

**Briefing Paper No. 25**

# **THE TIMOR GAP TREATY – WHERE TO NOW?**

**Oxfam Community Aid Abroad  
February 2000**

This paper was researched and written by Brian DuBois. It is based on initial research by Monique Hanley and Kirsty Miller

## **Introduction**

On 5 May 1999, Indonesia, Portugal and the United Nations entered into an historic agreement about the future of East Timor. It was agreed that the East Timorese people would be consulted about their future by direct ballot. The ballot took place on 30 August 1999, with the East Timorese voting overwhelmingly for independence from Indonesia. This independence was to be achieved via a transitional process under UN auspices. The wave of violence and dislocation that engulfed East Timor when anti-independence forces reacted to the ballot, and the international community's response to this wave of violence, is another story that is told elsewhere.

On 19 October 1999, the Indonesian People's Consultative Assembly finally endorsed the East Timorese vote, thereby relinquishing any claim to East Timor. Ostensibly, this would include any natural resources within East Timor's maritime boundaries. The best-known of these resources: the oil and gas fields of the Timor Gap.

Negotiations over the Timor Gap oil fields have a long and complex history, stretching back well before the Indonesian invasion of East Timor in 1975. They are an integral factor in the often tense relationship between Australia and Indonesia.

## **Defining the "Gap"**

The island of Timor was colonised in the 16th century. Portugal occupied the eastern half, and the Netherlands the western half. Thus when Indonesia won its independence from the Dutch, the western half of Timor became part of Indonesia, with Portugal remaining the colonial power in the east.

In 1969, Australia and Indonesia started negotiations to settle their mutual seabed boundaries, which culminated in maritime boundary agreements in 1971-72. These agreements did not, however, apply to the area off what was then Portuguese Timor. This was the subject of separate negotiations between Australia and Portugal in 1974-75.

The 1971-72 agreements with Indonesia were advantageous to Australia. The Australian government had argued that the natural dividing line between Australia and Indonesia was the southern edge of the Timor Trough, a trench three kilometres deep that lies closer to East Timor than to Australia. Indonesia rejected this, claiming that the boundary should be the line of equi-distance between the south coast of Timor and the coast of Northern Australia. In the end, they split the difference. This gave Australia control of about three-quarters of the continental shelf areas between Australia and Indonesia, with the agreed boundary lying along the southern margin of the Timor Trough on the continental slope.

There were several reasons for Australia's success in the negotiations. It had the stronger bargaining position due to its relative economic and trade strength. Australia had also accrued considerable goodwill diplomatically and through aid to Indonesia. When Indonesia agreed to a settlement favouring Australia, it allowed them to be less beholden to Australia. Also, by displaying its willingness to negotiate sensitive strategic issues, Indonesia hoped to allay suspicions held by some Australians that it was an expansionary power and a threat to Australian security. Finally, the oil companies active in the Timor Gap region since 1963 had, by the early 1970s, accumulated a great deal of knowledge about its potential oil and gas reserves. The Australian government was privy to this information, and the Indonesian government was not. (Mills 1990: 6)

### **Portuguese Timor to "Indonesian" East Timor**

In Portugal in 1974, progressive elements of the armed forces overthrew the Salazar dictatorship. Until then, the Portuguese government had seen its overseas territories not as colonies, but as integral parts of Portugal. This meant they consistently refused to recognize the territories' right to self-determination. In contrast, the new Portuguese government allowed the East Timorese to form political parties, promising them the right to choose their own future. Three major political parties emerged: one (Fretilin) sought early independence, another (UDT) wanted a gradual approach to independence with continuing Portuguese presence and assistance, and the third (Apodeti) favoured integration with Indonesia.

In mid-1975 the UDT, fearing that Fretilin might stage a coup, pre-empted this by staging its own. Fretilin opposed the UDT coup, and civil war erupted. The small Portuguese administration, unwilling or unable to restore order, withdrew to the offshore island of Atauro where it became irrelevant to subsequent events. By August 1975, Fretilin had gained the upper hand, and on 28 November, with the knowledge that the Indonesians were about to invade, it proclaimed the Democratic Republic of East Timor. Apodeti, the party seeking integration with Indonesia, together with elements of UDT, demanded that Indonesia "intervene to restore order". Indonesia obliged - first with Indonesian/Timorese "volunteers" and then with a full-scale invasion on 29 November 1975. (Shearer 1995: 949)

Six months earlier - in June 1974 - Fretilin's Jose Ramos Horta had obtained an unequivocal assurance from Indonesia's then Foreign Minister, Adam Malik, that Indonesia supported the right of the East Timorese to self-determination, and had no intention of expanding its territory at East Timor's expense. (Stepan 1990:11). What brought about the complete turnaround a year later? There were probably a number of reasons for Indonesia's actions:

"First the spectre of nationalist disintegration and separatism was one that constantly haunted the Indonesian Government. The example and encouragement an independent East Timor would give to internal ethnic groups in Indonesia to secede from a Java-dominated central government was not one the Indonesian government welcomed. They also feared having an unstable and possibly communist East Timor on one of their

borders. The Timorese political parties were viewed as immature by the Indonesians and there was a general irritation with Lisbon's perceived irresponsibility and ineptitude in not fulfilling its colonial responsibilities." (Stepan 1990: 11)

In addition, Australia's then Prime Minister, Gough Whitlam, had indicated that Australia would not oppose an Indonesian annexation of East Timor. Perhaps more important was the perceived "green light" given to the Indonesian government by the United States, when a mere twelve hours before the invasion, President Gerald Ford and Secretary of State Henry Kissinger departed Jakarta, with the latter telling reporters that "the USA understands Indonesia's position on the question of East Timor". (Stepan 1990:11-12)

Having convinced itself that there were very good reasons to annex East Timor, and assured itself of, at the very least, non-interference by the only two nations with the means to stop it, Indonesia proceeded to invade East Timor, with a massive loss of life. Indonesian forces quickly overcame the resistance put up by the mainly Fretilin forces, and the latter withdrew to the island's interior, where they would continue a guerilla war for the next twenty-five years.

