MANAGING OIL WEALTH: LESSONS FOR BRUNEI TO LEARN FROM NORWAY

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PREFACE

بسم الله الرحمن الرحيم

Alhamdulillah, with the will and blessing of Allah Subhanahu Wa Taala, this book is ready in its current form and shape to be published just in time for the occasion of the 8th Mahrajan Hafl Al-Takharruj (Convocation Festival) of Universiti Islam Sultan Sharif Ali (UNISSA).

Most of the chapters of this book were largely extracted from an earlier version of my Master thesis entitled "The future of Brunei Darussalam including lessons which could be drawn from the Norwegian model" back when I was pursuing my postgraduate studies at the University of Melbourne, Australia. In order to accommodate to a more general audience, some adjustments had been made in the creation of this book in order to make the material digestible for those readers who have an interest in the economy of Brunei Darussalam, whether researcher or lay-man.

This book provides a thoughtful review of the achievements and difficulties that Brunei Darussalam has undergone in its journey of diversifying its economy for the past few decades. As a form of contribution to the achievement of the Brunei National Vision 2035, this book aims to offer alternate ways of managing the income streams of oil revenues by studying the more successful Norwegian policy and learning which methods this policy can offer and be applied to Brunei Darussalam and the management of its own oil wealth.

This book was published with the expectation of instigating local researchers to generate a continuity as well as impart information to those readers who would like to be knowledgeable about the scope and background of Brunei's economy, especially its natural resource economics: oil revenue management.

I would like to express my sincere appreciation to Professor John Langmore, my supervisor, who kindly and patiently encouraged and supervised me in preparing my thesis which has then been transformed and published as part of this book. I would also like to express my greatest appreciation to the Ministry of Education, Brunei Darussalam, for sponsoring my studies in Australia and the United Kingdom. Finally, I must express my utmost gratitude to all my family members and friends, especially my parents, Haji Basir bin Haji Ibrahim and Hajah Latifah binti Haji Kamarudin, who had given me their full understanding, encouragement and support.

Last but not least, once more, I thank Allah, for it is with His will that this book was finally and successfully completed.

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List of Abbreviations

AGC – Attorney's General Chamber
BEDB – Brunei Economic Development Board
BIA – Brunei Investment Agency
BINA – Brunei Industrial Development Authority
BSP – Brunei Shell Petroleum
CF – Consolidated Fund
CIMB – Commercial Bank
ESCWA – Economic and Social Commission for Western Australia
ETAS – Enterprise Technical Assistance Scheme
FSR – Fiscal Stabilisation Reserve Fund
GCC – Gulf Countries Council
GCI – Global Competitiveness Index
GDP – Gross Domestic Product
GNP – Gross National Product
GPF – Norway's Government Pension Fund-Global
GSDP – General Secretariat for Development Planning
HDI – United Nation Human Development Index
HM –His Majesty
ICT – Information and Communication Technology
IMF – International Monetary Fund
LegCo – Legislative Council
LTDP – Long Term Development Plan
MOF – Ministry of Finance
MIPR - Ministry of Industry and Primary Resources
NBIM – Norges Bank Investment Management
NDP – National Development Plan
NOK – Norwegian Krone
OBG – Oxford Business Group
PLEDS – Promising Local Enterprise Development Scheme
RBDM – Resource-based development model
RF – Reserve Fund
R&D – Research and Development

SDCF – Strategic Development Capital Fund
SFO – Sustainability Fund Order
SMEs – Small Medium Enterprises
SWF – Sovereign Wealth Fund
USD – United States Dollars

CHAPTER 1

INTRODUCTION

Background

The current prosperity in Brunei Darussalam (herein Brunei) is a result of the abundance of oil and gas resources and a small population giving her the fifth highest average income in the world. This leads to high level of government spending on a large civil service, social programs and infrastructure development. However, there are a number of concerns with the current development of Brunei, such as the future of real GDP growth not keeping up with population growth; decreasing oil production; question about the use of future investments; and lack of diversification of private sector development. Brunei's aim is to move away from being a carbon-based economy by reducing the reliance of hydrocarbon and developing a more diverse economy. Thus Wawasan Brunei 2035 (here in Vision 2035) was introduced to accompany the Ninth National Development Plan (NDP) (2007-2012) to achieve this ambitious goal. The NDP does not seem to be effective, as the plans to diversify its economy has been carried forward since the Second NDP.

