

Chapter 9 CONCLUSION

This thesis presents original research that has explored whether existing institutional mechanisms to manage petroleum revenue can enable Timor-Leste's sustainable development. A generic framework for understanding the relationship between institutions and natural resource revenue was developed. A thorough analysis of Timor-Leste's formal and informal institutions, and mechanisms for managing petroleum revenue, were presented and the problem of managing Timor-Leste's petroleum revenue was illuminated with the opinions of East Timorese and foreign advisers (both with and without a decision-making role). This research makes substantial contributions to the field of knowledge about the challenges of managing a natural resource boom in Timor-Leste. This concluding chapter highlights four aspects of the unique contribution this research has made to understanding how Timor-Leste might manage its petroleum revenue to achieve sustainable development.

9.1 Analysis of the institutional aspects of the resource curse

A major contribution of this research is to the literature that explores the institutional aspects of the resource curse which, until now, has been limited. An exploration of the challenges of managing a natural resource boom revealed that the traditional view of the institutional aspects of resource curse was that natural resource wealth affected the quality of institutions. In some countries an influx of resource revenue had resulted in corruption, conflict and the mismanagement of natural resource revenue. Yet, other countries institutions were less affected by an influx of revenue and the pre-condition of institutions appeared to be a key factor in avoiding the resource curse and sustaining development. Thus, a framework for a more holistic understanding of the relationship between institutions and natural resource revenue was developed, and a deeper analysis of the institutional aspects of the resource curse was possible. Scholars who engage in the resource curse debate will find much in this research which adds to their understanding of its institutional aspects, particularly as this framework is illuminated with the practical experiences of the Timor-Leste model and the views of a broad range of people (both within and external to the petroleum revenue management decision-making process).

Institutional quality can affect the management of natural resource revenue. Strong productive institutions support, whilst strong destructive institutions and weak productive institutions may hamper wise petroleum revenue management. Institutions that are cursed need to be distinguished from those that might be resource cursed. That is, corruption, conflict and revenue mismanagement may exist independent of natural resource wealth. A state may create mechanisms and institutions to manage its petroleum revenue wisely, but it would need to

weaken any pre-existing destructive institutions if it was to avoid the resource curse. Unfortunately, people who benefit from destructive institutions (e.g. corruption or rent-seeking) are likely to behave in ways that perpetuate those institutions, and weakening those institutions (particularly informal ones) is more difficult and takes time. Productive institutions such as transparency and accountability (or mechanisms to enhance them) can counteract or retard the progress of these destructive institutions. The resource curse literature explores these themes in only a general way. However, this research has contributed to a deeper analysis of what determines institutional quality. East Timorese decision-makers should be mindful of these issues as they further develop current and establish new petroleum revenue management mechanisms.

The framework developed by this research and repeated in Figure 9.1 proposes that human and social capital are key determinants of institutional quality, and therefore essential to wise petroleum revenue management. Discussion of the problem of a lack of human capital in managing natural resource wealth has entered the resource curse literature. Low levels of human capital, particularly in government institutions, mean that the skills and knowledge to invest and spend petroleum revenue need to be developed and, if the lack of human capital is not addressed, petroleum revenue may be mismanaged. A lack of human capital in civil society is also problematic, because without an understanding of how petroleum revenue should best be managed, civil society can not hold a government to account.

The problem of a lack of social capital in managing natural resource wealth has been less commonly discussed in the resource curse literature. Social capital is the stuff that generates the will to participate. Bonding social capital (between family members and close friends) and linking social capital (between government and civil society) are most relevant to the petroleum revenue management discussion. Close connections to family and friends can have negative effects if corruption and nepotism are accepted ways of doing business. An over supply of this form of social capital can affect the wise management of petroleum revenue. A lack of linking social capital means that government and civil society's will to meaningfully engage with each other in the transparent and accountable management of petroleum revenue does not exist. Thus, the framework this research is based on reflects the importance of human and social capital in understanding the relationship between natural resource revenue and institutions. A state may establish potentially productive institutions to manage petroleum revenue but, if human and (linking) social capital are in short supply, the bureaucrats may find the institutions difficult to maintain, and civil society may find it difficult to participate in those institutions.