On 12 December 1975, the UN General Assembly met to consider the Indonesian invasion. A majority of 72 states, including Australia, voted in favour of a resolution condemning Indonesia's intervention, and calling upon it to withdraw. The resolution also called on all states to respect the rights of the East Timorese to self-determination. Ten states, including Indonesia, voted against the resolution, and 43 states abstained. Subsequently, the Security Council passed a similar resolution unanimously.

In the years between 1976 and 1982, during its regular sessions, the UN General Assembly passed resolutions in gradually weakening language, and with diminishing support, calling upon Indonesia to respect the East Timorese right to self-determination and expressing concern at the humanitarian situation.

In 1996, following "consultations" with traditional leaders in East Timor, Indonesia sought to obtain UN approval for the integration of East Timor. However the Security Council rejected the validity of the request, on the basis that the consultations did not constitute a genuine act of self-determination. It again called upon Indonesia to withdraw its forces.

### **Decade-long negotiations**

With the de facto annexation of East Timor, Indonesia inherited the Timor Gap dispute. In October, 1976 Australian and Indonesian officials began informal negotiations to establish a seabed boundary between Australia and East Timor. This coincided with a change in Australia's vote at the UN, from support for the resolution condemning Indonesia, to abstention. There appears to be little doubt that the change was brought about by the Australian desire to resolve the Timor Gap issue. Fretilin lodged protests against the negotiations. However, the politically sensitive issue of Australia's recognition of the Indonesian annexation caused the negotiations to stall.

There appears to have been little or no progress in the bilateral talks for the next two years. Perhaps in order to exert pressure on Australia, Indonesia in 1978 began discussions with the oil company to which Portugal had granted exploration rights in 1974. Australia found itself in a "foreign policy dilemma, committed as it was to upholding the principle of self-determination and protection of human rights, as well as maintaining its pragmatism in policy towards Indonesia." (Mills 1990:7)

In late 1978, the Foreign Minister, Andrew Peacock announced that Australia was ready to grant de jure recognition to Indonesia's occupation of East Timor. Formal recognition occurred in February 1979, when negotiations were formally commenced over the Timor Gap. Australia had become one of a handful of nations legally recognise Indonesian sovereignty over East Timor. This distinction would be the source of some embarrassment to successive Australian governments over the next two decades.

Both parties were keen to conclude negotiations quickly. Exploration - suspended with the commencement of formal negotiations - had highlighted the Timor Gap's petroleum potential.

"The only well sunk in the Gap, Flamingo No.1 in 1971, had encountered good shows of oil and gas at 3,700 metres. Located within the Gap was a geological structure known as 'Kelp'. Potentially it could hold oil, gas or merely sea water. But a 1977 in-house study by French oil company Elf Aquitaine concluded that it was very possible an extremely large discovery would be made in the structure". (Stepan 1990:2)

The possibility of recovering large quantities of oil was important to both parties. Australia was seeking a source to supplement the dwindling Bass Strait reserves, thereby maintaining its energy independence. Indonesia, while then a net exporter of oil, could see a time not too far in the future when it would become a net importer. (Stepan 1990:2) Despite this, negotiations dragged on year after year.

There was widespread public opposition in Australia to the government's de jure recognition of Indonesian sovereignty over East Timor, and to the continuing human rights abuses - to the great embarrassment of Australian governments. This opposition included large sections of the media (no doubt influenced by the murder of five Australian journalists during the invasion); many academics; former members of the then Department of Foreign Affairs; non-government human rights and development organisations; and World War Two veterans, many of whose lives were saved at great cost to the East Timorese.

Indonesia became increasingly hostile towards what it saw as this anti-Indonesia lobby in Australia, and towards Indonesian language broadcasts of Radio Australia. Much of the hostility arose from misunderstandings by both parties. The bickering that went on illustrated the relative immaturity of the bilateral relationship. (Mills 1990:7)

In 1983, with a new Labor government in power in Canberra, Indonesia demanded a clarification of Australia's position on the East Timor issue. In 1985 - despite widespread opposition in Australia and the UN's continued non-recognition of the occupation - the Labor government confirmed its predecessor's policy on East Timor. It was not till 1986,

however, that Indonesia and Australia agreed that the "complex negotiations could proceed free from external pressure." (Mills 1990:8)

With Australia's Foreign Minister Gareth Evans heading negotiations, an approach to sharing the disputed area was first mooted in 1988 and agreed on in principle in October 1988. (Evans 1989). The Gap was to be divided into three zones. Zone A, overlying the median line between the countries, would be under joint control and its proceeds would be equally shared. Zone B, on the Australian side, would fall under Australian control, with 10 percent of the income going to Indonesia. In Zone C the situation would be reversed.

This concept was warmly embraced by both governments, not only as a resolution to the sea-bed boundaries dispute, but as a strong basis for future cooperation and goodwill between the two governments. In his address to a 1989 conference on "Indonesia's New Order: Past, Present and Future", Gareth Evans stated: "The treaty is thus not just an important agreement in itself; it is a symbol of a more sophisticated approach to the security concerns between us which springs naturally from our geographical proximity". (Evans 1989)

Not everyone was as enthusiastic. Portugal, already unimpressed by Australia's de jure recognition of Indonesian sovereignty in East Timor, first expressed concern with the agreement, then warned that it would take the matter to the International Court of Justice if the agreement went ahead.

