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UNITED STATES SECURITY INTEREST IN RECENT DEVELOPMENTS AFFECTING THE SUPPLY OF RUBBER, WITH PARTICULAR REFERENCE TO SOUTHEAST ASIA

Strategic Importance of Rubber.

Rubber is one of the most strategic commodities for the conduct of a major war. When the Japanese cut off United States imports of natural rubber from Southeast Asia, the source of most of our supplies of that commodity, it became necessary for the US to build a huge synthetic rubber industry. Continued maintenance of synthetic rubber-producing capacity is essential to US security as long as the possibility remains that access to the natural rubber of Southeast Asia may again be cut off. Since rubber products using present grades of synthetic require, on the average, about 25 percent of their content to be natural rubber to assure good quality (heavy-duty truck and bus tires particularly require a high percentage of natural rubber) an adequate stockpile of natural rubber also is essential to national security. Furthermore, not only because of the importance of the products deriving from this area and the contribution of the dollar return from them to Western Europe but also because of the strategic location of Southeast Asia, the establishment of political and economic stability in this area is of serious concern to US security.

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US Synthetic Rubber Program.

Present Government synthetic rubber capacity is adequate to provide nearly 70 percent of current US annual consumption of new rubber. The Rubber Act of 1948, which expires 30 June 1950, requires that 665,000 long tons of that synthetic rubber capacity be maintained in active or standby condition and that these facilities shall produce not less than one-third of their rated production capacities. The law further provides allocation and specification controls, under which regulations have been promulgated requiring that the mandatory production of synthetic rubber be consumed in the manufacture of products used in the transportation field. In the United States--United Kingdom--Canadian conversations of September 1949, the US agreed to increase the competitive area for natural rubber, and accordingly modified these regulations so as to permit an estimated 50,000 tons of natural rubber to replace a like amount of synthetic rubber in 1950, in addition to 15,000 tons permitted by changes made in July. Actual consumption of synthetic rubber is considerably higher than the mandatory requirements, and includes substantial voluntary consumption in the non-transportation field, thus indicating preference for man-made rubber in many uses and a permanent inroad on future consumption of natural rubber. An inter-agency committee is preparing recommendations for legislation to extend the synthetic rubber program beyond 30 June 1950. These recommendations will cover sale or lease of the Government synthetic rubber plants and mandatory production and consumption of synthetic rubber. In formulating its recommendations the committee will give consideration to the relationship of synthetic rubber production and consumption to national security, including the economic and political effects of the program in Southeast Asia.

The recently developed "cold" synthetic rubber, which is coming into full production with rated annual productive capacity of 200,000 long tons, is claimed to give 30 percent greater mileage in passenger car tires than natural rubber. Some authorities are of the opinion that as its cost of production is reduced and its quality improved, "cold" rubber will substantially replace natural rubber in transportation uses in the next ten years. Such a development would be highly unfavorable to natural rubber, as about 70 percent of United States consumption of new rubber is in the transportation field. Others maintain that considering the ever-growing uses of rubber, consumption of natural rubber nevertheless will not be reduced despite its displacement in the passenger-car tire field.

US Stockpile Purchases.

The present Government stockpile of natural rubber amounts to about 430,000 tons (not all received), sufficient for about 9½ months' supply at the current rate of consumption of natural rubber. The current stockpile objective is 600,000 tons, but as a result of the US--UK--Canadian conversations the US has agreed to give consideration to increasing this goal. Government purchases, temporarily suspended in the first half of 1949 because of exhaustion of funds are now (fiscal 1950) retarded by application of stockpile funds to purchase of other strategic materials of which a lower percentage of the goal has been acquired. Some acquisitions, however, are being made through the use of ECA counterpart funds.

Importance of the Natural Rubber Industry to Southeast Asia.

The natural rubber industry is highly important to the economies of Southeast Asia, which area produces over 90 percent of world output. Malaya and Indonesia alone produce three-fourths of the world total. Natural rubber is the most important dollar-earning commodity of the sterling bloc and constitutes over one-half of the value of Malaya's exports and about one-third of Indonesia's. Investments in the rubber industries of the two areas total about $1\frac{1}{2}$ billion dollars. During and after the war, however, considerable damage was inflicted on rubber lands and producing facilities in Malaya and to a lesser extent in Indonesia. Following the surrender, additional damage resulted from depredations by bandits and guerrillas in Malaya and by certain Republican elements in Indonesia. The cost of rehabilitation has been heavy and the work is not entirely completed.

Malaya's present leadership as the largest producer of natural rubber will decline over the next few years as its older trees become less productive and as production from younger and higher-yield trees increases in other areas, particularly Indonesia. About 6 or 7 years are required for a rubber tree to come into bearing, and only a small portion of Malaya's rubber acreage has been replanted with high yielding strains.

The rubber-producing interests in Southeast Asia attribute much of their difficulties to the US policy of mandatory consumption of specific quantities of synthetic rubber. As a result, some ill-will toward the US has been aroused in that area.

