

# The La'o Hamutuk Bulletin

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## Editorial: Can East Timor Avoid the Resource Curse?

Around the world, many countries, including East Timor, have oil and gas under their territory. These can provide tremendous wealth for some citizens of the country, and for the companies which extract and sell the oil and gas (petroleum). But in most nations, the wealth does not benefit most of the people, and developing the petroleum resources can cause more harm than good. This is especially true for nations which did not have a well-established government, long democratic traditions, and a strong and diverse economy before they began to sell their petroleum.

If East Timor is to be the exception to this pattern, we must first understand why many people around the world, from Venezuela to Nigeria to Aceh, believe that they would be better off if oil had never been discovered in their territory.

In rich, industrialized countries, the comfortable lifestyles of most people depend on oil and gas — for electricity, for transportation, for industry, and for petrochemical products. International oil companies are among the largest corporations in the world. This industry, based on complex technology which requires huge investments and employs few workers, is one of the most profitable on the planet. For example, Shell's annual revenues are nearly twice those of the Australian government; ConocoPhillips receives three times as much as Indonesia each year.

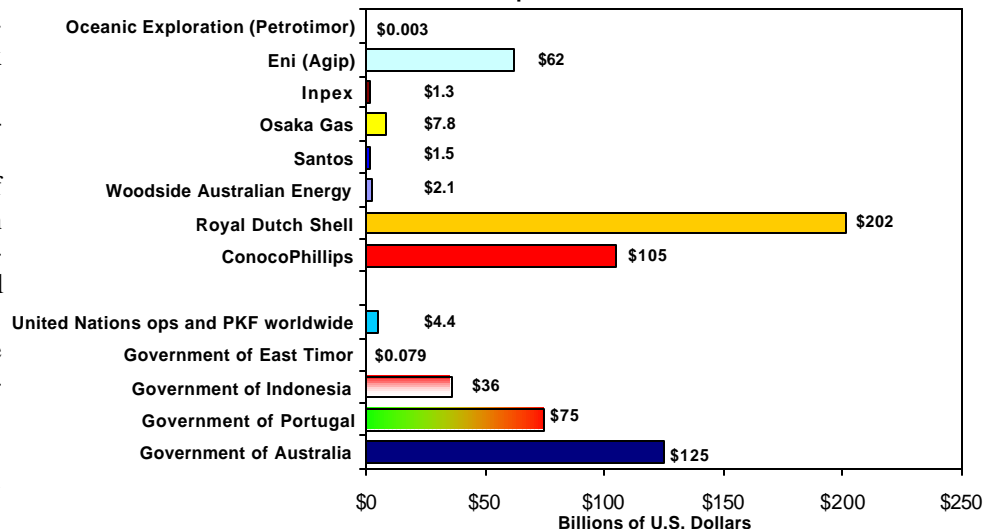
### What harm can oil development do?

More often than not, oil development does not benefit most of the people of the country, especially if the country does not have a well-established government with strong traditions of professional civil service, responsiveness to the voters, and accountability of officials. Instead, the money goes to a few people or leads to misguided or unsustainable economic policies. The oil industry can damage the environment, and often leads to war or human rights violations. This takes place in many ways:

#### ☹ Corruption of public and industry officials

Oil profits are so large that they tempt both public and corporate officials, and can lead to fraud or bribery. From Suharto to Saddam Hussein, dictators have taken power to obtain oil's huge profits, and used them for personal gain, to maintain control, and to finance repression. But even in rich, democratic countries, corruption is widespread in the oil industry. For example, the heads of Statoil (Norway's state

Annual Revenues of Oil Companies and Governments



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oil company) and Royal Dutch Shell were implicated in paying bribes and false reporting last year, and forced to resign. Norway is being used as a model for East Timor, and Shell had a reputation of being one of the most conservative companies in the industry. In another example, three major oil companies, now known as ExxonMobil, BP, and Conoco-Phillips, systematically lied to the government of Alaska state, USA, for many years. After more than 141 legal cases, Alaska forced the companies to pay it more than \$10.6 billion.

### ⊗ **Environmental destruction**

Wherever petroleum is extracted, processed and used, on land or in the sea, the natural environment is at risk. Catastrophic accidents — fires, explosions, spills or pipeline breaks — are an ever-present danger to workers, nearby communities, and the local environment. But even during normal operation, low-level leakage, pollution and small spills can injure marine and land environments, affecting water, fishing, biological diversity, agriculture and daily life.

