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Proceeding

International Joint Seminar

Muslim Countries and Development :

Achievements, Constraints and Alternative Solutions (Multi-Discipline Approach)

Yogyakarta, 2nd December 2006

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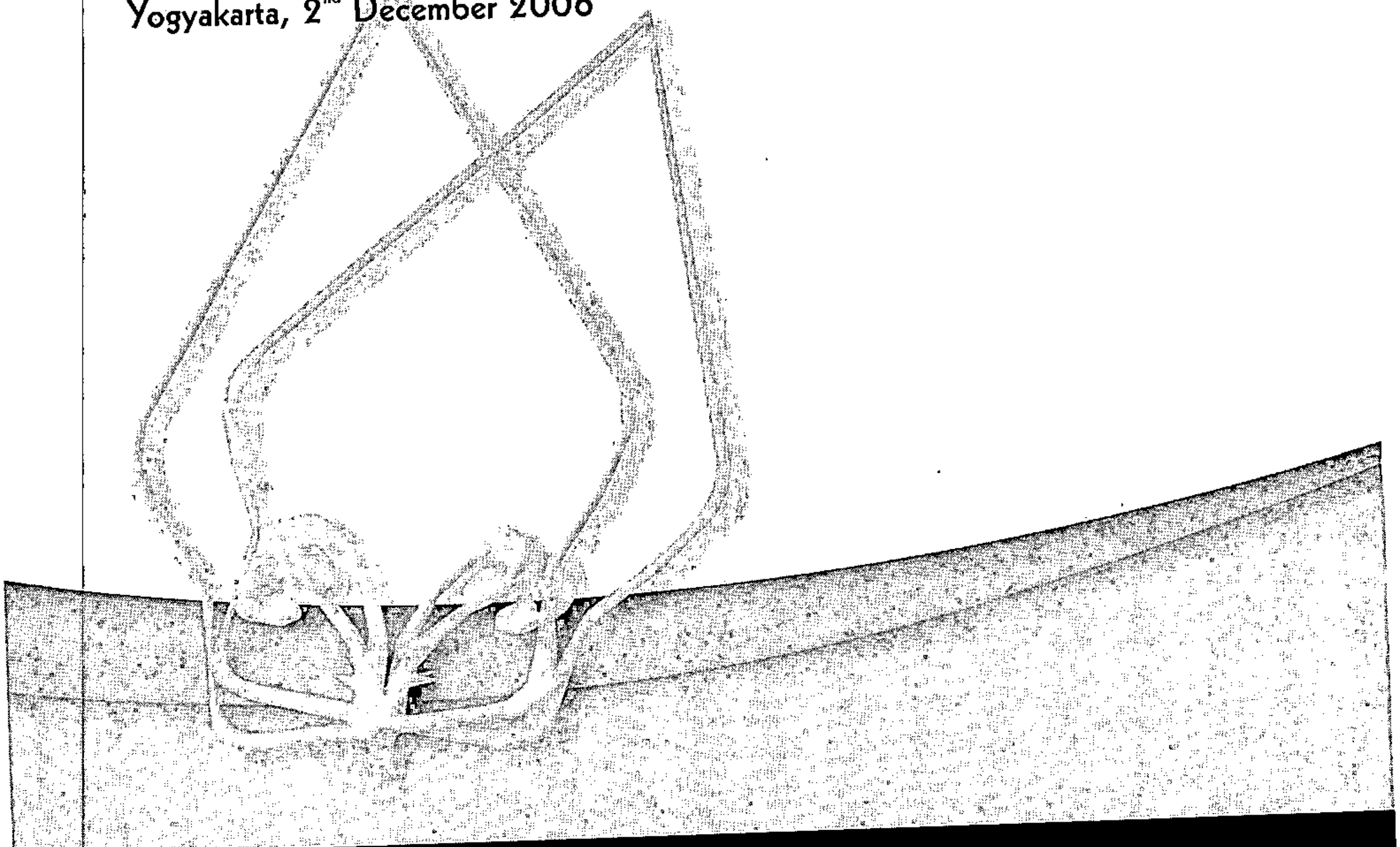

Organized by:

UMY
Universitas Muhammadiyah Yogyakarta

IIUM
International Islamic University Malaysia

Education and Cultural Attache Embassy of The Republic Indonesia in Malaysia

MESSAGE FROM THE RECTOR OF UNIVERSITAS MUHAMMADIYAH YOGYAKARTA (UMY)

Assalamu'alaikum warahmatullahi wabarakatuh

All praise be to Allah SWT, Lord of the world. Peace and blessings on Muhammad SAW, His Servants and Messenger.

First of all, as the rector of Universitas Muhammadivah Yogyakarta (UMY), I would like to welcome to the honourable guests, Rector, Dean of Postgraduate Studies (CPS), Dean of ISTAC, Dean of IRKHS, Deputy Deans and Head Departments from various Kulliyah, lecturers, postgraduate students of International Islamic University Malaysia (IIUM), and all participants in this joint seminar.

Academic cooperation between UMY and IIUM started several years ago. The cooperation between us is based on a solid foundation; both us are Islamic universities having same missions to develop Islamic society, to prepare future generations of Islamic intellectuals, and to cultivate Islamic civilization. In fact, improving academic quality and strengthening our position as the producers of knowledge and wisdom will offer a meaningful contribution to the development of Islamic civilization. This responsibility is particularly significant especially with the emergence of the information and knowledge society where value adding is mainly generated by the production and the dissemination of knowledge.