The key challenge for achieving sustainable development of Brunei in line with its Long-Term Development Plan (LTDP), Vision 2035 is how to preserve the current high standard of living. The future condition of the country is at stake and thus there will be considerable insecurity, anguish and anxiety that the community in particular will face once the oil has depleted. Therefore, the study aims to find ways of managing oil wealth and finding

alternative oil income to maintain current standard of living in short to medium term.

Another small nation, Norway, is highly dependent on oil and gas but surprisingly is able to escape from the resource curse [1] and has achieved successful economic progress and development. It is important to understand the limitations in the development of Brunei and what Brunei could learn from Norway. In addition, oil rich Gulf countries such as Qatar will be discussed to see how the issues of resource curse and sovereign wealth fund (SWF) are addressed, as Qatar has many similarities with Brunei, with a small population and a monarchical political system.

Norwegian Model as a Benchmark

The Norwegian model is used as a benchmark based on the transparency of the successful economic progress, and worldwide acceptance of their governance and behaviour despite its dependency on oil and gas. The findings of this comparison are utilised to improve the NDP towards its Vision 2035.

Norway with a population of 5 million is a major producer and exporter of petroleum. It is 13th largest oil producer and 8th largest oil exporter. Its petroleum output accounts for half of national exports, 25% of government revenues and 21% of its GDP. Unlike many other petro-states, Norway has largely escaped from the resource curse and stands on top for the latest United Nation Human Development Index (HDI) ranking which brings together

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[1] The resource curse, also known as the paradox of plenty, refers to the paradox that countries with an abundance of natural resources, tend to have less economic growth, less democracy, and worse development outcomes than countries with fewer natural resources.

economic indicators, level of education and life expectancy (Campbell, 2012). Education is seen as a public good which benefits the whole society and is provided free up to the university level.

Norway has managed its oil wealth extraordinarily well as a result of a unique combination of factors. According to Campbell (2012), research on the petro-states shows the importance of government policy and institutions in determining a country's success or failure in managing its oil wealth. Therefore, the Norwegian experience reflects its good policies and institutions.

Norway is reported to have one of the most equitable societies in the world, where, Norway had a generous welfare system supported by a high and diversified tax base (Campbell 2012). Following the discovery of oil in 1969, Norway has determined to manage its petroleum resources to ensure oil was developed for the benefit of the entire society, thus steering away from the resource-curse, by minimising rent-seeking behaviour and corruption.

Objectives

The on-going National Development Plan of Brunei ever since its dependency shows that, Brunei is not having any problems in planning, and numerous research projects to address the problems of economic development show that Brunei is aware of the importance of finding alternative pathways to its hydrocarbon-based economy. However, means of addressing the problem are still inadequate as are the responses. Therefore, the need of further research on what works, what has not worked, and how they can be improved. This is done through the investigation of enabling factors, identifying potential lessons from Norway to find

measures in addressing the issue of finding alternative sources of income as a way to achieve diversification and for the sustainable economic development of Brunei and the welfare of her people.

Scope and Methodology

The scope of this study focuses on how to manage income streams from oil revenues, and how to strengthen the service industries and private sectors with reference to Norway and Qatar. In other words, what are the enabling factors that Brunei can learn from these countries towards achieving sustainable development and evolving from a hydrocarbon-based economy?

The issue on transparency in oil wealth management will also be discussed to ensure stability of income flows. Transparency of natural resource fund is important as it promotes sustainability, more efficient public financial management, financial crisis prevention, investor confidence and easier access to capital, trust and accountability (Toledano & Bauer, 2014). For example, in Norway, investment guidelines and strategies are published. Middle East countries like Qatar achieve a reasonably strong position in terms of the world's ranking in Global Competitiveness Index (GCI). However, as Brunei Investment Agency (BIA) continues to remain a highly secretive investor, the practical solutions of the problems addressed in this book will be affected.

This study employs a comparative approach by analysing the economic diversification efforts and management of oil income streams from oil industries undertaken in both Brunei and Norway. According to Ville and Wicken (2012, p.1342), 'the comparative approach

out what works and what has not worked for Brunei to learn. In addition, coverage of the oil rich Gulf country, Qatar, will be undertaken to suggest and recommend the enabling environment. This book discusses the following issues:

1. The policies of the Sovereign Wealth Fund (SWF). As Brunei is highly dependent on the oil and gas sector, the income stream from a similar fund would not be enough for the population to live off, if the SWF and other non-oil industries are not generating sufficient income to replace the lost oil and gas revenues when they are exhausted. If Brunei aims to maintain its current standard of living, it has to generate equal or more income than what are being produced by the current oil and gas sector.
2. What does Norway have that Brunei does not? The answers to this question are the potential enabling factors for Brunei to learn.
3. What are the challenges in adopting the Norwegian Model? The constraints of the local environment (conflicting objectives) will be discussed and suggest what the trade-offs are, what should be done to create enabling environment for diversification to happen.
4. What policies does Norway have in place with its management of oil revenues to benefit the whole community?

