A second approach would be through the effective use of farmer cooperatives. In Indonesia, cooperatives are often used as a semi-autonomous arm of the Government to direct farmers toward new, promising and profitable activities. The cooperative promises to market and process the resulting output for its members. In practice, however, the track record of cooperatives

in Indonesia has left much to be desired. But there are a few, mostly non-government assisted, who have successfully entered the agroprocessing industry. The PUSPETA regional cooperative federation in Central Java, a recipient of USAID-funded assistance, is a prime example.

An additional constraint facing firms in the agro-processing industry is the high cost of inputs such as packaging materials, labels, cans, tin plate etc.. One of the mechanisms for trying to deal with this constraint was the package of deregulation measures of 1986 which included procedures allowing companies to import packing materials under the P4BM scheme. It was observed, however, that many companies find the administrative cost of direct import to be too expensive and consequently still face the high cost of the restrictive trading system. And, the fact remains, that the customs duty drawback facility under the P4BM scheme is considered by many to be too complicated.

The artificially high sugar price, set by Government, reduces the potential for effective competition in world markets. At present prices Indonesian agroprocessing firms find themselves at a price disadvantage relative to competitors in other countries not affected by such measures.

3. Marketing Problems

There seems to be a failure among many agroprocessors to understand that a fundamental principle of all successful diversification programs is that they are driven by market demand. Closely related to the problem of poor product quality caused by raw material constraints and inferior manufacturing practices is a large package of marketing problems. Simply put, it is difficult to sell a poor quality food product in any market but especially in a competitive international market. Due to health considerations, for example, buyers are wary of purchasing unwholesome food products. Indonesia has a reputation of producing poor quality products, even if a few producers do produce acceptable products. Thus it is not only the fact of poor quality, relative to other producers, but also the market perception that hinders Indonesia's marketing efforts. Changing this reputation will be difficult.

Providing Indonesian manufacturers with proper training for their workers can help them to improve the quality of their products. They will also need to improve their marketing practices in order to successfully enter the international market and even to appeal to the growing middle class domestic consumers. In addition to quality problems with products and their packaging mentioned above, Indonesian manufacturers also have problems with their labelling. Most Indonesian producers

have very poorly produced labels. When placed on shelves with most competitive non-Indonesian products, they do not "reach out" to the buyer. They tend to be too simple or otherwise unattractive and therefore not competitive.

In dealing with the export market, these problems are compounded by a lack of reliable and affordable marketing information. For example, since there are no good sources of information on world prices and competitor activities, most Indonesian companies operate in an information vacuum. With little or no institutional or industry association support, they must collect information on their own. This is difficult because rarely do they have the overseas offices or the budget to collect the necessary information for targeting their activities

4. Transport and Logistic Problems

Due to Indonesia's long distance from many of the major international markets, the cost of freight is an inherent disadvantage to Indonesian enterprises attempting to enter those markets or to expand their sales. Transporting Indonesian goods is expensive; for instance, air cargo costs for shipments in excess of 45 kilos range from \$ 4.88/kg from Jakarta to Japan, to \$ 5.34/kg to Los Angeles and \$ 8.09/kg to Amsterdam. Major competitors, including Thailand, Taiwan and Caribbean Countries, are much closer to the major markets, at least as measured in freight costs.

Small-farmer cooperatives in the Karo Highlands complain of the high cost of air freight to their primary market for their fresh produce in Singapore. It was noted that the cost of air freight from Medan to Singapore is substantially higher than from Jakarta to Singapore, even though the distance is substantially shorter. Comparing a range of shipments to Singapore shows the following discrepancies:

| | | |
|------------|-----------------------|------------------------|
| 100 kilos: | from Medan \$0.71/kg, | from Jakarta \$0.50/kg |
| 250 kilos: | from Medan \$0.64/kg, | from Jakarta \$0.45/kg |
| 500 kilos: | from Medan \$0.55/kg, | from Jakarta \$0.31/kg |

The quoted rates for reefer containers are:

| | |
|------------------|----------------------------|
| Jakarta - Japan: | 20 foot container \$ 2,400 |
| | 40 foot container \$ 3,800 |

| | |
|----------------------|----------------------------|
| Jakarta - Rotterdam: | 20 foot container \$ 3,800 |
| | 40 foot container \$ 5,200 |

| | |
|------------------------|----------------------------|
| Jakarta - New York: | 40 foot container \$ 6,440 |
| Jakarta - Los Angeles: | 40 foot container \$ 5,780 |

The need to transport raw materials from across the vast area of Indonesia to the relatively few processing centers which are presently available does drive up the cost of the product. As an example, rambutan is transported over large distances to the only processing facility available in Medan, North Sumatra. The high cost of surface and marine transportation dominated by monopolistic practices and a general shortage of vehicles (trucks, boats, etc.), multiple transshipment and a poor network of roads make inter-island movement costly and unreliable.

5. Credit Constraints

Although not as important as some of the other problems, lack of credit may be a constraint in individual cases to increased investment in the agroprocessing industry. Two basic types of credit are used by the food processing industry. The most substantial, and the most problematic, is investment credit. Less of a problem is operating credit, especially for firms involved in export ventures.

Credit for investment purposes is not in short supply in Indonesia, but it is very expensive. Investment loans for the agroprocessing industry command an interest rate of approximately 19.5 percent. Indonesian banks are allowed to lend up to 65 percent of the total project cost. Loan terms are usually short, about five years for most investments. Although these loans can be rescheduled, they rarely are.

Indonesian investors have used a number of methods to overcome these restrictions. Most large investments in the agroprocessing area are handled by the large business groups. Most of these groups have their own banks, and are thus able to provide their own financing at discounted rates. It is also common practice for Indonesian investors to overstate the value of their project, thereby in reality receiving more than 65 percent financing. In fact, the leveraging of some projects is said to be as high as 90 percent of the project value. In such cases the investor has only a minimal personal investment in the project.

The Government sponsors programs to subsidize development of specific agricultural sectors, such as the PBSN scheme under which low interest loans are made available. Recently, there has been movement toward U.S. dollar financing as well. For projects that are export oriented, financing in U.S. dollars can be obtained at

the more competitive Asian dollar rate. Since earnings are in foreign exchange, the currency depreciation risk is minimal.

Financing operating expenses is even more expensive than investment financing. To finance raw material purchases and production costs, the commercial bank lending rate is about 22 percent. For firms involved in exporting, however, there is relief from these high rates under the Preshipment Export Financing Program. Under this program, an exporter can obtain a loan for up to six months to finance the cost of producing his product. The loan is given only after a Letter of Credit (L/C) is opened for the product and it is due upon shipment of the product. The loan can be for 85 percent of the value of the L/C. Until May 1989, the rate on this loan was 9 percent for primary products and 11 percent for non-primary products. The rate was raised in May 1989 to 14 percent for primary products and 14.5 percent for non-primary products.

The largest users of this program have been the exporters of unprocessed food products. These products qualify for the primary product interest rate. The program has also been used by a few processed food exporters but here the use is much smaller for a variety of reasons. First and foremost, Indonesia's exports of processed food products are much smaller than those of unprocessed products. More importantly, perhaps, is the fact that there are few large exporters of processed food products. This is important because using the program is somewhat complicated. Also, there is a definite risk for the lending bank, even though a loan guarantee program is available for them. Banks have reported difficulties in collecting under the guarantee program when a loan holder defaults. As a result, they have become very careful about whom they make loans to. In fact, they now use the same criteria as when making a commercial loan, including requiring the placement of collateral.

The result has been that the program has not provided the assistance that was hoped when it was formed. Most of the loans have gone to large business groups who do not need the subsidized financing of their cash flow. The loans have also gone primarily to traditional unprocessed food products whose trade links are already well established. The special bank requirements have excluded those who most need the financing; i.e. small companies with little or no experience or collateral.

Although no company managers mentioned credit as a major constraint to expanding or entering into the agroprocessing industry during the interviewing process for this report, it is an area that needs continued watching. It may well still be serving as a barrier to entry for prospective new firms.

6. Regulatory Constraints

The food processing industry is one of the less regulated components of Indonesia's agribusiness sub-sector. Nonetheless, there are still a number of Government policies and regulations that affect it, usually in a negative sense. Among the more important are the following:

(i) Licensing. Formerly, licensing was a major obstacle to entry into the food processing and other industries. Consolidation of numerous licenses under the General Business License has shortened the time required to set up a manufacturing venture and eliminated much of the corruption which was formerly associated with establishing a business. Due to this reform, perhaps, no food manufacturing plant operator mentioned licensing as a major problem. But, certain restrictions do remain. Investment in palm oil and milk processing, two of the biggest processing sectors in Indonesia, are closed under BKPM's so-called "negative list".

(ii) Land Tenure. Restrictions on land holdings also remain a significant problem. Leases for Government concession land are for only 25 years and even this length of lease can be difficult to obtain. Foreign partners in joint ventures are not allowed to own land in Indonesia, a fact that discourages foreign investment.

(iii) Duty Drawback Scheme. The adoption of the P4BM system of duty drawbacks is one action that has positively affected the exports of food products, albeit on a very small scale. Under this system, inputs to manufacture an export product can be imported freely and without duty. While in theory the development of this system is a positive step, it has had little impact, primarily for two reasons. First, Indonesia exports very few food products that have an imported input component since this category accounts for only about five percent of total agricultural exports. Second, while large companies have been able to use the program effectively, it has been at great administrative cost while more cost averse smaller companies have not been able to derive much benefit at all.

The major use of the duty drawback system for the food industry is in the area of packaging. Tin plate for can manufacture is an important and expensive part of producing a high quality product for the export market. Imports of tin plate are restricted in Indonesia, however, in order to protect the monopoly manufacturer of tin plate, PT Latinusa. PT Latinusa was formed in 1985 as a joint venture between Krakatau Steel, PT Tambang Timah (a Government company) and PT Nusamba (part of the Hasan Group). In order to protect PT Latinusa, Krakatau Steel was given the ex-

clusive rights to import tin plate. This has allowed PT Latinusa to price its tin plate about 40 percent above the import price. It has also allowed PT Latinusa to produce a clearly inferior product.

Canned tuna, pineapple and mushrooms are all important export items and require high quality packaging and competitive export prices to enter the world market. The duty drawback system has been used by the manufacturers of all of these products to overcome the import restrictions set up to protect PT Latinusa, and to improve their competitiveness. It is important to note, however, that there are only a few companies involved in tuna canning, and only one each in pineapple and mushroom canning. These companies are all large and have their own can making operations. Perhaps most importantly, they all have the sophistication to deal with the duty drawback program, while complaining that it is confusing and costly in terms of time.

Smaller manufacturers may not have the ability to participate in the program. Because they are small, rarely do they have the financial capability to import packaging material, even if they can obtain the legal authority to do so. For example, although importation of tetrapack paper is done privately, it is handled by a consortium of companies under the leadership of PT Ultra Jaya. This consortium fixes the price of tetrapack paper up to 40 percent above the import cost. Again, however, most drink manufacturers are not big enough users to import on their own account.

The importation of sugar, a major ingredient used in the food processing industry, is also restricted. Both domestically produced sugar and imported sugar are controlled by BULOG. It holds the sole rights to import sugar into Indonesia. BULOG sells the imported sugar at its high domestic price, which is normally well above the C&F import price. In theory, a manufacturer who is using sugar in a product that he is exporting can import sugar without restriction or duty; in practice this does not happen because a normal sugar shipment is for a minimum of 10,000 to 12,000 tons. No one manufacturer in Indonesia can use this much, and firms are prevented by BULOG from buying in groups, selling the remainder on the local market, or even selling the remaining quantities to BULOG. Nor is BULOG interested in making joint purchases with the private manufacturers. What BULOG has done instead is offer a slightly discounted price to the buyers. This price was Rp. 700 per kg. (US\$ 398 per ton) when BULOG was importing at US\$ 260 per ton. Low cost sugar is essential for encouraging exports of processed food products but the present situation is political and therefore not solvable in the short-run.

(iv) Standards. While in many cases Government regulation can be over bearing, at other times it is woefully lacking. This is especially the case in the inspection services that the GOI

provides. Although the Government does issue written standards for most products, they are usually unable to adequately inspect for compliance. The standards are frequently disregarded by producers. Many international buyers require independent surveys of the products that they are buying but Indonesia's inspection companies, even those associated with international companies, have a reputation of being unreliable. Thus, buyers are often forced to send their own people to Indonesia to guarantee quality. This is expensive and surely limits export sales.

(v) Regulations. While at present the agroprocessing industry is free of Joint Marketing Boards and Approved Exporter regulations that effectively control bulk agricultural exports, it is likely that processed foods will be included under a similar scheme at some point in the future. As was mentioned above, there is talk in the industry about restricting the exports of frozen prawns to approved exporters. If a number of people entered the mushroom export market and price began to fall, there would probably be an attempt to restrict entry there as well. The Government is constantly trying to prevent "unhealthy competition." Restricting entry into the industry is an effective but undesirable way to do this.

7. Institutional Constraints

Most of the Government's involvement with the agribusiness sub-sector has been directed toward regulating bulk agricultural exports. This has been done with the intention of raising prices for bulk commodities and increasing profitability of exports. Little attention has been directed toward increasing the exports of processed food products, however. Almost no institutional support exists to encourage these exports. Little capacity is available in any ministry for data collection and analysis of world market trade trends. Little capacity is available to promote Indonesia's food products in foreign markets. Primarily, the Government sees itself as a regulatory body but it does provide some services. Some of the GOI institutions involved with agribusiness, and particularly agroprocessing are as follows:

(i) NAFED. Export promotion is the domain of the National Agency for Export Development (NAFED), an agency established in 1971 within the MOT. It is divided into three product promotion groups: (i) agricultural products; (ii) industrial products; and (iii) handicraft products. In 1987, a market analysis group was also created, but it is not yet operational. The main activity of NAFED is the administration of 11 trade promotion centers located around the world. NAFED also forms teams to participate in international trade shows and organizes shows within Indonesia.

About 75 percent of NAFED's present annual budget of US\$ 12 million is spent on salaries. Almost half of its promotional budget of US\$ 2.5 million is spent on maintaining its trade promotion centers. Little money is thus actually available for promoting Indonesian products of any kind.

NAFED spends very little time promoting the export of food products. In a recent series of interviews conducted by Bishop, Sutrisno Associates of food exporters, none reported receiving any tangible assistance from NAFED, although a few did participate in NAFED sponsored trade shows. NAFED has almost no trade information to share with Indonesian food exporters. It has no way to disseminate what it does have and has little ability to collect information in a systematic way. The commercial counselors in the Indonesian embassies, potentially an excellent source of information, are responsible to the Director General for Foreign Trade and do not deal directly with NAFED.

(ii) Export Support Board. The Export Support Board was established with World Bank funding in 1987 to provide much more direct support for Indonesian exporters, mainly in the form of technical assistance. The Export Support Board suffers from numerous administrative difficulties as well as competition from NAFED. Many Indonesians expected the Export Support Board to replace NAFED but in fact it is only able to provide one major service technical assistance. It is not currently geared to provide promotional assistance or market information.

(iii) Trade Associations. Indonesian trade associations do little to promote the export of the products that they represent. In the food industry, the best organized trade associations are those for the unprocessed products, like coffee, spices, tapioca and frozen prawns. Their primary interest is not in promoting exports but rather regulating their commodity group. AEKI, the coffee association, does have a small program to introduce smallholder farmers to better cultivation techniques. It also participate in negotiations on the International Coffee Agreement but does little else. The pepper export association has a representative office in Europe but this type of promotion is quite exceptional.

The activities of the processed food associations, especially the Association of Food and Beverage Entrepreneurs (GAPMMI), are extremely limited and ineffective. Part of the reason for this is that Indonesian food trade associations have very limited professional staff. Usually their directors, including the marketing director, are from member companies and are not association employees. With this system, there is always the question of conflict of interest. To overcome this problem, Indonesian trade associations need professional staffs. They also

need to reorganize to change their focus from regulation of their members to one of promotion. They need to do this in concert with the Government. Either group working alone to promote food exports will not be as effective as if they work together.

(iv) Farmers' Organizations. Encouraging the expansion of strong farmers' organizations has long been an important part of GOI's agricultural/rural development strategy for achieving economic growth and improved income distribution. During field visits, the ACA Team had an opportunity to review the success or failure of a few cooperatives in Central Java and in North Sumatra. It was noted that, due to strong leadership, the cooperatives in Java were progressing and were achieving at least some of their goals and objectives. In North Sumatra, far less progress is being made. For example, a German foundation funded project which has provided technical support to farmer cooperatives for over ten years has been only marginally successful. This can be attributed mainly to the fact that cooperatives were imposed from the top down instead of growing from the bottom up. Lack of strong management, undue political influences and mistrust by the members seem to be the major factors impeding progress at this time.