Today's joint seminar signifies our attempts to shoulder this responsibility. I am confident to say that this joint program will be a giant step for both of us to open other pathways of cooperation. I am also convinced that through strengthening our collaboration we can learn from each other and continue learning, as far as I am concerned, is a valuable ingredient to develop our universities.

I sincerely wish you good luck and success in joining this program

Wassalamu'alaikum Wr, Wb.

Dr. Khoiruddin Bashori

Rector, UMY

MESSAGE FROM THE RECTOR OF INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA (IIUM)

Assalamu'alaikum warahmatullahi wabarakatuh

In the name of Allah, the most Gracious and the most Merciful. Peace and blessings be upon our Prophet Muhammad (S.A.W).

First and foremost, I felt honoured, on behalf of the university to be warmly welcomed and to be given the opportunity to work hand in hand, organizing a respectable conference. Indeed, this is a great achievement towards a warmers bilateral tie between the International Islamic University Malaysia (IIUM) and Universitas Muhammadiyah Yogyakarta (UMY) after the MoU Phase.

I would also like to express my heartfelt thanks to Centre for Postgraduate Studies (CPS), Postgraduate Students Society (PGSS), contributors, paper presenters, participants and our Indonesian counterpart for making this program a prestigious event of the year.
This educational and cultural visit is not only an avenue to foster good relationship between organizations and individuals and to learn as much from one another but a step forward in promoting quality graduates who practices their ability outdoor and master his or her studies through first hand experience. The Islamic platform inculcated throughout the educational system namely the Islamization of knowledge, both theoretical and practical, will add value to our graduates. This comprehensive excellent we strived for must always be encouraged through conferences, seminars and intellectual-based activities in line with our lullaby: The journey of a thousand miles begin by a single step, the vision of centuries ahead must start from now.

My utmost support is with you always. Looking forward to a fruitful meeting.

Ma'assalamah
Wassalamu'alaikum Wr, Wb.

Prof. Dato' Dr. Syed Arabi Idid
Rector, IIUM

MESSAGE FROM EDUCATION AND CULTURAL ATTACHE EMBASSY OF THE REPUBLIC OF INDONESIA KUALA LUMPUR

Assalamu 'alaikum warahmatullahi wabarakatuh

All praise be to Allah SWT. This is the moment where implementation of MoU between Universitas Muhammadiyah Yogyakarta (UMY) and International Islamic University Malaysia (IIUM) comes in the form of action by organizing this Joint Seminar. The efforts of both sides to implement the MoU are highly appreciated, especially, in the context of which both universities effort to enhance the quality of education.

Substantially, I believe that this Joint Seminar will bring many benefits. In term of the development of knowledge, it is a means for developing academic quality, for exchanging of information on academic development, as well as for constructing intellectual atmosphere at both universities. In term of international relations, both universities have taken part in increasing close relationship between Malaysia and Indonesia. RUM and UNIY as well are using 'soft power' to increase bilateral relations among citizens which brings a lot of benefits for both nations.

Therefore, I hope that both RUM and UMY can make use of this program as a 'kick-off' for other programs in the future, especially in using UMY's vast networks with other Muhammadivah Universities in various cities in Indonesia as well as IIUM's network. The support of IIUM for UMY also means a progress for IIUM and UMY. I hope such joint program will continue in future for betterment of both Indonesia and Malaysia. Embassy of the Republic of Indonesia in Kuala Lumpur will always support these efforts.
To our honorable guests, Rector, Dean of Postgraduate Studies (CPS), Dean of ISTAC, Dean of IRKHS, Deputy Deans and Head Departments from various Kulliyah, lecturers and students of IIUM, I warmly welcome you to Yogyakarta. I hope you enjoy your stay in the cultural city of Yogyakarta.
Finally, as the Attache of Education and Cultural, Embassy of the Republic of Indonesia, Kuala Lumpur, I sincerely wish you good luck *and a* successful program with unforgettable memories.

Wabillahit Taufiq Wal Hidayah
Wassalamu 'alaikum warahmatullahi wabarakatuh.

M.Imran Hanafi

Education and Cultural Attache Embassy of the Republic of Indonesia

MESSAGE FROM DEAN CENTRE FOR POSTGRADUATE STUDIES

Assalamu'alaikum warahmatullahi wabarakatuh

Praise be to Allah. May the peace and blessings of Allah be on the last prophet and messenger, our master Muhammad and on his household and companions. It is a great privilege for me to foreword this message to this wonderful event that is jointly organized by the Universitas Muhammadiyah Yogyakarta (UMY) and International Islamic University (IIUM).

First and foremost I would like to record my special gratitude to management of Universitas Muhammadiyah Yogyakarta for their co-operation.

In order to obtain comprehensive excellence, the Centre for Postgraduate studies has always facilitates postgraduate students of the university to achieve the highest quality in their academic work. This seminar is one of the many programs that Centre for postgraduate studies has to ensure quality graduates.

I would therefore like to thank all the participants and programme coordinators who have worked hard to realize this event.

May Allah SWT shower His blessing upon us.

Wassalamu'alaikum Wr, Wb.

Prof. Dato' Dr.Wan Rafaei Abdul Rahman
Dean, Centre For Postgraduate Studies

MESSAGE FROM THE ACTI
PRESIDENT OF POSTGRADUATE STUDE

Assalamu'alaikum warahmatullahi wabarakatuh

On behalf of Postgraduate Students' Society (PGSS), my gratitude and appreciation to our beloved Dean of Studies, the Embassy of Indonesia in Kuala Muhammadiyah Yogyakarta and the organizing com IIUM and the Universitas Muhammadiyah Yogyakarta huge success. Postgraduate Students' Society (PGSS) u supervision of the Center for Postgraduate Studies (CP this event.

