Timor-Leste's oil wealth: financing government, building for development and providing for its people

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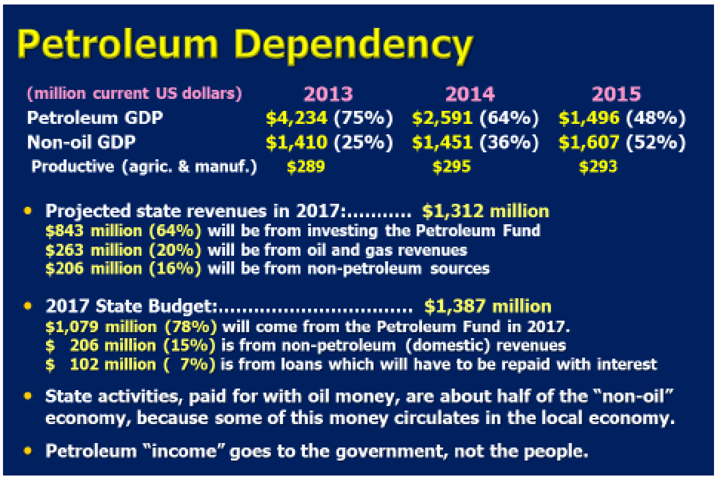
In 1991, IPJET joined the people of Timor-Leste in struggling for their legal right to self-determination. At the same time, people in the U.S. formed ETAN, the East Timor Action Network. After the Timorese people restored imminent independence in the 1999 referendum, we both asked our friends there what they needed from international solidarity.

Many had similar answers – "we've been isolated and focused on our struggle against Indonesia, and haven't had the chance to learn about the world. Our country is being flooded with institutions we know little about — and they all tell us what's best for our people. We know enough not to believe everything they say – but please help us understand what they want, who they serve, what they have done in other places, and how we can ensure that their presence supports the Maubere people."

Seventeen years ago last week, La'o Hamutuk was formed in response to that request, as an independent, small, local civil society organization. We began to analyze and report on international organizations active in Timor-Leste. We encouraged them, and later Timor-Leste's own government, to strengthen political sovereignty (including the maritime boundary with Australia), legal accountability (including ending impunity for crimes against humanity committed during the Indonesian occupation), environmental protection, and sustainable, equitable economic development.

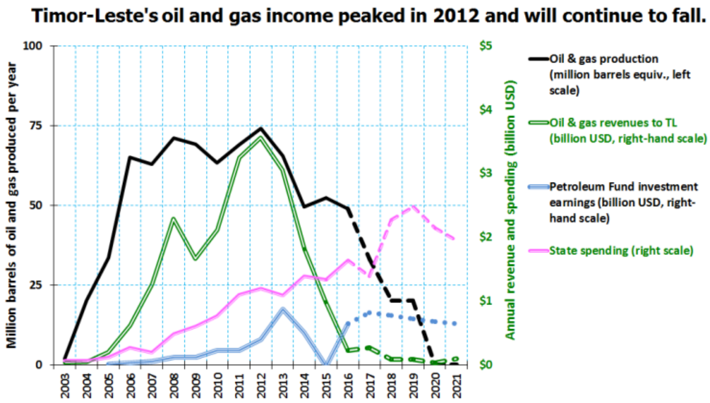
Today I'm going to talk a little about the last point – the implications of Timor-Leste having been one of the most petroleum-export-dependent countries in the world, and possible consequences and adaptations as that era comes to an abrupt end.

As we heard earlier, the independence struggles of both Western Sahara and West Papua are also entangled with non-renewable resources, and I hope Timor-Leste's experience can provide some lessons for them as well.



Moving away from petroleum dependency

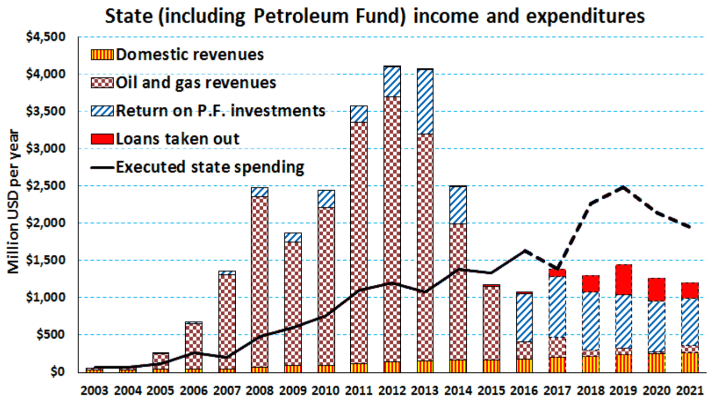
Although oil companies have explored Timor-Leste for oil and gas for more than a century, large-scale extraction activities began in the Timor Sea in the late 1990s. Since then, Timor-Leste's government has received about US $21 billion in oil revenues from Elang-Kakatua, Kitan and Bayu-Undan – and only about $0.4 billion more remains.[1]