(v) Rural cooperatives (KUD) Time constraints prevented an in depth survey of farmers' cooperatives; however, quoting from the FAO/UNDP agricultural policy options report (1989), the following comments are worth taking into account:

"Rural cooperatives (KUD) are legal entities and the most dominant form of Government-sponsored rural organization. Multi-purpose cooperatives serve as distribution channels for subsidized inputs, principally fertilizer and, until recently, pesticides and, to some degree, credit. They also act as the Government's mechanism for the purchase of rice entering the BULOG national stock pile. Some special-purpose cooperatives, such as the "milk cooperatives", serve more selective functions on behalf of their members. Government intends to expand and strengthen the cooperative movement during REPELITA-V. The major challenge will be to improve management and devise means whereby board members and managers are accountable to their members. Further, cooperatives can perform growth and equity functions."

It appears that cooperatives are a strong potential tool to improve many areas of diversified agriculture in Indonesia. For example, through their members, systems of contract farming can be

more easily implemented. Upgrading of cooperatives should be considered in any effort to expand the agro-processing sector of Indonesia.

Future Prospects for Growth

Indonesia is the largest island nation in the world. Its land area is almost 2 million square kilometers and if the Exclusive Economic Zone is included Indonesia has jurisdiction over some 7.9 million square kilometers of fishing grounds.

With the extensive area under its domain and with its many diverse climates and micro-climates, the potential for Indonesia to expand the agricultural base into more diversified areas is considered to be enormous. Java is heavily overpopulated, however, and farms are often too small to be economically viable. Much remaining land is not suitable to cropping while in the Outer Islands land may be available but labor is sometimes in short supply and an infrastructure is limited or non-existent.

In consideration of the objectives stated in REPELITA-V, agribusiness in general and agroprocessing is particular are topics very much in the foreground. For example, they have been the subject of many discussions and investigations by various donor agencies and non-governmental institutions. Some of the activities and reports which deal with the subject are as follows:

- * The Office of Agriculture and Rural Development. USAID/Indonesia, in cooperation with ANE/TR/ARD Washington, D.C. recently commissioned the American Society of Agricultural Consultants International to study the potential for increased U.S. Agribusiness Activities in Indonesia.
- * A UNDP-financed project executed by the International Trade Center (ITC), together with NAFED reported on the development of processed foods and on the export potential for Indonesia. A report entitled Export Development was prepared by Mr. J.N. Parkhill.
- * The Netherlands Economic Institute submitted a working paper, The Agroprocessing Industry of Indonesia, in 1988.
- * The Asian Development Bank recently prepared a confidential and restricted report, Agro-Based Industries in Indonesia.

- * Tabor et al, (1989) prepared a report, Agricultural Policy in Indonesia: The 1980's Experience and the Outlook for the 1990's

It was not in the scope of work of the ACA Team to analyze all of Indonesia's agribusiness opportunities in detail. On the basis of available information and extensive field observations, however, there appeared to be some promising options. These are listed below as being technically possible but note must be taken of the fact that many of them have not yet been subjected to comprehensive economic feasibility studies.

1. Domestic Markets

With the continuously growing population of Indonesia, coupled with its increasing buying power, the market for traditional agricultural products as well as for new processed and value added products will increase significantly over the years to come. Steve Tabor et al, (1989), state in part:

In the 1990's, the Indonesian population is projected to increase from 182 million to 216 million (Central Bureau of Statistics). Assuming that real incomes do not decline, this will add about 19 percent to domestic food demand. Compared to the 1980's, there will be more middle-aged people with less younger people to support in the population as a whole. In as much as full-grown consumers have higher nutrient requirements than infants and children, this change in age structure is expected to add further pressure on domestic food demand. This change in the composition of the population will add approximately 3% to total food demand.

Not only will there be more people to feed in the 1990's, but these consumers will have the purchasing power to back up their numbers. The average consumer in the 1990's will place a priority on foodstuffs.

Due to population growth and urbanization, nearly fifty percent more food and other agricultural commodities will have to be processed and traded to urban markets to supply consumer requirements.

In summary, domestic foodstuffs demand will continue to rise, largely as a result of population growth, age structure change and urbanization.

Given the above quoted projections, it becomes quite clear that the domestic market opportunities are extensive. Although

the main demand will be in the basic foodstuffs, growth will also develop for the secondary crops, together with commodity processing activities such as improving and expanding:

- Production and processing of soya beans.
- Operation of feedlots and meat processing facilities.
- Production and processing of hot peppers and bell peppers.
- Operation of shrimp cracker factories.
- Production and processing of garlic.
- Grain storage systems in order to reduce post-harvest losses.
- Production and processing of Indonesia's wide range of tropical fruits.
- Production, processing and marketing of vegetables and cut flowers.
- Production of high quality hybrid vegetable and flower seeds for domestic use.

The above noted activities, which at best constitute only a partial list, at least give some indication of what possibly can be done. Entrepreneurs will in any case have to determine whether these and/or other opportunities will be economically viable. Given the increasing interest in agroprocessing, there should be a large market for doing feasibility studies and this will provide opportunities for private consulting firms.

2. International Trade Opportunities

Future prospects for Indonesia in the international agribusiness markets will have to be oriented towards penetrating and expanding the markets of the United States, the EEC countries, and the other major nations of the Pacific Rim Area. The latter group includes Japan, Singapore, Korea, Australia and New Zealand. But any expansion here will face strong and established competition by Thailand, The Philippines and an emerging role for China and possibly other neighboring countries.

A great deal of emphasis has been given to the possibility of Singapore as a major market for Indonesia's processed food products. Although Singapore would seem to be a logical market,

given its proximity and income level, it is also going to be a very difficult market for Indonesia to penetrate.

Singapore is a relatively small market with only about 2.5 million people. It is also a highly competitive market where products from Europe, the United States, Japan and Australia all compete with foods produced in Singapore and the other ASEAN countries. Standards of food quality are high in Singapore, both as mandated by the Government of Singapore, and as demanded by the Singaporean consumer.

With a few minor exceptions, the Singapore food industry has shown little interest in Indonesia's processed food products. At the wholesale level, margins on imported products in Singapore are very low, usually only around 10 percent. Most products sold in Singapore are major lines that are well known worldwide. Given the competitiveness of the market, it is difficult to introduce new products into the supermarkets. Like in the United States, shelf space is often sold at the retail level for new products. With the low profit margins, Singaporean traders thus report little interest in taking the risk of introducing new Indonesian products, especially since these are not really "new" products, but only the same product produced by a different manufacturer.

This problem is heightened by the poor quality of Indonesia's products. Singaporean traders report that they have imported products, or have heard of imports of inferior quality products from Indonesia which do not pass Government inspection, or products that look so bad that they cannot be sold to the quality conscious Singaporean consumer. The Singapore trade complains about the poor quality of packaging, labeling and general food preparation of Indonesia's products.

This problem is further complicated by the fact that many products which would seem to have a natural niche in Singapore (such as sauces and refined cooking oil) are already widely produced in Singapore and exported (see Table III.2). Indonesia's major success in the Singapore market has been instant Indomie noodles produced by Sanmaru Food Manufacturing Company.

Fresh Indonesian produce has not fared much better in the Singapore market. Again the trade in Singapore feels that Indonesia's products are expensive, often of poor quality, and probably contaminated with pesticide residuals. A large amount of produce, especially fresh vegetables, comes from Malaysia. Malaysian produce can be trucked into Singapore, and thus has a definite price advantage over Indonesia, where produce must be air-freighted at very high prices. Further, Malaysia can produce just about everything Indonesia can.

In early 1989, an outbreak of food poisoning in Singapore was attributed to pesticide residuals on Malaysian produce. This led

to increased inspection and rejection of many produce shipments by Singaporean health authorities. While this problem has been addressed in Malaysia, many traders fear the possibility of rejection of Indonesian produce, and are thus inhibited from substantially increasing their imports.

Thus, while Singapore represents a potential limited market for processed food products and fresh fruits and vegetables, it is not a market that Indonesia can effectively compete in without substantially upgrading the quality of its products. Obviously, the same would hold true for other potential markets such as Japan, the United States or Europe.

TABLE III.2
 PROCESSED FOOD EXPORTS OF SINGAPORE
 (THOUSANDS OF U.S. DOLLARS)

| <u>PRODUCT</u> | <u>1986</u> | <u>1987</u> | <u>1988</u> |
|------------------------|-------------|-------------|-------------|
| PREPARED MEATS | 4,973 | 7,020 | 7,041 |
| MILK & CREAM | 8,964 | 14,738 | 17,378 |
| CANNED BUTTER | 3,662 | 2,094 | 2,017 |
| CANNED FISH | 3,059 | 5,128 | 7,785 |
| CEREAL PREPARATIONS | 32,401 | 39,256 | 51,930 |
| VEGETABLE PREPARATIONS | 702 | 811 | 1,022 |
| FRUIT PREPARATIONS | 7,353 | 8,719 | 10,936 |
| SUGAR PREPARATIONS | 1,145 | 1,435 | 2,300 |
| GROUND SPICES | 1,658 | 1,296 | 1,689 |
| CHOCOLATE PREPARATIONS | 13,341 | 20,342 | 29,274 |
| MARGARINE | 7,235 | 14,858 | 31,245 |
| OTHER PREPARED FOOD | 20,001 | 23,217 | 36,953 |
| BEVERAGES | 44,939 | 75,849 | 93,981 |
| TOBACCO, MANUFACTURED. | 10,917 | 11,300 | 29,820 |
| REFINED COOKING OIL | 82,619 | 148,911 | 127,711 |
| TOTAL | 248,619 | 371,974 | 451,082 |

Source: Singapore Trade Yearbook

Assuming that the seven constraint categories previously discussed can be removed or sufficiently alleviated, the list of potential trade activities for Indonesian agribusiness firms is a long one. It includes the following:

- Expand integrated marine shrimp projects. The Asian Development Bank has supported such projects in Indonesia for many years. The incidence of shrimp farming has increased rapidly during the last few years.

Although there has been a major recent price drop in Japan, there is further export potential to Europe and the United States.

- Expand Indonesia's fishing fleet. In the past, a shortage of Indonesian flag fishing vessels and lack of technically trained fishermen with appropriate technology led to the wholesale granting of licenses to foreign companies to fish in Indonesian waters. There are indications that this policy will soon be reversed.
- Expand the processing of canned fish products. As more and more fish will be caught by Indonesian flag vessels opportunities will develop for expanding the canning facilities for tuna and skipjack.
- Expand integrated snail, crayfish and frog leg operations. These enterprises, although small at the present time, could be expanded as markets and raw material supply expand.
- Expand and support lowland and highland vegetable production. With the many climates available, a wide range of vegetables can be grown. The immediate market for fresh produce seems to be Singapore. Some cooperatives in the North Sumatra area have already penetrated this market. Future expansion in this area should be a possibility for fresh and well as processed vegetables.
- Expand the production and processing of high quality flower and vegetable seeds for planting in Indonesia as well as export. With Indonesia's abundant and cheap labor, this could become an area for expansion. One company in the Karo highlands is already doing this very successfully.
- Expand the integrated pineapple and tropical fruit production and processing. Indonesia is already successfully competing in the area of canned pineapples and perhaps this could be expanded. Results in the area of other canned tropical fruits such as rambutan, mango, durian, mangosteen have been spotty. Thailand is much more advanced in these endeavors.
- Expand the market for fresh fruits such as rambutan, mango, mangosteen, papaya, citrus and others. The market may be small now but has further development potential.

- Expand the chocolate industry. Indonesia produces substantial amounts of cocoa beans. Although the processing thereof will remain mainly for the domestic market, opportunities may present themselves to process more of the raw material and add to their value.
- Enter the market with cut flowers. With more and more flights becoming available to Europe, Japan and the United States, and if airfreight rates become competitive, this area could warrant some investments.
- Obtain added value by processing and marketing the many spices produced in Indonesia. At present most spices are exported as raw commodities. Joint ventures with prominent spice companies could lead to additional processing and packaging steps in Indonesia.
- Obtain a share of the expanding world market for cocktail snacks. Indonesia should obtain a market share with products such as peanuts, cashew nuts, macadamia nuts and assorted crackers (krupuk, emping, banana chips and cassava chips)

CHAPTER IV.

ROLE OF GOVERNMENT

As noted previously, the GOI has been relaxing controls on private sector investment and participation in the economy with generally favorable results. But the impact on the agribusiness sub-sector so far has been minor. The agencies that most influence agricultural policy and programs have shown little inclination to accommodate or support the emerging agribusiness sub-sector. For example, the MOA continues primarily as a regulatory, production oriented agency with its major focus on a food (rice) self-sufficiency objective. So far, it has done very little to include agribusiness in its support programs.

Nor has the GOI fully clarified the respective roles of most of the other ministries and public agencies that have or may soon develop an interest in agribusiness development. These include the following: Forestry (resource management and wood products); Home Affairs (rural and regional development); Public Affairs (water resources); Trade (domestic and international trade in agricultural inputs and processed outputs); Industry (secondary-level agroindustries); Cooperatives (agricultural and other rural institutions); Transmigration, (land development, resettlement and nuclear estates); Population and Environment (pollution and environmental degradation control); Finance, (monetary and fiscal management); BULOG (price control and supply regulation of rice and selected other primary food crops); and, BAPPENAS (central planning and policy formulation).

During the present period of uncertainty that began after the GOI announced its new private sector development policy for PELITA-V, and within the vacuum created by general government agency inaction relating to agribusiness since then, some true entrepreneurs and risk takers have been moving into selective agroprocessing ventures. As was shown in the previous chapter, however, serious constraints to further growth in agroprocessing do exist. At least some of these bottlenecks could be removed or reduced by positive GOI actions but at the moment, further deregulation is at a standstill. The current situation can be summarized by saying that, although the GOI now has set forth some agribusiness policy at the national, political level, it has yet to develop an agribusiness development strategy that can be implemented at the provincial level.

The Current Policy Dilemma: Who Should Do What?

While the GOI has not yet taken many concrete steps to promote and service the agribusiness sub-sector, it has at least begun to recognize the need for further action. Government is actively

soliciting donor agency technical and financial assistance and has already approved some of their project proposals. There is still active debate underway within BAPPENAS and even within the Office of the President, however, on how to create a viable support program for agribusiness development. And, specifying which agencies should be involved and what they should do has only barely begun.

One such recent action made to clarify the agency involvement question was the Joint Decree of the Minister for Agriculture and the Minister for Industry, No. 98/M/SK and No. 246/Kpts/OT 210 dated April 25, 1989. (See Annex D). It established a Permanent Agricultural-Industrial Working Commission, which has become commonly known as the Joint Agribusiness Committee (JAC). It is co-chaired by the Junior Minister of Agriculture and Junior Minister of Industry. So far, it appears to have been severely constrained in achieving its mandate to become a viable coordinating institution. Among other problems, the JAC has not yet prepared its work plans for GOI sanction and has only been provided with a modest initial operating budget.

Nonetheless, the JAC is now operational. Directors and staff members in both Ministries are optimistic and feel that it will play a positive role in agribusiness development, particularly in regard to rural based firms. Although so far very little has been done to develop specific agribusiness support programs within the two action agencies that oversee the JAC, there are expectations for extending to the agribusiness sub-sector some of the program functions that particularly the MOA has previously been extending to the primary producing sub-sector. Such functional areas that appear to be most important to agribusiness in general and to the agroprocessing industry in particular include: (i) policy formulation and implementation; (ii) regulatory interventions; and (iii) service functions.

While many other government ministries and agencies could be involved in these three functional areas, it is worth noting that the highly successful agribusiness development in the U.S., which Indonesia would like to emulate, has long had a heavy involvement of the U.S. Department of Agriculture (USDA). The USDA has been extensively involved directly through its own price support, subsidy and service programs. Indirectly, the USDA also exercises considerable influence on legislative action, policy formulation in the Executive Branch and on program implementation in relevant, non-agricultural departments such as Commerce, Interior and the Environmental Protection Agency. Given the successful U.S. example, and since we are looking for areas of comparative advantage for USAID's agribusiness involvement in Indonesia, the focus in this chapter will be first on what role Indonesia's MOA does and/or can play directly. Second, in cases where a program is centered elsewhere (e.g. in, the MOI, MOC or BULOG), that function can be further examined to see if it can be favorably

impacted, either from within the respective agency or indirectly by the MOA

Policy Formulation and Implementation

As noted above, the most direct and only major action so far to implement the GOI's new agribusiness policy for REPELITA-V, was the Joint MOA/MOI Ministers' Decree of April 25, 1989. One of its internal directives was that Commission's Steering Committee would be chaired by the Junior Minister of Agriculture. This action has been interpreted in some circles within the GOI and among some of the donor agencies as a signal that the MOA is to take planning leadership for rural agribusiness development. Nonetheless, it is clear from the Joint Ministerial Decree that GOI program action responsibility will be shared primarily by the two ministries. Earlier, there were indications that MOT representation would be added to the JAC but this has not been done. At the provincial level, however, the Decree called for the formation of formal Provincial Working Groups chaired by the Governor in each province. Along with membership from Agriculture and Industry, Trade is also represented in some cases in these provincial level committees. These Working Groups are being used by the JAC for their provincial contacts. Organizational charts for the JAC and the Provincial Working Groups are given in Annex D.