As I strongly believe that the initial stages of unity a and building the new generation, who will represent t more, such programs, not only achieve the missio universities but to achieve the global mission and Therefore, I believe today, we have to have understa and then only we can appreciate our diverse cult acknowledge the different strengths posses in us an weaknesses through knowledge in this age of informa sure this joint seminar will initiate unity among the fut along with integrating them.

Thank you,

Mohd Nabi Habibi

MESSAGE FROM PROGRAM DIRECTOR

Assalamu'alaikum warahmatullahi wabarakatuh.

Praise be to Allah. May the peace and blessings of Allah be on the last Prophet and Messenger, our master Muhammad and on his household and companions.

Honestly speaking, we are pleased to be trusted by Postgraduate Students' Society (PGSS) and Centre for Postgraduate Studies (CPS) to organize the programme named Educational and Cultural Visit to Yogyakarta, Indonesia. For this, We express our gratitude to the management of both PGSS and CPS. This programme is of immense value. It has the potentials to promote intellectual endeavor, develop leadership capabilities and enrich cross-cultural understandings. We sincerely believe and hope that program of this kind will be organized in a regular fashion in future.

It is a great privilege for us to play twofold role in organizing this event: *as a host* and as *guest*. In fact, this is a fascinating experience to manage this event. Since our inception here, we have found meaningful interaction of students in an interweaving of cultures into complicated, yet beautiful, embroidery of social fabric. We are proud to say that this dearly loved university has produced graduates of high quality, who are distinct from those of the local universities.

Finally, we wish to express our special thanks to Bapak M.Imran Hanafi, Education and Cultural Attache of Indonesian Embassy, Bapak Herdaus, S.H., Assistant of Immigration Attache of Indonesian Embassy, Bapak Tharian Taharuddin for their immensely valuable assistance and co-operation in making this program a success. I sincerely appreciate all local committees at Yogyakarta, the colleagues and program coordinators and committee members who worked diligently to materialize this event. We wish to pass on good wishes to the PGSS for their valuable efforts it expended for this event.

May Allah s.w.t shower His blessing upon us.

Wassalam,

Nasrullah
Programme Director

Todi Kurniawan
Co-Programme Director

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ECONOMICS AND DEVELOPMENT ISSUES

The Impact of Rising Oil Prices on The Malaysian and Indonesian Economy

Mohd Edil Abd. Sukor*
Management Centre, International Islamic University Malaysia

Abstract

Oil is one of the great importance resources for the Malaysian and Indonesian economies. It is extremely difficult to view these two countries economic development without their oil resources and the revenue from it. The oil industry also has made substantial contribution in the infrastructural development to the countries. In December 2005, Asia's oil-guzzling economies are bracing for the worst as crude oil price threatens to hit USD$$70 a barrel, stoking fears of slower economic growth, soaring inflation and rising interest rates. Even Malaysia as a net oil exporter, believes it should also take an appropriate action in order to ensure the increase in oil price will bring a positive impact to the economy. As so as for Indonesia which has recently become a net oil importer as a result of dwindling production and rising consumption. If both of these countries do not conserve this situation, they will reach to the point where the countries' oil bill is threatening the foreign exchange reserves. This study will examine the consequences of hike in oil price to Malaysian and Indonesian economy through analyzing the microeconomic impact as well as the impact to the overall economy system. The study will also look into related factors such as the causes of price increase and the actions had been taken by the government to overcome this problem. Finally, the study will bring forward the market outlook for the oil industry and propose several solutions that can help the government to fix this problem. The main objective of this study is to ensure that the increase of oil price in this region will not harm the citizens of this country as well as the Muslim community. On the other hand, as a net natural resources (oil and gas) exporter, the countries should benefit from this situation and manage to enhance the distribution of Muslim wealth.

Keywords: oil price; impact; Malaysia; Indonesia; economy.

Introduction

When we talk about oil it is the crude oil that we are referring to. According to a Bloomberg dictionary crude oil is unrefined petroleum and it is a naturally occurring liquid. This commodity is traded in barrel as a standard measurement in the international trade. One barrel equals to 42 American gallons of oil at 60 degrees Fahrenheit. On the other hand, an American heritage dictionary published by Houghton Mufflin Co 2004 (4th edition) defines oil as any of numerous mineral, vegetable and synthetic substances and animal and vegetable fats that are generally slippery, combustible, viscous, liquid or liquefiable at room temperatures, soluble in various organic solvents, such as ether but not in water, and used in a great variety of products, especially lubricants and fuels.

Oil is one of the great importances to the Muslim economy. It is extremely difficult to view some of Muslim's economic development such as Malaysia and Indonesia without their oil resources and the revenue from it. On the other hand, oil industry has made substantial contribution in the infrastructural development in these countries. The oil corporations in these countries have developed the once remote regions in the east and west via new town development, improved port facilities and new and better transportation construction.

History of the oil industry

1- Malaysia

Oil was first discovered in Malaysia in a small town called Baram near Miri in the East Malaysian state of Sarawak in July 1882. However, commercial exploitation of this energy resource was not taken place until 1909 when the Anglo-Saxon Petroleum Company (i.e Sarawak Shell today) was given the authority to exploit the petroleum resources throughout the state. Prior to the 1950's, most of the oil exploration was done inshore until some preliminary evidence of oil deposits were found in the offshore areas of Peninsular Malaysia. During the late 1960's and early 1970's, oil exploration was performed by multi national oil companies (MNOCs) such as Shell, Esso, Elf Acquitaine and Oceanic and Sabah Telseki Oil Company in East Malaysia.