Although demand for natural rubber has exceeded the supply since the end of the war, there is a probability that within the next decade a surplus will arise. This is based on the assumption that the outcome of the Indonesian and Indochinese situations will be peaceful, that the Malayan output will continue to be available, and that synthetic rubber will make further inroads into the US market.

Prices and Costs of Production

The dollar price of natural rubber is now at approximately the same level as in 1939 despite much higher wage and other costs of production and a general level of prices much above the prewar level. The principal cause of the divergent trend of the natural rubber price from that of most other commodities since prewar years is the production and utilization of synthetic rubber on a large scale. In the absence of synthetic rubber production, supplies of natural rubber would have been extremely short (relative to demand at prices in the current range) with the consequence that natural rubber prices would have been very much higher.

Natural rubber prices received by producers during the first three-quarters of 1949 were at a level which, coupled with declining sales to US markets, tended to produce economic hardship, and consequently to aggrevate political instability, in the rubber producing areas. Sterling devaluation in September 1949 has helped to alleviate that situation somewhat for the present, as the sterling price of rubber--the price received by the producers--increased immediately and is now about 30% above the pre-devaluation level.

The dollar price of first-grade natural rubber is now (December 1949) about 5/8-3/4 cents below the Government price of 18½ cents per pound for GR-S or general-purpose synthetic rubber, a competitive price relationship which will tend to stimulate increased US consumption of the natural product. So long as consumption or substantial quantities of synthetic rubber is mandatory, however, there can be no freely competitive market for the two types of rubber.

At least just prior to devaluation a considerable portion of Malayan estate rubber was produced at a loss. Cost of production of natural rubber varies widely because of local conditions, differences in estate and smallholder operations, different methods of arriving at the costs, and other factors. Before devaluation, cost of production on rubber estates in Malaya, which produce about 56 percent of the total rubber output there, ranged from US 11 cents to 24 cents per pound, and averaged about 16$\frac{3}{4}$ cents. Smallholders' cost, which is more difficult to ascertain, ranged from 9 to 12 cents per pound. The average cost of production of both estates and smallholders was estimated to be from 14 to 15 cents per pound before devaluation. Costs of estates and smallholders are not strictly comparable, however, because of differences in grades of rubber produced, and methods of arriving at the cost figures. Cost of production in Indonesia is lower than in Malaya.

By way of comparison, cost of production of GR-S rubber is about 14$\frac{1}{2}$ cents per pound for out-of-pocket expenses, and 18.1 cents including depreciation, interest on investment, and administrative expenses.

Whether the increase in the price of rubber in Southeast Asia since devaluation will afford sufficient economic relief, and whether it will continue, cannot be determined at this time.

Although it is not possible to predict future prices for natural rubber, it is apparent that a rather tenuous balance now exists between supply and demand. This balance could be upset by the following factors: (1) Increased use of synthetic rubber at the expense of natural, (2) Increased supplies of natural rubber following a return to more nearly normal conditions in Indonesia or Indochina, (3) Decreased US demand resulting from a curtailment of US business activity, (4) Cessation of US stockpiling programs.

Malaya is more vulnerable than Indonesia to any marked decline in rubber prices both by reason of its greater dependence on rubber and by reason of its greater proportion of higher-cost, estate output. Its vulnerability is made more acute by the necessity for importing two-thirds of its rice supply--and at prices which, in contrast to rubber, are several times those prevailing before the war. It may be noted that Malaya's only other important export, tin, also faces declining prices.

Although it is less vulnerable than Malaya, at least a a moderate drop in rubber prices, the economic viability of the emerging state of Indonesia would certainly be jeopardized should the return from its second most important export be greatly reduced.

Within the Malayan rubber industry the European estates are the most dependent upon maintenance of present prices. They employ large labor forces which are wholly dependent upon their wages.

Further Considerations

Although the Communists in Malaya have to date acquired no mass following, the British have been extended in containing their depredations. British resources are scarcely such that they could provide either greatly increased security forces or adequate economic relief in the event of widespread unemployment.

To lessen the dependence of Malaya on the rubber industry would obviously alleviate the vulnerability of its position, but drastic change in the structure of its economy can be accomplished only over a matter of decades. In contrast, a depression in its now basic rubber industry could occur over a very short period.

It is evident, therefore, that: (1) the economic and political stability of Malaya and, to a somewhat lesser extent, that of Indonesia are dependent upon the prosperity of the natural rubber industry and the return from rubber exports, (2) a decline in the price of rubber substantially below that now obtaining will, other things being equal, aggravate instability in both areas, with the degree of instability dependent upon the magnitude of the decline.

Proposed ORE
16 January 1950

UNITED STATES SECURITY INTEREST IN RECENT DEVELOPMENTS AFFECTING THE SUPPLY OF RUBBER, WITH PARTICULAR REFERENCE TO SOUTHEAST ASIA*

A decline in world demand for natural rubber much below the current level would have adverse repercussions on the economic and political situation in Malaya and, to a lesser extent, on that of Indonesia. Such decline would result, for example, from a business recession in the US or from a widespread substitution of improved synthetic rubber, such as the recently developed cold process type, for natural rubber. The consequent depression in the natural rubber producing industry of those countries would have detrimental effects there upon wages and employment, earnings and new investments, political stability, and the susceptibility of those areas to western influence.