It is still too early to firmly identify all of the agribusiness policy implementing agencies. It appears, however, that the MOA will emerge with a dominant role and that the MOI will also certainly be a major actor. Perhaps the MOC could emerge as a major player as well, given its direct linkage to many farmers whose small unit outputs will have to be mobilized in order to provide adequate raw material supplies for agroprocessing plants. It is also important to note that the GOI has stated a policy of further strengthening cooperatives and other farmer groups during PELITA-V. Therefore, their potentially strong ties to the emerging agribusiness sub-sector cannot be discarded out of hand by donors, in spite of the poor image that government mandated KUD cooperatives have at the present time.

The MOT also will have some direct but more limited involvement in policy issues. Some members of the MOT have argued that their Ministry should be added to the Joint Committee on Agribusiness and chair it because they represent a "neutral" position and thus would offset the vested interests of the Agriculture and Industry Ministries. Nonetheless, that is highly unlikely so Trade's role will probably continue to be limited primarily to those policy areas related to its licensing and related regulatory functions.

BULOG continues to hold the most powerful regulatory control over parts of the agricultural sector. However, there are now indications that its role will soon be diminished, except in rice and sugar, rather than extended directly into more crops and into agroprocessing (5).

For the longer term, Tabor, et al (1989) may well turn out to have been correct in their recent forecast that:

"Finally, as the 1990's (decade) wears on, agricultural policy will increasingly slip away from the agriculturists. It should come as no surprise if agricultural policy is primarily the domain of the Ministry of Finance and key industrialists by the turn of the century. As the 1990's proceed, agricultural interests will be increasingly subordinated to special industrial interests in order to facilitate a more rapid industrialization and structural transformation of the economy. There are signs of this with the export bans on plywood (sic. logs) and raw rattan in the 1980's. Tradeoffs between raw material producers and downstream processors will become increasingly acute as the economy industrializes and liberalizes."

While major policy announcements are made directly by the President, the primary policy formulation agency is BAPPENAS. The primary internal players for making agricultural policy are the Head and staff of the Bureau of Agriculture and Irrigation (BAI). It is not yet clear where in BAPPENAS the agribusiness policy formulation responsibility will finally be located, although it appears that it will also be given to the BAI. At present the State Minister for BAPPENAS is also taking a personal interest in policy formulation for the emerging agribusiness sub-sector.

In the meantime, the Ministry of Agriculture has requested the World Bank to do an updated agribusiness sector study, based on its earlier unpublished general agricultural sector study. The new study would include development strategy recommendations for agribusiness. After some delay, following an initial rejection by the IBRD of this request in early 1989, it is now again under active consideration. There are some indications, however, that BAPPENAS, while now supporting the need for such a study, may request one of the other donor agencies to do it. In part, this is because the World Bank is beginning to curtail its agricultural loan programs. Another reason is that for economic and policy studies BAPPENAS increasingly prefers input from U.S. specialists.

Regulatory Interventions

Dr. Chairil Rasahan noted in an annex to the recent FAO/UNDP agricultural policy options report that usually just one of three

major reasons cause governments to attempt to regulate their economies, but all three reasons are important in Indonesia. He identified them as follows (1):

..... First, because they may really be needed in order to provide justice and equality for society. Second, because one or more interest groups who have influence will use their positions to create a law or regulation in order to protect or enhance their positions of power. Third, because the regulation itself could create an income stream or create economic rent for an individual or group of individuals who have access or influence for creating such a regulation.

The history of imposing regulatory controls on agriculture in Indonesia and why it remains the most regulated sector is embodied in the above quote. Yet, some deregulation measures that at least indirectly effect the agricultural sector have been taken in recent years. It is important to understand, however, that such actions were not necessarily taken of its own free will. Rather, the large drop in oil prices during 1985/86 forced the GOI to look elsewhere for revenues to finance its development programs and to service its foreign debt load. Achieving growth in non-oil exports, including agriculture, was the only option available. Whether or not the option is viable in the longer term will depend on whether the selected deregulatory measures will sufficiently spur private investment and participation in this sector. But the effect is not the same as if the motive had been to help the private sector expand just because this is a "good" thing to do for it.

Entrepreneurs are well aware of this and so many of them are tending to delay taking investment risks. In part, this is because there is a feeling that, should oil revenues recover sufficiently, the GOI might again impose tighter regulatory controls on the private sector. Nonetheless, overall, most of the non-oil sectors are responding reasonably well to selective deregulation. A noted exception is in the agroprocessing component of the agribusiness sub-sector where value-adding expansion of exports is only now really getting started.

Although agricultural commodities do contribute the largest export value share of non-oil exports, in 1987/88 for example, this amount was actually lower than the amount achieved in 1983/84 before all the deregulation efforts began. In part this reflects the fact that recent deregulation efforts have been concentrated primarily in the banking, trade and industrial sectors. It appears that, before the agribusiness sub-sector can fully participate, further reduction in barriers impacting agroprocessing and distribution will also have to be addressed. Many of these barriers were established in the late 1960's and early 1970's in order to insure that an overriding food self-

sufficiency objective would be met. These production and marketing controls have now largely served their original purpose. They might well make way now for a freer interplay of market forces of the kind that a major expansion of the agribusiness sub-sector will require. Ideally, such issues would now be under intense policy review and implementation by the GOI but, unfortunately, this is not the case.

Some Government created institutions and organizations that were formed to support the earlier food security policy objectives are still very much alive and are seeking ways to maintain their power. Examples include the agricultural parastatals now run primarily through the MOA, the monopoly role in rice and other major food commodities held by BULOG and even the BIMAS program for distributing credit and other inputs indirectly controlled through the MOC. Such vestiges of an earlier era are by their very nature not going to be responsive to a free market oriented development of the agribusiness sub-sector. Several donor agencies have noted that further deregulation adjustments in the agricultural sector would be desirable and should be made quickly. But no further deregulatory action have been taken in recent months.

The fact remains that policy decisions for dealing with this issue can only come from within the GOI and only when it is ready to do so. The continued delay is not just a matter of government decision makers "not understanding the problem." For example, Dr. Saleh Afiff, State Minister for BAPPENAS selected agribusiness as his topic when addressing the 1988 Masters of Business Administration graduating class of the Indonesian Institute for Management Development in Jakarta. He stated in part (6):

".... Rising domestic incomes and foreign markets could stimulate a significant diversification of Indonesia agriculture into high-valued crops and animal products. However, the existing regulatory framework is not conducive to speed this process efficiently. In addition, inefficient domestic marketing systems prevent farmers in receiving the market signals on what consumers, domestic or foreign, really want. To alleviate these problems deregulation of the agricultural economy is a necessary condition."

Given the above, it would appear that the continued delay in further GOI action to deregulate agriculture underscores the political power of those agencies and even individuals who would lose much from such action. Since this is a fact of life in Indonesia, it must be taken into account when designing donor assistance projects for the agribusiness sub-sector. It also explains why some donors are moving outside of the traditional agricultural agencies and some are seeking ways to channel funds and technical support directly to private sector entrepreneurs.

This may well turn out to have been an appropriate strategy, provided such efforts are not discredited in the future by the reemerging anti-conglomerate backlash, or if the GOI, through BAPPENAS, unduly delays the further deregulation of the agricultural sector.

Service Functions

The timeworn slogan of all good capitalists, "Government serves its constituents best when it governs least", is certainly relevant to modern-day agribusiness development in Indonesia. There are a number of service functions, however, in which Government has a comparative advantage or which are not profitable to the private sector involved in the agricultural sector. This discussion will focus primarily on three of the most important - education, research and knowledge dissemination. But there are many others as well, including some forms of regulation such as safety, health and quality standards.

The agriculturally-oriented education, research and information dissemination functions were developed initially in Indonesia to service only the primary (producing) sub-sector. This was appropriate policy at the time because these producers also constituted by far the largest consumer group. While this will soon no longer be the case, the fact remains that over 75 percent of the population still lives in rural areas. And, although almost half of this rural group may no longer work in agricultural production, they will likely have to receive employment from agroprocessing and related agribusiness activities for some time to come.

In the U.S. as in most agricultural-based, developed countries, the above listed agricultural services are now also being provided to participants in the agribusiness sub-sector. The problem, of course, is that in Indonesia they are still geared to serving only farmers in the primary sub-sector. The MOA administrators do not appear to be all that convinced that their efforts should be extended to encompass the agribusiness sub-sector. But, while this situation presently is viewed as a problem, for the future it also becomes an opportunity and this seems to be the view of the JAC. This is one area in which USAID support efforts could well have a comparative advantage, given the U.S. experience with successfully providing services to its agribusiness sub-sector within its Land Grant University/USDA System. Therefore, some comments on the unique aspects of agricultural educational, research and information dissemination through Government are in order.

As Indonesia moves toward an agribusiness oriented agricultural sector, it can benefit for a reorientation of

priorities and deliverables in those agricultural education, training, research and information dissemination systems being provided as government services. That is not to say, however, that some aspects of all three of these will not emerge directly in the private sector, as indeed they have in the U.S. What is important to remember, however, is that all such private efforts are indirectly dependent upon some government provided educational and basic research services. Therefore, both public and private support needs should be considered as an Agribusiness Support Project is developed by USAID.

1. Education

Indonesian agricultural universities are structured quite similarly to U.S. Land Grant Universities except that there are no Extension specialists that have faculty appointments. They share a common objective to educate scientifically trained manpower in a number of disciplines important to the agricultural sector, along with some shorter term training that is now increasingly in demand. In the U.S, the universities did respond, although somewhat belatedly, to changing agricultural manpower needs during a period of rapid growth of its agribusiness sub-sector after World War II. In Indonesia, however, where an agribusiness sector is only now rapidly emerging, such adjustments in manpower education programs have not yet taken place but will be needed soon.

The U.S. experience is very relevant to what is now happening in Indonesia. For example, in the U.S., the first major post-war change was in the discipline distribution of graduates that strongly reflected the overriding manpower demands of agribusiness firms. While most of the graduates in highest demand were in managerial, analytical, economics and business areas, there has also been a growing demand for specialized scientists in such areas as tissue culture and genetic engineering.

Most of the U.S. graduates in agricultural economics now go to agribusiness firms or to government jobs that provide support services for the agribusiness sub-sector. In some departments, up to 75 percent of total graduates follow this career path. It will be some time before such drastic changes will occur in Indonesia but it is not too early for their universities to begin making some curriculum changes. USAID has long provided financial support for Indonesian graduate education and could now perhaps investigate options for helping to affect changes in undergraduate programs as well. It is at that level where most of the job opportunities will first develop in Indonesia's agribusiness sub-sector, particularly within private firms.

The agribusiness sub-sector in Indonesia will also generate a large demand for short-term training. Such non-degree training activities can range from simple one-day seminars through short to long duration workshops and can include up to year-long special graduate programs abroad. While U.S and Indonesian universities have greatly expanded their efforts in such activities, they are not their sole domain. Government agencies, non-profit organizations, individual private firms and various business associations are also heavily involved, particularly in the one-day seminars and short duration workshops. There is a wide range of topics that can be offered that would be of benefit to the emerging agribusiness sub-sector, including, for example, plant sanitation, business management and international marketing. Funding such training programs could present yet another avenue by which the USAID could provide a needed and valuable technical assistance input.

2. Research

There are two major types of government sponsored research activity that will directly facilitate more rapid and efficient agroprocessing development in Indonesia. These are: (i) basic and applied research directed to farmers so that their product outputs can have more of a market orientation in terms of both quantity and quality and (ii) research geared directly to managers of agroprocessing firms which can range from commodity oriented feasibility studies to domestic and international marketing studies for individual product lines.

Almost all of the research included in category (i) will continue to be carried out by the Agency for Agricultural Research and Development (AARD) in the MOA. Some applied field testing will gradually increase in the private sector, along the lines already underway by the PUSPETA cooperatives in Central Java. As to the research to be conducted under category (ii), more of it will be of an applied nature and therefore a lower percentage of the total will likely to be done by Government ministries, particularly within the MOA.

One exception in which a major government sponsored program will likely develop is in the agribusiness oriented research that falls within the discipline of agricultural economics. These studies can range from farm enterprise business analyses to many of the items under category (ii), including commodity sector type feasibility studies and international market analyses. Such kinds of studies are already underway in the Center for Agro-Economic Research (CAER) of the AARD located on the agricultural university campus in Bogor. Some are being done under contract by agricultural economics and economics faculty at several other universities. Such research could easily be expanded if

additional funding were provided, as most of the research centers and universities have highly educated staff, many with Ph.D. degrees from the leading U.S. universities. It does not appear likely that the ministries other than Agriculture will be developing much of a research program in the areas of economics and management of agribusiness firms.

Some of the government sponsored studies will be successfully bid for by private consulting firms, many of whom employ university and government personnel on a part-time basis. To the extent that the private sector will increasingly sponsor research directly when proprietary information is desired, private consulting firms will either get the business or the larger firms will simply hire the necessary personnel and do such work in-house.

Some short-term, policy issue oriented studies affecting agribusiness development will be carried out by staff in the newly established Task Force on Agricultural Policy Analysis (TFAPA). This new research unit represents an implementation of one of the major recommendations of the FAO/UNDP Policy Analysis Team which submitted its report in January, 1989. Initially this group of young, highly trained agricultural economists will be used primarily as staff support for the JAC. This Task Force can also commission some special studies of mid-term duration to outside consultants and university faculty. For example, a feasibility study of applying the BIMAS approach to non-rice food crops is being carried out by the Research and Economic Development Center at Gadjah Mada University in Yogyakarta. Another recently approved study but which is not yet underway is a feasibility study of the role of contract farming in developing the agroprocessing industry in rural areas. It is anticipated that most of the Task Force's commissioned studies will be carried out by private consultants. Some funds for the Task Force's research agenda is another area in which USAID could perhaps provide some assistance as part of an Agribusiness Support Project.

Much of the basic research and some applied research needs in support of agribusiness development can most efficiently be provided as a service function by the MOA and MOI. One of the primary functions of the JAC would likely be to coordinate the placement of infrastructure in relationship to the agricultural potential of each location. In addition, it appears that the JAC will first have a coordinating function, and then an education function, but that the line ministry offices would do the actual work.

On the other hand, many kinds of applied research studies now desired by the private sector are not a proper function for government researchers. For example, the GOI should not conduct feasibility studies for establishing local agribusiness firms, nor recommend that the necessary licenses for such ventures be

granted, even if the development plan is found to be economically feasible and consistent with regional development and environmental plans. Studies that would benefit individual firms cannot be justified for the use of government funds and personnel. Such narrow, micro-level issues would represent a poor use of the Task Force's scarce manpower and budget resources in any case because there are many more important macro-level policy issues to which to direct their efforts.

This JAC example points to a potential problem area for agribusiness research in general, however, in terms of where to draw the line between public and private research responsibilities. In terms of USAID funding support, both areas may be appropriate but USAID involvement will likely have to be determined on a case by case basis. Particularly in the private sector component, care must be taken to insure that the USAID-funded research efforts are truly "firm neutral," i.e. that the results do not become proprietary property of individual firms or potential investors.

3. Information Dissemination (Extension)

At least in the farmer-oriented information dissemination system, commonly known as extension services, it follows that little reorientation of this effort can be done ahead of the reorganization of research programs as proposed above. In the absence of a total reorganization of the MOA, however, as advocated recently by Tabor, et al, which will not likely happen in the short-run, the MOA's national level extension programs will continue to be split into a series of mini-services run by individual director generals. For agroprocessing extension needs, however, this could be an advantage since only a few directorates would be involved, notably fisheries and horticultural crops. It should be easier to revamp the extension programs in selected directorates than to try to revamp the total extension system.

According to discussions held with shrimp processors near Surabaya, a desirable reorientation in fisheries extension is already underway. They reported that the fisheries extension people are readily accessible, are up to date in their knowledge and have put the processors in direct contact with fish researchers at the agricultural university in Bogor and even with some faculty researchers in U.S. Universities. The Export Support Board was able to accomplish this by covering the travel and per diem costs and in some cases providing small honoraria for participation in industry sponsored workshops. The recent successful USAID-funded shrimp industry workshop in Surabaya, which included government researchers and extension personnel, is a case in point.

Another innovation to consider is the use of joint appointments for agribusiness oriented research and extension workers. This approach would allow for a highly trained research specialist to provide his own extension dissemination on request over a wider area than territories normally assigned to extension workers. A less effective but more costly alternative is to try to partially upgrade a large extension group to provide a service for which the initial demand will be small and widely dispersed. The joint appointment approach has been used successfully for providing services to agribusiness interests by U.S. universities and could perhaps be adopted in Indonesia as well. An ideal place to start would be with agricultural economics researchers in the CAER unit of AARD located at the agricultural university in Bogor. A pilot effort of this sort could also be considered as part of a USAID-funded Agribusiness Support Project.

Some of the most effective information dissemination will likely be done directly in the private sector as is already being done in the U.S. and elsewhere. For farmers, this most often is part of the sales pitch of fertilizer and other input suppliers. In Indonesia this was demonstrated by an input supply firm visited by the ACA Team in Surabaya. At the processing level, such efforts will likely include several channels, ranging from use of equipment suppliers to the activities of chambers of commerce and export promotion organizations. Clearly, USAID could provide technical assistance in this area. As with the research function, however, the selection of appropriate "firm neutral" targets of opportunity will have to be done on a case by case basis.