Historically, it was after the 1969 racial riots which led to the introduction of the New Economic Policy (NEP) that initiate the development of many new industries including the crude petroleum industry in Malaysia. In mid 1974, the government enacted the Petroleum Development Act with the major theme being the establishment of a government corporation who will be in charge with owning and administering all petroleum resources in this country. That national petroleum corporation is known as PETRONAS. Petronas later expanded to include its upstream and downstream businesses. With that, the government has reduced its overdependence on MNOCs for production technology and know-how. Among the initial steps taken by PETRONAS at that time was to abolish the "unfavorable" Concession System. August 17 1974 marked the transition from the Concession system (under which the petroleum operations in Malaysia were handled by multinational oil companies) to the current system of Production Sharing Contracts. Under the new system, the foreign oil companies are awarded offshore blocks to prospects of petroleum. Any oil or gas extracted, after deducting 10 per cent and 20 per cent for royalty and cost recovery for the contractors respectively, will be shared between PETRONAS and the contractors in the ratio of 70:30.

Based on macro analysis, Malaysia experienced steady growth in the production of crude oil. Beginning from 4,000 barrels per day in 1968 until more than 900,000 barrels per day of crude oil was produced in 2004. The initial exact drastic increase in production took place in 1973 with the formation of oil cartel, OPEC in the oil industry followed by the establishment of PETRONAS in 1974. Petroleum exports accounted for only 4 percent of the total exports in 1973, which later increased their share of the export structure to 7.9 percent in 1975. In ringgit terms, crude petroleum earned an export value of RM727 million in 1975. By 1980 with an export value of RM6.70 billion, it had become the country's chief foreign exchange earner outnumbered Malaysia's earlier other exports earners like rubber, palm oil and tin. In 1982, Malaysia's major export markets were Singapore, Japan, Thailand and the United States, which accounted for 46.08 percent, 27.86 percent, 10.99 percent and 3.74 percent respectively, of total crude oil exports. By 1986, crude petroleum products was largely serving the Japanese market, which accounted for 35.54 percent of the total crude oil exports overtaking Singapore, Thailand and the United States. Until today Japan is one of the major oil importing countries in the world.

2- Indonesia

In December 1871, Jan Reerink a young Dutchman has drilled and risked his private capital in Cibodas that marked the beginning of oil and gas exploration and drilling in Indonesia. The concession was granted to him in August 1873. Since his strategy was not successful and the enterprise was deemed not commercial Jan lost his capital and quit from the industry. Another explorer followed, Aeilko Jan Zijlker who in 1880 visited a plantation in Sumatra. He got an oil concession from the local Sultan of Langkat, and oil exploration soon began with a sponsorship of the Dutch government in the Telaga Said area of the Northern Sumatra. In 1884 Telaga Tunggal-1 in Northeast Sumatra was successfully drilled. In September 1890, the Royal Dutch (company for exploitation of oil resources in the Netherlands Indies) received a concession for the area instead of Aeilko Jan Zijlker.

Even though Indonesia had proclaimed its independence on the 17th August 1945, and the Dutch government recognized the sovereignty of the Republic of Indonesia, foreign oil companies' petroleum activities were still based on the Indische Mijnwet (the valid mining law during Dutch Indies) when they returned to Indonesia in 1949 to resume their operations. In 1951, an Indonesian lawyer and a former Governor of Sumatra Teuku H. Moehammad Hasan has filed a motion to replace the Indische Mijnwet with a National Mining Law and urged the government to postpone the issuance of new concession and exploration rights. His effort has continued by the first Minister of Basic Industry and Mining, Chairul Saleh where he has finalized the National Mining Law, because up to 1960 the parliament was unable to formulate it. In 1960, the Government Regulation on oil and gas mining was accepted by President Soekarno and completely replaced the Indische Mijnwet. As a follow up to this regulation, the Government formed three state oil companies, namely PN PERTAMIN (Indonesian State Oil Mining Company), PN PERMINA (National State Oil Mining Company), and PN PERMIGAN (State Oil Mining Company). In 1963, the Government succeeded in persuading the existing three foreign oil companies, i.e. SHELL, CALTEX and STANVAC, to co-operate in the form of Work Contracts with those three state oil companies.

In 1966, PN PERMIGAS was dissolved, and its assets were handed over to PERTAMIN and PERMINA. In 1968, these two companies were then merged to become PN PERTAMINA (National State's Oil and Gas Mining Company), which, later, in 1971, became PERTAMINA (the State's Oil and Gas Mining Company) with the task to carry out the exploration and production of petroleum resources throughout Indonesia. PERTAMINA has legally transformed to be PT PERTAMINA (PERSERO) since September 17, 2003 by the enactment of Government Regulation No.31/2003. Pertamina is now under the coordinator of the State Minister of State-owned Enterprises. Like other contractors, as a business player Pertamina also holds Cooperation Contract to Oil and Gas Regulatory Body. Due to the transformation to be a Limited Liability Company, Pertamina becomes a pure business entity which is more profit oriented. Indonesia joined OPEC in 1962 and during 2004, Indonesian Minister of Energy and Mineral Resources Purnomo Yusgiantoro held the rotating OPEC presidency. In June 2005, Indonesia received a 233,000 barrel per day (b/d) quota increase to 1.451 million b/d, although actual output is closer to 1 million b/d. The Ministry of Energy and Mineral Resources has stated that Indonesia intends to remain an OPEC member despite its falling net oil export volumes. As Indonesia finds it increasingly difficult to maintain a net exporter status, industry observers will likely continue to question whether the country should keep its OPEC membership. Asian countries are the largest markets for Indonesian crude oil exports. In 2004, Japan accounted for 25 percent from the total export, followed by South Korea (20 percent), China (12 percent), Australia (9.7 percent) and the United States (5.7 percent).