Clearly, these are issues of importance to Timor-Leste. The Government acknowledges the lack of human capital within its bureaucracy. The lack of human capital in civil society is less-widely acknowledged and there are fewer donor-funded programs that address this issue. More critically, the problem of a lack of social capital between Government and civil society should

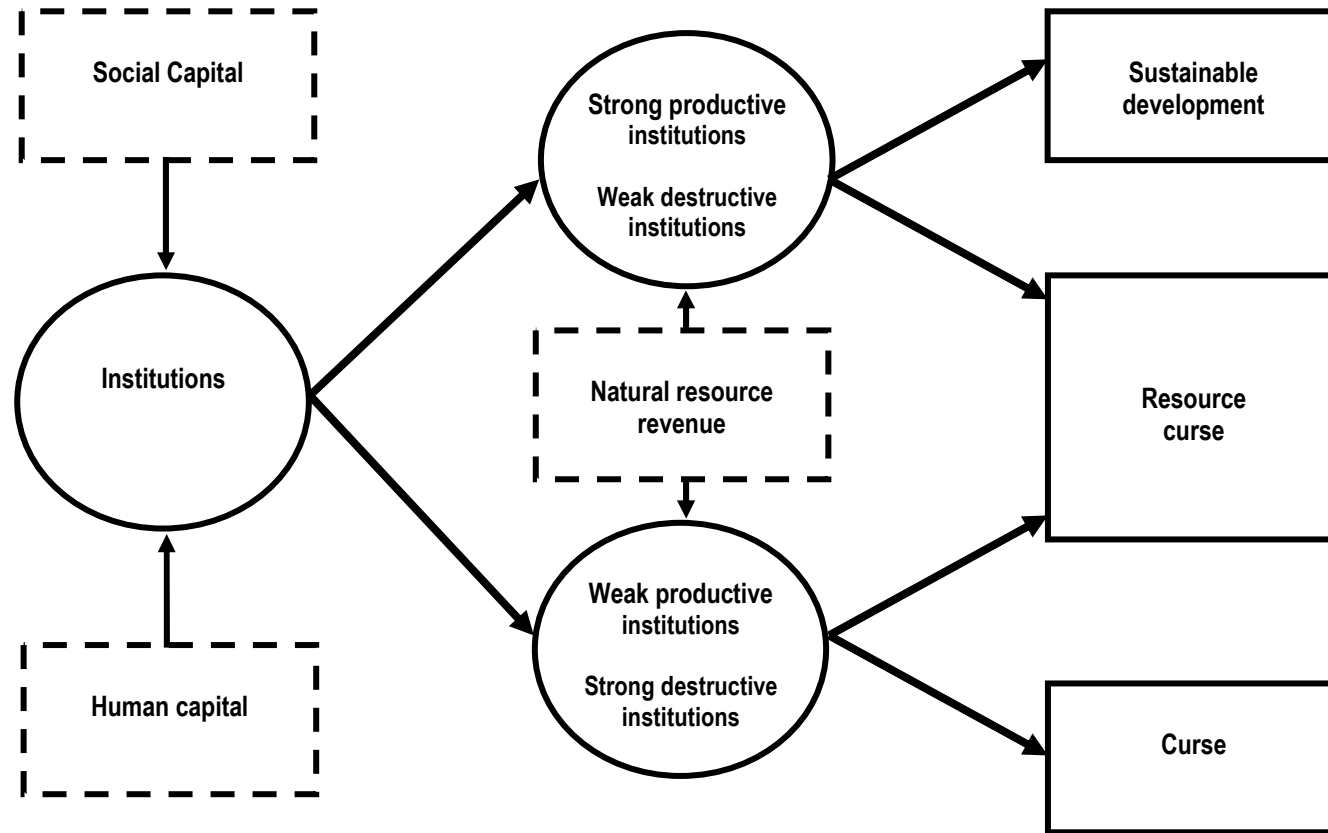


Figure 9.1 A framework for understanding the relationship between natural resource revenue and institutions

be addressed if petroleum revenue is to be managed wisely, and ultimately to sustain Timor-Leste's development.