4. Other Services -

There are, of course, a number of other appropriate government services for agribusiness that can better be provided by ministries other than the MOA. For example, during the field work phase, a number of private sector agroprocessing entrepreneurs pointed to a lack of reliable and timely market information. They also called attention to a general lack of incentives that could be provided through preferential tax and licensing procedures during their early development stages. Clearly, such services could be provided through appropriate ministries if the GOI chose to do so. Such efforts would certainly merit USAID and other donor agency support.

Conflict Resolution and Strategy Development

Among some GOI planners a myth has developed that merely by deregulating some parts of the constraints in the private sector, this would lead to a restructuring of the agricultural sector so that a well balanced agribusiness sub-sector would somehow automatically emerge. This myth was further reinforced when deregulation of banks and licensing and other restrictions to industry and trade was carried out during the past two to three years. In reality, however, agribusiness ventures have received relatively few benefits other than some improved credit opportunities and relaxing of some barriers to export. GOI planners and policy makers have only begun to face up to the fact that agriculture remains the most regulated and controlled sector in the economy. Even though most of this impacts on the production sub-sector, this limits the quantity and quality of raw product supply which is constraining agroprocessing development in rural areas.

At the present time, the GOI has some broad political aspects of an agribusiness policy in place but it certainly does not yet have an agribusiness development strategy. Without such a strategy, the roles of the respective ministries and other government agencies responsible for policy formulation, determining what regulatory measures should be retained or added and what services to agribusiness should remain a Government function cannot be fully resolved. As a result, there is still considerable in-house debate going on about which GOI agencies should do what. Therefore, it has been extremely difficult for the donor community to respond effectively to the GOI's request for technical and financial assistance for its agribusiness development.

The necessary first step to resolve this dilemma is for a donor agency to carry out a comprehensive sector study which would include detailed strategy design recommendations. The World Bank has a well deserved reputation for its sector studies. A request for such a study of agribusiness from the Junior Minister of Agriculture is now under consideration.

Should the IBRD decide not to do such a study or if BAPPENAS withholds its support for a World Bank study, then other donors, including USAID through its ARSSP, may have an opportunity to fill the breach. In the meantime, the internal GOI discussions regarding the control of the agribusiness sub-sector versus retention of power associated with the status quo are very real and likely to continue. Until a clearer picture emerges of who will control what within Government, USAID should keep some of its options open as it begins to engage in initial agribusiness development support efforts.

CHAPTER V.

DONOR AGENCY SUPPORT PROGRAMS

The following review and analysis of donor agency activity in Indonesia's agribusiness sub-sector should be of interest to USAID, primarily for three reasons. First, such information can help the agency avoid unnecessary duplication. Second, USAID can assess the significance of GOI signals for projects in the agribusiness area already given to other donor agencies. Finally, gaps in the total technical assistance picture for agribusiness revealed by this analysis, and there are many, can be compared to the USAID's perceived areas of comparative advantage.

Official development assistance to Indonesia is largely provided by the members of the Inter-Governmental Group for Indonesia (IGGI). There are 13 countries who hold membership in IGGI, and four additional countries hold observer status. Yet, the bulk of the bilateral technical assistance and funding is provided by only five countries -- Australia, Canada, Japan, Netherlands and the USA. Multilateral members of the IGGI with major programs in Indonesia include the World Bank or International Bank for Reconstruction and Development (IBRD), the Asian Development Bank (ADB) and the United Nations Development Programme (UNDP)

Current Agribusiness Oriented Projects

According to the latest UNDP Annual Report, Development Cooperation: Indonesia, (7), the total amount of new and firm commitments of externally financed concessional assistance to Indonesia in 1988 was approximately US\$ 4.3 billion. This was a 26.7% increase over the 1987 level of US\$ 3.4 billion. The Development Cooperation report desegregates these commitments by project categories and lists all individual projects by title. Unfortunately, this UNDP report does not separately identify agribusiness support projects within a set of 16 "sectors" included in its project classification system. Since individual projects are listed by titles, however, a search could be made of all funded projects. As a result, however, only seven on-going projects and five projects in the funding pipeline were identified (See Annex B). Funding sources for these 12 projects included only one bilateral agency (Belgium), two United Nations agencies (UNDP and FAO), two multilateral agencies (Asian Development Bank and the Commission of European Communities), and three small non-governmental organizations. Discussions with the major donors turned up a list of 15 additional agribusiness projects that are now in the planning stage (Annex B, part 3).

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An additional review of program priority statements of the donor agencies, also presented in the UNDP Development Cooperation report, revealed that many of them have objectives that fall outside of potential program areas that would possibly support future agribusiness programs, (i.e such as in environmental, health or human resource projects). The remaining agencies whose program statements in the UNDP annual report indicated potential support, along with relevant future funding plans for agribusiness projects now in various stages of implementation by some of them, are summarized in the following sections:

Bilateral Assistance

1. Australia. Australia's programme of technical and economic cooperation with Indonesia during the year ending 30 June 1988 amounted to approximately US\$ 60 million, sixty percent of which was in grant form. Australia's programme is focusing increasingly on Eastern Indonesia in a number of sectors including agriculture. Future funding plans, however, do not include separate agribusiness support projects at this time.

2. Canada. It has no agricultural or industrial projects now and no plans for agribusiness projects in the future.

3. Federal Republic of Germany (FRG). The FRG development cooperation aims to improve the living conditions of the needy in rural areas on the one hand and to contribute to the development of industry and trade in accordance with the priorities set forth in REPELITA-V on the other. Annual funding commitments of between US\$ 20 to 25 million are disbursed through its Technical Cooperation Program. For the foreseeable future, priority will be given to: (i) selected areas of rural and agricultural development; (ii) development of small and medium sized enterprises in selected industrial branches; (iii) environmental protection; and (iv) training.

There are now three agribusiness oriented projects in the planning stage. Two of these projects are under development with the Ministry of Industry; these are:

GTA 280. "Study for the Development of the Agro-Processing Industry", and

GTA-175. Development of an Agro-Based Industry -- Fruits and Vegetables."

The terms of reference for the latter project are very similar to those of a project under discussion with the Ministry of Agriculture, as follows:

ATA-438. "Improvement of Post-Harvest Handling of Secondary Food Crops."

The FRG would like to see the last two named projects combined. They have been talking about this separately with the two ministries instead of utilizing the services of the new Permanent Agricultural-Industrial Working Commission.

Another new project in the early planning phase, "Support for Agricultural Machinery Industries", will actually be phase II of an ongoing "Agricultural Innovations" project. The phase I effort has had some difficulties which are attributed in part to its funding and staffing by the FRG's Science and Technology Agency. For phase II, however, it will be taken over as a technical assistance agency effort. The intent of this project will be to establish a machinery institute with membership from both government agencies and private agribusiness firms. The private firms' membership fees would be totally subsidized initially and then the institute would gradually be made self-supporting by the private sector. This "institute" approach has been very successful in the FRG and it is hoped that this success can be replicated in Indonesia.

4. France. It has no agricultural or industrial projects and no plans for agribusiness projects in the future.

5. India. Same as for France.

6. Italy. The budget for total development aid is very modest and no new agribusiness projects are indicated. Some joint agribusiness ventures by private Italian firms are under consideration however.

7. Japan. Japan is the largest single source of donor credit, technical and capital assistance for development projects in Indonesia. During 1988, Japan's total contribution of US\$ 1.65 billion through its Japan International Cooperation Agency (JICA) desegregated as follows: US\$ 1.58 billion for capital grant assistance and only US \$72 million in technical assistance grant disbursements. In addition, Japan provided the equivalent of US\$ 1.54 billion in concessional lending through its Overseas Economic Cooperation Agency (OCEF). Japan currently places priority on the following areas: (i) development and improvement of infrastructure, including inter-island transportation; (ii)

promotion of non-oil exports; (iii) development of human resources; (iv) development of small and medium scale enterprises; (v) development of agriculture and fisheries; and (vi) development of energy.

On September 11, 1989 Japan signed an ODA loan of 17 billion yen (US\$ 116.3 million) for the Bank of Indonesia in a Private Firms Credit Project which was designed specifically to promote the development of Indonesia's emerging agro-industry and the export of non-petroleum products during PELITA-V.. These monies are being provided for on-lending by State and private banks through their PBSN subsidized credit schemes to private national estates. No technical assistance is provided for in conjunction with this loan.

8. Netherlands. Most of the Netherlands' financial support is provided through a "Country Programme." For 1988, the programme ceiling was at NFL 182 million (US\$ 95.8 million) and the ceiling continued at the same level for 1989. These funds were directed primarily to block grants and concessional loans. In addition, however, during 1988 NFL 50 million was made available above the country programme ceiling. Some NFL 147 million of the total funds available were earmarked for project-oriented aid and concentrated in six priority program areas including agriculture and rural development. In addition to the country programmes, some NFL 90 million (US\$ 42.9 million) for aid is channeled to industrial development, rural development, education, research and miscellaneous activities. Overall, a very high proportion of total financial assistance is earmarked for local cost financing for support of development projects partially funded by other donors.

Two agribusiness oriented projects are now in the early planning stage. They were identified as follows:

"Project for Standardization of Quality Control for Agricultural Export", (for the Ministry of Trade), and

"Small and Medium-Scale Food Processing Industry", (for the Ministry of Industry).

Some agribusiness oriented activity is also being included in some of the newer rural development projects, particularly marketing. These projects are located in selected provinces in Sumatra, Western Java and Central Sulawesi. It is expected that agribusiness would get more emphasis in their future projects but would remain closely tied to improving conditions in rural areas.

9. New Zealand. Its technical assistance program is rather modest, totalling only US\$ 1.67 million in 1988, and with less than a third of the total in the agricultural sector. The only agribusiness related project in the funding pipeline is one dealing with abattoir development. No new agribusiness projects are in the planning stage.
10. Spain. It has no agricultural or industrial projects and no plans for agribusiness projects in the future.
11. Switzerland. Same as for Spain.
12. United Kingdom. Same as above.
13. United States of America. During 1988, the USA, through its Agency for International Development was the largest single donor to technical assistance support for Indonesia. It contributed US\$ 97.7 million, compared to US\$ 73.3 for second place Japan. Its total development support fell far short of Japan's, however, because the USA is not a major player in the capital assistance arena.

According to the UNDP Development Cooperation program report the 1988 USAID program statement showed a definite movement away from the strong sector orientation and high priority for the agricultural sector identified in previous years to one with more of a functional and policy emphasis. Nonetheless, actual funding disbursements during 1988 continued to show a strong sector orientation and with a continuing high priority given to the agricultural sector. Specifically, about 84 percent of total funding was allocated to only three of the 16 sectors in the UNDP classification system.

The allocations were as follows:

| | | |
|--|--------------|--------|
| General Development Issues, Policy and Planning | \$33,223,000 | 34.0% |
| Agriculture, Forestry and Fisheries | 33,967,000 | 34.8 |
| Health | 14,600,000 | 14.9 |
| Sub-totals | (81,790,000) | (83.7) |
| All other sectors | 15,913,000 | 16.3 |
| <hr/> | | |
| Totals | 97,703,000 | 100.0 |

It is likely that future funding levels will more closely follow the functional focus outlined in the current Indonesian Country Development Strategy Statement (CDSS). After all, USAID is still in the first year of the period covered (1989-93) and it takes time to reorient programs and funding priorities. Suffice it to note that a new agroprocessing support project would likely contribute significantly to the employment and income generating objectives which are given high visibility in USAID's current CDSS.

Multilateral Assistance

1. United Nations Development Programme (UNDP).

The UNDP is the primary United Nations agency concerned with agricultural development in its member nations. Technical support is provided for projects in 13 of the 16 sectors included in its project classification system. The largest category is the agriculture, forestry and fisheries sector. During 1988, it accounted for US\$ 4.17 million or 16 percent of its total disbursement of US\$25.94 for technical assistance projects. The UNDP is presently in the last year of its Third Country Development Programme (1985-89). An agricultural policy analysis team was fielded by the UNDP in October 1988 to assess new program requirements within the agricultural sector and it submitted its report in January 1989. Among other recommendations, the review team called for: (i) recognition of and support for the emerging agribusiness sub-sector; (ii) acceptance of a service responsibility for this sub-sector within the Ministry of Agriculture; and, (iii) give high priority to agribusiness project support by UNDP and other donor agencies.

Long term agribusiness support projects did not emerge in the UNDP pipeline during 1988 or 1989, although two short-term project design efforts were included. During January 1989, an FAO Programming Mission prepared an assessment of the Third Country Programme and presented recommendations for the Fourth Country Programme (1990-94) (8). For the first time, a separate program focusing on agribusiness was identified as one of five priority program areas for implementation starting in 1990 under the Fourth Country Programme. It appears that this was the first of the new donor development program plans in support of REPELITA-V to give agribusiness projects a separate program category.

The UNDP programming mission made two sets of agribusiness technical support recommendations. These were: (i) suggested areas of expansion for assistance by other interested donors and (ii) priority activities for UNDP/FAO assistance.

The suggested areas of agribusiness oriented expansion for general donor assistance included support for the Ministry of Agriculture in the following areas: (8)

(i) Priority should be given to formulating a viable agribusiness development strategy, taking into account regional variability in response capability and national and international market absorptive capacities.

(ii) An agribusiness research and analytical agenda that includes structural analyses of agribusiness commodity systems, policy impact analyses, feasibility studies of processing technologies, export feasibility analyses and micro-level feasibility analyses of new agribusiness ventures in rural areas should have a high priority in the Ministry of Agriculture.

(iii) Related changes in the extension services should shift from basically an agronomic focus (that was) primarily on rice and other selected food crops to a more integrated horizontal and vertical diversification objective and to an overall enterprise management technical support service for farmers and operators of small agribusiness firms.

(iv) Formulation of a special Agribusiness Investment Priorities List for inclusion in the annual investment list of the National Investment Coordination Board.

Agribusiness project activities recommended for direct UNDP and/or FAO technical assistance in support of REPELITA-V were rank ordered, as follows: (8)

- (i) A Review of the Agribusiness Sub-Sector, its Current Status and Development Strategy.

(Note: A design team prepared a project document for this effort during early 1989, titled "Expanding the Role of Private Sector in Agribusiness Development, with a proposed 20 months of technical manpower input and a total project budget of \$240,000. This is one of the sector studies that would include developing recommendations for the GOI agribusiness development strategy that is presently under consideration by BAPPENAS.)

- (ii) Integrated Development of Selected Commodities Supporting Vertical Integration of Agribusiness Development

(Note: A request for proposals for one such vertically integrated commodity support project was circulated in mid-1989 and selection of a contractor is pending.)

- (iii) Creation and Support of an Agribusiness Promotion Center

- (iv) Improvement of Product Grading to International Standards

- (v) Development of Local Capability for Production of Fish Feeds, including Artemia

The recent visibility given to a new agribusiness program area by the UNDP/FAO program planning team has created considerable interest among some of the more agriculturally oriented members of the donor community. Primary reasons for this interest include UNDP's claim that their focus reflects GOI priorities for support in the agribusiness sub-sector and because UNDP has indicated that it would welcome opportunities for joint ventures with other donors in this new program area. In particular, it is noteworthy that the UNDP/FAO have indicated a strong interest in exploring a joint venture with USAID, given their successful previous joint efforts in manpower training and integrated pest management projects. Apparently this interest is in recognition of USAID's assumed potential comparative advantage in supporting the technical and managerial aspects of agribusiness ventures in the private sector.

2. Food and Agriculture Organization of the U.N.(FAO).

Although FAO is not a major development assistance funding agency, it houses a large multidisciplinary group of agricultural scientists. These personnel staff a few small FAO-funded technical assistance projects but mostly staff and/or manage UNDP projects and some of the projects of the other multilateral donors. FAO's main partners in Indonesia are the Ministries of Agriculture, Forestry, Cooperatives, Transmigration, Population and Environment, and Public Works. It also works directly with selected agricultural universities and research stations.

During 1988, FAO provided direct technical assistance for five projects funded from its own resources under its Technical Cooperation Programme (TCP) but with a total budget of only US\$244,000. In addition, however, FAO executed 18 UNDP financed projects, in which other donor governments financed projects through FAO. During 1988 and 1989, FAO fielded agricultural policy and UNDP programming planning missions. These review teams made recommendations that called for giving high visibility to the emerging agribusiness sub-sector. While FAO will likely manage some of the new UNDP-funded agribusiness projects, no new agribusiness projects with direct FAO funding are presently in the planning stage

3. International Bank for Reconstruction and Development (IBRD).

The IBRD, popularly known as the World Bank, has over the last 20 years lent to Indonesia a total of about US\$ 12.6 billion. These funds were desegregated into 177 projects but only 29 percent or US\$ 3.7 billion was provided for projects in the agricultural sector (including irrigation). At present there are 74 Bank-financed projects under implementation, with an undisbursed balance of US\$3.25 billion remaining from previous Bank commitments. During 1988, the Bank approved nine loans totaling US\$ 1.1 billion.