Timor-Leste has wisely invested most of its oil income in its Petroleum Fund, whose investments have earned more than $3.8 billion. Timor-Leste's government has spent nearly $9 billion of the money from oil and investments, and about $16 billion remains in the Fund, whose balance peaked about two years ago and has begun to decline. Between 2002 and 2016, oil money paid for 83% of all government spending. The Ministry of Finance expects the Petroleum Fund to finance 75% of state activities during the next five years, although oil and gas income in 2016 was only one-eighth of its 2012 peak.[2]

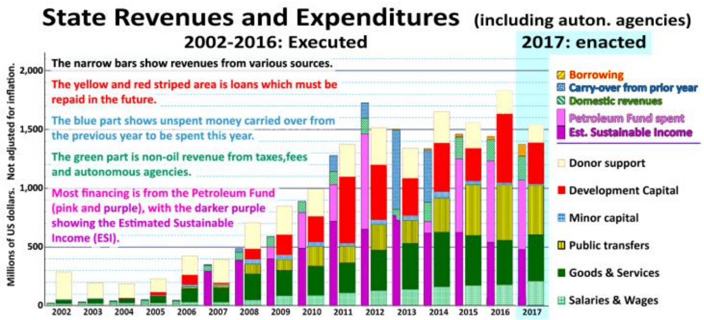
[1] Since 1998, Australia has taken in nearly $5 billion that should legally belong to Timor-Leste, about half from their 10% share of those three fields, and half from Laminaria-Corallina, which is just outside the Joint Development Area and has paid nothing to Timor-Leste.
[2] This is after adjusting for taxes that were over-assessed in 2010-2013 and refunded to the companies in 2015-2017. Actual revenues received in 2016 were 1/16 as much as were received in 2012.

If you consider the Petroleum Fund as part of the state, Timor-Leste went into deficit in 2015, and the funding gap will increase significantly after this year. All of the numbers I have used so far come from government reports, but the government does not release projections more than five years into the future. Therefore, La'o Hamutuk made our own estimates, and we expect that the Petroleum Fund could be entirely empty within a decade if the state pays for all the things it intends to build.

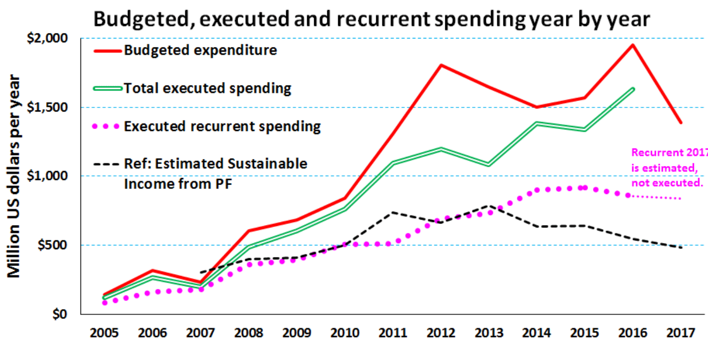


Where the money goes

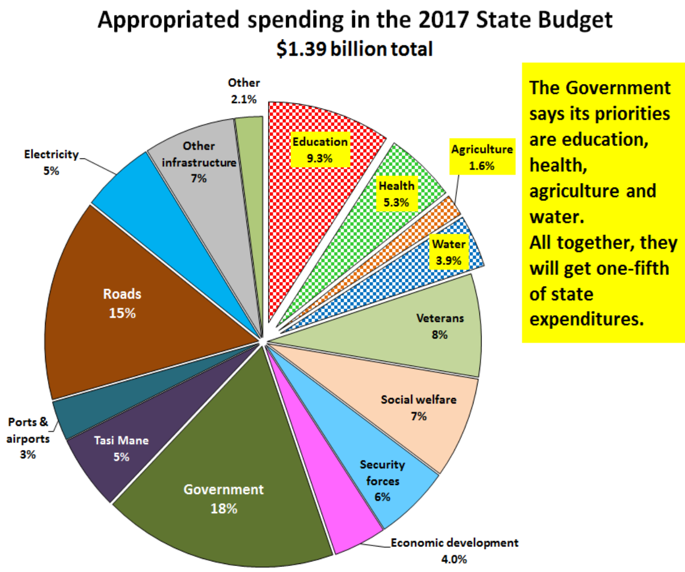
Ten years ago, oil revenues began to surge, a new government was elected, and Timor-Leste's state budget became the second-fastest growing in the world. Expenditures increased ten-fold between 2005 and 2012.



