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East Timor

Boundary row escalates as finances deteriorate

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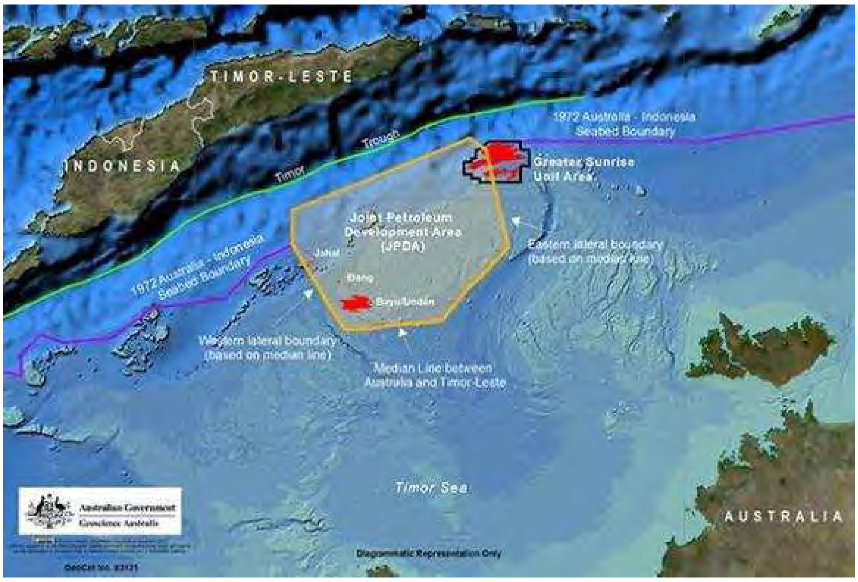


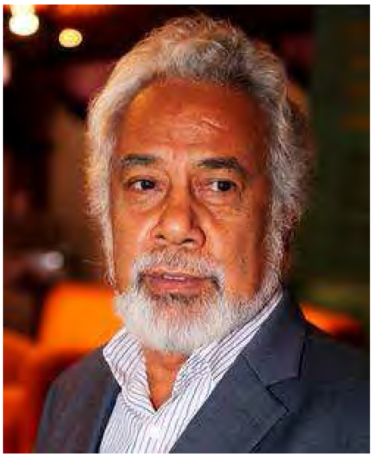
Map courtesy of Australian Department of Foreign Affairs and Trade

SYDNEY -- As a guerrilla leader, Xanana Gusmao fought the Indonesian occupation of his homeland, a former Portuguese colony on the eastern half of the rugged island of Timor, his elusiveness often ascribed to magical powers.

When East Timor, also known as Timor-Leste, finally became independent in 2002, Gusmao became its first president, and then prime minister. Early this year he handed the reins to a younger colleague, Rui Maria de Araujo, but he remains revered and influential as minister for planning and strategic investment.

In that post, Gusmao is still driving East Timor's government on two fronts -- a controversial and expensive scheme for three energy-related developments on the island's south coast, and an increasingly bitter dispute with neighboring Australia over the maritime resource boundary between the two countries.

Australia is holding to an arrangement it worked out with Indonesia during the occupation. This established a "joint development zone" covering the disputed area between the existing boundary in the Timor Trench -- a deep trough close to East Timor that Canberra claims is the natural boundary, and the median line in the Timor Sea.


Xanana Gusmao © Reuters

Canberra fears that conceding a median line boundary to East Timor would prompt Indonesia to seek renegotiation of its seabed boundary, agreed in 1972, which gives Australia more of the area's deep-sea petroleum resources than would the median line.

Boundaries of agreement

Australia has conceded to East Timor a more than equal share of petroleum flows in and around the joint development zone. In 2004 it agreed to raise the new nation's share from ConocoPhillips' Bayu-Undan field from 50% to 90%. In 2006 it lifted the future share from the much bigger Greater Sunrise discovery, which edges into the zone on the east, from about 18% to 50% -- but only on the condition that East Timor agreed to set aside claims on a permanent boundary for 50 years.

East Timor's government is now seeking to void the second treaty, arguing that Canberra showed bad faith during negotiations by spying on East Timorese negotiators. Gusmao argues that the "provisional arrangement" his government is seeking to overturn has "locked up an unfair share of the resources of the Timor Sea."

By this he means the 5.1 trillion cubic foot Greater Sunrise gas field. Gusmao and colleagues such as Petroleum Minister Alfredo Pires have built hopes of rapid industrialization around this resource, aiming to lift one of Asia's poorest countries into the ranks of the middle-income nations by 2030.

Their $5 billion scheme, Tasi Mane (Male Sea), as the Timorese call the rough water to their south, is based on gas being brought to the island's south coast at Beaco by a pipeline across the Timor Trench for processing into liquefied natural gas, which can then be exported in refrigerated tankers.

Further along the coast, a refinery and petrochemical complex are to be built at Betano, and an offshore oil servicing base and industrial estate at Suai, in the west, with the three sites linked by a new road. The sites are at present small towns on a rugged shoreline, reached by tenuous mountain roads from East Timor's more populous north coast.

Many supporters of East Timor's independence struggle are cheering the new state in its David-and-Goliath legal battle with Australia. But critics are concerned that East Timor's leaders are deluding their people about the benefits of winning the case and wasting resources desperately needed to raise health, education and nutrition levels in the fast-growing population, now 1.2 million.

The premise that a median-line sea boundary would bring all of Greater Sunrise into East Timor's resource zone is false, the critics point out, since 79.9% of Greater Sunrise's reserves would remain in Australia's zone, to the eastern side of the present joint development zone.

Should a median-line boundary unravel the present Australia-Indonesia border, any resources in the area would go to Indonesia. The eastern boundary might be shifted to the southeast, to bring more of Greater Sunrise under East Timorese control, but this would depend on negotiations with Jakarta.