Although the Bank engages in some small technical assistance efforts, all of their support in Indonesia is reported as capital assistance. Sectors of major involvement that are of potential interest for support to agribusiness projects include (02) General Development Issues, Policy and Planning, (04) Agriculture, Forestry and Fisheries, (05) Industry, and (07) International Trade and Development Finance. Of these sectors, the largest funding area, by a large margin, is (07) while the smallest is (04), including irrigation projects.

Unlike most of the other major donors in Indonesia, the Bank until very recently has not evidenced a strong interest in the

agribusiness sub-sector. Even its present interest appears to be largely confined to offering to do a centrally financed (non-loan) agribusiness sector study. This would likely be an update on an in-house study of the total agricultural sector. The Ministry of Agriculture had first requested this study early in 1989 but the Bank's central administrators had turned it down at that time. Now they have indicated that if agreement on terms of reference could be reached quickly, central funds could still be made available this fiscal year. Whether this new development reflects a change in Bank policy and what BAPPENAS' reaction to such a proposal will be are not clear at this time.

4. International Fund for Agricultural Development (IFAD).

While not previously active in the agribusiness sub-sector, this agency is a potential source of credit for agribusiness activities. To date, it has only approved five loans to Indonesia for five projects which totaled US\$ 111.0 million. These have been in projects covering irrigation, livestock and general credit sub-sectors. In the latter case, credit could easily be earmarked more directly for agribusiness activities.

5. Asian Development Bank (ADB).

The ADB has been involved in technical assistance in Indonesia since 1967 and since then has funded 152 projects with total funding of US\$ 33.4 million. Loan operations of the ADB only started in 1987 but as of 31 December, 1988, the ADB had approved 133 loans totaling \$US 4.9 billion. Indonesia is presently ADB's largest borrower. The largest single category of lending is the agricultural sector, including irrigation, production and agribusiness projects, with a little more than a third of the total budget.

One of the first ADB projects with a large agribusiness component was its Brackish Water Aquaculture Development Project that was funded in 1985. The ADB gave further strong visibility to the emerging agribusiness sub-sector with a US\$30 million loan for agro-industries that was activated in 1988. Additional projects with agribusiness components are in the planning stage. Due to the nature of its overall strategy for support of Indonesia's development programs, however, the ADB is not likely to become a major supporter of agribusiness assistance projects through its loan and technical assistance projects in the non-agricultural sectors. But, it will likely continue to support agribusiness oriented projects within its agricultural sector program.

The ADB is nearing completion of an internal study leading to an articulation of the Bank's new development strategy in support of REPELITA-V. The final study report is still under review and therefore unavailable. But it is reported that recommendations include a call for an expanded ADB focus on the agribusiness sub-sector and an increase in technical assistance support for its various projects. If these recommendations are adopted, it is the intent of the local ADB Mission to provide such technical assistance under grants instead of via loans.

The ADB has recently approved funding for a "Second Brackish Water Aquaculture Development Project", along with expanded technical support for it. This project will continue with a strong emphasis on the vertical integration of the shrimp industry, including processing and export components. The ADB has no other agribusiness projects in the funding pipeline. This sub-sector will become much more visible in the more conventional agricultural projects. These include its overall Agricultural Sector Loan, the Java Dairy Development Project, the Livestock Sector Project and, indirectly, even its Fourth Irrigation Package. Finally, it is noteworthy that the ADB has retitled its agricultural program and now calls it the "Agriculture and Agro-Industry" package.

6. Commission of the European Communities (CEC).

The aid programme provided by the European Economic Community (EEC) is being financed within a framework agreement between the Commission of the European Communities and the Republic of Indonesia dating from 1982. Directly or indirectly, this programme has continued to focus on improved agricultural production encompassing crops, livestock and fisheries. A much smaller allocation of its aid budget has been utilized in connection with the trade and industry sectors, supporting such aspects as training, seminars and trade promotion. Agribusiness as a separate program area has not yet emerged. But there is one project in the planning stage that will be activated in 1990, entitled "Palawija Seed Production and Marketing." It will likely develop, however, particularly following the major policy changes in the European Common Market about to be implemented. The CEC should be of particular interest to Indonesia's agribusiness sub-sector because, along with Japan and the USA, the EEC membership represents a primary market for Indonesian agricultural products.

Non-Governmental Donor Organizations

There are a number of non-governmental organizations operating in Indonesia. Although they account for three small-scale agribusiness oriented projects in the pipeline, it is unlikely

that these agencies will emerge any large-scale agribusiness projects. And even if they wished to expand activities in this program area, the impact would likely be severely limited because their available funding levels are extremely modest.

Program Implications for USAID

While a number of donor agencies have indicated an interest in Indonesia's emerging agribusiness sub-sector, there are presently very few ongoing projects or even new ones in the funded pipeline. But there is increasing planning activity related to future projects underway, particularly in the UNDP/FAO, and by some of the bilateral agencies. At latest count, there are now 14 such agribusiness projects in the planning stage.

Within the bilateral component of the IGGI, countries representing potentially large export markets for Indonesia's agribusiness sub-sector appear most likely to develop viable agribusiness support projects. These include Japan, countries in the European Common Market and the USA. Japan is already particularly active in the credit area while the USAID is presently in the pre-project planning stage for a new agribusiness project. Within the EEC, such activity presently appears to be limited to the FRG, the Netherlands and Belgium but strong potential also exists in Italy's programs.

Among multilateral agencies, most of the agribusiness oriented interest and planning activity has been within the UNDP, primarily with technical expertise provided by the FAO, and in the ADB. The UNDP/FAO have limited budgets for supporting agribusiness projects but have evidenced interest in joint efforts with bilateral agencies. Of particular interest to the UNDP seems to be the USAID in recognition of its potential comparative advantage in providing expertise in the technical and managerial aspects of agribusiness.

The World Bank and the ADB, both with large agricultural sector programs, will continue to channel most of their financial support through lending for large-scale capital assistance and credit projects. The ADB has also shown a strong interest in the emerging agribusiness sub-sector, however, and may potentially provide more technical assistance through administration of its various projects in the agricultural, industry and trade sectors.

This change in direction would be in agreement with major recommendations to expand both agribusiness and technical assistance for such projects during PELITA-V contained in an internal ADB program strategy report now under review by the central administrators of ADB. The World Bank has shown little interest to date in the agribusiness sub-sector and has no such

projects in the loan pipeline. However, the Bank does have the potential to engage in comprehensive studies of this sub-sector as part of its ongoing economic and sector work carried out directly for central GOI policy makers. The ADB has also recently proposed to BAPPENAS that it begin to engage in agricultural policy dialogue, including agribusiness issues, as part of its agricultural sector loan. This proposal initially met with severe resistance from BAPPENAS, however, and until recently was still under negotiation.

Following the recent GOI requests to the donor community for financial and technical assistance for its emerging agribusiness sub-sector, most of the major donors (except the World Bank) now have such projects in the planning stage. But the GOI has not yet adopted an agribusiness development strategy and until it does, these uncoordinated support efforts will lack sharp focus and direction. The World Bank has the strongest reputation for carrying out sector studies that include recommendations for sector development strategy. The Ministry of Agriculture has requested IBRD to carry out such a study of the agribusiness sub-sector. This proposal is now again under consideration by IBRD and in BAPPENAS.

If the World Bank should decline this request, a second best choice for carrying out this needed study would be the current FAO/UNDP proposal. These agencies have a good reputation for carrying out objective (no ax to grind) policy studies. A third option would be for the USAID to carry out such a study as part of its ARSSP. Although BAPPENAS planners are generally suspicious of policy advice offered by bilateral donors, they are well aware that the USAID could field the best quality technical personnel for such an effort.

In any case, the proposed agribusiness sector study is badly needed now. An ideal situation would be achieved if the study were carried out either by the World Bank (as first choice) or by the FAO/UNDP (as second choice) in a joint effort with USAID, and with USAID providing the technical staff under contract. Until the GOI clarifies its agribusiness development strategy, however, the USAID should keep its agribusiness funding options flexible.

CHAPTER VI

ALTERNATIVE USAID SUPPORT OPTIONS

The agroprocessing industry is subject to numerous constraints, ranging from technical limitations, to regulatory constraints, transportation problems, and credit issues. Addressing the constraints in project form requires numerous different activities. Solving only some of the problems of the agroprocessing industry in isolation is only a partial solution. The purpose of this chapter is to provide suggestions on how to comprehensively address the seven constraint areas which were developed in Chapter III. Although the proposed activities are basically separable, it is important that they be coordinated within a comprehensive framework. Therefore, this question will be addressed, as well as how the project can be effectively linked with the GOI and the private sector participants.

Most of the activities discussed here will be aimed at providing services to the private sector. Doing so may be difficult for many reasons, the main one being that often some private sector companies can benefit overly much and others very little from some service activities. Distribution issues have been considered during the analysis phase and an attempt has been made to develop a program that has the flexibility to positively impact a wide range of the agroprocessing industry.

Political reality in Indonesia requires that donor funded technical assistance projects be coordinated with the GOI. In doing this for the Agribusiness Support Project, however, it is important that the private sector orientation of the project not be lost. As is shown in Chapter IV, there are numerous Government organizations that are involved in the agribusiness sub-sector, or that would like to become involved. Therefore choosing the right partner or group of partners is complicated. This chapter includes discussion about and provides some suggestions on the appropriate Government agency with which to become involved.

The proposed Agribusiness Support Project will be opening doors to the rapidly growing agroprocessing industry. The project therefore can also provide a vehicle to support U.S. trade and investment opportunities with the Indonesian food processing industry. Suggestions in this regard will also be provided in this chapter.

Finally, the recommended project related activities will be grouped into pre-project and in-project categories. Specific activities that will require coordination with and/or would be better done in existing USAID projects will be identified.

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Addressing the Constraints

Chapter III identified seven major constraint areas within the agroprocessing components. This section addresses potential activities for each of those areas. They will be addressed in the order of importance of the constraint within the sub-sector. The order of recommended implementation will be discussed in a later section.

1. Technical Agroprocessing Constraints

Chapter III identified numerous technical processing problems as the primary agroprocessing constraint. Most Indonesian food processors produce a poor quality, unwholesome product. This is because they do not understand and/or implement the principles of Good Manufacturing Practices. These principles concern basic company management, plant sanitation, quality assurance and quality control. As was mentioned in Chapter III, very few people in Indonesia, especially those in lower level positions, in processing enterprises are trained in these principles and practices. The result is usually a poor quality and often unsanitary product which is uncompetitive in the market place.

To address this problem, a program for training workers in the principles of Good Manufacturing Practices is needed. Such training is not just an Indonesian problem, it is one of worldwide importance. Training courses are given to food handlers on a constant basis in the United States and in Europe. Developing such a training component for Indonesians as a core activity of the Agribusiness Support Project is recommended.

In terms of content, the training courses should be geared primarily to lower level management and staff. Courses should be taught in Bahasa Indonesia and be no longer than a day or two. They should be applied courses, instructing the manufacturing plant personnel in such simple things as personal hygiene and cleaning techniques in a sanitation course, and the structure of a quality assurance program and a complementary quality control program in another. The capability to teach these courses in the plant is essential.

In terms of organization, USAID should not attempt to offer the courses itself. Rather, during the project design, different types of organizations which could be formed or recruited to deliver the training should be analyzed. One option for implementing the training program would be to organize an industry group that would establish a self-supporting institute devoted solely to training. Another option would be to merge the proposed

training program with one or more of the existing non-government operated training institutes already in existence.

One such organization to consider linking the training program with is Bina Swadaya (Badan Pengembangan Swadaya Masyarakat - Community Self Reliance Development Agency). It is self-supporting by offering its services on a fee basis. It already offers some training in agribusiness activities but not exactly the type described here. It could however, add them to its curriculum through a phase-1 "training the trainers" activity and the Director has indicated that they would welcome such an opportunity. The comparative advantage of this linkage would primarily be that it offers an existing infrastructure which could support the proposed program, both in Jakarta and through its nationwide network of training centers. It also publishes the "Trubus" magazine which could be used as an information dissemination mechanism.

Under either scenario offered above, assistance to an industry-supported Good Manufacturing Practices training organization could be provided, either self-contained or affiliated with an existing training organization. USAID could provide funding to such an organization in order to establish a curriculum, initially probably no more than four or five courses. This program should copy courses already developed in the United States but have them translated into Bahasa Indonesia. For example, the first set of courses might consist of the following: (i) Good Manufacturing Practices; (ii) Plant Sanitation; (iii) Basic Quality Assurance-Quality Control Systems; (iv) Plant Management Accounting Systems; and, (v) Basic Manufacturing Management Principles.

Under this proposal, the proposed organization would be similar in structure to the Food Processors Institute in the U.S. Since the development of the recommended courses is somewhat technical and sophisticated, a specialist from the U.S. should be brought in to work with the organization to establish the program. The specialist should have extensive experience in Good Manufacturing Practices, in the food processing industry and in developing and delivering a training program. For example, a former employee of the U.S. Food and Drug Administration would likely have the kind of qualifications desired. Such an individual would organize the program, train trainers, and provide quality control.

In order to develop a sustainable program, the Indonesian food industry must participate in its establishment. It is also essential that the program be revenue generating. As demand for the courses grows, or as new courses are needed, the Institute must be able to expand its program. USAID could initially at least provide support for the expansion. USAID should also be ready to subsidize personnel from smaller firms wanting to enter

the program but who do not have sufficient funds or would not initially pay the full cost. The basic cost of the program should be borne by the food industry, however, and USAID's contributions be structured so as to appear "firm neutral".

In the United States, the courses developed by the Food Processors Institute are offered in a variety of ways. They can be sold to the training units of bigger plants and taught as in-house training programs. They are also taught by the Institute itself, and by professional training companies. A multiple delivery system should be considered for Indonesia so as to allow firms in cities outside Jakarta to take advantage of the program.

The lack of training is probably the biggest obstacle to upgrading the quality of processed food products and the problem is industry wide. Many companies also have problems which are specifically related to their own operations. For example, such problems may be in their quality control procedures or may relate to improper manufacturing techniques.

In addition to a training program, a flexible system of providing technical expertise to firms with problems on a short term basis should be developed. To solve a whole series of unique problems will require a system for accessing very selective U.S. and/or local expertise. Therefore, the technical support activity must be able to draw on a wide variety of resources, especially technical consultants, if it is to deliver the necessary services. In order to provide these services, it is recommended that an "Agribusiness Support Group" (ASG) be established as a core element of the proposed Agribusiness Support Project.

The types of services to be provided for dealing with in-plant problems are similar to those needed to solve the raw material constraints; only the specialty expertise differs. Therefore, the same vehicle can be used for both. The proposed ASG-based organization is discussed more fully in the next section.

2. Raw Material Constraints

Indonesian food manufacturers are also severely constrained by a lack of steady supplies of high quality raw materials for the production process. Unfortunately, few farmers now produce products specifically for the processing industry, nor are many processors involved in the actual production of the raw materials that they process. As a result, the raw materials available to supply the processors are often of inferior quality, are sometimes unavailable, and/or must be transported long distances.

Addressing this problem is much more difficult than providing an in-plant quality training program. The specifics of the problems and the solutions can vary greatly on a case by case basis. The Export Support Board faced this problem although not in the food processing sector. The response of the Export Support Board was to approach the problem in a flexible manner. Since they could not determine in advance exactly what problems they would be called on to solve, they created a system whereby Indonesian firms could approach them for technical assistance and they would then arrange appropriate temporary assistance on a sliding fee basis.

Although the Export Support Board has had numerous problems, especially in their relationships with some of the Government agencies, the basic concept of providing a service on demand is sound. It allows for the establishment of an organization with minimum overhead that can address a variety of different problems in different industries. Therefore, this is the underlying concept being proposed for the ASG.

To assist food processors in their development of good quality raw material supplies, a similar project could be developed for the food processing industry. The organization would have a small staff, but should be able to call on a number of different sources for part-time expertise needed to meet the individual needs of the contracting firm. Thus, the "Agribusiness Support Group" should be tied in with foreign sources of expertise as well as local private and Government sources. For example, it could be housed within the proposed training institute and provide some of the training inputs.

An example of the way the technical advisory delivery service of the ASG could be structured is as follows. If a sauce manufacturer needed assistance in obtaining a steady supply of acceptable quality chile peppers for his chilli pepper sauce plant, he would approach the Director or staff of the ASG and present his problem. Together, they would determine the type of assistance needed, its timing and the cost. If the price were agreeable, a firm or person that has had experience developing contract farming would be brought in to work with farmers on proper growing techniques. While doing this, he would also be training a group of company employees in the same techniques so they could eventually replace him. This process would thus create an in-house "extension service" to solve the agronomic and related raw material supply problems of the company.

The major problem with an "ASG" type of organization is in developing a clientele. Although there is a tremendous need for such support services, there are few Indonesian companies that take a long enough view to recognize and accept it. Indonesian companies are also known to be overly expense conscious, in addition to being overly cautious and not trusting outsiders. The

Export Support Board has found this to be the case and this has led to great difficulty in establishing its program. The proposed ASG activity will initially require a high subsidy level from the USAID project during the start-up phase and a long term commitment to the effort with gradually decreased funding.

