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Timor-Leste's Oil: Blessing Or Curse?

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Synopsis

Timor-Leste's revenue from oil and gas is rapidly declining due to diminishing resources and withdrawals from the Petroleum Fund for infrastructure projects. However, following recent negotiations with Australia, there is a window of opportunity for long-term sustainable development.

Commentary

THE OIL and gas sector is the mainstay of Timor-Leste's economy, with almost 90% of government revenue coming from oil. The non-petroleum economy, which scarcely existed at Independence is still very small, only about a quarter of the GDP. It is mostly generated by state spending for public administration, procurement, and infrastructure construction. Currently, the only non-oil export is coffee, whose value fluctuates with the weather and the global market.

Nearly all the petroleum revenue Timor-Leste earns at present comes from the Bayu-Undan field in the Joint Petroleum Development Area established by the Timor Sea Treaty with Australia in 2002. To manage the oil revenue, Timor-Leste established the Petroleum Fund (PF) not long after it gained independence from Indonesia in 2002.

Declining Fund for Development

Every year, the Ministry of Finance calculates an estimated sustainable income (ESI) benchmark. The ESI informs the decision of how much to withdraw from the PF each year to finance the state Budget; it was exceeded every year from 2008 to 2012, and again from 2014 onwards. Overspending the ESI has lowered the balance in the Fund, reducing its future investment earnings.

In May 2016, the IMF warned that "withdrawals from the Petroleum Fund remained above the level consistent with the estimated sustainable income (ESI), in part to finance front-loaded capital investments. This, coupled with lower oil receipts and negative net investment returns due largely to foreign exchange valuation losses, saw the balance of the Fund decline for the first time, to US$16.2 billion at the end of 2015".

In line with the government's Strategic Development Plan (SDP) for 2011-2030, the bulk of the infrastructure spending so far has been for roads, bridges, electricity, airports and ports. There is a need for improved roads and infrastructure to link the rural populations to urban centres and improve access to schools, health services, markets and employment.

Then Prime Minister Rui Araujo in his statement to Parliament in November 2016 on the 2017 budget explained what front-loading was. He said "front-loading" for capital expenditures -- taking more than the sustainable amount from the Petroleum Fund -- was justified because they will produce social, economic and financial returns in the medium and long term.

Zero Fund by 2026?

However, since 2011, the government embarked on two capital-intensive projects in isolated areas which have come under criticism from several quarters. Foremost among these is the Tase Mane project, on the south coast of the island. The project is based on plans for a future petroleum industry and includes a supply base, a refinery, an LNG plant, a 156-km highway, oil pipelines, and the Suai airport (already built). Critics of the project say that it will make Timor-Leste even more dependent on the oil and gas sector.

The second large project is in the enclave of Oecussi (bordering Indonesian West Timor). This enclave is geographically isolated and the project includes the development of an airport (already completed), a multi-storey hotel, a hospital and a university, among others. Many NGOs and other Timorese fear that the project may not benefit the local population as the country lacks the necessary skills required to participate in the project.

The Ministry of Finance has been reducing its predictions for future oil and gas revenues from Bayu-Undan which will end production by 2020 or 2022. Petroleum experts, economists and politicians differ as to whether the savings in the Petroleum Fund will run out in another 10 or 15 years, depending on how much the government withdraws from the Fund and the world demand for oil.

The local NGO, *La'o Hamutuk* which follows the Petroleum Fund closely, has predicted that "if projected levels of spending are carried out…the Fund could be drawn down to US$10 billion by 2020 and to zero by 2026."

More Oil In Future?

Timorese officials however are upbeat about Timor-Leste's future because of the untapped oil resources in the Greater Sunrise field and in areas onshore. On the former, since January 2017, Timor-Leste and Australia have had several rounds of discussions on maritime boundary delimitation between them in the Timor Sea.

In December 2017, a press statement issued following the latest round of talks stated that the parties had reached agreement on the text of a treaty which delimited the maritime boundary between them in the Timor Sea. It also addressed the legal status of the Greater Sunrise gas field, the establishment of a Special Regime for Greater Sunrise, a pathway to the development of the resource, and the sharing of the resulting revenue.

The treaty is expected to be signed in March this year. The details of the agreement have not been made public but there are indications that the Timorese government is satisfied with the outcome: Timor-Leste will receive a greater percentage of the revenue from Greater Sunrise than under the old treaty between the two countries, which has now been terminated. Exploration is also ongoing for possible oil resources onshore in several places in the country.

Timor-Leste's leaders now have a window of opportunity to make full use of its potential oil resources for sustainable development. It has a young population, and ensuring that they are educated, healthy and productively employed are the biggest development challenges facing the country. The World Bank has advised the country that it "needs to diversify its economy and sources of revenue, elevate the quality of health and education services, and equip the population with viable skills".

In July 2016, Prime Minister Araujo, in a speech to Timor-Leste's development partners, stated that the government "is aware of the challenges we continue to face. We are striving to improve public service delivery, promote the diversification of our economy, and improve the quality of our infrastructure". With far-sightedness, wisdom, and courage, Timorese leaders can make the best decisions for their people's future and avoid the pitfalls that have befallen other countries with easy access to non-renewable wealth.

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