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IMPACT OF INDONESIA'S ECONOMIC CONFRONTATION OF MALAYSIA

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IMPACT OF INDONESIA'S ECONOMIC CONFRONTATION OF MALAYSIA

Indonesia's decision to break trade relations and to undertake a serious campaign of economic confrontation against Malaysia not only will have most serious effects on the already depressed economy of Indonesia but also will have adverse effects on the economy of Malaysia. For Indonesia the break in trade relations will have its most serious impact in the rubber and petroleum markets, which constitute its most significant foreign exchange sources. The recently announced economic stabilization program, which was linked to continued economic support from Western nations, will be seriously endangered if not altogether cast aside. The most serious effect on the economy of Malaysia will be felt in Singapore, where the cut in entrepôt trade will reduce employment and revenue from port activities.

1. Loss of Exports

During 1962, about 30 percent of Indonesia's total export trade of $674 million was shipped to Malaysia, primarily for reexport. If smuggling and false documentation are taken into account, however, exports to Malaysia may have been as high as 50 percent. 1/ Crude rubber, petroleum, and tin are the most significant commodities in this trade. Whereas Indonesia could carry on some limited trade on a government-to-government basis, Indonesia does not have the marketing facilities to maintain exports at their present level. Trade channels and financial arrangements have been seriously disrupted and will need to be newly established.

a. Rubber

Rubber, Indonesia's most important export, accounts for about 44 percent of total exports. In the past, Malaysia has been the primary outlet for Indonesian rubber, taking about 60 percent of Indonesia's total rubber production. Much of the Indonesian rubber is sent to Singapore and immediately transshipped to other countries; the remainder is remilled, processed, and graded in Singapore before shipment to consumers. The economic consequences of suspended trade in natural rubber will depend largely on Indonesia's ability to develop alternate processing and marketing facilities for its rubber. Indonesia's ability to perform the remilling and other processing operations, formerly handled by Singapore, is problematical. In the opinion of trade experts, however, the most serious problem facing Indonesia is the marketing of the additional unprocessed rubber that formerly was transshipped from Singapore. In apparent substantiation of the difficulties forecast by trade experts, Indonesia's First Minister Djuanda stated that at least 6 months would be required to readjust the processing and marketing of Indonesian rubber. 2/ Although the considerable smuggling between Indonesia and Singapore is likely to increase, an outlet would not be provided for a significant portion of Indonesian rubber.

b. Petroleum

Petroleum has been the most reliable support for the Indonesian economy, accounting for about 31 percent of Indonesia's total exports by value. The severance of trade relations between Indonesia and Malaysia could have a drastic effect on the operation of Indonesia's petroleum refineries, for the limited availability of storage facilities and the inability to dispose of petroleum products would soon force a shutdown. The closing of refineries not only would seriously reduce Indonesia's foreign exchange earnings but also would deprive Indonesia of its domestic supply of products including kerosine, which is in chronic short supply, and of the earnings from such exports in non-Malaysian markets. Exports of crude oil, which account for about two-thirds of total POL exports but only one-third of the earnings of foreign exchange from POL, will be virtually unaffected.

c. Tin

Approximately 50 percent of Indonesia's tin ores are shipped to Malaysia for smelting and reexport. Markets for Indonesia's tin exports, valued at $32 million in 1962, 3/ are largely in Western Europe. Loss of smelting facilities at Penang may be overcome by use of excess smelting capacity in the Netherlands. Although this shift might involve higher freight and smelting costs, it could be accomplished fairly promptly and without too much difficulty.

2. Loss of Imports

Indonesia receives only 15 percent of its imports from Malaysia. 4/ These imports consist of textiles, rice, spare parts for automobiles and machinery, and various raw materials. The goods are largely of non-Malaysian origin and could be imported direct at somewhat greater expense.

Indonesia hopes to solve the trade problems that it has created by finding marketing facilities that can be adequate substitutes for Singapore and Penang. The desire to carry on entrepôt activities in Indonesia cannot be realized immediately, because of the lack of warehouses and port facilities necessary for this trade. Approaches have been made to the governments of the Philippines and Japan to use their facilities for financing, marketing, and storage. The success of these proposed diversions of trade will not be known immediately, but it is apparent that delays in establishing new trade channels will be considerable and could be a damaging blow to the Indonesian economy.

3. Loss of Foreign Assistance

The actions of the past month have dimmed Indonesia's hopes for Western economic assistance. The US has withheld all new economic aid, and, without US support, there probably will be no convening of the meeting of the Development Assistance Committee scheduled to consider economic aid from other Western nations. The $50 million of standby aid from the International Monetary Fund, contingent on Indonesian economic reforms, was suspended after $20 million had been drawn. It is possible that Indonesia will lose up to $300 million in economic aid 5/ from the West as a result of its action against Malaysia.