9.2 Timor-Leste's unique case

Timor-Leste's case presents a unique opportunity for a nation to learn from the experience of countries that have been cursed by natural resources, and to manage their petroleum revenue wisely. This thesis offers great insights into Timor-Leste's informal and formal institutions which provide the backdrop to its petroleum revenue management challenges. In particular, the Government of Timor-Leste's plans for managing its petroleum revenue, which it is so heavily reliant on, are provided in detail. This knowledge is explored within the context of the framework for understanding the relationship between institutions and natural resource revenue, and is also used to inform and analyse the opinions of the research participants. In many ways, Timor-Leste's plans for petroleum revenue management are wise and, potentially, sustainable. Thus, in the same way that Timor-Leste can learn from the mistakes of other countries, those countries may learn from the good example Timor-Leste appears to be providing.

A great effort has been made by the Government of Timor-Leste to avoid the resource curse. Great care has been taken to design the institutions that will manage petroleum revenue based on best practice and in consultation with stakeholders. Although it was almost five years from the time Timor-Leste received its first petroleum royalty payment until its Petroleum Fund Law was promulgated, the Government attempted to be thorough in the process of establishing a petroleum fund. The road to a petroleum fund included a five stage process of consultation over ten months. Timor-Leste's Petroleum Fund Law is the cornerstone of its model of petroleum revenue management, but other institutions are also relevant (e.g. Timor-Leste's Central Bank, the Office of the Inspector General and the Provedor of Human Rights). Governed by these institutions Timor-Leste's petroleum revenue may, in theory, be managed wisely.

The thesis provides a detailed analysis of these institutions and the different components of the Petroleum Fund Law, their strengths and their weaknesses. The Petroleum Fund Law integrates the Petroleum Fund with the State Budget. All petroleum revenue is deposited into the Petroleum Fund and can only be withdrawn for use through the State Budget. The Petroleum Fund Law also requires that Parliament is informed of the value of Estimated Sustainable Income¹⁸⁰ prior to its decision about how much revenue should be withdrawn from the Petroleum Fund. This mechanism may reduce the volatility of the flow of petroleum revenue, which will assist Timor-Leste to plan its expenditure strategically, rather than in reaction to external factors. These aspects of Timor-Leste's petroleum revenue management, along with

¹⁸⁰ Estimated Sustainable Income is the amount of revenue that can be withdrawn from the Petroleum Fund such that an equal amount could be withdrawn every year thereafter.

some strong fiscal policies (e.g. the Government has a policy of not taking a loan from an international financial institution) are encouraging. But, the mechanisms Timor-Leste has in place are untested and, regardless of their potential strength, they alone can not ensure protection against the resource curse.

The effects of Portuguese colonisation, Indonesian occupation, United Nations' administration, and years of poverty, are evident in Timor-Leste today. Timor-Leste gained independence only in May 2002 so its formal state institutions are weak, but some of its most destructive informal institutions are strong. The execution of the State Budget is a problem (in the last financial year only 30% of the Capital and Development budget was executed), as is the fact that informal institutions, such as corruption and violence as a means of dispute resolution, are ingrained in the East Timorese way of life. These institutional factors will affect expenditure of Timor-Leste's petroleum revenue, and the responses of the research participants confirmed this analysis.