The option of piping the gas to East Timor for processing into LNG is opposed as risky and uneconomic by the Greater Sunrise partners, which comprise Australia's Woodside Petroleum (with a 33.4% interest) as operator, ConocoPhillips (30%), Shell (26.6%) and Osaka Gas (10%). The partners have long indicated a preference for a floating LNG facility anchored directly over the field.

However, Timor GAP, East Timor's small, state-owned oil company, says studies have confirmed the technical and economic feasibility of the pipeline to Beaco. In 2008 and 2009, U.S. offshore engineering company DeepGulf conducted a comprehensive bathymetric, or underwater topographical, survey, and in 2013, the Dutch underwater specialist Fugro used a small robotic submarine to make a high-resolution survey of the pipeline route.

The findings of the two surveys have not been made public and Woodside, when asked by the Nikkei Asian Review, declined to say whether it had been shown the surveys and whether it accepted the feasibility of a pipeline. In an emailed statement, the company said it was studying "different development options, including an East Timor based option, Darwin LNG and Floating LNG" and hoped to reach "alignment" with the East Timorese and Australian governments to proceed with the project.

Marc Moszkowski, the senior DeepGulf engineer who carried out the bathymetric survey, also said he was bound by client confidentiality not to disclose the contents of his report. However, he agreed to comment on information revealed by others, including Timor GAP, about Tasi Mane.

Moszkowski said the 286km pipeline to Beaco would traverse a maximum depth in the Timor trench of 2,830 meters, with pressure requiring a 35mm steel pipe thickness around its internal diameter of 24 inches (609.6mm: Under U.S.-set oil industry standards, internal pipe diameters are measured in inches). If it flooded during the laying operation, there could be immense damage and injuries on the surface platform, and the pipeline could break and be lost.

The rugged seabed would also require supports for the pipeline that no present underwater tool could handle at such depths.

The heaviest pipeline ever built is Blue Stream, a 24-inch pipeline at a depth of 2,150 meters that crosses the Black Sea from Russia to Turkey, Moszkowski said. "The Sunrise pipeline would be deeper and thicker, weighing 75% more," he said. "No such pipeline has ever been attempted anywhere in the world, and in such unforgiving terrain. In the absence of alternatives, such a pipeline would not be impossible to install, but given the existing alternatives it is certainly terribly risky."

Ends justify means?

The DeepGulf engineer is also scathing about the economics of the land-based

Tasi Mane projects, which would be located in areas with no natural harbors, skilled labor, road access, power supply or industrial base. La'o Hamutuk, an independent development monitoring organization based in Dili, East Timor's capital, was also critical. "We also wonder about the economic viability of the Tasi Mane project, given that no private-sector investors have shown interest," the organization said. "From an investment perspective, the returns may not justify the amount of public money being expended."

East Timor is pursuing the Tasi Mane project against a backdrop of seriously strained public finances. Its Petroleum Fund, a Norwegian-style sovereign wealth fund, relies on revenues from the oil and gas industry, which have been flowing from ConocoPhillips' Bayu-Undan field since 2004.

Payments to the fund peaked at $3.72 billion in 2012. But Bayu-Undan's production has been declining since 2011 and is likely to end around 2020, while oil prices have fallen sharply since late 2014. The government now expects oil revenues to reach only $834.1 million this year and $718.7 million in 2016, according to Agio Pereira, minister of state and government spokesman.

In addition, Gusmao's government decided in 2010 and 2011 to diversify the Petroleum Fund's investments away from dollar-denominated Treasury bonds into other currencies, and to put 40% of the fund into equities. Stalling share prices and a rising dollar have hit the value of the fund this year, which remained stuck at its peak of around $16.8 billion from mid-2014 until the September quarter when it fell by $450 million to $16.44 billion as of Sept. 30.

"The gambling of the Petroleum Fund on stock markets and foreign exchange is totally absurd," said Vicente Maubocy, an East Timorese activist and businessman who has attacked Gusmao's handling of the fund's finances and his insistence on pushing ahead with the Tasi Mane scheme -- most recently in the Dili newspaper Tempo Semanal.

The government, which insists the fund is following a "long-term" investment strategy, has continued with high-spending budgets emphasizing infrastructure. Its budget for 2016 is $1.56 billion, only slightly less than in 2015, financed largely by a draw-down from the Petroleum Fund of $739 million, in addition to the $545 million estimated sustainable income from the fund.

The budget includes $56.6 million for a start on Tasi Mane. In June, the government awarded a $720 million contract to Korea's Hyundai Engineering & Construction and Hyundai Engineering to build a 3.2km sea wall and other facilities for the Suai supply base. But in yet another problematic twist, a judicial audit body has halted the contract because of "noncompliance with basic standards in force in East Timor," the Portuguese news agency, Lusa, recently reported.

According to an analysis by La'o Hamutuk, a proposed 27% increase in infrastructure will be financed by cuts to health, education, the judiciary, veterans' pensions, the security forces and agriculture.

As the World Bank has pointed out in recent reports, few if any other developing countries have savings worth 10 times their annual budgets, as East Timor does, thanks to its Petroleum Fund. Yet unless the government, Woodside and its partners come to a consensus on how to develop Greater Sunrise, those savings will run out quickly.

Almost certainly, agreement would require East Timorese leaders to drop their Tasi Mane scheme in favor of either the floating LNG plant or --the cheapest and easiest option of all -- a 454km pipeline through relatively shallow waters to Darwin, possibly connecting to ConocoPhillip's existing pipeline.

Time, however, is running out, said La'o Hamutuk, who warns: "If current trends continue, oil and gas revenues will end around 2020, and the Petroleum Fund will be entirely spent five to eight years later."