The Soviet Bloc and Communist China as a political gesture could offer some economic assistance to Indonesia in its confrontation of Malaysia, but for the present it is unlikely that significant economic assistance will be forthcoming or that the Soviet Bloc or China can solve the long-term problems that are apt to arise from Djakarta's action in cutting off economic relations with Malaysia. The USSR may offer to shift some of its purchases of rubber from Malaya to Indonesia. Such purchases, however, would benefit the Indonesians only if they were exchanged for hard currency or goods normally purchased with foreign exchange. The possibility of the Soviet Bloc extending outright gifts or hard currency also appears dim. The Chinese are not likely to offer significant economic assistance. They already purchase more than 50 percent of their total rubber imports from Indonesia and are not likely to increase this amount with a consequent disruption of their traditional rubber trade with Ceylon. The Chinese also cannot afford to make large purchases of rubber for stockpiling. The Chinese do not import significant quantities of crude petroleum, and the government of Indonesia does not have the refining capacity to supply products to China.

4. Long-Term Losses

Although the immediate effect of the trade break on the economy of Malaysia probably is not so severe as it is on Indonesia, the break, if protracted, would have a serious effect on the economy of Singapore and to a lesser extent on that of Malaya. Singapore receives about 20 percent of its GNP from entrepôt trade, 6/ and Indonesia provided a significant share of this trade. Penang, the entrepôt port of Malaya, also carried on a large trade with Indonesia. Penang's total trade is not so great as that of Singapore, however, and the effect on the Malayan economy is proportionately less. In addition, the loss to Malaya may be partly offset by gains from increased prices in rubber and other Indonesian commodities temporarily denied to world markets. The effect of the trade break on the economies of the Borneo states will be insignificant because Indonesia is not an important trading partner. Sarawak, however, stands to suffer some economic setback because military activity along the border between Sarawak and Kalimantan will disrupt the subsistance economy in the border area.

Singapore accounted for about 80 percent of the trade of Pan-Malaya (Malaya and Singapore taken together) with Indonesia in 1962. Moreover, Indonesia was Singapore's second most important trading partner after

Malaya, providing about 20 percent of Singapore's imports and taking about 8 percent of its exports. 7/ Principal imports from Indonesia were rubber, petroleum, copra, and food products, and exports were textiles and other manufactured goods. A total break in trade with Indonesia could cause a loss in national income of from 6 to 8 percent and could result in unemployment and underemployment possibly affecting 10,000 additional workers. 8/ The high unemployment already existing in Singapore, coupled with an annual rate of growth in population of about 4 percent, emphasizes the significance to the economy of Singapore of such a drop in national income.

Indonesia has been supplying about one-half of Singapore's rubber, which makes up about one-third of its exports and reexports. The sorting, processing, and grading of rubber in Singapore before reexport provide an important source of employment and profits for Singapore traders. In addition, significant amounts of Chinese capital fleeing Indonesia go to Singapore through devious trading manipulations, largely in the rubber trade, providing an uncounted but important source of capital for industrial development.

Petroleum plays a smaller role in Singapore's entrepôt trade, and the loss to Singapore from withholding Indonesian petroleum will be limited to the loss of charges from storage and the servicing of reexport transactions. Malaysian refineries, with a capacity of about 100,000 barrels per day, operate almost entirely on crude oil from Brunei and the Middle East. Malayan requirements of fuel oil and other petroleum products, which are supplied in part from Indonesian refineries, can be met from other sources.

The volume of the entrepôt trade of Penang is about one-fourth of that of Singapore, and there are no statistics to indicate how much of this trade is with Indonesia. Products in Penang's entrepôt trade are the same as in Singapore except that tin ore from Thailand and Indonesia makes up about one-third of the imports from neighboring countries. 9/ The denial of Indonesian tin ore, therefore, could cut significantly the Penang entrepôt trade, cause unemployment, and deprive Malaya of tin for export. It has been estimated that the national product of Penang may be cut by 5 percent as a result of the break in trade and that up to 1,000 may be unemployed. 10/ It should be noted, however, that Penang was eventually to lose the tin ores imported from Indonesia and Thailand, for both are building their own tin smelters.

In both Penang and Singapore, there has always been a large unrecorded trade with Indonesia. Such smuggling probably will increase during the break in trade. The real danger to Singapore as the embargo continues and as Indonesia finds new trade channels is that a certain part of this lost trade never will return to former patterns.

An additional danger to Malaysia is that increased patrolling activities to curb smuggling may result in incidents that could escalate into an all-out military conflict between Malaysia, supported by the British, and Indonesia.

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