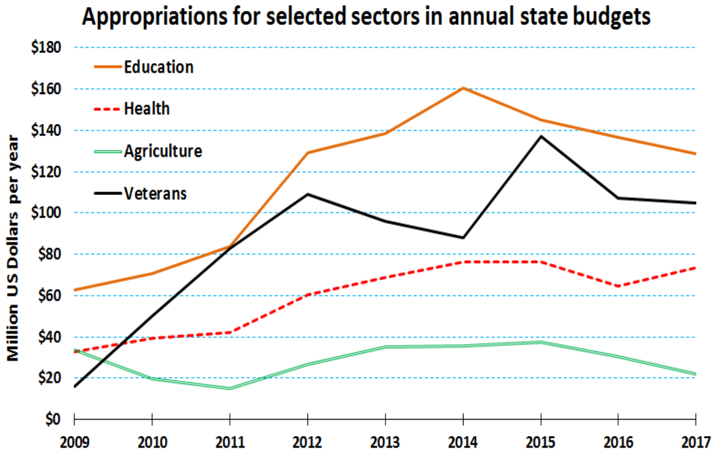
Although budget escalation has moderated since then, spending continues to go up and, since 2014, recurrent spending has been far more than the sustainable income from the Petroleum Fund. The government expects this to continue through at least 2021.



Timor-Leste's leaders say that their priorities are health, education, agriculture and water supply. Unfortunately, all four of these together will get only one-fifth of state spending this year. More money goes for roads and other physical infrastructure, veterans and other pensions, and the machinery of government.



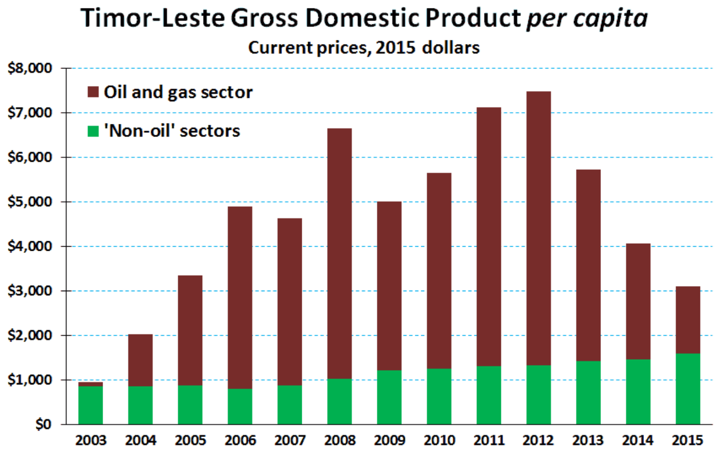
Half of the people in Timor-Leste are under 20 years old, and 60% make their livelihoods as farmers, but appropriations for education and agriculture have been dropping during the last four years. Education spending has been cut by 20%, even as the number of school-age children went up by 10%. Child malnutrition is among the highest in the world, yet spending on health is lower than it was in 2014 – and is less than half of the norm for developing countries.



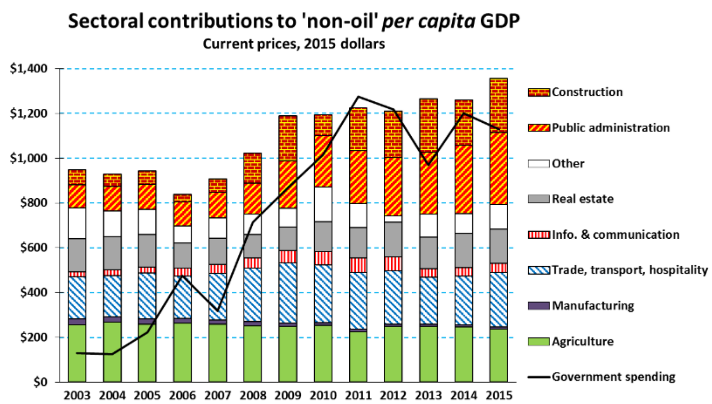
Time does not allow a detailed discussion of other programs which consume state resources but may not provide social or economic returns greater their financial, social and environmental costs. The Tasi Mane project, the Oecusse special zone and three international airports will absorb billions of dollars without benefitting most people. In addition, Timor-Leste is borrowing more than a billion dollars to build infrastructure, which will have to be repaid after the Petroleum Fund is gone. La'o Hamutuk estimates that basic services, already far below what people deserve, may have to be slashed by 85% in about ten years.