It is hoped that, this research will help to find alternative pathways to sustainable development. In addition, this research will also help to find ways about how to ensure that high quality services of education, health and employment are still accessible to everyone after oil runs out.

Several feasible policies will be identified which may help policy makers in formulating more effective

provides grounds for generalising about the conditions for successful development in resource-based economies'. This is undertaken by doing a comparative assessment of Brunei Vision 2035 and Norwegian Model reports (available on websites) which analyse what factors does Norway have that Brunei does not, and what are the enabling factors which could contribute to the effective diversification efforts of Brunei. This analysis will look closely at two important aspects of future of Brunei, namely, successful diversification and future income stream. Study carried out and reported by Tisdell (1998) observes that, the problems of economic diversification in Brunei are similar to those of the oil-rich Gulf states as studied by Livingstone (1993).

Cook and Nielson (2011) point out that there is no a 'one size fits all' description which applies to diversification as each country has its own unique history of diversification. This book mainly learns the lessons from Norwegian model. Occasionally, it also makes comparisons with the Gulf due to the similarity in political system about their efforts to address the problem of resource curse and SWF. Beblawi (2011, p.187), writing after ten years, stresses the continued dependence on oil and notes that 'it is clear that neither oil-based nor import substitution industries have much hope to survive or to expand in a post-oil era'. Therefore, it is best to see what Norwegian has to offer to Brunei.

Ville and Wicken (2012) remark that Norway managed to the avoid resource curse and moved on to the next modern level of development as a resource-based economy. Norway did this by its diversification efforts into new resource products and industries where the process involved innovation, and the close ties that have existed between resource-based industries and knowledge producing and disseminating sectors of societies (Ville & Wicken 2013).

Outline of the Book

Following the introduction, the remainder of this book consists of five chapters. Chapter two reviews a literature on Resource curse, Dutch disease and diversification in order to understand problems with Oil-based economies and learns experience from the Gulf. Chapter three discusses briefly on the economy of Brunei and efforts to diversify the economy including achieving Wawasan Brunei 2035 (Vision 2035). Chapter four will examine Brunei's efforts in managing its income streams and diversification and the gap will be identified to find out what are the root causes that lead to the problems of diversification of Brunei.

Chapter five offers a comprehensive review about how countries like Norway managed to escape from the resource curse. What does Norway have that Brunei does not? Enabling factors serve as keys to unlock and unravel this issue. A comparative analytical approach is employed to find the answers to the question 'how'; what can Brunei learn from these enabling factors. This chapter also studies the Norwegian model and examine the road map for transparent institutional development, on how Norway managed its oil income stream through the SWF mechanism. This will simultaneously compare how Norway and Qatar addressed the problems and identify the best solutions for Brunei. The crucial question of whether policies in Norway can be used in the context of Brunei will be answered in the final chapter. Further studies and investigations will also be recommended.

2 PROBLEMS WITH OIL-BASED ECONOMIES

Resource curse and Dutch disease

Sachs and Warner (1995) have shown in their very influential paper a strong negative association between natural resource exploitation and economic growth. The resource curse is a phenomenon where a country which is heavily dependent on natural resource exports tends to perform poorly on a variety of measures of social, economic and political development (Pegg, 2006). However, the term resource curse is very broad.

It has always been a debating issue whether a resource curse is inevitable in oil rich countries and whether there is a way in which the 'curse' could be avoided? The World Bank argues that this phenomenon is inevitable, but that both good governance and economic policies are the form of intervention which can help to mitigate the ill effects of resource curse, such as, Dutch disease[2] and lack of diversification (Pegg, 2006).

According to Duraman (2011), the oil and gas industries result in the transformation from a feudal agrarian society into a modern affluent society where high income from the oil and gas enabled Brunei to leapfrog some phases of the development process. It is seen to be problematic to Brunei as there is a lack of secondary sectors as a result of

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[2] The Dutch disease is the apparent causal relationship between the increase in the economic development of a specific sector (for example natural resources) and a decline in other sectors (like the manufacturing sector or agriculture).

the 'leapfrog' which forced Brunei to be highly dependent on hydrocarbon resources, where these resources are vulnerable to external shocks (Duraman, 2011).