3. Marketing Constraints

As was mentioned in Chapter III, marketing problems are a function of all the other problems faced by the agroprocessing industry. It is hard to sell a poor quality product. It is hard to sell a product with high transport costs. It is hard to assess market opportunities without institutional support. Addressing these problems will greatly improve the marketability of Indonesian products. There are numerous other problems related to marketing that do not easily fit in the other categories that were identified. These include product identification, packaging, and promotion.

Product identification is the first stage of marketing. Identification justifies the business activity, either as a new venture or as a new line. It provides the justification for developing the business. As such, the identification phase includes a basic feasibility study and development of business plan for starting the venture.

The ASG could assist in these areas, either as the instigator or as a support operation. For example, in the same way that the ASG would have the ability to provide expertise in raw material problems, it could also find the appropriate expertise for conducting the feasibility study. As a well informed observer, it could also serve the function of encouraging investment in a given area or helping to organize joint ventures between American and Indonesian investors.

The ASG services could also extend to helping in package design and labeling, both from an informational perspective and from actual design. The group should also be able to provide advice on penetrating foreign markets, or to assist a firm in finding an advisor for their production process. These kind of services, combined with those on the raw material supply and the training will result in a better quality, more marketable product. The proposed organizational structure for the Agribusiness Support Project will provide the ASG and USAID the flexibility needed to insure success.

4. Transport and Logistic Constraints

Chapter III identified a number of constraints related to the transport of food products, especially those entering the international market. Transporting Indonesian goods is expensive, partially because of a shortage of containers and partially because of collusion in maintaining high freight rates.

Although this is a major problem in expanding the trade in processed food products, it is not a problem that can easily be addressed by USAID through the Agribusiness Support Project. It can be discussed with the GOI as part of a policy dialogue through ARSSP but there is little value in attempting to address the problem directly as part of the Agribusiness Support Project.

5. Credit Constraints

Credit was also mentioned as a problem in developing agroprocessing enterprises, especially for smaller, less well connected business groups. Overall, it did not appear to be a major problem. Providing credit to establish a business venture is an expensive proposition, however, and one in which USAID has little advantage in becoming directly involved. There is one possible input, however; a short-course for credit managers in private banks that focuses on how to appraise an agribusiness venture could be offered through the proposed training program.

6. Regulatory Constraints

Numerous regulatory constraints also inhibit the growth of the agroprocessing. Although these have eased somewhat in recent years with the policy reform initiatives of the GOI, they still remain a major constraint. In the short term, of special importance are the regulations which keep the prices of packaging materials and sugar high. Over the longer term, land tenure laws and joint venture requirements inhibit foreign investment in the agroprocessing industry.

These problems can be addressed by USAID, either as part of the ARSSP or in a new Agribusiness Support Project, or in both. As part of the proposed project, a policy agenda should be formed which addresses these questions, especially those related to packaging materials and sugar prices. The issues could then be raised with the GOI within a continuing policy dialogue framework. The development of a policy dialogue requires some type of direct relationship with a Government entity. Rather than do this under the auspices of an agribusiness support project, however, it would

be more efficient to use the framework already established by ARSSP. Rather than duplicating efforts, the two projects would become complementary.

7. Institutional Constraints

Institutions which can provide support for the agroprocessing industry have not developed adequately in Indonesia. For example there is no effective Government support for promoting exports, nor are there any effective trade associations to assist their operations. There are many services that trade associations and government agencies can provide much more effectively than private companies can provide on their own. There is a need to examine this limitation in assisting the development of a private sector industry.

The development of service oriented institutions is needed in many different areas to support the agroprocessing industry. These areas would include: (i) development of service oriented trade associations; (ii) development of an effective export support agency that could provide both information resources and promotional activities; (iii) development of an effective research and extension program that would concentrate on products needed for the processing industry, i.e. first in fisheries and horticultural crops; and, (iv) assisting GOI policy oriented institutions which can analyze options and then recommend proper Government policy; i.e. such as the new JAC. Developing institutions is a time consuming and costly process, however, and thus priority should be given to the development of needed existing institutions that can be restructured in a shorter time frame, rather than starting off with creating new ones.

Given the above stated recommendation, the development of an effective trade association for the agroprocessing industry is of the most immediate necessity. There are some food processing organizations but they do little, including the Association of Food and Beverage Entrepreneurs which has over 300,000 members. In the project design, these associations would need to be examined more closely to see if any can offer enough encouragement to justify support. If not, the Food Processors Institute discussed above might be able to serve as a nucleus for a service oriented trade association. Assistance would be given to the associations to guide them in creating services for their industry. For example these could include training, standards development and export promotion.

Trade associations are most effective when they work with a well organized Government program which can complement their activities. In the U.S., the relationship between the USDA and the agricultural trade associations is an example of a well

organized and joint-executed program. It uses the services of the Foreign Agricultural Service of the USDA to provide an information network, analysis of alternatives and funding of promotional activities. The trade associations provide the in-depth knowledge of their industry which is needed to promote their products. The trade association also becomes a vehicle for the USDA to communicate with the association members. USAID should examine the possibility of encouraging this type of joint program as part of their agribusiness support activities. This does not necessarily mean that it must be part of a new Agribusiness Support Project since it could easily be incorporated into the Trade and Investment Project. In either case, this is an activity that is needed in Indonesia to begin to link its MOA and the private agribusiness sub-sector together in a constructive manner.

Consideration should also be given to supporting a policy analysis group within the Government that would address many of the issues facing the development of the agroprocessing industry. Such an organization, the Task Force on Agricultural Policy Analysis in the office of the Junior Minister of Agriculture, has recently been formed. This could potentially have the benefit of providing justification for limited Government involvement rather than increased involvement, particularly via its regulatory functions. This activity would potentially be well suited for linkage through the new JAC for which the Task Force clearly serves a staff function. The JAC is also directed to develop four Working Groups at the national level and Working Groups in each province chaired by the governors and these two may merit financial and technical support, especially during their implementation stage. (See Annex D for a discussion of the structure and functions of the JAC.)

Working on the research and extension upgrading and delivery problems is more difficult and potentially very costly. Therefore, given its limited resources and many other options for involvement, the Agribusiness Support Project should probably not become directly involved in trying to solve these problems. These Government institutions are important, however, for helping to solve the raw material supply problems. Therefore, specific attention to the issues is recommended under the existing USAID Applied Agricultural Research Project. Whatever project support USAID decides to offer, the greatest payoff appears to be in working initially with research and extension programs in the Directorate of Fisheries and Directorate of Food Crops, and within Food Crops, with the Horticulture Crops unit. These two program areas focus on commodities most likely to be selected by small and medium sized agroprocessing firms who will be trying to crack the export market barrier in the years ahead.

Activity Coordination

Activities developed to address the constraints to the agroprocessing industry will necessarily be quite diverse. They range from very short term training to technical assistance to policy dialogue to institution building. Given this diversity, it is essential that some type of coordination be developed to enable the different efforts to complement one another. This section will discuss this issue and give recommendations for organizing the Agribusiness Support Project and other USAID activities which can supplement a basic agribusiness project. The timing of these activities is very important so this issue will be discussed as well. Finally, there are a number of supplemental activities that USAID should participate in. These include activities that may be outside the focus of the project, reducing constraints to agroprocessing growth, but nonetheless are agribusiness-oriented activities in which USAID should participate. These activities will also be discussed.

1. The Case for Recruiting an Agribusiness Specialist

Successful coordination for the proposed project will ultimately fall on one individual. Therefore, USAID should recruit a senior agribusiness specialist to assist Mission staff in overseeing the overall agribusiness program. This individual should be brought on board as soon as possible so as to assist in the design of the Agribusiness Support Project. Eventually, he/she would also take responsibility for establishing and directing the "Agribusiness Support Group" and organizing other pre-project and in-project activities.

With all the emphasis now being placed on agribusiness development in Indonesia, one would expect to find numerous suitable people already in Indonesia. Such is not the case, however. For example, at the present time the USAID Mission does not have a senior, peer-recognized agribusiness specialist to work full-time in the agribusiness arena. Discussions with the major donor agencies showed that this is a common problem. With possibly a few exceptions, they have no such persons on board either. The Government has a few agribusiness academics but they tend to be young, recent Ph.D. graduates who are not yet directly involved in policy formulation and/or program implementation. The present situation clearly presents an opportunity for USAID to move into a leadership position by recruiting a highly qualified, peer recognized agribusiness specialist.

It must be understood that such a person should not only have general training in agricultural economics, but also have extensive training and experience in agribusiness. In order for

a USAID funded person to assume a leadership role, his/her peer recognition must be based on experience and prior demonstrated performance in the agribusiness industry. This person must also have excellent contacts within the U.S. food processing industry, the equipment manufacturing industry, and the consulting industry, and must have a working knowledge of agricultural production processes. He/she must be able to find the right persons quickly for various services and training jobs. While proficiency in Bahasa Indonesia and familiarity with Indonesian conditions would not normally be absolutely necessary to work within USAID, they definitely would be needed to work effectively within the Indonesian business community and provincial-level government.

Having this individual in place immediately would allow USAID to begin its project related activities well before the project actually begins. For example, this agribusiness specialist could begin coordinating USAID activities, especially with regard to forming a policy agenda and designing a trade association development program. This person could also begin to become familiar with the agroprocessing industry, and he/she would identify USAID as a leader in the agribusiness field, both as seen by the GOI and the other donor agencies. Following activation of the Agribusiness Support Project, the incumbent in this position could become the project coordinator and serve as director of the ASG.

2. Timing

As was mentioned above, USAID already has projects that allow for the creation of a policy dialogue and providing institutional support. Since these projects are already operational, they should be used now to start addressing the constraints caused by Government regulation and the lack of institutional support.

The first activity leading to implementation of an Agribusiness Support Project should be the recruitment of the senior agribusiness specialist mentioned above. A second priority is the hiring of a Good Manufacturing Practice coordinator/trainer to facilitate assistance to a food processing training organization. Once these two persons are on board, they would begin working with their respective organizations. Both should be viewed as nucleus efforts in the beginning, and not try to over extend. For example, the food processing training organization should start with the development of only a few courses. Too many courses would confuse the market, and put a high demand on finding enough participants and trainers. If the initial package of courses is successful, another four or five could be added after a year or two.

Other Pre-Project Agribusiness Related Activities

In addition to developing a viable Agribusiness Support Project, USAID should also look into the possibility of carrying out other related activities before the project starts which will involve them in the whole process of agribusiness development in Indonesia. These could include:

1. Participating in an Agribusiness Sector Study

It appears that this is an opportunity that has recently become viable. As noted in previous sections, three multilateral donor agencies have offered to carry out such a study. All three of their proposals are now under active consideration by BAPPENAS. After almost a year of delay, BAPPENAS has indicated only recently that such a study would now be timely. Further, there was a strong indication that BAPPENAS would prefer that uniquely qualified U.S. agribusiness personnel be involved in the study. Such a study is already overdue so it should now be activated as soon as possible. It presents an excellent opportunity for USAID to get involved at a critical policy formulation point in time because such a study will include recommendations for the GOI's agribusiness implementation strategy (see Annex C for a SOW for the sector study).

2. Providing Temporary Advisory Services to the Permanent Agricultural-Industrial Working Commission

USAID could provide a badly needed technical input at this time. The Commission is at a critical stage in its young life. It shows signs of a possible terminal illness but in the opinion of the ACA Team, it is definitely worth saving. Although sometimes criticized as a "do-nothing" institution, it nonetheless is the only new organization around with Presidential sanction to carry out needed GOI coordination and policy formulation staff work responsibilities. The Commission is presently developing its work plans but early indications are that the present focus could turn out to be too micro-oriented, regulatory oriented and/or otherwise inappropriate. USAID should provide an objective advisory input into its plan formulation at this time. This effort would be relatively low cost and would most likely be welcomed and appreciated by Government.

3. Sponsoring a Series of Agribusiness-oriented Seminars, Workshops and/or Training courses.

Starting on these activities would be appropriate at this time, even though the project itself is still in the design stage. These could include, for example, a donor agency conference on agribusiness project planning, an internal MOA/MOI workshop on agribusiness policy and/or short-courses on plant sanitation or business management for workers and managers of agroprocessing plants. While USAID could sponsor these directly, their greatest impact on GOI activities and private sector response would likely be achieved if these efforts were supported through the new Permanent Agricultural-Industrial Working Commission.

Linkage with Government

Although the Agribusiness Support Project will be primarily geared toward assisting the Indonesian private agroprocessing industry, there is a requirement to coordinate and/or otherwise link the activity with the GOI. There are many Government agencies involved in agribusiness as was shown in Chapter IV. The question then arises: Who in Government should USAID look to for political support and coordination linkages for the proposed Agribusiness Support Project?

1. Possible Ministry Linkages

Part of the problem in coming to a decision on this question involves the inter-agency rivalry over agribusiness issues that is particularly acute in the GOI at this time. The MOA would seem to be the normal place to look for support for an agricultural sub-sector project effort. But, processing is also viewed as an industrial activity that just happens to depend on agricultural production so the MOI also has a vested interest in agroprocessing. Thus, there are limitations and possible political fall-out to looking only to either Ministry for support.

The MOT could also be looked to, especially since many problems relate to the marketing of the products. But dealing only with Trade would ignore the vital roles to be played by Agriculture and Industry. In addition BAPPENAS would now like to plan a grand strategy for agribusiness development. But, it has little experience in the technical production or marketing problems that would be involved. Finally, the MOC would like a bigger role because of the potential involvement of cooperatives and other farmer groups in vertical integration into processing activities. Clearly, there are too many potential partners.

Ideally some combination of these Ministries would probably be able to provide the best linkage for the proposed project. The beginning of such a combination now exists in the form of the new Permanent Agricultural-Industrial Working Commission. The Commission is still very new and therefore unproven. It does have a Presidential mandate, however, and was formed by a joint Ministerial Decree so it would likely be a good first choice for establishing a linkage with the GOI. Another advantage to starting here is that it does not yet have set policies or a large staff. Since it is in the program formulation stage, it can possibly be molded into a supportive organization easier than individual ministries. With proper guidance, it may also assume a somewhat more neutral position than the other Ministries can adopt.

2. The Permanent Agricultural-Industrial Working Commission

The Commission, popularly known as the Joint Agribusiness Committee (JAC), was established by a joint MOA/MOI Ministerial Decree on April 24, 1989. It is co-chaired by the Junior Minister of Agriculture. It is the newest government institution involved in the agribusiness arena. It was designed to serve primarily as a coordinating mechanism for Government activities (See Annex D).

The Commission already has excellent staff support in policy analysis through the Junior Minister's Task Force (TFAPA). Program development and Government support services are to be coordinated through four additional Working Groups, called for in the Ministerial Decree, that are now being organized. The Head of the BAI in BAPPENAS has indicated that the Commission will be called upon from time to time to do staff work on emerging agribusiness policy issues. Finally, through its linkage with the new Provincial Working Groups chaired by the governors, there is the place where the really worthwhile interaction between Government and private agribusiness interests can take place. Given the above, we recommend that the Commission serve as the primary link to the GOI for USAID's proposed Agribusiness Support Project.

Further, if this Commission is supposed to become the coordinating Government body for this project, it would be worthwhile to make sure that early budget support, such as that which is currently coming from ARSSP, remains available. Also, the provision of an advisor would help direct its program into one of support for the agribusiness sub-sector rather than one of regulation. This concern is in fact very real, as the Commission has been discussing the possibility of setting up a system whereby it would approve all food processing investments, making it a BKPM for the agroprocessing industry. It is also looking at ways in which it can help "manage" the new set-aside funds from state

corporations to help ailing businesses and cooperatives, as authorized in the November 11, 1989 Ministerial Decree from the Ministry of Finance. Again, if this authority were to be misused by the Commission, it could easily turn into a constraint rather than an incentive for agribusiness development in the private sector. Providing some technical advice on these matters by USAID would appear to be needed now rather than latter.

This discussion about the Commission is not to say that other Government agencies should be ignored by the Agribusiness Support Project. In fact quite the opposite is true. The job of keeping all the players on the same track is very important to the success of the project. What is needed is their friendship without their veto power.

U.S. Trade Opportunities

The development of the proposed Agribusiness Support Project will establish strong links with the Indonesian agroprocessing industry. These links, in addition to assisting the development of this industry, can also serve to promote U.S. commercial interests. Four basic areas of U.S. commercial interest can be identified in this regard. They are: (i.) food processing equipment sales; (ii) agroprocessing consulting services; (iii) investment opportunities; and (iv.) the purchase of Indonesian products for the U.S. market.

In designing a mechanism within the project to address these commercial opportunities, the Director and staff of the ASG becomes very important. As the ASG staff advises processors on their manufacturing operations, it is in the position to inform them of different types of American equipment which is available. It is in fact directly selling U.S. consulting services through its operations. In its position, it can also serve to put U.S. investors in touch with reliable Indonesian partners to develop processing activities. Finally, it is in the position to help U.S. buyers find a good source of products for their U.S. markets. If the Support Group could provide these services for a fee, it could also generate income in serving U.S. trade interests.