A newspaper photograph - which was to become infamous - showed that the deal was done. On 11 December 1989, Gareth Evans and his Indonesian counterpart, Ali Alatas, signed the Timor Gap Zone of Cooperation Treaty, while flying over the Zone in an RAAF aircraft.

## **The Timor Gap Treaty**

The full title of the Timor Gap agreement is the "Treaty between Australia and the Republic of Indonesia on the Zone of Cooperation in an area between the Indonesian province of East Timor and Northern Australia". It refers to a relatively small area of the Timor Sea between Darwin and the Timor Trench. A coffin-shaped area, it extends from well within Australia's Exclusive Economic Zone, straddling the Western Australian and Northern Territory boundary, and extends well into East Timorese territorial waters. The area subject to the Treaty is known as the Zone of Cooperation or more simply as "the Zone".

The Zone's boundaries are defined in detail in Annex A of the Treaty. It is divided into three Areas: A, B and C. In Area A "there shall be joint control by the Contracting States of the exploration for and exploitation of petroleum resources, aimed at achieving optimum commercial utilization thereof and equal sharing between the Contracting States of the benefits of the exploitation of petroleum resources...". In Area B, Australia is responsible for the exploitation of the petroleum subject to certain notifications to the Indonesian government and payment to them of 10 percent of the Resource Rent Tax

collection arising from petroleum production. In Area C, the reverse is the case. It is Zone of Cooperation A ("ZOCA") therefore, that is the subject of discussion in this paper.

To deal with petroleum exploitation in ZOCA, Article 3 of the Treaty sets up a Ministerial Council ("the Council"), and a Joint Authority ("the Authority"). The Council consists of an equal number of Ministers from each of the two Contracting States (currently one each) and has "overall responsibility for all matters relating to the exploration and the exploitation of the petroleum resources in Area A".

The Authority is responsible to the Council. Its responsibilities include any and all activities necessary for the day-to-day management of ZOCA. The Authority has two Executive Directors, appointed by the Contracting States, and three operational Directorates: Technical, Financial and Legal. A fourth Directorate, Corporate Services, provides administrative support to the Executive Directors. The Directors of the four Directorates are appointed equally from the Contracting States, on condition that the Technical and Financial Directors are not from the same Contracting State. The Authority has two offices. The one in Darwin is the base of one of the two Executive Directors, and the (Indonesian) Director of the Technical Directorate. The other, which at the end of 1999 was still in Jakarta, is the base of the other Executive Director, and the (Australian) Director of the Financial Directorate.

The Treaty was incorporated into Australian domestic law in the Commonwealth Petroleum (Australian-Indonesian Zone of Cooperation) Act 1990.

### **Unforeseen complications**

The signing of the Treaty was momentous for several reasons. It was an important gesture by both parties toward the development of good relations generally. The recovering Indonesian economy would be aided by the oil exploration in the region. Most significantly, the "Timor Gap Treaty is the only legal agreement anywhere that effectively recognizes Indonesia's right to rule East Timor." (da Silva 1995:40) However, if either party thought that handshake in an aircraft over the Timor Gap was the end of the story, they were very much mistaken.

In 1991, Indonesian troops fired upon a large and peaceful crowd of East Timorese at the Santa Cruz Cemetery in the capital Dili. More than two hundred East Timorese were killed. Wounded and fleeing people were secretly filmed, and the images sent around the world. There was an immediate international outcry, and the issue of self-determination for East Timorese flared up again in the world arena.

In February 1991, Portugal launched an action against Australia in the International Court of Justice (ICJ). Portugal was still considered the "administering power" for East Timor by the United Nations, which gave it legal standing to bring the action. It claimed that Australia, by entering into negotiations with Indonesia over the Gap, had "breached its duty in international law to respect the rights of the people of East Timor to self-determination." (Shearer 1995: 950) Australia was named as the respondent because it

(Australia) acknowledged the jurisdiction of the International Court of Justice (ICJ), while Indonesia did not.

The basis of Portugal's claim was that East Timor had a right to the resources on its seabed which extended to the median line under the 1982 UN Convention on the Law of the Sea. (Willheim 1987:5). Portugal argued that by entering into an agreement with a party other than the "administering power" for East Timor, Australia had "interfered with the rights of Portugal as the lawful administering power and with the rights of the people of East Timor". (Shearer 1995: 951)

The ICJ decision, handed down in 1995, was basically a non-decision. The Court decided that it could not proceed to deliberate on the case because one of the two parties to the Treaty, Indonesia, did not recognize the Court's jurisdiction. The Court concluded that it could not rule on Australia's part in the Treaty without deciding on the legality of Indonesia's occupation of the island nation, and since Indonesia did not recognise the authority of the court "it could not make such a determination .... in the absence of Indonesia's consent". (Scobbie 1995)

All sides saw this as a victory. The Australian government chose to look at it as a de facto signal to proceed with the Treaty's implementation. The East Timorese resistance welcomed the decision "inasmuch as the highest UN legal body has endorsed the right of the people of East Timor to self-determination". (Ramos-Horta 1995). The Portuguese government regarded the result as a "technical draw" and said that the "ruling actually reinforced Portugal's political-diplomatic capacity". (Gomes 1995)

### **Within the Zone**

The main instrument which governs the relationship between the Authority and the petroleum companies developing the oil and gas fields is the Production Sharing Contract (PSC). These are the means by which the Authority enters into agreements with petroleum operators. They have a 30 year term, but can be terminated early if no commercial quantities of petroleum are discovered within six years. The PSCs can also be extended if petroleum remains to be extracted after the 30-year period. A model PSC can be found in the Act.