9.3 A participant driven vision for Timor-Leste

The challenges of managing Timor-Leste's petroleum revenue were illuminated with the opinions of East Timorese and decision-makers (East Timorese and foreign advisers) in this research. Qualitative and quantitative research methods were used to interview 67 people. Although the sample is small and selective and therefore does not claim to represent the larger population, it includes the (then) President and the (then) Prime Minister of Timor-Leste, and East Timorese from a variety of stakeholder groups (e.g. young people, women, teachers, health workers, academics, etc.), and thus the research offers important preliminary evidence on issues that are crucial to Timor-Leste's sustainable development.

Participants were questioned about their vision for the future of Timor-Leste and how their petroleum revenue should be invested and spent. A unique software application (Point*Wizard) was used to elicit participants' preferences in regards to which sectors petroleum revenue should be spent on, and which petroleum revenue management decisions were most important. Their comments, in response to the dilemmas posed to them, revealed a vision for Timor-Leste's petroleum revenue management that is unprecedented. On the eve of Timor-Leste's 2007 parliamentary election, the insights offered by this research are a timely and rich resource that should be considered by the incoming decision-makers. The views of East Timorese expressed in this research (both the decision-makers and those outside of government) also offer a rich resource for citizens of other countries struggling to manage their natural resources wisely.

Above all, Timor-Leste's policy makers should heed the overwhelming message expressed by participants; that they want to participate in petroleum revenue management decision-making. This research highlights the importance of building social capital, and therefore the essential

nature of a good and genuine relationship between Government and civil society. This relationship is crucial to the generation of successful petroleum revenue management outcomes and the political sustainability of whichever political party holds power. The research provides comments from non-decision-makers on a range of important petroleum revenue management decisions, thereby providing exactly the information the decision-makers need to consider in determining whether current and proposed policies indicate the will of the people. In recognising the value of listening to and considering the effect (political or otherwise) of their decisions, the outcomes for policy-makers and the East Timorese people will be enhanced.

The results of this research reveal that what Timor-Leste's petroleum revenue is spent on is the most important decision the Government makes. The participants imagined that spending petroleum revenue would improve the quality of their lives, and that the sectors most in need of increased expenditure were health and education. Given a choice, participants preferred spending petroleum revenue on social services, rather than infrastructure (such as roads and electricity). This preference is striking and one that the new East Timorese government should consider. Yet the opinions of Xanana Gusmão and Fernando 'Lasama' de Araujo expressed in this research show a preference for spending on infrastructure as a priority:

In the first years we need to create infrastructure, agricultural, medium and small scale industry so that people can be productive. In this way I believe the money that will come from the depths of the sea shall be well applied and well spent. (Xanana Gusmão, Citizen of Timor-Leste)

We need infrastructure. First we need good roads all over. (Fernando 'Lasama' de Araujo, Partido Democratico)

To allocate funds to population-wide programs may be less politically rewarding in comparison to the electoral rewards a party may win by funding highly visible infrastructure projects such as roads and bridges. However, in a country such as Timor-Leste where the majority of the population lacks quality basic health and education services, spending natural resource revenue on infrastructure (whilst health and education services show little development) may disenchant voters further. Participants explained they were in favour of investing in health and education because they could envisage its long-term benefits and contribution to human capital. By contrast, participants were very much against the idea of using petroleum revenue to fund individual or royalty payments, as they could not see any sustainable benefits from such a plan. At the time the research was conducted, Xanana Gusmão said 'I am against [individual payments]. The State can not be seen as a paternal state. The people, themselves, must become productive. This is stupidity.' (Xanana Gusmão, Citizen of Timor-Leste).

Participants also held strong opinions about some key petroleum revenue management decisions that indicate Timor-Leste's true autonomy (politically, financially and strategically) is of great importance to them. How budget expenditure is financed was the most important of six decisions about saving and investing Timor-Leste's petroleum revenue. The majority of participants (79%) preferred to use Timor-Leste's petroleum revenue to fund State budget

expenditure, as opposed to seeking a loan from an international financial institution. Further analysis showed that East Timorese participants without a decision-making role in petroleum revenue management were even more adamant that Timor-Leste should avoid taking a loan (90% preferred to fund budget expenditure using petroleum revenue). There is a clear mandate from the participants in this research that the policy of remaining debt-free should be maintained, and the new government would do well to heed this message.