Oil money and the economy

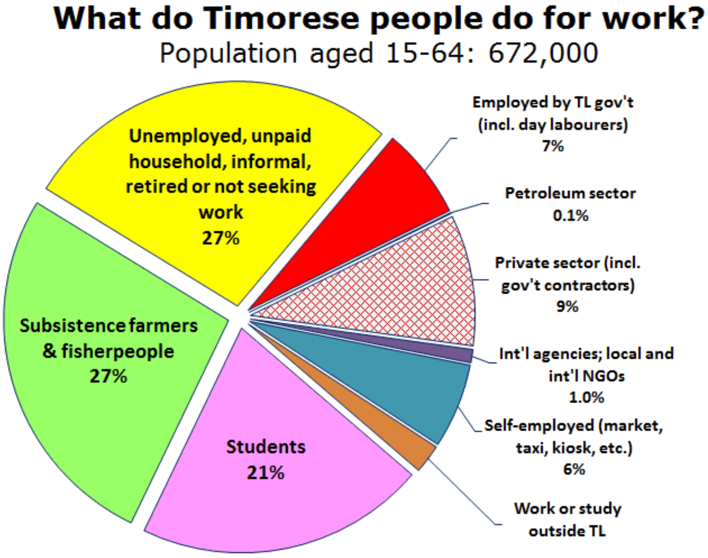
If Timor-Leste can develop a strong, diverse economic base, this austerity will not be necessary. Unfortunately, the so-called 'non-oil economy' is still not strong enough to sustain the country.



About half of the 'non-oil' economy is fueled by state spending of oil money, as exemplified by construction and public administration. After adjusting for population growth and inflation, the productive sectors of agriculture and manufacturing have shrunk during the fifteen years since independence.



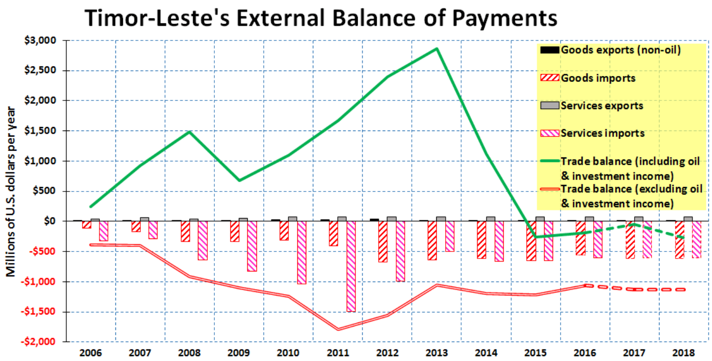
La'o Hamutuk believes that GDP gives a misleading picture of how an economy serves its people, especially when more than 40% live below the poverty line. We think it is more appropriate to count people, not dollars.



Graph by La'o Hamutuk based on information from the 2017 State Budget, 2015 Census, 2015 Business Activities Survey, 2013 Labor Force Survey and our own research and estimates. March 2017

Only about a quarter of the working-age population are in the formal economy – the rest are subsistence farmers or fisherpeople, not working for income, or students. Of those who work for dollars, roughly equal numbers work for the government, the private sector, and very small family businesses. Although this picture shows that there is tremendous under-utilized human potential, it also shows the challenges of expecting private companies, such as foreign investors or the oil industry, to build the country's economy.

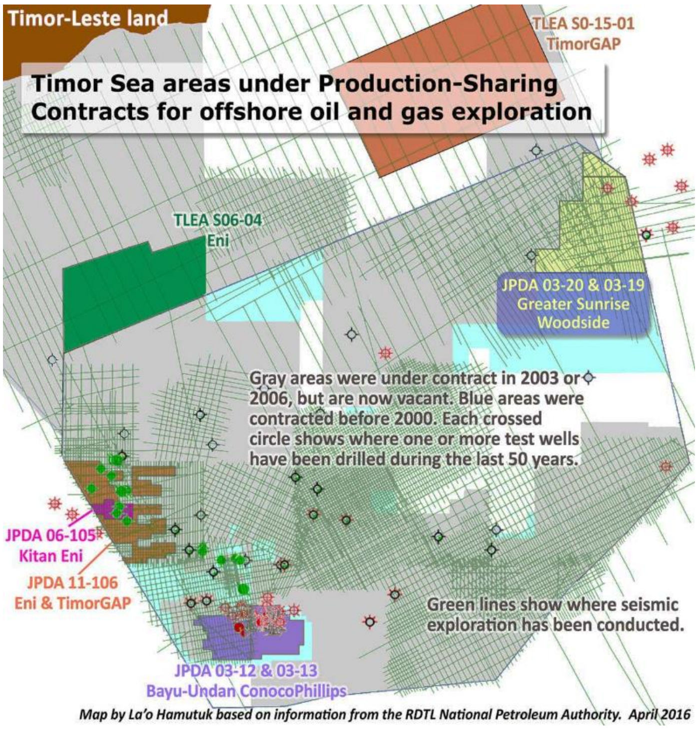
The post-war baby boom is reaching working age, and the potential labor force will increase by about 19,000 this year and even more in the future. Projects like Heineken, TL Cement and Tasi Mane will each employ fewer people than join the labor force in a single month. A more holistic approach to economic development is clearly needed, concentrating on agriculture and production for local consumption.