There are two main oil and gas fields found so far within ZOCA. The larger and potentially more profitable one is the Bayu-Undan field and the other lesser one is the Elang/Kakatua/ Kakatua North field. The Bayu-Undan field is located about 500 kilometres west of Darwin and 350 kilometres south-east of Kupang. It straddles two PSC areas, known as ZOCA 91-12 and ZOCA 91-13. In July 1995, the Undan-1 well found a large condensate acculation within ZOCA 91-12 and 91-13. In both PSCs, BHP Petroleum was the major equity holder and was accordingly appointed Unit Operator.

Eighteen kilometres north of Bayu-Undan is the Elang/Kakatua/Kakatua North field, also within ZOCA 91-12. In January 1994, the first oil was discovered here by the Elang-1 well. Five months later the Kakatua-1 well also struck oil. Then in February 1997, the Kakatua North-1 well encountered a separate oil field immediately to the north of

Kakatua in ZOCA 91-12. Approval was granted by the Authority to develop these three fields, and the first oil was produced in July 1998. (BHP 1997:42)

BHP Petroleum had interests in a number of PSC areas within ZOCA, but in April 1999 sold them to American-based company Phillips Petroleum. (BHP 1999:34)

The development plan for the Bayu-Undan field was agreed upon by the Unit Participants and approved by the Authority in October 1999. The Australian government welcomed the news "that a commercial consortium will proceed with an oil and gas project in the Timor Gap" and the Minister for Natural Resources, Mr. Nick Minchin, said "the Bayu-Undan group plans to invest about \$ 2 billion in the first stage of production to build off-shore platforms and production and storage facilities". (ABC News Online, 26 Oct 1999)

The Unit Participants in ZOCA 91-12 (as of mid-1999) are:

**PHILLIPS PETROLEUM PTY LTD**, a subsidiary of Phillips Petroleum Company, described on its website as "a major, integrated oil company based in the United States with worldwide operations". In 1998 Phillips Petroleum Company had US\$ 14.2 billion in assets and US\$ 11.8 billion in total revenues. Phillips Petroleum Pty Ltd is the Unit Operator in ZOCA 91-12 and 91-13.

**SANTOS (ZOCA 91-12) PTY. LTD**, a subsidiary of Santos Ltd, an independent oil and gas exploration company with 1998 sales of US\$ 470 million and 1998 net income of US\$ 107.9 million.

**INPEX SAHUL LTD**, a subsidiary of a Japanese oil company.

**PETROZ (TIMOR SEA) PTY.LTD**, a subsidiary of Petroz NL, an Australian oil and gas exploration and production company with interests in Australia, ZOCA, Indonesia and the UK. It has a current market capitalisation of \$69 million.

**EMET PTY LTD**, No details available.

The Unit Participants in ZOCA 91-13 (as of mid-1999) are:

**PHILLIPS PETROLEUM COMPANY ZOCA LTD**, another subsidiary of Phillips Petroleum Company.

**KERR-MCGEE (ZOC) ENERGY PTY LTD**, a subsidiary of the Oklahoma-based Kerr-McGee Corporation, with worldwide interests in oil and gas exploration and production. In 1998 it had a total sales of over US\$ 1.2 billion and net operating profits of US\$ 8 million.

**BRITISH-BORNEO AUSTRALIA 91-13 PTY LTD**, a subsidiary of a British oil company.

**PHILLIPS PETROLEUM TIMOR SEA PTY LTD**, another subsidiary of Phillips Petroleum Company.

There are other lesser PSCs within ZOCA, among them ZOCA 96-16. Upon completion of drilling of the Coleraine-1 well, expected in November 2000, the Unit Participants in this PSC will be: Phillips Australasian Exploration Co. (the Unit Operator), Norwest Energy NL, West Oil NL and Trans-Orient Pty. Ltd. (Norwest Energy website)

### **Independent East Timor**

Until 1998, discussions about East Timorese claims to the oil and gas in ZOCA were hypothetical, since to many, there seemed to be little chance of an independent East Timor in the near future. In 1990, Jose Ramos-Horta stated, "A future government of an independent East Timor would certainly review all oil exploration agreements in the area and will not be bound by any agreement signed by third parties". (Stepan 1990 : iv)

More recently, the National Council of Timorese Resistance (CNRT), formed as an umbrella organisation in July 1998, stated in the period immediately preceding the commencement of oil production from the Elang field that:

"This oil is a natural resource from which the people of East Timor have a right to benefit under International Law ... CNRT demands that until an internationally acceptable resolution of the East Timor conflict is achieved, the funds currently destined for Indonesia be placed in a special trust fund for the people of East Timor by the Timor Gap Joint Authority". (CNRT 1998)

However, the CNRT wanted to reassure the Australian Government and the oil companies:

"The National Council of Timorese Resistance will endeavour to show the Australian Government and the Timor Gap contractors that their commercial interests will not be adversely affected by East Timorese self-determination. The CNRT supports the rights of the existing Timor Gap contractors and those of the Australian government to jointly develop East Timor's off-shore oil reserves in cooperation with the people of East Timor". (CNRT 1998)

A month later, a different view of the future was provided by Estanislau da Silva, a Central Committee member of Fretilin: "Any future government of East Timor will have to look at the agreement and we will have to see what we can do to give a permit for oil exploration. It will benefit not only East Timor but Australia because from our point of view it belongs to Australia and East Timor, it doesn't belong to Indonesia". (Drillbits and Tailings 1998:4)