Causes of Price Increase

In December 2005, Asia's oil-guzzling economies are bracing for the worst as crude oil price reached USD$70 a barrel, stoking fears of slower economic growth, soaring inflation and rising interest rates. Before we analyze what are the consequences of hike in oil price to the Malaysia and Indonesia economy, we must first know why has it increased? According to National Economy Action Council (NEAC), the reasons are mainly due to forces of demand and supply, adverse whether conditions and speculation of oil price.

Global oil demand for the first half of 2005 is at 82.8 million barrel per day (mb/d). The figure is 1.3 million barrel more that the same period in 2004 despite the price increase. The driving factor is the strong demand from the developing Asia especially China and India and still-strong growth in US. Together, China and India accounts for 40 percent of the growth in oil demand. Despite the robust demand, the supply is uncertain. The refiners are facing severe capacity constraints thus, struggle to increase operating inventory levels. Most countries have lifted their oil inventories due to tight and volatile supply. Moreover, there is a lack of investment in appropriate refining capacity due to mismatch of type of refining capacity and the resources available.

To accommodate the demand, world oil supply has increased as well, up by 1.7 mb/d to 84.1 mb/d in the first six month of 2005. However, OPEC's spare capacity has reduced to 2.2 mb/d. There were also countries that are prone to supply disruption such as Iraq, Nigeria and Venezuela. Excluding the supplies from these countries, world spare capacity is at 1.4 mb/d. Events such as hurricane along the US Gulf Coast, anxieties over Iran's resumption of nuclear activities and terrorist attacks on Saudi Arabia has pushed the price through out the year. High price of oil is expected to remain through 2006. Constraints are being felt along the supply chain. Fundamental tightness in current crude oil supply-demand balance, risk and threat of supply disruption, robust demand and weather-accident related supply cut has contributed to the increase.

Consequences of the Oil Price Increase to the Economy

1- Malaysia

Malaysian economist has projected that the growth for 2005 is 5 to 6 percent as compared to 2004 of 7.1 percent. The first quarter of year 2005 has recorded a 5.7 percent growth but it is expected to drop to 5.1 percent towards end of the year. The drop is actually very minimal due to the offsetting effect of the increased growth in the oil production sector and reduced growth of non oil sector and demand for partner countries. The hike in oil price has directly affected the production of oil in Malaysia. The first six month of 2005 shows that production of crude oil and concentrates dropped by 7.2 percent and the volume of export has declined as well. The drop in oil production is mainly due to the lack of major new oil discoveries in the last years. According to Deputy Prime Minister Najib Razak, if Malaysia does not find new oil reserves from 2005, then by 2009, Malaysia will become a net importer. On the other hand, the production of natural gas has expanded to 16 percent thus contributing overall positive growth of 0.9 percent. *In short*, the growth in crude oil has dropped but being offset by the growth of natural gas production. Therefore, the increase in oil price did not give significant impact on the growth of oil production as the production of crude oil in Malaysia has decreased. The offset thus gives a marginal growth of 0.1 to 0.2 percentage points.

The high oil consuming sectors are badly affected by the higher oil price. Examples are transportation and industries sectors. The total energy consumption of both sectors is amounting to 40 percent where industries are dependent on fuel oil and transportation needs diesel. Therefore, increase in the fuel price will significantly increase their cost of operation and squeeze the profit margin. An obvious example is the impact on airlines sector. Both Malaysia and low cost carrier Air Asia responded to rising fuel costs by imposing surcharges for the first time. Players in the freight industry also bore the brunt of higher oil prices as their business volume declined. The Airfreight Forwarders Association of Malaysia said cargo shipped by air to and from Malaysia had dropped, as high jet fuel prices were forcing companies to use the cheaper sea route. The bottom of all the adverse effect to the non oil production is a drop of real growth by 2.25 to 2.5 percentage points.

Malaysia real GDP is made up significantly of export of goods and services to partner countries. Apart from manufacturing, the tourism sector is also significant to the country growth. Statistically, the main tourists are from Singapore which accounts for 60 percent, followed by Thailand and Indonesia. Thus, any distress in their economic will be Malaysia major concern as it will restrain the growth and demand of Malaysian good and services. In fact, the average growth rate of Malaysian seven important export countries has declined by to 3.7 percent in 2005 as compared to 5.2 percent in 2004, a drop of 30 percent. The arrival of tourist from these countries has also dropped. Overall, the demand for Malaysian products and services is reduced for the year and will contribute of approximately 9 percentage points to the overall growth as compared 2004 where it has contributed 17.6 percentage points. Hence, the net impact of the Malaysian real growth is negative, between -0.6 to -0.7 percentage points.

Furthermore, the oil price hike has put pressure on the prices of goods and services. The recorded consumer price inflation was at 3.4 percent by end of 2005, 1.3 percent higher from 2004. This has been speed up collectively by the three times increase in retail oil price and the raise in transportation cost such as taxi fares and freight fees in such a way that has increased the ceiling price of control items such as chilies, flour, coconut etc. Rise in oil prices has reduced industry output through higher costs of production. This supply side impact exerts inflationary pressure on the economy. As mentioned before, industries that consume a great deal of energy and chemical products will be directly affected by escalating oil prices. Airlines will be the most direct and largest hit because they cannot fully hedge the fuel cost. Malaysian Airlines has already making losses. However, the effect could have been more upsetting if government did not postpone the further change in oil price and electricity tariff to 2006. Thus, the monthly inflation rates for the last four months of 2005 declined gradually and are expected to decline hereafter although year 2005 has recorded a figure which is doubled from 2004 figure (2005: 3 percent, 2004: 1.4 percent). In March 2006, the inflation rose to 4.8 percent, but moderated to 3.9 percent in May 2006, partly because of the February 2006 increase in retail fuel prices. The impact of an oil price rise can be amplified by price-wage spiral effect. As the price level for most of the goods and services are higher, the work force will demand higher salary to compensate the reduced purchasing power. This will increase the cost of production which will then, be transferred to consumer via again, higher price. This situation could cause hyper inflation.

