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War in Aceh, Its Economic Impact

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Not only the people of Aceh who are concerned when the last minute negotiation failed in Tokyo. People in the Aceh's neighboring Sumatra provinces, as well as neighboring countries such as Singapore, Malaysia, and Thailand should justifiably be concerned as well.

What is least needed at this time would be another source of economic uncertainty for a region that has been battered by bad news since September 2001. Putting the well known political and social impacts aside, we offer a look at the economic repercussions of such war.

How Important is Aceh?

One of the arguments for putting less attention to the economic aspect of Aceh war is the size and economic importance of Aceh. After all, some would argue that this province's contribution to Indonesia's GDP continued to dwindle from 3.6% in 1990 to only 2.2% in 2001 (for which the latest provincial data is available). This hardly qualifies as big number that merit careful scrutiny.

Further, the only time any economically important news on Aceh appear in the press was related to its gas field in Arun / Lhok Semauwe. These oil/gas fields are jointly-operated by Indonesian government-owned Pertamina, Exxon-Mobil, and Jilco (a Japanese company). Even in this business, Aceh contribution to Indonesia's GDP in mining continued to decline, from 13% in 1990 down to only 5% in 2001, partly due to the substantial depletion in its gas reserves after years of exploration.

Aceh contributions in other sectors were also minimal. Agriculture only contributed 3.6% of the nation's 2001 agricultural output, while manufacturing's share contracted from 4.2% in 1990 down to only 1.8% in 2001. Other sectors exhibit the same tendency.

Given these statistics, it is too easy to ignore Aceh. But war in Aceh have regional economic implication as well. This comes through interaction of Aceh with other provinces in the Indonesia, both directly and indirectly. In turn, those provinces may have commercial linkage with Indonesia's neighboring countries such as Singapore, Malaysia, and Thailand.

But let us be specific. A protracted war in Aceh will disrupt production activities in the province, and further disrupt production linkages that Aceh has with other provinces. These production linkages take place in forms of purchase and sales of raw materials between Aceh and other provinces.

Given the status of Aceh as a supplier of primary products to other regions, a production disruption will first and foremost hurt the Aceh economy itself. Aceh's inability to self-produce or outsource raw materials is expected to reduce its output by 14%. Some secondary damages are also expected to hit North Sumatra output (-0.6%), West Sumatra (-0.3%), and Jambi (-0.1%).

Although these seem to be minor, there is another aspect that we have yet to consider. A war makes it difficult for Aceh businesses to maintain its production schedule. The war will also hamper the province's ability to supply raw materials to other regions. As a result, the entire Sumatra (outside Aceh) can be expected to have its gross output contracted by close to 11%, with South Sumatra shouldering most of the brunt (suffering 6.7% loss in output), followed by North Sumatra (1.3%), and Riau (1.1%). Combined Java provinces will have 0.6% reduced output as a result of Aceh's inability to supply raw materials, while the rest of Indonesia will only feel minor economic effects.

Deeper analysis suggests that the South Sumatra will feel the largest impact of the impending Aceh war, through the oil and gas delivered from Aceh. Hence, an implication of this is that if the war cannot be avoided, then the next best thing that Indonesian government can do to minimize the economic impact of war would be to secure the oil and gas fields around Aceh, plus its shipping route.

Going Forward

But even if the oil/gas fields are secured, the economic impact of the war on other regions cannot be completely eliminated. The major casualties, however, will then remain mostly localized to the Aceh economy and this, more importantly, will contribute to a deeper misery for the local Aceh people.

For the Indonesian government, there are clear economic incentives to settle the Aceh solution peacefully. For example, a peaceful solution will put less pressure to the already-strained state's budget. Indirectly, a peaceful solution will help the country's image to foreign investors. But if it cannot be avoided, going to war clearly has an incentive as well for the Indonesian government as it sought to minimize (among others) the impact on other regions, as we have shown earlier.

War or no war, it is imperative for the Indonesian government to seriously think about and implement a new economic development paradigm in Aceh. A once-rich province, Aceh is an example of an economic mishandling that has produced one of the slowest growing province in Indonesia that contributes to poverty and further fuel local suspicions of foreign influence. Such vicious circle must be eliminated if the welfare of the population of Aceh province is to be increased. And this, of course, is also in the best interest of neighboring countries along the Malacca strait.

Avoiding the war in Aceh should benefit the Indonesian economy in general. But our analysis suggests that the biggest beneficiaries of peace would be the people of Aceh themselves. As such, the economic well-being of the Aceh People will be well represented by those who speak and act in peace. Unfortunately, this message gets lost in the negotiating table.

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