Another way to look at Timor-Leste's economy is to examine the money flowing in and out of the country. We import more than $500 million worth of goods each year, and about the same amount of services. Non-oil goods exports, almost all coffee, are around $20 million. As the red line in the graph shows, our non-oil trade deficit is about a billion dollars each year, and hasn't changed much since 2013. The green line shows the balance after oil revenues and returns from investing the Petroleum Fund are added in. This first fell below zero two years ago, and will converge with the red line as the Petroleum Fund is depleted. Although the deficit may decline after Timor-Leste has no more money to pay for imports, the effects on people will be disastrous if local production has not significantly improved.

What does the future hold?

Bayu-Undan is almost empty, with less than a half-billion dollars more expected. Although petroleum sector officials raised public hopes last week by announcing that the government has approved ConocoPhillips to drill more wells in that field, this is not something to celebrate. The cost of these wells, which are necessary to extract the last puddles of oil and gas from the nearly-exhausted reserve, will come out of Timor-Leste's revenues.



Development of the Greater Sunrise oil and gas field, which is somewhat larger than Bayu-Undan, has been delayed due to disagreements with Australia about maritime boundaries and disagreements with the oil companies about where to liquefy the natural gas. The government has recently awarded no-bid contracts to national oil company TimorGAP to explore onshore and offshore for new fields, but prospects are limited. It would be foolhardy to pin Timor-Leste's future on the faint possibility that deposits were missed during more than half a century of exploration.

While talking about economic diversification, policymakers continue to dream of wealth obtained without facing the daunting challenges of developing Timor-Leste's workforce and productive sectors. Parliament is discussing a mining law, and government is proposing to create a state-owned Mining Company and a Minerals Fund, although Timor-Leste's limited reserves of non-precious minerals have nowhere near the value of already-exploited petroleum fields.

In addition, tax holidays and a new private investment law and policy hope to attract foreign investors, who will take more money out of Timor-Leste than the capital they bring in. A huge new container port will make it harder for local products to compete with imports, as will free trade agreements that come with ASEAN membership.

La'o Hamutuk is hopeful about the future of Timor-Leste, provided that policy-makers change course soon and prioritize renewable sectors which involve many people and are realistically sustainable. These include:

- Food production, primarily for local consumption
- Agricultural processing, so that more of the money from our crops stays in the country
- Light industry, to manufacture products used locally and to reduce imports
- Eco-tourism which makes use of the country's unique advantages and potential markets, rather than trying to divert business from Bali's luxury resorts
- Remittances from Timorese workers who are temporarily overseas, while encouraging them to come home and contribute more to the development of the nation.

The struggle for sustainable, equitable economic sovereignty – building a diversified economy which can fulfill the economic and social rights of the poorest and most vulnerable – is more complex and difficult than overcoming the Indonesian occupation. Without a common enemy like Indonesia, it is harder to unify people, especially when a small part of the population is doing well from public money, either as contract brokers or implementers, or as advisors or pensioners paid by the state.

Timor-Leste's greatest resource is its people, and history has proven that they can endure tremendous hardships while achieving victory against overwhelming odds. The country would not be independent today except for their persistence and the support of IPJET and other international friends.

We each need to encourage our own governments, including the one in Dili, to prepare for the end of oil, and to leverage what's left of Timor-Leste's limited natural resource endowment to invest in a country, economy and society which build on their own strengths to provide for all of Timor-Leste's people.

Time is running out.

Thank you.

Thank you.

You will find more and updated information at

- **La'o Hamutuk's website** http://www.laohamutuk.org
- **La'o Hamutuk's blog** http://laohamutuk.blogspot.com/

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