In 2004, Malaysian government spent RM4.8 billion for fuel subsidy. The amount has risen to RM6.6 billion even after the government reduced the subsidy. It is due to the fact that there has been an increase in oil consumption. By lifting part of the subsidy, the government actually saved approximately RM1 billion as the projected subsidy for 2005 was RM7.6 billion. The saving could be used for the benefit of the citizen such as building more schools and public infrastructures. The overall picture of subsidy impacts has created market distortion since the fuel price in Malaysia does not reflect the actual cost of oil production. This scenario could jeopardize Malaysia economics that resulted in excessive fuel consumption and wastage due to inefficient usage by oil consumers. Furthermore, due to fuel price scheme difference has attracted illegal trade such as smuggling. This activity has created outflow of Malaysia government money worth of RM 660 million from the allocation for subsidy. Through a better system this loss could be recovered and this big amount of money can be converted to an opportunity cost for constructing and improving public infrastructure such as hospital and road surface condition. Beside that, the recovered subsidy money from illegal trade can be used to reduce budget deficit.

Hence, as a net oil exporting country, Malaysia is benefiting from the oil price increase as it increases the revenue via corporate income taxes payable by the oil companies, import duties and excise duties. The government also collects non-tax revenue in the form of cash payments from petroleum production and dividends from PETRONAS. Furthermore, as a net oil exporter, we gain more as the big rises in oil prices has shifted the income from consumer to producer (and so from net importing countries to net exporting countries).

To summarize the impact of oil prices to Malaysia's economy, it would be beneficial to measure the impact on the individual components of Gross Domestic Products (GDP). We would first look into the Consumption Expenditure (C). The higher goods and services prices has lowered consumers' purchasing power thus, reduce national consumption. Because of the partial subsidy lift and increase in tax collection, government revenue has increased. However, the impact was minimal due to loss of revenue in terms of tax exemption. Therefore, for Government Purchases (G) component, there was not much difference. In order for the Malaysia government to curb or contain with inflation problem, they need to reduce the spending activities by Malaysian and encourage public to increase their saving. This could be achieving through imposing higher interest rate. The main reason of this shall lead investors to avoid investing within the Malaysia market. From this scenario, it shall contribute to decrease in total investment (I) and dampen the growth. As a net oil exporter (X), the price increase has boosted the export thus, resulting in trade balance surplus as well as current account surplus. As a conclusion, the impact of rising oil price has resulted in slow growth of the Malaysia economic. This is basically due to the contribution of two GDP components C and I that are having declining situation. Where else other having one increasing condition and one nearly no effect at all.

2- Indonesia

Sustained high oil prices will act as a drag on Indonesian economic growth, because Indonesia has recently become a net oil importer as a result of dwindling production and rising consumption. Estimates of Indonesia's growth rate for 2005 have been marked down. The global bank UBS revised its projection for the second half of the year from 5.2 percent to 4.7 percent and now forecasts a growth rate of just 4.3 percent for 2006. Other analysts put the growth figure for the year at between 5.5 and 4.8 percent. Reflecting deteriorating economic conditions, the Jakarta stock market by late August had dropped 13 percent from its record high in July. In order to alleviate economic hardships, the government has offered one-time subsidies to qualified citizens. The government has stated to reduce subsidies, aiming to reduce the budget deficit to 1 percent of gross domestic product (GDP) in 2005, down from around 1.7 percent last year.

As oil prices have risen, the government has had to budget billions of dollars more to provide these subsidies. In March 2005, Indonesia faced major protests after the Government cut fuel subsidies by 29 percent. Then, in August, the rupiah tumbled in the currency market on concerns that monetary policy was too loose and that continuing oil price increases and tightly capped fuel prices would expand the Government's fuel subsidy bill to as much as USD$14 billion or five percent of GDP in 2005.

As a net importer, the added cost of buying imported oil has also contributed to the fall of the rupiah as state oil companies, including Pertamina, have had to purchase extra US dollars. Oil imports cost USD$1.6 billion in July 2005, up from USD$1.1 billion in January. The country's central bank, Bank Indonesia, has been compelled to intervene to try to prop up the value of the rupiah, which has fallen 10 percent against the US dollar since the beginning of the year. Between April and mid-August, Bank Indonesia spent USD$5 billion, 15 percent of its foreign currency reserves. The bank also hiked up its key interest rate twice in a week by 0.75 percent and 0.5 percent to 10 percent by September 6. The problem has been made worse by the lack of investment in the oil industry, which has led to falling domestic production even as consumption has been rising.

Furthermore, the oil price hike has made inflation in Indonesia rather remarkable. In October 2005, The Jakarta Post reported that rice, sugar and cooking oil prices had begun to rise before the fuel price hikes were announced. In addition, low-income people, who normally use kerosene daily, have suffered when the government increased the kerosene price. Inflation is running at an annual rate of 9.1 percent. In December, due to the substantial drop in rupiah value, the government was forced to cut its massive fuel subsidies. This led to a more than doubling in the price of consumer fuels, resulting in double-digit inflation. The situation has stabilized, but the economy continues to struggle with inflation at 17 percent in January 2006. The fuel price hike policy will indeed increase the burden of the people, and may even cause an increase of poverty.