Estanislau da Silva's view appears to be in the minority, for all East Timorese officials stress that whatever happens, their leaders "live in the real world and are not likely to do anything that destabilises anything or upsets people. They want to form alliances and partnerships". (Davis 1998 :31)

At BHP's Annual General Meeting in 1998, when it was still the major participant in ZOCA, the then CEO, Jerry Ellis, was asked whether independence would have a negative effect upon the company's interests in the Timor Gap. He replied: "I think the straight answer to your question is no ... I don't believe that a change in the political situation there would impact on shareholder earnings in BHP". (Sullivan 1998)

As the pace of events in Indonesia, East Timor and Australia began to accelerate, increasingly the opinion seemed to be that the oil and gas fields would become East Timorese upon independence, and accordingly, their proceeds would go to East Timor. The Australian view, expressed by the Foreign Minister, Alexander Downer, was that:

"an independent East Timor would take over Indonesia's share of joint oil and gas deposits in the Timor Sea and could seek to re-negotiate the existing Timor Gap treaty with Australia ... If East Timor chooses independence, then according to the principle of successor states, the treaty would remain in place ... Obviously, if the new East Timorese state wants to pursue further amendments or adjustments, that would be a matter for negotiation." (Williams 1999a)

The Indonesian view was expressed by the then Minister for Mines and Resources when he said "there would be no quarrel from Jakarta over relinquishing rights in the Timor Gap, if East Timor chose independence to resolve the 23-year-old conflict." (Sydney Morning Herald, 27 Feb 1999.)

In April 1999, a conference on "Strategic Development Planning for East Timor" was held in Melbourne. Presentations were made on agriculture, the economy, education, environment, gender, government, public administration, health infrastructure and the judicial system. Surprisingly little attention appears to have been paid to the oil and gas deposits in ZOCA. Joao Mariano Saldanha and Helder da Costa said in their presentation that "the treaty should be renegotiated among the parties involved, giving the legitimate chance for the East Timorese to share the profits of the oil exploration within its own jurisdiction." It is unclear whether by renegotiation they mean on the substantive terms of the treaty. (Saldanha and da Costa 1999)

When Phillips Petroleum purchased BHP's interests in April 1999, it was of the view that the treaty should continue essentially as it stood then, between Australia and "whomever the new government might be." (Alexander's Oil and Gas Connections 1999)

On 25 October, six days after the Indonesian People's Consultative Assembly endorsed the East Timorese ballot results, the UN Security Council adopted Resolution 1272 (1999) establishing the United Nations Transitional Administration in East Timor (UNTAET). UNTAET would be "endowed with overall responsibility for the administration of East Timor and will be empowered to exercise all legislative and executive authority including the administration of justice."

According to the Australian Department of Foreign Affairs and Trade (DFAT), the legal procedure by which East Timor will replace Indonesia as a party to the treaty is relatively straightforward. The law of State Succession simply requires an "expression of will" between Australia and the successor state. The "expression of will" is evidenced by a

brief document, and involves a two-step process. The first step: a brief agreement between Australia and the United Nations, consulting with the East Timorese, confirming a continuation of the treaty during the period of the UN mandate. The second step: an agreement between Australia and the independent state of East Timor to the same effect. The treaty document itself need not be amended to substitute Indonesia with East Timor. Eventually, the Australian government will need to amend the Petroleum (Australia-Indonesia Zone of Co-operation) Act 1990 to take the changes into account, but this is not a priority.

On a practical level, a Memorandum of Understanding was drafted to deal with operational matters during the transition. According to this, UNTAET will nominate a person to represent it on the Ministerial Council as well as one of the two Executive Directors on the Authority. (French 1999)

On 6 December 1999, Foreign Minister Downer informed Parliament that:

"On 17 November the Indonesian Government confirmed ... that the Treaty is no longer between Indonesia and Australia. During the course of last week, I discussed the Treaty arrangements with Sergio de Mello, the special representative of the Secretary General for East Timor. The UN is willing to act for East Timor as Australia's treaty partner during the transitional phase. Thereafter, the treaty will be a matter for an independent East Timor. The East Timorese have confirmed to us their acceptance of these transitional processes". (Hansard, 6 Dec 1999)

On the substantive terms of the treaty, the Foreign Minister had this to say:

"On 4 December, officers from my Department had discussions in Darwin with both the United Nations and the CNRT - the East Timorese officials. The East Timorese made it clear during those discussions that they still intended to respect the terms of the treaty. They may wish to revisit some aspects of the treaty later, but they do recognize the very great importance of maintaining a stable basis for investment, because clearly that is not only in Australia's interest but above all - and much more importantly - it is in East Timor's interest". (Hansard, 6 Dec 1999)

DFAT is very aware of the need for qualified people to represent UNTAET and East Timor on the Authority. The Department believes there are qualified East Timorese nationals available who can fulfil this need. Meanwhile, any income meant for East Timor that accrues during the transition period will be deposited in a special trust fund on behalf of UNTAET and the East Timorese. The use to which the income will be put is entirely a matter for those two parties. (French 1999)

Given the repeated reassurances, it seems that, in the near future, the substantive terms of the treaty will not be amended due to any demands by East Timor. The East Timorese have probably taken this position because of a recognition that any attempt to renegotiate the treaty would be long and painful, and is likely to defer for a long time any economic benefits that might accrue to East Timor. It would also put East Timor in the position of asking Australia for increased aid, while trying to renegotiated better terms for East Timor in the Timor Gap Treaty.