Another petroleum revenue management decision that revealed the passion with which the East Timorese fought for their country's independence was the issue of when to exploit the Greater Sunrise petroleum field. Since the research was conducted the Government of Timor-Leste has agreed with the Government of Australia that resolution of a permanent maritime boundary between the two countries will be deferred for at least 50 years. Thus, it is not surprising that only two of the eleven decision-makers (18%) ranked 'when maritime boundaries with Australia are resolved' as their choice for when Greater Sunrise should be exploited. In contrast, eight of ten participants (80%) without a decision-making role did. On this issue the research revealed a difference between the opinions of the decision-makers and the participants without a decision-making role. This decision can not readily be reversed by the new Government, but a forthcoming decision (that was not canvassed in this research) that will certainly elicit local views that favour financial independence is the choice of where Greater Sunrise petroleum is processed. This is a decision that the East Timorese people will have strong views about and the new government is encouraged to consult widely if they do have any power to influence the outcome of the operating petroleum company's decision.

9.4 Sustaining Timor-Leste's development

Timor-Leste chose to exploit its natural resources and convert that natural capital into financial capital so that it might sustain its development. Sustainable development implies that the needs of both current and future generations are met. Timor-Leste's Petroleum Fund was designed to ensure that some of the benefits from exploiting their petroleum resources today will be available to future generations. But, this research has revealed that weaknesses in some of Timor-Leste's productive institutions, and some strong destructive institutions, may jeopardise Timor-Leste's sustainable development. Avoiding the resource curse is one of the greatest challenges Timor-Leste will face.

The lack of human and social capital currently available to Timor-Leste must be addressed. The research has reiterated the problem of the Government of Timor-Leste's budget execution, and until the lack of human capital within the Government bureaucracy is addressed, sustainable development will not be possible. But, these things take time and poverty can not wait. Short-term solutions (such as increased foreign advice and support) will be required to resolve the problems of budget execution, and provide tangible improvements to people's quality of life. In

this way, the current levels of dissatisfaction with the progress of the Government may reduce the potential for conflict. As the skills and knowledge, both within government and in civil society, increase and the relationship between government and civil society improves, productive institutions will be strengthened.

The Government must retain and strengthen its resolve to address corruption and nepotism, and other destructive institutions, and thus their commitment to the Extractive Industries Transparency Initiative should be maintained. The research participants clearly indicated that mechanisms to enhance transparency and responsibility were needed. The level of knowledge of the participants about the resource curse and their understanding of the value of transparency and access to information shows that civil society in Timor-Leste is well-placed to build the human capital needed to hold the government to account. Participants recognised that increased investment in education (both formal and otherwise), and continued foreign advice and support, were ways in which Timor-Leste could build its human and social capital, to ensure that its petroleum revenue is managed wisely. This level of awareness is possibly unprecedented in other natural-resource dependent developing countries. With improvements to transparency and accountability, openness on the part of the Government, and better access to information, in conjunction with increased participation by civil society, the destructive institutions can be weakened. Further research in these areas is crucial.

At this time Timor-Leste is not developing sustainably, it is unable to service the needs of its current generation, let alone provide for its future generations. But, the institutional weaknesses and problems are not (yet) a result of Timor-Leste's natural resource wealth. Rather, its history has cursed Timor-Leste. This curse is not a permanent one. Petroleum resources present an opportunity to develop a revenue base that Timor-Leste can use to counter the negative influences of the past, and to strive towards sustainable development. Timor-Leste has a most productive and positive force on its side which may assist it to achieve its goal, the fierce determination of its people to overcome the challenges they face, against all odds.