Some funding might be made available to support this activity directly. One possible activity would be to form a U.S. equipment demonstration and training center. Under this proposal, American equipment manufacturers would donate equipment to the center which would then be used for demonstration and training.

Another possible activity might be to use project funds to fund an annual Indonesian trade mission to the U.S. to purchase U.S. made equipment and/or to fund a U.S. team to visit Indonesia. Continuous contact is needed between the two industries if trade

relations are going to strengthened. If possible, these activities should be coordinated with the Foreign Commercial Service, U. S. Department of Commerce..

Summary of Program Recommendations

An analysis of the seven major constraints presently limiting the growth of the agroprocessing industry indicated a number of areas in which USAID could have a positive impact. It will take from 12 to 18 months, however, before a new Agribusiness Support Project can become fully operational. Therefore, recommended USAID program activities in support of agribusiness development are grouped into two categories: (i) pre-project activities and (ii) proposed project elements. The timing and program coordination relationships between these two proposed sets of activities are shown in Figure VI-1 and summarized in the following sections.

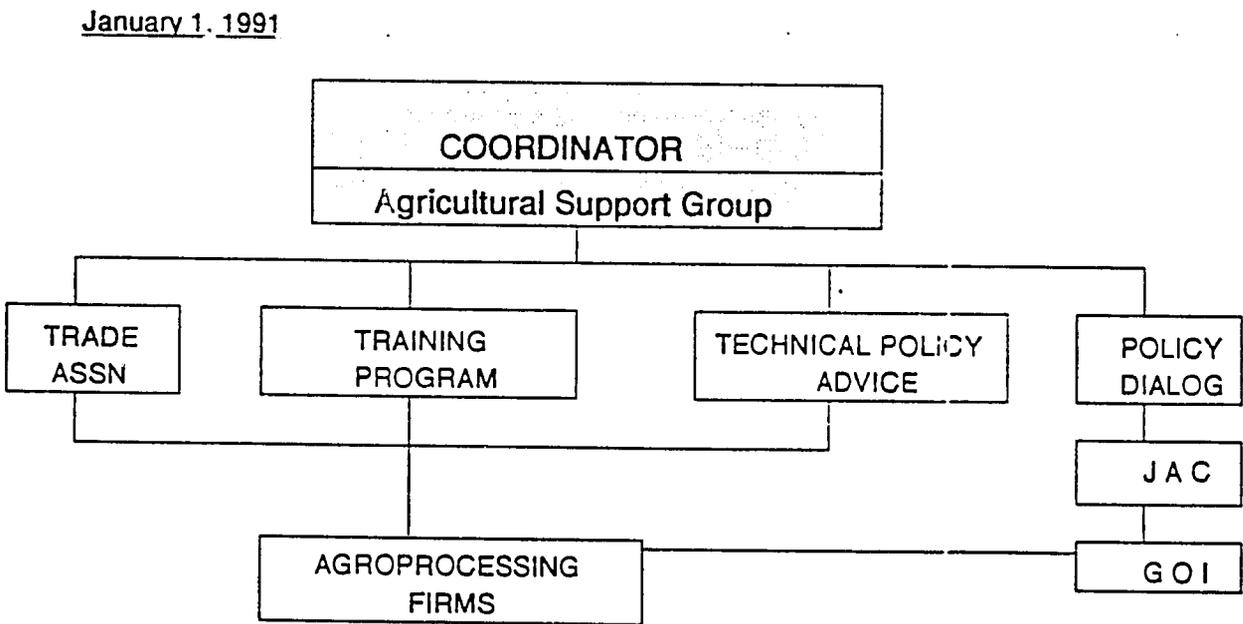
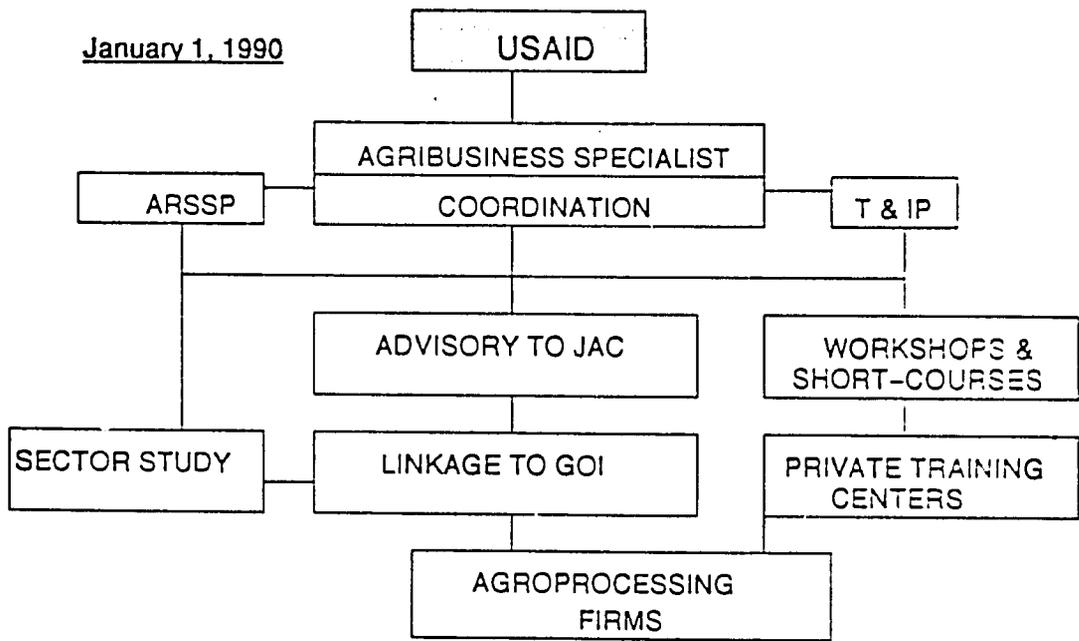
Pre-project Activities

It appears that government is finally getting ready to make some concerted efforts in the very near future to encourage and service the emerging agribusiness sub-sector. Areas in which USAID can assist and gain a leadership role in the process include:

- (i) Recruiting a senior agribusiness specialist to serve as a coordinator for USAID's pre-project activities and as an advisor to the GOI and private sector agribusiness interests.
- (ii) Participating in a forthcoming donor-funded and staffed agribusiness sector study.
- (iii) Providing temporary technical services to the new Permanent Agricultural-Industrial Working Commission which has Presidential sanction to work closely with the emerging agribusiness sub-sector.
- (iv) Sponsoring a series of agribusiness seminars, workshops and short courses.

FIG. VI.1

ORGANIZATIONAL CHART OF USAID AGRIBUSINESS ACTIVITIES



The recommended pre-project activities listed above are rank ordered. As a minimum, if due to budget or other constraints only a limited effort could be mobilized in the short-run, at least the recruitment of an experienced agribusiness specialist should be accomplished.

2. Proposed Project Elements

- (i) Develop an industry-led training program to provide low level in-house training for the food processing industry in the basic principles of "Good Manufacturing Practices."
- (ii) Develop the Agribusiness Support Group to serve as a vehicle for providing technical assistance to the food processing industry.
- (iii) Prepare a policy agenda to address regulatory constraints. This effort should be complementary to the ARSSP.
- (iv) Establish a program to support the development of a service oriented food processing trade association. Coordinate this activity with the Trade and Investment Project.
- (v) Establish support mechanisms for promotion of U.S. agribusiness products and services in cooperation with other appropriate U.S. agencies.

Final development of activities under these broad-based activities will necessarily have to evolve from the project design team efforts for the Agribusiness Support Project.

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ANNEXES

ANNEX A

REVISED TERMS OF REFERENCE

Study Purpose and Definitions

1. The Original Terms of Reference

Purpose. As part of its agribusiness project identification effort, the Office of Agriculture and Rural Development (O/ARD) of USAID/Indonesia contracted with the InterAmerican Management Consulting Corporation to carry out a short-term study, "Agribusiness Sector Profile and Constraints Analysis." The Contractor was expected to provide a broad overview of the agribusiness sub-sector, including an analysis of constraints to growth and private sector investment and participation. In addition, recommendations on how to structure an agribusiness project to help insure maximum impact with limited USAID resources are to be developed. The recommendations are to take into account the fact that USAID is most interested in those interventions which would lead to increased employment and income levels and contribute to a more efficient agricultural system, in line with the USAID/Indonesia Country Development Strategy Statement (CDSS) for the period 1989-93. It is expected that the results of this IMCC contract study will be utilized by O/ARD to design an Agribusiness Development Project. The goal of that project will be "to improve long-term sustainable employment and income opportunities in Indonesia through development of an efficient and competitive agribusiness sub-sector."

Scope of Work. The relevant PIO/T introduced the Scope of Work with the following directive:

While in Indonesia the profile team will gather information and data, primarily from secondary sources, on the agribusiness sector through: (i) interviews with GOI, private sector, trade associations, USAID, and other donor representatives; (ii) a review of appropriate studies and statistics; and (iii) visiting selected provinces with an existing agribusiness sector or with high growth potential to gather information from private sector and GOI representatives.

Specific work assignments for inclusion in this report were as follows:

- (i) Conduct a broad review of the present agribusiness policies and programs, nature of existing agribusiness

activities and enterprises, and the respective roles of the public and private sector in these.

- (ii) Identify, analyze and priorities the major constraints to more rapid agribusiness development.
- (iii) Identify major agribusiness growth opportunities.
- (iv) Provide specific recommendations to USAID/Indonesia on the overall approach and design of the USAID Agribusiness Development Project.
- (v) Recommend additional analyses necessary to develop an agribusiness project and provide draft SOWs.

Staffing. As originally specified in the Terms of Reference, the contract team was to consist of four expatriate specialists with total time inputs of 120 person/days (20 six-day weeks), as follows:

- Team Leader-Agribusiness Specialist (36 days)
- Agribusiness Public Sector Specialist (24 days)
- Trade Specialist (24 days)
- Private Sector Specialist (36 days)

The 4-person contract team was originally expected to be working in-country during early summer - 1989. Due to delays in contract finalization and recruiting difficulties, however, a somewhat different, 3-person team was fielded for a total of 108 person/days during the period October 20-December 17, 1989, structured as follows:

- Team Leader-Public Sector Policy Specialist (48 days)
- Trade Specialist (30 days)
- Private Sector Specialist (30 days)

While the total person/days provided was 12 less than had been expected and one less team member was provided, these deficits were offset in part through the use of a local consultant input.

2. Study Modifications and Rationale

In late October, 1989, following the arrival of the first two IMCC team members, and after positive identification of the third team member, the original Terms of Reference were reviewed with relevant O/ARD personnel. In an effort to optimize the results of this contract study and to capitalize to the degree possible on the unique qualifications of the individual team members, agreement was reached with USAID project directors to narrow the focus of the study somewhat. Specifically, it was agreed that:

1. Although agribusiness as a sub-sector of the agriculture sector includes both: (a) the processing marketing and distribution of agricultural products and (b) the manufacturing, marketing and distribution of agricultural inputs, the IMCC team study will focus primarily on the first listed component.

2. All agribusiness activity in the forestry, tree crop, high seas fisheries and MOI parastatal components of the agricultural sector will be excluded from the study.

3. Most of the IMCC team's data gathering and analysis will be devoted to private sector involvement in agroprocessing and related marketing and distribution activities. Commodities from which case studies will be selected include small fruit, vegetables, horticultural crops and shrimp.

The decision to narrow the focus of this study, as outlined above, was based on the following considerations:

1. Although non-estate crop processing, marketing and distribution presently account for a very small portion of total agribusiness activity, particularly in international trade, it is in this component where the most rapid growth in private investment and participation will likely occur; therefore, the highest prospects of payoff from a USAID agribusiness support project in the short run is also likely to be in this area.

2. While the GOI has recently relaxed some of its regulatory controls on private sector involvement in the economy, agribusiness activities are still heavily regulated and the GOI has not yet developed a set of service activities for this sub-sector in any way comparable to those services provided to the primary agricultural production sub-sector. Yet, the GOI has sent strong signals to the donor community that it would welcome technical assistance in this area.

3. Several donor agencies are in the process of developing agribusiness technical support projects but it appears that

USAID has a comparative advantage in concentrating its initial support efforts in the agroprocessing component of the agribusiness sub-sector.

4. Since there are several other agribusiness project design studies underway, both within USAID and in other donor agencies, the focus of this study was narrowed in some instances so as to avoid unnecessary duplication with projects already funded or in the pipeline.

ANNEX B

DONOR-FUNDED AGRIBUSINESS PROJECTS DURING 1988 AND PIPELINE PROJECTS FOR 1989 AND BEYOND

1. On-going Projects during 1988

Individual donor funded technical and capital assistance projects in 1988 in which the title clearly indicates a primary agribusiness focus are given below, by UNDP classification categories:

01. through 03: None

04 Agriculture, Forestries and Fisheries

1. INS/86/009. "Standardization and Quality Control Development of Food and Agricultural Products"

Source: UNDP

Duration: 1989-92

Total Budget: \$ 669,780

1988 Budget: 3,200

Purpose: Assist in developing an institutional capacity in food and agricultural products standardization and quality control program

2. "Training for Development of a Cooperative Marketing Network Project".

Source: Friedrich Ebert Foundation

Duration: 1983-92

Total Budget: \$ 2,700,000

1988 Budget: 300,000

Purpose: Assist in setting up a cooperative marketing network; diversification of produce and markets/outlets

05. Industry

1. INS/85/015. "Study for the Development of Marine Based Industry"

Source: UNDP

Duration: 1987-89

Total Budget: \$ 2,429,800

1988 Budget: 179,000

Purpose: Make a comprehensive plan for development of marine based industries in Eastern Islands specifically focussing on fish, shrimp and seaweed

2. OTA-R-24. "Transmigration Areas - Agro Industries

Source: Belgium

Duration: 1988-89

Total Budget: \$ 218,500

1988 Budget: 8,500

Purpose: Assistance to development of agro-industries in Sumatra

3. "Assistance to Agro-based Industries"
Source: Int'l. Executive Services Corps
Duration: 1988
Total Budget: \$ 41,200 (with client contrib.39,730)
1988 Budget: 41,200
Purpose: Assistance to install management information system (Jakarta); poultry breeding to increase productivity and profits (Surabaya); meeting FDA regulations for tuna fish plant (Manado)

4. 881-INO. Agro-Industries Credit
Source: Asian Development Bank
Duration: 1988 -
Total Budget (loan credit): \$30,000,000
1988 Budget: N.A.
Purpose: To provide 15 year term investment and working capital, capital credits for 20 small and medium scale agro-based enterprises for establishment, expansion and modernization of facilities

06. Transport and Communications: None

07. International Trade and Development Finance

1. INS/86/015. "Quality Improvement of Selected Agricultural Export Commodities"
Source: UNDP
Duration: 1987-89
Total Budget: \$ 466,000
1988 Budget: 272,000
Purpose: Improve quality levels of selected agricultural export commodities in accordance with target market requirements

08. through 16: None

2. Approved Projects for 1989 and Beyond.

Planned externally financed technical assistance projects reported to be in the funding "pipeline" for 1989 and beyond included the following:

04. Agriculture, Forestry and Fisheries

1. TCP (TA 88/6). "Marketing Efficiency of Horticultural Produce"
Source: FAO
Duration: 1989 - ?
Total Budget: N.A.

1989 Budget: \$ 106,000

Purpose: To assist the Government to plan for more efficient fruit and vegetable marketing and to prepare appropriate proposals for technical assistance and investment projects

2. "Tree Crop Processing"

Source: Asian Development Bank

Duration: 1990 - ?

Total Budget: N.A.

1989 Budget: \$ 500,000

Purpose: To identify and conduct feasibility study on the proposed tree crop schemes where post-harvest processing require urgent assistance

3. ALA/INS/86/021. "Palawija Seed Production and Marketing"

Source: Commission of the European Communities

Duration: 1989-1994

Total Budget: N.A.