According to Movahed (2013), most oil-exporting countries especially in the Gulf region, did not have sound industrial sector prior to the discovery of oil and a resource boom can be detrimental to manufacturing and industrial sectors. A famous example is the Netherlands. Manufacturing sectors in the Netherlands were paralysed, causing significant decline in employment and this phenomenon is known as Dutch disease (Movahed, 2013).

Dutch disease is an adverse impact of the natural resource boom on the manufacturing sector due to the temporary appreciation of the real exchange rate. Movahed (2013) explains that revenues generated from oil are received in dollars making the current currency of the country become stronger compared with other nations making the non-oil sector exports more expensive and less competitive. Therefore, Movahed (2013) suggests that, oil-exporting countries should adopt long-term internal and external policies to compensate the depletion of oil as it is to be the heritage of the generations to come. The latest discourse of development suggests that oil-exporting countries can learn from the Norwegian model. Movahed (2013) in his study suggest two approaches for the government in oil-based economies to manage and sustain their oil wealth:

1. Accumulate foreign assets;
2. Invest in productive activities in productive domestic economies.

Movahed (2013) argues that, the two approaches have been very successful in Norway. The explanation of these two approaches will be elaborated in chapter 5.

Norway's success does not mean that it can or should be imitated entirely to ensure the same outcome. Kotler, Jatusripitak and Maesincee (1997) confirm that, there is no single prescription that all countries should follow in order to build their wealth and national welfare as different countries' endowment and the paths they have taken resulted in different growth performance. They further suggest that, a systematic methodology should be performed for a respective country to apply, by assessing their existing economic environment, opportunities, strength and weaknesses (Kotler, Jatusripitak & Maesincee, 1997).

Diversification

Diversification in the political economy

Within political economy, diversification can happen in two ways, namely, horizontal and vertical diversification (Hvidt, 2013). Hvidt (2013) explains that, horizontal diversification happens when new opportunities are sought for new products within the same sector, for example mining and energy, while, vertical diversification entails more stages of processing domestic and imported products. Vertical diversification seems to be an enabling factor for Brunei and this will be further explained in chapter 4.

Diversification is also associated with risks for oil exporting countries such that price and demand are the basic components of the world's economic system which fluctuate over time and diversification is an option for societies, firms and individuals to protect them from this phenomenon (Hvidt, 2013). Risk is not the only concern for GCC governments, as El-Kharouf, Al-Qudsi & Obeid (2010 p.135) found: 'low growth rates, lack of public and private incentives to accumulate human capital, lack of

competitiveness in the manufacturing, the likelihood of shocks and spill-over effects in the economies, and various rentier effects make it imperative for the countries to pursue economic diversification strategies'. Furthermore, the General Secretariat for Development in Qatar (2011, p. 10) states that 'A more diversified economy is inherently more stable, more capable of creating jobs and opportunities for the next generation and less vulnerable to the boom and bust cycles of oil and natural gas prices'.

Diversification and industrialization

To find out why high oil exports did not deter the growth of industrial and manufacturing sectors in Norway can be explained by the dichotomy of oil wealth and deindustrialisation (Mohaved, 2013). Looney (1994) defines diversification as spreading risk by creating different sources of income.

The flow of income generated from oil and gas revenues increases export earnings and this leads to appreciation of the Brunei dollar. This appreciation increases the price of Brunei's exports in other countries which tends to reduce these exports, and also reduces the price of imports so discouraging the establishment of enterprises competing with goods and services which could be produced in Brunei. This is what is meant by the Dutch disease. To avoid this, the government of Norway monitors the domestic injection of oil revenues which could impede establishment or expansion of other enterprises in Norway. To avoid this problem, the revenue is channelled into her SWF, the Government Pension Fund (GPF) which is now the largest SWF in the world (Mohaved, 2013). This will be further explained in chapter 5.

Diversification and the private sector

ESCWA (2001, p.vii) sees diversification as 'reducing the leading role of the public sector in the GCC economies by promoting the growth of the private sector'. Hvidt (2013) explains that the link between diversification and private sector is due to two main reasons. Firstly, due to the allocation state model, in which a relatively small part of the local population is involved oil and gas extraction – which is capital intensive and therefore does not provide many jobs (Hvidt, 2013). Therefore, the emphasis on private sector development as a way to create jobs involves a large section of the population in production (Cook & Nielson, 2011).