The recently developed "cold" synthetic rubber, which is coming into full production with rated annual productive capacity of 183,000 long tons, is claimed to give 30 percent greater mileage in passenger car tires than natural rubber. Some authorities are of the opinion that as its cost of production is further reduced and its quality improved, "cold" rubber will substantially replace natural rubber in transportation uses in the next ten years. Such a development would be highly unfavorable to natural rubber, as about 70 percent of US consumption of new rubber is in the transportation field. The United States, Canada, the Soviet Zone of Germany, and the USSR are the only countries which are producing synthetic rubber on a commercial basis.

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* This paper is based on a more comprehensive report available as a D/Ec Working Paper.

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While the development of new markets and new uses for natural rubber will tend to support demand for the natural product, that support may not be sufficient to offset the possible decline in the use of natural rubber in transportation or to absorb the increased amount of natural rubber that could be produced under stable political and economic conditions.

The natural rubber industry is highly important to the economies of Southeast Asia, which area produces over 90 percent of world output. Malaya and Indonesia alone produce three-fourths of the world total. Natural rubber is the most important dollar-earning commodity of the sterling bloc and constitutes over one-half of the value of Malaya's exports and about one-third of Indonesia's. Investments in the rubber industries of the two areas total about $1\frac{1}{2}$ billion dollars. During the war, however, considerable damage was inflicted on rubber lands and producing facilities in Malaya and to a lesser extent in Indonesia. Following the surrender, additional damagehas been inflicted by the terrorists in Malaya and by the Republican guerrillas in Indonesia. The cost of rehabilitation has been considerable and the work is not entirely completed.

The rubber-producing interests in Southeast Asia attribute much of their post-war difficulties to the US policy of mandatory consumption of specific quantities of synthetic rubber in the transportation field. Consumption of synthetic rubber, however, is considerably higher than the mandatory requirements and includes substantial voluntary consumption in the non-transportation field, thus indicating preference for man-made rubber in many uses and a permanent inroad on future consumption of natural rubber. Competition from synthetic rubber in US markets has kept the price of natural rubber from rising much above prewar levels despite much higher wages and other costs of production in the natural rubber-producing countries. In the absence of synthetic rubber, supplies of natural rubber would have been very short and prices very much higher. As a result of US synthetic rubber policy, some ill-will toward the US has been aroused in that area.

During the first three quarters of 1949, declining sales to US markets contributed greatly to the decline of prices received by rubber producers to a level which tended to increase economic hardship, and consequently to aggravate political instability, in the rubber-producing areas. Sterling devaluation in September 1949 has helped to alleviate that situation for the present, as the sterling prices of rubber--the prices received by the producers--increased immediately and are now about 30 percent above the pre-devaluation level.

The Malayan economy is more vulnerable than the Indonesian to any marked decline in rubber prices by reason of its greater dependence on rubber. Its vulnerability is made more acute by the necessity for importing two-thirds of its rice supply--and at prices which, in contrast to rubber, are several times those prevailing before the war. It may be noted that Malaya's only other important export, tin, also faces declining prices. Although Indonesia is less vulnerable than Malaya, at least to a moderate drop in rubber prices, the economic viability of that emerging state would certainly be jeopardized should the return from rubber, its second most important export, be greatly reduced.

Within the Malayan rubber industry the "European" estates are the most dependent upon maintenance of present prices. They employ large labor forces which are wholly dependent upon their wages.

Although the Communists in Malaya have to date acquired no mass following, attempts to prevent the depredations of Communist-led bands have taxed British capabilities. British resources are scarcely such that they could provide either greatly increased security forces or adequate economic relief in the event of widespread unemployment.

To lessen the dependence of Malaya on the rubber industry would obviously alleviate the vulnerability of its position, but drastic change in the structure of its economy can be accomplished only over a matter of decades. In contrast, a depression in its now basic rubber industry could occur over a short period.

It is evident, therefore, that: (1) the economic and political stability of Malaya and, to a somewhat lesser extent, that of Indonesia are dependent upon the prosperity of the natural rubber industry and the foreign exchange earnings from rubber exports; (2) a decline in the price of rubber substantially below that now obtaining will, other things being equal, aggravate instability in both areas, with the degree of instability dependent upon the magnitude of the decline.

At estimated current costs of producing natural and synthetic rubbers, natural rubber can, at least for the present, compete favorably on a price basis with the synthetic product. Prices received by producers are now at a level which should encourage natural rubber production. The principal threats to profitable natural rubber production are likely to come from (1) the development of a greatly improved synthetic product or (2) further reduction in the cost of producing the synthetic or (3) business recession in the principal rubber markets or (4) large increase in output of natural rubber in Indonesia. Increased competition from the synthetic, however, is not likely to be felt for at least another year.