Going for broke

TIMOR-Leste (East Timor) was once seen as the poster child for developing nations. It had natural resources, a comprehensive legal framework covering their extraction and an oil fund. Now, almost 11 years after attaining independence, the country better resembles a problem child.

Unlike other developing countries, Timor-Leste's challenge is not earning revenue, but understanding how to spend it. Despite having more than $12 billion stashed away in a petroleum fund, as well as annual oil income which peaked in 2012 at $3.6 billion, the tiny southeast Asian nation could be bankrupt by 2022.

In 2005, its leaders were hailed by the international community when, in a bid to stave off the resource curse, they established an offshore sovereign wealth fund. But symptoms of the curse have started to show.

State spending has surged, and based on present rates of increase – the actual budget for 2012 was 28% higher than 2011 – is unsustainable. Without adjusting for inflation, spending has jumped 587% since 2007 – when the oil money really started to flow – to $1.8 billion in 2012. If this trend continues, the petroleum fund could be empty by 2020, warns Dili-based policy think tank La'o Hamutuk.

From 2008 to 2012, total government expenditures of $4 billion should have resulted in a much greater improvement in the quality of life of the country's 1.1 million citizens. Yet, as inflation has surged from around 1% in 2005 to 11% last year, the percentage of people living below the poverty line increased, hitting 52% in 2011, up from 36% in 2001, a government source says, citing an unpublished report. The UN says the extent of poverty is even more severe: 68% of the population, about 748,000 people, suffers multiple deprivation, while a further 18% – 198,000 people – are vulnerable. Health and education spending is low, with just 3.3% of last year's $1.8 billion budget allocated for health care, and 7.1% for education. On the UN's human development index, Timor-Leste ranks 147th out of 187 nations, below Pakistan and Bangladesh, and well below the regional average. Malnutrition rates are high. According to non-government organisation Save The Children, 54% of children under five are stunted due to malnutrition, up from 40% in 2002 – and the third highest rate in the world after Niger and Ethiopia.

In 2002, when former guerrilla leader Xanana Gusmão was sworn in as the country's first president, many believed the country's hydrocarbon revenues would be used to help diversify the economy; allow Timor-Leste to meet development targets and reduce – perhaps even eliminate – the need for foreign aid receipts. The hopes have not come to pass.

Worryingly, little of the country's oil wealth has been used to promote sustainable development of the non-oil economy. Rather, funds have been channelled towards large-scale infrastructure projects, many of which will create no extra income for the country.

Timor-Leste has limited oil and gas resources. The nation's main producing field, Bayu Undan, will be dry by 2024. Given the lack of energy sector development, it is hard to see where future income will come from once it stops producing. If the stalled development of the 5 trillion cubic feet of gas in the Greater Sunrise fields, which lie in the Timor Sea's shared joint development area with Australia, goes ahead, it would net Dili about $15 billion or so over 30 years, but this is hardly enough to sustain the nation, especially if current rates of state spending are maintained.

This year's state budget forecasts that domestic revenues, about half of which are derived from oil income, will cover less than 10% of spending from 2013 to 2017. On top of this, it projects a non-oil fiscal deficit of more than $1 billion per year, rising to $1.8 billion by 2017.

Gusmão, who is now the country's prime minister, is convinced Timor-Leste's petroleum sector can be used as a cornerstone for development, spurring growth in other sectors. Yet very little effort, and little cash, has been expended to diversify the economy.

The main thrust of Gusmão's development plans centre on an onshore liquefied natural gas (LNG) export plant supplied by Greater Sunrise. This would be the centrepiece for a petroleum corridor, known as Tasi Mane.

The Tasi Mane blueprint includes a port, fabrication yards, and offshore supply base, as well as a refining and petrochemicals complex. Over the next five years, Dili will spend more than $1.3 billion on Tasi Mane. Of this, $700 million will be used to build the supply base and $500 million to build a four-lane highway connecting the corridor. Expenditures are expected to be even higher, even without the LNG plant, but estimates have not been made public.

At best, the plan appears naïve. There are no offshore operations to service, as all operating fields in the Timor Sea are supplied from Australia. More importantly, a development agreement covering the Greater Sunrise fields has yet to be finalised.

The Greater Sunrise development has been stalled for years. As well as the unresolved maritime border between Timor-Leste and Australia, the best development plan is itself a matter of dispute. Gusmão's government insists the gas be processed onshore, in Timor-Leste, while operator Woodside prefers what it claims is a more commercially competitive floating LNG scheme.

Sunrise's uncertain future has come back into focus as the termination trigger for a resource sharing pact – the Treaty on Certain Maritime Areas in the Timor Sea (CMATS) – ratified in 2007 between Australia and Timor-Leste comes into play shortly. CMATS essentially puts a gag on discussions over the countries' maritime boundary in return for revenue sharing. By agreeing to CMATS, Dili gets 50% of Sunrise revenues, once the fields are on stream, instead of the 18.1% it would get under the Sunrise International Unitisation Agreement, which provides the legal basis for the development.

After 23 February, either nation can give notice to cancel CMATS. Government officials in Dili have repeatedly hinted they may do just that. Cancelling CMATS would allow the East Timorese to air long-standing grievances about the maritime border and exisiting Timor Sea developments. But withdrawing from CMATS would certainly erode the political will needed from both sides of the Timor Sea to develop Sunrise.

Under international legal principles, which would draw a boundary along a median line, all of Sunrise would belong to Timor-Leste and the country could develop it as it pleased. But Australia has refused to give ground in boundary negotiations. For Gusmão, taking back what he sees as Timor-Leste's rightful territory is of utmost importance. Bringing the LNG plant to Timor-Leste would be a lesser victory, but a victory nonetheless.

However, such single-minded determination may ultimately see Sunrise's development permanently stalled, a move which would also stunt Timor-Leste's development.

Gusmão needs to put national pride to one side. He must be pragmatic and focus on ensuring Sunrise is developed and the revenues are used to underwrite the sustainable, long-term development of Timor-Leste's non-oil economy.

If this does not come to pass, it is hard to avoid the conclusion that Timor-Leste is a failed state-in-waiting. ●