## **How much oil?**

It is important to recognise that claims about the potential of the various fields and the income to be derived from them has varied greatly over the years. Perhaps the most extravagant claim was made in September 1998 by Mike Head of the International Committee for the Fourth International (the self-described "leadership of the world socialist movement, the Fourth International founded by Leon Trotsky in 1938"). He claimed that the Kakatua field was expected to yield "some 30 million barrels of oil, worth US\$ 600 million over four or five years." (Head 1998)

In fact, according to the Department of Industry, Science and Resources, this field has earned only US\$ 2 to 3 million since production was commenced in July 1998. More importantly, production is expected to cease much earlier than anticipated, after only two or three years, conditional on such factors as the rate of production. (Kjar 1999)

There are some smaller fields in ZOCA, such as Sunrise-Loxton and Troubador in the north-east corner of the Zone. Two years ago, Woodside Petroleum and Shell conducted a joint feasibility study of these fields, and to date no decision has been made on whether to proceed or not with exploration and exploitation. (Kjar 1999).

Therefore, only the Bayu-Undan field offers any significant promise in the future. As with the Elang-Kakatua field, various claims have been made about the potential of Bayu-Undan. Again the most exaggerated one appears to be by Mike Head who claims that: "it holds the equivalent of 900 million barrels of oil." (Head 1998). However, according to Phillips Petroleum, the recoverable reserves are approximately 400 million barrels of liquids (condensate and Liquid Petroleum Gas) and 3.4 trillion cubic feet of gas.

The oil companies are mainly interested in the liquids. To date, over US\$ 1.4 billion has been invested in "upstream development" of this field. "Downstream development" to commercialise the field's valuable gas is also planned. (Bayu-Undan Project Site, Phillips Petroleum). This downstream development faces a number of problems, not least that the Treaty does not apparently deal with gas per se. (Australian Financial Review, 23 Feb 1999)

Setting aside the gas development project, what is left is the 400 million barrels of oil. Obviously the value of that oil will depend on factors such as the world oil price and the taxation system under the treaty, which is quite onerous, according to some commentators, because tax is required to be paid to both Contracting States.

What role is this resource likely to play in the economy of an independent East Timor? In order to answer that question it is necessary to briefly examine the state of that economy at the end of the Indonesian occupation, and its future prospects.

## **The future economy of East Timor**

This examination is largely based on a lengthy article by an anonymous (for security reasons) East Timorese economist, which appeared as a Special Supplement in a 1998

issue of the journal *Timor Link*, produced by the London-based organisation, the Catholic Institute for International Relations (CIIR). (*Timor Link* 1998)

Upon taking control of East Timor in 1975, Indonesia introduced an economic development model meant to bring "civilisation" and "progress" to East Timor. The four stages of the model, Rehabilitation, Consolidation, Stabilisation and Short-term Development, were followed by three Five Year Plans, the last of which commenced in 1994. According to its own statistics, Indonesia achieved an impressive annual economic growth rate of eight percent in East Timor.

However, the anonymous author of the CIIR article makes the point that these processes also resulted in the deaths of approximately 200,000 East Timorese, widespread human rights abuses, the attempted suppression of the Timorese language, culture and traditions, environmental degradation, monopoly ownership of coffee plantations and massive involuntary migration. In addition, East Timor became totally financially and administratively dependent on Indonesia.

The article's author summarises the state of the East Timor economy at the end of the 1990s thus: "Agriculture accounts for nearly 40 percent of GDP, government and defence for 20 percent, construction 18 percent and trade 10 percent. East Timor's once vibrant tourist industry has collapsed and there is no industrial production. . Exports represent only 6 percent of GDP, and constitute less than 3 percent of the total budget."

The author suggests that, given this background, the appropriate macro-economic policy for East Timor in the next twenty to thirty years, is a phased, export-oriented model. The author also suggests that, in order for such a policy to be implemented, certain short and medium term policies must first be put in place.

"In the short term, restructuring and expanding the agricultural sector should be a priority. This requires land reform and expanding cash and food crop production. These changes will increase exports from the agricultural sector, opening the country up to global markets, expanding foreign exchange earnings and creating job opportunities. In the medium term, East Timor will also have to develop its manufacturing and industrial base, which will take longer because of its small population ... The economy will grow more rapidly if oil and gas revenues are forthcoming."

The author sees the role of the state as crucial in any attempt to achieve these lofty economic aims - and believes that its first priorities must be land reform and agricultural expansion. In order to remedy Indonesia's destruction of the traditional East Timorese way of life and the traditional agricultural methods, the author says the population must be allowed to return to their traditional villages and gardens. However, this will require sufficient land to be made available, and a degree of certainty about land rights. The need is to create a "significant number of owner-cultivators, the basis for commercial farming and greater equality". It would also be necessary to expand agricultural production into cash crops like coffee, cocoa, sandalwood and cashews. Food crops such as rice and maize, which account for 21 percent of agriculture's share of GDP, also have the potential to increase self-sufficiency.

After land reform and agricultural expansion, the author's next priority is the sugar industry, which was only introduced into East Timor in 1996. After sugar, the development of a manufacturing and industrial base, in order to avoid a total reliance on the export of primary products which are subject to price and demand fluctuations. Three possible areas for development are suggested: cement, garment manufacture and tourism.

The author's fourth priority (and the last for our purposes) is oil and gas. However, the article is based on an over-estimation of the size of the petroleum resources in ZOCA. Despite that error - understandable given that the article was written in mid-1998, before the true size of the deposits was known - the writer places oil and gas fourth in terms of priorities. This is a something to keep in mind when considering the more accurate data on this resource.