On-shore oil extraction and processing uses land for factories, pipelines, roads, security buffer zones, wells and other facilities, displacing local people.

And globally, processing and burning petroleum and other fossil fuels adds carbon to the atmosphere, causing global warming, rising sea levels and extreme weather conditions, which will drastically change our planet over the next century.

### ⊗ **War, militarization and repression**

Oil is so valuable that governments go to war to obtain it. We know that one of the main reasons Australia supported Indonesia's invasion of East

Timor was to get access to Timor Sea oil. More recently, one of the principal reasons for the United States-led invasion of Iraq last year was Washington's desire to better control global oil supplies.

In Indonesia, Aceh is rich in oil and gas, but the benefits are not shared by the local population. When people resist the Indonesian military responds with violence, partly to keep ExxonMobil's facilities secure so that oil money continues to flow to Jakarta. In Malaysia, Niger Delta, the Ecuadorian Amazon and around the world, military forces repress local people to protect oil and gas facilities.

### ⊗ **Economic and social consequences**

The unstable price of oil, combined with its huge revenues, causes even non-corrupt governments to make development decisions against their people's long-term interests. Other sectors of the economy, such as agriculture, are often neglected because policy-makers see oil as an easier and larger source of revenue. Imported food and other items may be preferred over local products, reducing self-sufficiency.

When oil prices and revenues are high, governments undertake major development and infrastructure projects, or embark on expensive programs. When the revenues later decline, they have to borrow from the World Bank or other international institutions. In many oil-rich countries, debt payments are now larger than oil revenues; total debt is larger than remaining petroleum reserves.

Petroleum is a non-renewable resource. The deposits under the Timor Sea will be exhausted in 50 years, and East Timor will have to rely on other sources of revenue. But oil revenues can be addictive, and very few countries have succeeded in using petroleum money to build a strong economic base



in other sectors. A similar problem exists globally — petroleum is so profitable that alternative energy sources are not developed or prioritized, leading to climate change and major crises when the petroleum flow is disrupted or used up.

Because of the specialized nature of oil facilities, the expensive infrastructure they require is rarely made available to nearby communities. Although some local workers will be hired during construction, the operation of petroleum facilities is very technical, and the few dozen jobs are highly technical, requiring particular skills. It will be difficult for many East Timor people to obtain this work.

### **East Timor's reality may bring the curse**

#### ⊗ **No history of democracy or self-government**

Because this nation is newly independent, we have no tradition of constructive public involvement in policy making. For most people, their relationship with government before 1999 was only to resist. Government officials tend to be protective of information and reluctant to trust civil society, which is still developing its ability to analyze and advocate on complex technical issues. When officials do engage with civil society, socialization often substitutes for consultation, where the government tells the people what it plans to do rather than asking what the people want or need. This pattern was set by Indonesia and the United Nations, and will be hard to break.

#### ⊗ **Few good examples to learn from**

The Portuguese colonial bureaucracy was famous for inefficiency and arbitrariness, and the Indonesian military and civil service here raised corruption and brutality to record levels. East Timor is trying hard not to continue those traditions. Many international agencies currently here teach about transparency and accountability, but often do not practice what they preach.

#### ⊗ **Inexperienced officials and civil service**

Because of the newness of East Timor's government, there few laws and regulations are yet in effect, and both the citizens nor the civil servants are just learning them. We lack a solid understanding of what is acceptable and what is not. Without a professional, experienced civil service, possibilities for corruption or inconsistent application of law are widespread, but it will take time to establish a tradition of honesty, transparency and accountability.

Because East Timor has so few experienced managers or public officials, and because our government structure has not had time to learn from its mistakes, there are a number of potential conflicts of interest and people serving dual roles, which could reduce East Timor's chances of making the best decisions possible. These are structural concerns, with no implication that any currently serving individuals are not honest, capable and well intentioned.

- ◆ The same person is both Executive Director of the Timor Sea Designated Authority (TSDA) and a Commissioner who oversees the TSDA, and is therefore his own supervisor.

- ◆ The Secretary of State for Environment, Tourism and Investment must balance environmental responsibilities against attracting investors to East Timor. He also serves as a Commissioner of the TSDA and interim head of the East Timor's petroleum operations.

- ◆ The Prime Minister is also Minister of Development and Environment, personally directing negotiations with Australia and development of oil revenue policies. Although the permanent Ministry for Petroleum is not yet established, he is expected to have a significant role. This is a lot of responsibility for one person.