Indonesia has experienced a significant slowdown in the growth of exports in sectors where it traditionally has had a comparative advantage, including furniture, palm oil, rubber, textiles, and footwear. In some cases, exports have seen an absolute decline. The average growth rate for non-oil and gas exports has slowed to about 13 percent in recent years, from 17 percent before the Asian financial crisis. Higher inflation and interest rates impeded both private consumption and investment spending as the year progressed. Growth of private consumption slowed by 1 percentage point to 4 percent, while growth in fixed investment, after showing encouraging signs of recovery, slowed by about 4 percentage points to 9.9 percent. Year on year GDP expansion stepped down from 6.3 percent in the first quarter to 5.6 percent in the second and third, and to 4.9 percent in the final quarter. Indeed, the economy contracted by 2.2 percent in the fourth quarter from the third. An 8 percent rise in government consumption spending in the later part of the year contributed to the full year GDP performance of 5.6 percent, up 0.7 of a percentage point from 2004. Overall, private consumption and fixed investment contributed about 4.5 percentage points, while net exports continued to be negative. As a conclusion, the impacts to the Indonesia economy due to the oil pricing increase are not so much different compare to Malaysia situation. Both countries experienced slow growth in real GDP. However, Indonesia face worse situation compare to Malaysia since now they became a total net importer of oil. The huge subsidies for the oil, depreciation in currency, drop in investment and increase in total production cost become the major factors for this situation.

Market Outlook and Suggestion

1- Malaysia

On the global front, overall economic outlook is not as encouraging in 2005. Country specific domestic factors aside, structural imbalances, adjustment in the world currency markets, heightened inflationary pressure as a result of persistently high oil prices, as well as a higher global interest rate environment, are expected to continue dampen growth prospects in the world major economies, hence dampening the economic growth of other developing countries which are predominantly dependable on exports, and exports to these industrialized nations. As a small net oil exporter, crude oil has a 5 percent share of exports. Malaysia benefits to a degree from the higher world oil prices. However, an extra USD$10 a barrel over all of 2005 could push up inflation by 1.4 percentage points, hurting domestic demand, and leading to a decline in the GDP growth rate of 0.9 percentage points. In the medium term though, burgeoning regional demand for energy offers many economic opportunities. Deepwater exploration is accelerating, driven by the expectation that higher prices are likely to be sustained for some time. Various new exploration agreements have been made public over the last few months. Petronas, the national oil company, plans to raise oil production by 20 percent over the next 10 years, which will require exploitation of many new oil and gas fields. Consequently, energy production is predicted to be a pillar of the Malaysian economy and a focus of new foreign direct investment.

Oil is a global commodity that has enduring economic and geopolitical dimensions. Price volatility obviously is the name of today's oil game and energy security seems to be today's response. To mitigate the region's heavy dependence on Middle East oil, coupled with the fact that oil exporters like Malaysia is expected to become net oil importers after 2010. Malaysia under ASEAN is pursuing a sustainable energy development agenda under its ASEAN Plan for Action in Energy Cooperation (APAEC) 2004 -2009. On the other hand, Malaysia should look into improving energy technologies with a view to enhance energy efficiency. For instance, the introduction of cogeneration technology, a method to produce both heat and electricity from a single fuel source, has been successfully applied in Thailand and Indonesia. Cogeneration plants can use almost anything as fuel, including coal, gas, petroleum, and agricultural by products, such as rice husks, oil palm or even animal waste.

Malaysia's oil and gas reserves in fact have sustained at the 19 to 20 billion barrels of oil equivalent (BOE) level over the last three years, up from just above the 18 billion barrel level in 2001. The 19.5 billion BOE reserves as at 1 January 2005 translate to a reserve life of 34 years for gas and 18 years for oil. In addition, Petronas has been actively building oil and gas reserves overseas as well. As at 1 January 2005, Petronas' oil and gas reserve overseas stood at 5.9 billion BOE that is equivalent to 30 percent of the size of its reserves in Malaysia. These overseas oil and gas reserves are largely located at Africa, Middle-East, Central and South East Asia.

Solutions should focus on the long term impact. From the tax perspective, the tax imposed under the Petroleum Income Tax Act should be increased to generate the revenue needed. The petroleum tax rate is in a reducing trend. If oil prices hit USD$100 per barrel, it may be economically viable to go into alternative energy sources. Biomass and oil palm have good potential. Perhaps tax exemption could be given for research expenditure into these areas, as well as the use of renewable energy. Overall, it would appear that sustaining the economic power of the consumer would have greater effect than protecting some industrial players from the economic crunch. With the object to ensure oil availability in the event of physical disruption in supply need to build up of strategic reserves of oil. This was in practice by the US and several Asian countries like PRC and India. Strategic Petroleum Reserve is the largest stockpile of government-owned emergency crude oil in the world. It also allows the Government to meet part of its International Energy Agency obligation to maintain emergency oil stocks, and it provides a national defense fuel reserve.

2- Indonesia

Indonesia Government's policy to subsidize domestic fuel prices has put the fiscal position under pressure if the global oil prices continuing soar. Despite major resources of oil, natural gas, and coal, Indonesia is still vulnerable to rising oil prices due to underinvestment in oil production and rapid demand growth. Furthermore, in the event of still higher oil prices, Indonesia budget deficits may be larger than expected, risking an end to several years of determined fiscal consolidation. If the Government stated that it plans to raise fuel prices again sometime after October 2005, it will face another negative reaction from the citizen as well as country's financial markets due to lack of clear policy measures.