Secondly, the need to develop private sectors is related to the foreign direct investment (FDI). Hvidt (2013) argues that, not only will it bring capital, but, jobs, new technology and new management methods will transform the societies into knowledge-based societies. However, FDI are private flows to private firms (ESCWA, 2001). Thus, the potential of FDI is limited without a well-functioning private sector (Hvidt, 2013). Thus, this study will seek ways of strengthening the private sector.

Management of oil revenues and the sovereign wealth fund

The next issue is about the management of oil revenues. For most resource-based economies, SWF is created for saving for intergenerational equity, macro stabilisation and pension reserve. Therefore, an effective and optimal management of SWF is important. El-Kharouf, Al-Qudsi & Obeid (2010, p.124) argues that, SWFs serve as 'an overall prescription for preventing the cyclical economic and fiscal imbalances of oil-based economies'. Their policy is implemented by

investing oil revenues in either local or international industries which enables GCC countries to convert the volatile and exhaustible oil incomes into a more stable financial stream of wealth that could be used to develop their societies in the long run (El-Kharouf, Al-Qudsi & Obeid 2010, p.133). According to Hvidt (2013), if all investments are mostly undertaken overseas, GCC countries will not create jobs in the local economies nor contribute to further education and training of the local workforce.

Transformation from an allocation to a production state

The distinction between these states was done by Luciani (1990) in her works entitled 'Allocation vs Production States: A Theoretical Framework'. The emergence of allocation states is due to the large income from oil and gas for instance which saves the states from having to tax the local economy to finance its activities (Luciani, 1990). Hvidt (2013) explains this is due to the resource incomes, the states do not have the incentive or no pressure to develop an economic foundation for the society and they only see their role in distributing the revenues which flow into the country.

The inverse situation happened in the production states where the creation of a solid economic foundation society determines the state's ability through taxation to strengthen its power, both nationally and internationally (Hvidt, 2013). An implicit assumption made by Ville and Wicken (2012, p.1342) states that, 'truly successful nations will transit from natural resource to manufacturing industries'. Thus Brunei needs, to learn the successful efforts of Norway in transiting from oil to manufacturing industries, and managing her oil income.

Experience from the Gulf

The issue of economic diversification is also observed in the Gulf countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates), where the three factors, namely, income from finite hydrocarbon, price fluctuation and this is practically the only source of wealth, have placed petroleum as the main political concern in the Gulf since oil was discovered (Hvidt, 2013). Hvidt (2013, p.2) found out that, the failure to diversify in oil producing countries is due to the 'allocation state' model where the economy 'relies on the sale of hydrocarbons, is state-led and state-driven, emphasises wealth distribution, makes extensive use of migrant labour, and is characterised by a significant underdevelopment of productive assets'. Thus, Kubursi (1984, p.1) argues that the reason the Gulf has a problem with economic diversification is that 'Were oil supplies everlasting, and the demand for oil strong and continuous, economic diversification would be pointless. The governments of the region would instead need only to ensure the distribution of oil revenues among the population'.

Hvidt (2013) further explains that, the model has also failed to support further development of the Gulf mainly due to two major aspects. Firstly, it fails to generate a stable and sufficient income for the population (Hvidt, 2013, p.2); and secondly, it also fails to create job opportunities for the growing group of young and well-educated citizens (Hvidt, 2011a, p.88).

CHAPTER 3

BRUNEI DARUSSALAM

Brunei in brief

Brunei is a small country located on the north-west coast of the Island of Borneo, right in the heart of Asia with a total land area of 5,765 km^2 (BEDB, 2008) and a population of 406,200 with an average growth rate of 1.6% (Department of Economic, Planning and Development, 2013). It is divided into four districts, namely, Brunei-Muara, Tutong, Belait and Temburong, and its capital city, Bandar Seri Begawan, is located in the Brunei – Muara district, the centre of Government and business activities.

Under the constitution, His Majesty the Sultan has executive authority and is assisted and advised by five constitutional bodies, namely, the Council of Succession, the Council of Cabinet Ministers, the Privy Council, the Religious Council and the Legislative Council (BEDB, 2008). The present Head of State and Head of Government is His Majesty Sultan Haji Hassanal Bolkiah Mu'izzaddin Waddaulah, the 28th monarch to success to the throne and he is also the Prime Minister and heads a team of Cabinet Ministers (BEDB, 2008).

Islam has been the official religion of Brunei since the 14th century and Brunei is currently ranked number one in the Islamic world in terms of the Human Development Index (HDI), which measures a country's quality of life (BEDB, 2008).