### **The role of "Gap Oil"**

The author of the CIIR article estimates the reserves in ZOCA at between 500 and 7,000 million barrels of oil plus 50,000 billion cubic feet of natural gas. At US\$13 per barrel, this means the annual revenue from oil would be approximately US\$ 2 billion. The author suggests that: "The revenue from oil and natural gas alone could rapidly transform East Timor from an agriculturally based economy to one of the major oil exporters, raising living standards and gross national product." The only problem is that the resource is much smaller than estimated.

The income from the Elang/Kakatua/Kakatua North field appears to be negligible, estimated at \$2 to 3 million in the twelve months since operations began in July 1998, and due to run out in about 2001. From around 40,000 barrels a day, production had fallen to 25,000 barrels a day by August 1999, which made the field uneconomical. As a result, Phillips Petroleum has decided to drill a new well off the Elang-1 "to access an untapped resevoir". This will cost Phillips and its partners \$US 6.5 million. (Sproull 2000 : 21)

Other ZOCA PSCs show more promise. PSC ZOCA 96-16 is estimated to have 150 million barrels of recoverable oil from the Coleraine prospect and 40 million barrels from the Foyle prospect, that is, in total almost half of the recoverable reserves from the Bayu-Undan field.

"Privately, East Timor's independence movement is circulating a three volume discussion paper outlining its future budget. The key point is that oil and gas income from royalties is estimated at US\$ 2.2 billion over twenty-five years, or US\$ 88 million a year". (Williams 1999b). If the more conservative estimate of recoverable oil is correct, the actual income is likely to be only about five percent of that estimated by the anonymous East Timorese economist. It is apparent therefore that oil revenue alone will not be raising living standards in East Timor.

On the other hand, the annual budget for East Timor under Indonesian rule has been estimated at US\$ 108 million, most of it from Jakarta, plus income from crops (US\$ 4 million), and total local trade and transport of US\$ 6.5 million. (Williams 1999b).

This means that the revenue from the oil in Bayu-Undan alone will bring in over two-thirds of the total income that East Timor required prior to independence. Post-independence there is the massive additional costs of re-construction. Setting those costs aside (since they will presumably be largely met from the US\$300 million aid package announced on 16 December 1999), it would still be unreasonable to expect that the budget of an independent East Timor would be the same as that of East Timor as a province of Indonesia. For a start there will be the additional costs of administration formerly carried out in Jakarta. Nonetheless, even with those additional administration costs, the income from the more conservative estimate of recoverable oil will still constitute a significant proportion of the East Timor budget.

The Timor Gap oil will therefore play an important role in the future East Timor economy. This fact can pose a great danger to a newly independent nation. A very serious dependency can develop on the one source of revenue. If that source is somehow imperiled, or dries up, the entire economy may suffer. In such an event, an independent East Timor may face the same shock and resulting problems as did Papua New Guinea in 1989 when the Panguna copper mine in Bougainville was shut down.

---

## **Bibliography**

ABC News Online,

Alexander Oil and Gas Connections (1999), Company News, East and Southeast Asia, Vol. 4, No.10, 28 May

BHP (1997), Report to Shareholders.

BHP (1999a), press release, "BHP sells Bayu Undan and other Timor Gap properties", [www.bhp.com.au/press/bhp\\_press/data/19990413a.html](http://www.bhp.com.au/press/bhp_press/data/19990413a.html)

BHP (1999b), Report to Shareholders.

CNRT (1998), "CNRT Statement on Timor Gap Oil", 21 July, in Timor Gap Oil and Gas Resources,

da Silva, W. (1995) "World Court hears evidence on Timor Gap Treaty", Asian Business Review, March, p.40.

Davis, Mark (1998), "Turmoil puts mining agreement in doubt", Business Review Weekly, 28 September, p.31.

Drillbits and Tailings (1998), 21 August,

Evans, Gareth (1989) "Australia and Indonesia - A developing relationship", Australian Foreign Affairs and Trade, Vol. 60, p.703.

French, Greg (1999), Legal Department, Department of Foreign Affairs and Trade, phone conversation with the author, 1 Nov 1999.

Gomes, Adelino (1995), "Portuguese government reaction to the ICJ decision" in Publico (Portuguese newspaper), 30 June, translated in Oil and Gas Resources in the Timor Gap,

Head, Mike (1998), "Tensions mount over oil-rich Timor", International Committee of the Fourth International, 5 September.

Kjar, John (1999), Commonwealth Department of Industry, Science and Resources, phone conversation with the author, 8 November.

Mills, A. (1990), "The Timor Gap Treaty: More paper for the cracks or a foundation for the wall", Inside Indonesia, No.22, March.

Norwest Energy website,

Phillips Petroleum website, Bayu-Undan Project,

Ramos-Horta, Jose (1995), "Statement by Jose Ramos-Horta CNRM, 30 June 1995, Oil and Gas Resources,

Saldanha, J. M., and da Costa, H.(1999), "Economic Viability for East Timor Revisited - Outlook for the 21st Century", East Timor Study Group Working Paper 01,

Scobbie, Dr. Ian, (1995), "Comments by Dr. Ian Scobbie...", 30 June, Oil and Gas Resources in the Timor Gap,

Shearer, I. A. (1995), "The decision in the East Timor case", Australian Law Journal, Vol. 69, No. 12 , December.

Sproull, Richard, (2000), "Phillips seeks more reach in Timor field", The Australian, 4 January, p.21.

Stepan, S. (1990), "Credibility Gap - Australia and the Timor Gap Treaty", Australian Council for Overseas Aid, Canberra.