Inflation averaged 7.7 percent in the first seven months of the year 2005, well above expectations, due to higher food prices, an increase in fuel prices, and a weakening of the rupiah. Full year inflation for 2005 was estimated at 7.5 percent, up from the 5.9 percent forecast in April by the Asian Development Outlook 2005. The inflation projection for 2006 also is raised, to 7.5 percent from 5.4 percent. During the course of 2006, pressure on the rupiah from high world oil prices may also subside with Indonesia's imports of petroleum products expected to fall after the government sharply increased fuel prices in October. Moreover, all the currency transactions related to the government's oil-related exports and imports are now carried out through the central bank. This new arrangement will certainly benefit the rupiah as the ups and downs in oil prices will no longer affect the demands for U.S. dollars in the forex market. Besides this, the rupiah may also be supported by some new currency trading restrictions recently announced by Bank Indonesia that oblige market players to have an underlying business transaction before carrying out any rupiah transaction.

The new Government has set itself a target of 6 percent real GDP growth on average per year during the next 5 years of its term. For this to be realized, Indonesia needs to attract greater foreign and domestic investments to offset the infrastructure shortfalls that have economy wide implications. Strategically, the Government's policy focus on the energy sector will be watched closely for two reasons. It needs to boost oil and gas production, through catching up on investments that have steadily declined over the last 10 years. At the same time, the Government also needs to address the politically sensitive issue of reducing the burgeoning domestic subsidies on oil.

Indonesia still faces a number of economic challenges and much work needs to be done. The first priority remains how to expedite the broad-based reform of the country's notorious bureaucracy and a crackdown on endemic corruption. In the year ahead, the government and the central bank must also work closely to maintain economic stability, budgetary discipline and, at the same time, keep inflationary expectations low. The government should also adopt a middle to long term strategy that allows the government to stop borrowing abroad and form a policy of substituting domestic debt for foreign debt to curtail the exchange rate risk.

In addition to spur further growth, the government needs to initiate breakthrough policies in the real sector, emphasizing particularly on how to encourage labor-intensive export-oriented manufacturing sectors. A continued effort to scrap unnecessary taxes, duties and illegal fees that only hamper export activities and a quick clearance of an investment bill would send out a strong and highly visible signal to investors. Finally, a robust monetary policy to ensure a stable rupiah would be in order, given the inflationary pressures in the next few months to come. Nonetheless, there are many pending issues that are still languishing, such as the excessive regulatory burden, investment and labor law amendments and tax reforms. Even the crucial tax reforms may only be implemented in early 2007 at the earliest due to the predicted debate in the legislature. However, we must realize that policy always makes a difference.

Islamic Perspective

In Islamic economy point of view, man should aware with his commitment to Allah, the focus of all his reverence, gratitude and action and the only source of value which we call as Tawhid. This mean an understanding of the concept of property in Islam is one of the foundations of behaviour for both the Government and citizens. The starting point is that Islam sets goals for human life. The distribution of wealth in the country must help in achieving social welfare or called maslahah. Maslahah was divided into three level: necessities (Dharuriyat), complements (Hajiyat) and embellishments (Tahsiniyat) according to order of priorities. Necessities relate to those elements that constitute the basis for life and order. These include all basic needs such as food, clothing, shelter, transport, etc. Infact the basic needs vary according to place and time. Complements are basically facilities that are meant to ease life and impart conveniences, such as investments in credit facilities. The third level, embellishments constitute mostly articles of luxury and beauty, for instance luxury cars, etc. The country's wealth must go and fulfill the necessities activities first before it goes to the other levels.

Wealth from natural resources such as oil according to many Muslim scholars cannot be private. It must be for the total altogether, for the benefit of the whole society. This is very important to bring forward justice in the society. Justice is the main agenda in the Islamic economy. The Government must ensure Justice for the people of the country. The country must provide the citizen with the rights and sufficient of food, shelter, clothes, education, medical services and security of life and property. In the eye of Islam, leaders are defined as servants of the people that they would have to ensure the above facilities and services for the citizens. On the other hand, Islam grants every citizen the right to express his opinions by all peaceful means under his disposal and to stand against oppression. The impact of rising oil prices on the Malaysian and Indonesian economy seem not so much difference. Indonesia as a net oil importer experienced slightly worse condition compare to it neighbour country Malaysia. Nevertheless, both of these Muslim countries need to ensure the increase of oil price in this region will not harm the citizens of this country as well as the Muslim community.

Conclusion

After the relatively low prices seen in the first half of the 1990s, when the price of crude petroleum rarely exceeded USD$20 per barrel, the price of oil began to rise in 1999 and culminated at USD$70 per barrel in December 2005. This surge in oil prices worries governments in many oil importing countries, which fear the detrimental effects of a substantial and long-lasting rise in energy prices on output growth. This is a special concern for many developing countries which have become increasingly dependent on oil imports as industrialization has progressed. Oil price shocks have repeatedly had a negative aggregate impact on global economic activity. The reason for this has to be mainly sought in the response of economic policy in countries affected by an oil price shock. Inappropriate reactions, particularly from those responsible for wage and monetary policies, can aggravate the situation and lead to losses in economic activity that could otherwise have been avoided. The fallen of world oil prices by almost 18 percent to USD$60 a barrel recently hope will become a great chance to the countries economy to recover any unfavourable condition which has occurred. The past experienced from the increase in oil prices can be a good teacher for them in running the country economy.

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