#### ⊗ **No effective checks and balances to guarantee accountability**

Up to now, East Timor has not established effective mechanisms for combating secrecy or corruption. Two years after independence, the Constitutionally-mandated Office of the Provedor has not yet been established, and draft regulations for this office do not guarantee sufficient independence. East Timor's legal system has little experience and many problems, both in the functioning of the courts and in the laws and procedures themselves.

At present, one political party has a large majority in Parliament, which reduces the ability of Parliament to counterbalance Government activities. Furthermore, the minority parties have little expertise or political experience, and have not yet developed the ability to constructively analyze and offer alternatives to Government policies.

In many democratic societies, the media can be a check on government corruption or misguided policies. In East Timor, journalists are largely inexperienced, with little tradition of independent investigation, or of checking statements by public officials against alternate sources or prior records.

## East Timor has some features which could reduce the oil curse risk

Because East Timor is just starting to exploit its petroleum resources, we can learn from failures and successes in other countries. Also, because most of our known resources are under the sea, disruption of local communities and environment may be less dangerous.

The people of East Timor are fiercely committed to this country's independence, and will continue to struggle for its sovereignty and rights, and to demand that our government serves the people's interest. Perhaps more than any other factor, this may help keep the government in line. In addition, East Timor's small size and effective rumor communications system make it harder for illegal activities or corruption to be conducted without exposure.

Also, the use of the United States dollar as East Timor's currency frees the country from managing inflation or foreign exchange problems caused by oil money. In return, East Timor loses the tools of financial control which could be exercised through appropriate, timely exchange rate adjustments, and has its economy linked in with that of the United States.

## Saving for future generations

Another major decision area, still to be made, is how East Timor will spend or invest revenues received from oil and gas, which will be used up within many of our lifetimes. One option is to use them for each year's government budget expenses, which could include "investment" in East Timor itself, such as education, health, infrastructure and economic development.

The International Monetary Fund (IMF) is providing a Norwegian advisor to work with the Ministry of Planning and Finance to design a "petroleum fund," which will help East Timor's people and government keep track of how much money comes in from petroleum, and whether it is spent or saved. But the proposed fund will not limit the amount of oil revenues spent each year, guard against unpredictable, global oil price fluctuations, or protect against bad economic decisions.

*La'o Hamutuk* will examine this "Norway Plus" fund model in more detail in the future, but we are worried that it will not adequately protect East Timor from having its major natural resource squandered over the next few decades, with nothing left for future generations.

According to the government's projected budget for the three years 2005-2008, 65% (\$139 of \$215 million) of non-donor government revenues will

come from oil, plus \$86 million additional oil money which will be saved in the petroleum fund. This will increase in following years, as Bayu-Undan Phase II and Greater Sunrise come on-line, and the temptation to spend will be great.

*La'o Hamutuk* is concerned about the government's lack of transparency on this issue so far. Last year, the IMF prepared a report discussing options in petroleum fund design for East Timor, but the government has refused to make it public. We are even more bothered by Banking and Payments Authority (BPA) and government secrecy about oil money already received. So far, the government has received approximately \$15 million in oil royalties (FTP), which was deposited in the BPA to be transferred to the petroleum fund when the fund is established next year. But repeated questions from media and civil society about where the money is currently invested have gone unanswered.

## Conclusion

East Timor has many of the pre-conditions which have cursed other oil-rich, newly-independent countries, and it will take tremendous effort to ensure that our petroleum is a net benefit to our people. But decisions have already been taken which might not be best for East Timor. There is momentum to extract the oil and gas as quickly as technically feasible, before maritime boundaries, a strong civil service and well-established regulations are in place.

However, East Timor may still be able to avoid repeating the bad experiences of other countries. The following steps are essential:

- ✓ Revenue and petroleum management must be transparent, accountable and protected.
- ✓ Checks and balances and independent oversight mechanisms within and outside the government must be implemented quickly and carefully .
- ✓ Civil society must engage with and closely supervise law-making, operational and financial decisions. This needs to happen more quickly and more actively than it has so far.
- ✓ Laws requiring public disclosure of government officials assets and income, as well as oil and gas revenues, investments and payments, should be implemented.
- ✓ Australia must comply with international law on maritime boundaries.

It will not be easy to ensure that East Timor's oil and gas benefits East Timor's people, in both the long and short term. But it is not impossible.