Sullivan, Neil (1998), "Report by Neil Sullivan, Friends of East Timor WA on BHP Annual General Meeting 1998", Timor Gas Updates 1998, Oil and Gas Resources,

Timor Link (1998), Issue No.43, June, "East Timor: Prospects for an independent economy", Special Supplement, Catholic Institute for International Relations, London.

Williams, Louise (1999a), "Distrust in Timor high says Downer", The Age, 26 February.

Williams, Louise (1999b), "New state will want a slice of the Gap", Sydney Morning Herald, 27 February.

Willheim, E. (1987), "Australia-Indonesia sea bed negotiations: Proposals for a joint development zone in the Timor Gap", *Maritime Studies*, No. 33, March/April, p.5-14.

---

## **Updates - November 2000**

During its original negotiations with Indonesia, the Australian government had insisted that the Australian maritime boundary be extended to the edge of the continental shelf rather than just to the median line between East Timor and Australia. That is, Australia claimed a maritime boundary well north of the median line and therefore closer to East Timor than to Australia. The Indonesian government wanted the median line to be the maritime boundary. As a compromise, the area or "gap" between the edge of the continental shelf and the median line was named Zone of Cooperation A (ZOCA), with income from the oil and gas therein being shared equally between Indonesia and Australia. It is in ZOCA that the most significant finds of gas and oil have thus far been made.

East Timorese authorities have for some time maintained that an independent East Timor would seek to review aspects of the Timor Gap Treaty. However they have also stressed that they do not want to do anything that upsets investors or potential aid donors.

Speaking at the National Press Club on 5 May, the CNRT Vice-President Jose Ramos-Horta hinted that the future East Timorese government would seek to re-negotiate the treaty. Then on 7 May, on ABC Radio, he stated "we are happy to continue to live with the terms of the agreement for the next year or two or three years. However at the same time we must begin negotiations to review some of the terms ... if you notice where the gas and oil findings are located, I would dare to say that up to 90 percent of the revenues from there could go to East Timor if we have a fair deal." (ABC Radio National, Background Briefing, 7 May 2000).

In mid-June, Marie Alkatiri, CNRT's economic planning chief, and Peter Galbraith, the political chief of the UN Transitional Administration in East Timor (UNTAET) opened discussions with the Australian Government to redraw the maritime boundary between East Timor and Australia, rather than to simply negotiate for a greater share in the proceeds under the treaty as it stands. "In a fundamental shift, the CNRT, effectively East Timor's government-in-waiting, is insisting that a new seabed boundary, drawn an equal distance between East Timor and Australia, is the starting point for negotiations on a new Timor Gap oil and gas revenue sharing deal" (Alford and Garran, *The Australian*, 14 June 2000)

This East Timorese demand that the boundary be moved south to the median line would, if successful, put ZOCA entirely within East Timorese waters. Australia would be left with Zone of Cooperation B (ZOCCB). Zone of Cooperation C (ZOCC) would also be within the East Timorese maritime boundary.

The East Timorese and UNTAET have a strong argument in their favour. Since the treaty was signed, the UN Convention on the Law of the Sea has established that "the

exclusive economic zone boundary between two states that are less than 400 nautical miles apart should be the mid-line between their coasts." (Sydney Morning Herald, 13 April 2000)

On 18 September 2000, the Australian government announced that negotiations with UNAET and East Timorese representatives would soon begin on the future arrangements for the exploration and exploitation of petroleum in the Timor Gap. While the treaty currently in operation would continue as long as East Timor remained under the stewardship of UNTAET, this agreement would expire on the date that East Timor becomes independent, and it was necessary to avoid a legal vacuum and provide commercial certainty during the transition to independence. (DFAT Media Release, 18 Sept 2000).

In the days immediately before the negotiations commenced, the chief UN negotiator, Peter Galbraith, maintained that "the East Timorese maritime boundary should be a median point about halfway between Australia and East Timor..." (Dodd, M., The Age, 9 Oct 2000, p.10)

The East Timorese did indicate some flexibility in their negotiating position. Alfredo Pires, energy adviser to CNRT, allowed that "the final amount of revenue sought by East Timor from the Zone of Cooperation could be offset by guarantees on training and employment opportunities for East Timorese" (The Age, 9 Oct 2000, p.10)

There is political pressure on Australia to be generous to East Timor. The Australian Democrats' Foreign Affairs Spokesperson, Vicki Bourne, called for 90 percent of the revenue from the Zone to go to East Timor as part of a new agreement as a "meaningful commitment to East Timor's economic viability." (ABC AustraliaOnline News 12 Oct 2000)

The first round of negotiations in early October lasted four days, and produced a surprising level of angst on the part of the Australian negotiators. The cause was not the potential loss of taxes from the product of ZOCA if the maritime boundary was redrawn. "At worst, Canberra will lose a couple of hundred million dollars ... this amount, small for Canberra, would be a saviour for East Timor's future government." (McDonald, H., The Age, 21 Oct 2000)

The real problem for the Australian government lies in the wider consequences of a redrawn boundary in the Timor Gap. A retreat to the median line there would put an absurd looking dog-leg in the seabed boundary along the Timor and Arafura Seas, opposite East Timor, that Indonesia would query. Indonesia might well seek to renegotiate the entire maritime boundary between Australia and Indonesia, using the renegotiated boundary between East Timor and Australia as a precedent. From the Australian point of view, this would endanger a much wider area of potential oil or gas reserves, of which the Timor Gap is only the centrepiece. This wider area is thought to contain approximately 15 trillion cubic feet of gas, about twice the reserves of the North West Shelf." (The Age, 21 Oct 2000)

The negotiations are continuing.