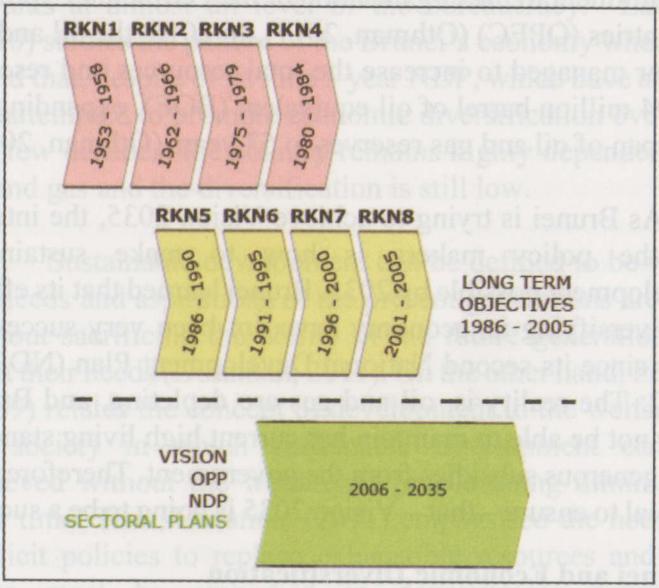
Figure 1: Negara Brunei Darussalam

Source: Google Map (2014)

Wawasan Brunei 2035 (Vision 2035)

The effort to diversify is not new to Brunei. According to Tisdell (1998), in anticipation of Brunei's non-oil future, Brunei stressed the importance of diversifying her economy at the beginning of her First National Development Plan (1954-1958) as shown in the following figure. Ever since its fifth NDP (RKN5) the first after its independence, the government of Brunei has consistently proclaimed the diversification of its economy as its main objectives (Siddiqui, Al-Athmay & Mohammed, 2012). However, it was claimed that Brunei failed to elaborate clear strategies for diversification and that the achievements are not seen as successful (Cleary & Wong, 1994).

Figure 2: History of RKN



Source: Department of Economic, Planning and Development (2008).

By 2035, Brunei Darussalam aims to be recognised for the accomplishments of its well-educated and highly skilled people, its population living with high quality of life, and a sustainable and dynamic economy (Department of Economic, Planning and Development, 2013).

In 2017, Brunei's oil production was estimated to be at 134,000 barrel per day compared to previous year's 139,000 per barrel[3] (Othman, 2017). One of the main reasons of the decline is due to the natural dwindling of resources,

[3] Statements in this paragraph are based on the speech of YB Pehin Datu Singamanteri Colonel (Rtd) Dato Seri Setia (Dr) Awang Haji Mohammad Yasmin bin Haji Umar, Minister of Energy and Industry at the Prime Minister's Office on the third day of the 13th Legislative Council (LegCo) session as reported by Borneo Bulletin.

suspension and deferment of production and the country's commitment to the Organisation of the Petroleum Exporting Countries (OPEC) (Othman, 2017). In 2016, the oil and gas sector managed to increase the total resources and reserves by 94 million barrel of oil equivalent (BOE), expanding the lifespan of oil and gas reserves to 53 years (Othman, 2017).

As Brunei is trying to achieve Vision 2035, the interest of the policy makers is how to make sustainable development possible by 2035. Brunei learned that its efforts in diversifying its economy have not been very successful ever since its second National Development Plan (NDP) in 1962. The reality is, oil and gas are depleting, and Brunei may not be able to maintain her current high living standard and generous subsidies from the government. Therefore, it is crucial to ensure – that – Vision 2035 is going to be a success.

Brunei and Economic Diversification

The government of Brunei has realised that the country's development is based on depletable resources and the government has aimed to convert the proceeds of oil and gas into SWF as an insurance for sustainable growth and development, so that the future generations can enjoy a good quality of life. Brunei has a SWF managed by Brunei Investment Agency, set up in 1983. There is a Consolidated Fund (CF) which aims for expenditure smoothing, and a General Reserve Fund (GRF) which focuses on inter-generational savings. Challenges to the development of Brunei due to the leapfrog process are: inefficiency of the state to perform important tasks in creating or promoting the structures of institutions; and lack of incentives for the private sector and market forces to perform their innovative and creative functions to generate and diffuse new products and services (Haddad, 1993). Ali (1992) adds that, the state machinery has lagged behind and is far from well-developed

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