1989 Budget: \$ 11,543,000

Purpose: Establish a sound institutional and policy framework for the development of the national palawija seed industry

05. Industry

1. "Improvement on Quality of Coconut Sugar"

Source: Oxford Committee for Famine Relief (OXFAM)

Duration: 1989

Total Budget: \$1,750

1989 Budget: 1,750

Purpose: Study on the improvement on quality, packing, promotion and marketing of coconut sugar

2. "Soy Sauce Small-scale Industry"

Source: OXFAM

Duration: 1989

Total Budget: \$2,660

1989 Budget: 2,660

Purpose: Establishment of a small industry on soy-sauce to increase rural incomes in Java, Madura and Bali

3. Agribusiness Projects in the Planning Stage.

Projects in the planning stage for 1990 and beyond are reported by title and donor agency, as follows:

a. Federal Republic of Germany

(1) Study for the Development of the Agroprocessing Industries

- (2) Study for the Development of an Agro-based Industry
-- Fruits and Vegetables
- (3) Improvement of Post-harvest Handling of Secondary
Crops
- (4) Support for Agricultural Machinery Industries
- b. Netherlands
 - (5) Standardization of Quality Control for Agricultural
Export
 - (6) Small and Medium-Scale Food Processing Industry
- c. United States of America
 - (7) Agribusiness Support Project (Tentative title)
- d. United Nations Development Program
 - (8) A Review of the Agribusiness Sub-Sector: Its
Current Status and Development Strategy
 - (9) Integrated Development of Selected Commodities
Supporting Vertical Integration of Agribusiness
Development
 - (10) Creation and Support of an Agribusiness Promotion
Center
 - (11) Improvement of Product Grading to International
Standards
 - (12) Development of Local Capability for Production of
Fish Feed
- e. The World Bank
 - (13) Indonesia: Sector Study of Agribusiness
- f. Asian Development Bank
 - (14) Second Brackish Water Aquaculture Development
Project
- g. The European Economic Community
 - (15) Palawija Seed Production and Marketing

ANNEX C

SCOPE OF WORK FOR AN AGRIBUSINESS SECTOR STUDY

Introduction

After non-oil exports emerged as a major source of GOI export revenues in the mid-1980's, the role of agribusiness as a major component for rural employment generation and as a contributor to export earnings began receiving increasing attention. Various donor-funded policy studies for the agricultural sector completed since then have recognized the latent potential of the agribusiness sub-sector and called upon the GOI to adopt an agribusiness development strategy. Since the release of REPELITA-V, most of the major multilateral donors have individually proposed technical assistance for carrying out a comprehensive sector study. Completing such a study at an early date is essential if an empirical basis is to be available to the BAPPENAS for formulating an agribusiness development strategy.

Background

Early in 1989, after completion of the FAO/UNDP-funded agricultural policy options study, the Ministry of Agriculture asked the World Bank to carry out the recommended agribusiness sector study. As part of its earlier economic analysis work for the agriculture sector, the IBRD had already completed much of the analysis that would be included in the requested study but had stopped further work on it. Not only did the Bank decline to finish the study at that time, for various reasons, the GOI has also delayed action in response to several donor agency recommendations calling for such a study.

In a recent meeting with the ACA Team, however, the Head of the Agriculture and Irrigation Bureau of BAPPENAS indicated that the time may now be right for carrying out the proposed agribusiness sector study. Further, he stated that three individual proposals from donor agencies for carrying it out, (i.e. from World Bank, ADB and UNDP) are now under active consideration. Given the BAPPENAS's recognition of the USAID's comparative advantage for providing access to highly qualified technical personnel with relevant U.S. agribusiness and international trade experience, however, the climate appears to favor its involvement in the proposed study as well.

Among the major donors, the economic analysis and sector work of the World Bank has the best reputation in various developing countries throughout the world. This programme is centrally

funded by the Bank, thus equivalent to grant funding, and this may in part account for its popularity. Nonetheless, its purpose is to improve the understanding of the structure and mechanics of a selected economic sector. The study results are normally used to lay a policy foundation with a host governments prior to the Bank and other major donor involvement in development programmes for the selected sector. To date, the Bank has carried out such studies for Indonesia's energy, industry, transport, education, health, irrigation, and transmigration sectors. In each case, the GOI has responded by adopting generally viable development strategies, even when the Bank imposed major conditionalities. The strategies in turn were incorporated into the REPELITAS and then reflected in donor-funded development projects.

Until quite recently, it was assumed that the Bank had declined the MOA's request to do an agribusiness study because of a forthcoming phasing out of loan activity for the agricultural sector. The apparent recent reversal of its position, (since it is now encouraging the local Bank Mission office to engage in further dialogue with the GOI on terms of reference for the study), suggests instead that the Bank may now be considering future loan funding for agribusiness as part of its industry sector portfolio. It doesn't really make much difference what the Bank's reasoning may be for its renewed interest in a sector study; what is important is that the study be done at the earliest opportunity so that the GOI will proceed expeditiously with adoption of a development strategy for the remaining years of PELITA-V.

Study Format

The general format for the Bank's sector studies is well known but specifics for such studies are necessarily formulated on a case by case basis, particularly in regard to the strategy aspects. Some guidelines for consideration of the necessary elements of an agribusiness development strategy were set forth in the recent FAO/UNDP agricultural policy options report. It stated in part:

Given the ... rationale for agroprocessing expansion and general agribusiness development, there is now an increasing need to translate it into a viable strategy. Such a strategy should subsequently be the basis for the formulation of plans, programs, and projects, and facilitate policies toward the establishment of rural agroindustries and the integrated agribusiness system-type of development for priority commodities. A development strategy for Indonesia should ideally consist of the following three key elements.

- (1) A policy environment conducive to private sector entrepreneurship in rural areas.
- (2) An adequate system of incentives for private entrepreneurs and investors.
- (3) A system of priority commodity systems and regions.

An accelerated agribusiness development strategy, such as Government has called for during PELITA-V, should not rely on a non-discriminating, shot-gun approach. Rather, it should deliberately target the most important commodities and regions, on the basis of some predetermined, consensus-generated criteria, such as the following:

- (1) rural employment needs;
- (2) magnitude of processable surplus;
- (3) magnitude of post-harvest losses;
- (4) consumption/nutritional considerations;
- (5) degree of dependence of the rural population on the commodity;
- (6) relative level of development in the region.

Given the above, it should be readily apparent why a World Bank type sector study should precede the adoption by the GOI of an agribusiness development strategy. Further, it strongly suggests that it should also precede implementation of extensive donor-funded agribusiness development support projects. Finally, because of the timing consideration, USAID involvement in the proposed study would have to be done under an existing program, such as the ARSSP, because a new agribusiness support project is at least 12 to 18 months in the future.

ANNEX D

STRUCTURE AND FUNCTIONS OF THE PERMANENT AGRICULTURAL-INDUSTRIAL WORKING COMMISSION

Introduction

The Permanent Agricultural-Industrial working Commission, more commonly known as the Joint Agribusiness Committee (JAC), is a relative newcomer to GOI agribusiness coordination efforts. Nonetheless, with the possible exception of government controlled KUD cooperative programs, this new institution has received more negative comment than any other government organization involved in agribusiness development. Such adverse reaction comes from both within the GOI and from the donor community. Criticisms expressed most often by donor agencies is that there is a perceived lack of constructive activity underway. In some circles within the GOI, there is a concern that it could lead to a consolidated power base for the Ministries of Agriculture and Industry, at the expense of the BAPPENAS and the Ministries of Trade and Cooperatives. Given all this "smoke", our ACA Team concluded that there may well be a "fire" and that, given proper technical support and direction, this new JAC could instead become a positive element in Indonesia's agricultural development process. In any case this new institution deserved a more balanced review than it had received to date, including an examination of its positive aspects.

Legal Basis for the Commission

This analysis starts with the premise that any institution based on Presidential Decrees represents a policy decision at the highest level and thus it begins life with a power mandate. In this case, the JAC is based on two such directives (Presidential Decrees No. 64/1974 A, as amended of March 21, 1988 and No. 47 of November 19, 1988. The administrators of the MOA and MOI were directed by the President in early January 1989 to meet in a joint planning agribusiness workshop during January 21-23, 1989. In due course, there followed a joint Decree of the Minister for Agriculture and the Minister of Industries of April 24, 1989 that created the Permanent Joint Agricultural - Industrial Working Commission. It is noteworthy, therefore, that the potential active life of the Commission (as of this date in early December, 1989) is only about seven months. Anyone familiar with government bureaucracy anywhere in the world should be aware that this is too short a time span in which to expect much if any useful completed work.

The most recent addition to its statutory authority for some of its assigned responsibilities is the Ministry of Finance No. 1232/KML 013 dated November 11, 1989. This decree relates to a directive to use state owned corporations by extracting a fee of up to 5 percent of profits to financially assist nearby private agroprocessing firms and cooperatives.

Commission Structure

The steering team of the Commission is chaired by the Junior Minister of Agriculture and the Vice Chairman is the Junior Minister of Industry. This Committee is very large and so it will likely meet infrequently. It includes the Senior Ministers and the Heads of the Planning Bureau of both ministries as well as all the echelon I (Secretary Generals and the Director Generals). This steering team must meet at least once a year, however, to formally report on progress to the Senior Ministers of Agriculture and Industry.

Reporting to the steering team is a smaller technical team chaired by the Head of the MOA Bureau of Planning and with the Head of Industry's Planning Bureau as Vice Chairman, plus only four other people. This team meets frequently to conduct business. There will be four working groups reporting to the technical team. These units are not yet fully developed but the technological utilization working group is farthest along. The Governors in each province chair provincial working groups on which representatives of Agriculture, Industry and sometimes Trade are represented. Two organizational charts, for the Commission and the provincial framework, respectively, are attached to this annex.

Commission Functions

Although some broad terms of reference for the Commission were spelled out in the Joint MOA/MOI Ministers Decree of April 24, 1989, the Commission is still trying to develop a viable work plan. Future work of the Commission could include some activities that are very micro-oriented. One example would almost become feasibility studies for individual firms. Such efforts would definitely not be appropriate, however, and could even open the door to corruption. Hopefully, we can assume instead that the Commission will focus on firm-neutral types of studies and analyses of policy options.

There is excellent staff support capability already available to the commission which allows it to function even before the four working groups called for in the Ministerial Decree are fully

staffed. The Junior Minister of Agriculture has decided to make his new Task Force on Agricultural Policy Analysis (TFAPA) available as technical staff support for the Commission. The stage is now set for the Commission to move into a period of intense activity. Whether it achieves its potential, however, will be largely dependent on it being able to develop and adopt a sanctioned work plan and if it receives adequate budget support. An initial budget allocation of \$170,000 from USAID's ARSSP for this fiscal year was provided. Although apparently this allocation remains largely unspent, it is not clear if that funding level will be adequate, once the Commission is fully staffed, or even what its future annual budget allocation will be.

A Policy Support Staff: The TFAPA.

The Task Force for Agricultural Policy Analysis (TFAPA) has recently been established in the Office of the Junior Minister of Agriculture. Initial staffing will likely be completed by early January 1989. This new organization is an outgrowth of one of the major recommendations in the January 1989 FAO/UNDP agricultural policy options report, calling for the creation of an Agricultural Policy Analysis Cell. The report recommended staffing as follows:

... A proposed Agricultural Policy Analyses Cell for Indonesia need not be large -- no more than 10 or 12 specialists. All the members should be highly trained, however, with a mixed expertise including agricultural production economics, farm management, natural resource economics, agribusiness and international trade. The group should include recent Ph.D. graduates who are skilled in the latest analytical techniques and some members with long term policy analysis experience.

The TFAPA is being staffed in close accordance with the above quoted suggestions. It is headed by Dr. H. S. Dillon, Special Policy Advisor to the Junior Minister and who is a senior policy analyst. Seven additional, much younger staff have already been appointed. These are: Dr. Ato Suprpto, Technical Secretary for the Junior Minister; Dr. Chairil A. Rasahan; formerly with the Center for Agro-Economic Research (CAER) in Bogor; Dr. Achmad Suryana; Dr. Rudy Wibowo; Dr. Marcellus Rantetana; and, Dr. Togar A. Napitupulu, a very recent graduate in agribusiness economics from Oklahoma State University. Three additional economists are scheduled to join the TFAPA in early January, 1989. Dr. Dillon has stated that one of the major responsibilities of the TFAPA will be to provide staff support to the Commission for analysis of agribusiness related policy issues.

Preliminary Assessment of Performance

Although it is still quite new, there are already a few positive aspects regarding the Commission that can be cited. Perhaps the most important impact of the Commission so far has been that both the MOA and MOI Ministers are now more cognizant of agribusiness issues and reflect this in their speeches and other public activities. There are some concerns about the long-run impact of the Commission. Nonetheless, BAPPENAS is considering using it as a place to have staff work done and to solicit recommendations from on major agribusiness policy-related issues. The Junior Minister of Agriculture has already directed his policy task force to study some issues that could either remove agricultural regulatory constraints to raw material supply and/or to provide other incentives desired by agribusiness firms.

Some important policy-oriented staff work is beginning to emerge from the TFAPA. Two policy briefs have recently been completed. A study of the feasibility of extending a BIMAS type subsidy program to secondary food crop producers has been contracted out to the Research and Economic Development Center at Gadjah Mada University. A study to investigate the feasibility of using a contract farming mechanism by small-scale agroprocessing firms in rural areas will be initiated in the near future.

Summary and Conclusions

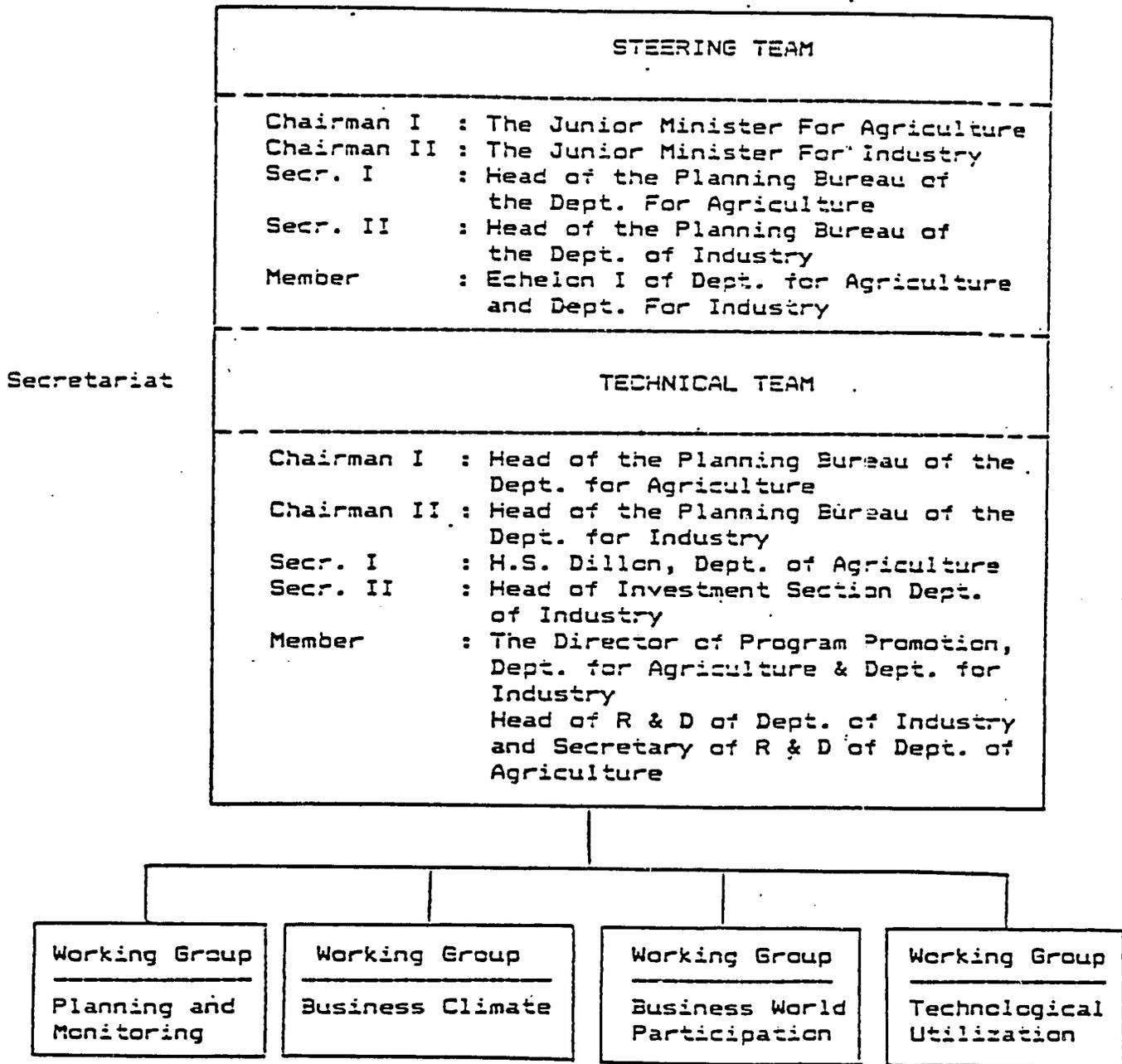
It appears that the work being undertaken by the Commission through the TFAPA will shed some badly needed light on a few of the major constraints to agricultural diversification and general agribusiness development. It is likely that, since these studies are being done by well trained Indonesians, they will be given due consideration by GOI policy makers who have shown increasing impatience with recommendations from donor agencies that far too often are based on little or no empirical data and inadequate economic analysis.

If the Commission continues with TFAPA staff inputs as outlined above and develops early a reputation for high quality performance, then it will survive and serve a useful service function for private sector agribusiness interests. Without adequate technical and budget support, (including some immediate badly needed advice on how to evolve a viable plan of work), however, the current doomsayer critics of the Commission will certainly make their negative predictions come true. Instead, USAID technical assistance could be used to assist the Commission to become a positive force in Indonesia's agribusiness development efforts.

**WORK PROCEDURE OF THE AGRICULTURAL - INDUSTRIAL
PERMANENT WORKING COMMISSION**

1. ORGANIZATIONAL SCHEME

THE MINISTER FOR AGRICULTURE
THE MINISTER FOR INDUSTRY



WORK RELATION PROCEDURES

01/77

