Chapter 3 TIMOR-LESTE’S INSTITUTIONAL LANDSCAPE

Chapter Two described the pitfalls of natural resource revenue management that involve institutional quality. The aim of this chapter is to review Timor-Leste’s institutions and highlight those aspects of East Timorese institutions that are relevant to an understanding of how well Timor-Leste might manage its natural resource wealth. An understanding of Timor-Leste’s institutional history and the state of the nation today provides a necessary background and a context in which Timor-Leste’s plans to manage their natural resource revenue wisely (described in the next chapter) can be assessed.

Like footprints of visitors past, the institutional dynamics of Timor-Leste’s history are still evident today. This chapter describes these institutional footprints left by the Portuguese, who colonised Timor-Leste for over 450 years, and the Indonesians, who occupied Timor-Leste for 24 years, and also by the United Nations, which administered Timor-Leste for two and a half years. Timor-Leste achieved independence only recently (in May 2002) so its own formal institutions remain in the developmental stages. In contrast, Timor-Leste has many informal institutions that have developed over time and are strong.

Today, the social and economic indicators reveal the effect of institutions, old and new, formal and informal. The indicators reveal the extent of poverty and low levels of development and show Timor-Leste to be a poor, small country with huge challenges to change the course set by its history and precedent. The State appears to be cursed already, with instances of corruption, conflict and weak institutions. Against this backdrop, Timor-Leste’s petroleum revenue is approaching like a tsunami, both in terms of its size relative to other revenue generating options, and also the height of the hopes that it will wash away the woes of a nation. Timor-Leste’s petroleum revenue is required to meet immediate needs, but its wise management is necessary to ensure future generations’ needs are also met.

3.1 Timor-Leste’s institutional history

Timor-Leste’s historical experience has left profound institutional (mostly informal) legacies that remain evident today. These institutional legacies are explored in this section because they are relevant to the way in which petroleum revenue is managed today and will be in the future. Portuguese colonisation, Indonesian occupation and administration by the United Nations have

Amandio Gusmão Soares (of the Government of Timor-Leste’s Oil and Gas Directorate) expressed Timor-Leste’s potential petroleum wealth in this way during a presentation at a Petroleum Revenue Workshop (Gusmão Soares 2006b).

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affected this tiny and fragile nation in many ways. Timor-Leste’s own traditional culture also plays a part in this history.

### 3.1.1 Colonisation by Portugal

Timor-Leste was a Portuguese colony for over 450 years, from around 1515 until 1975\(^{35}\). Initially attracted there by the trade in sandalwood, Portugal’s first two centuries in Timor-Leste revolved around missionary activities, and it was only in the early 18\(^{th}\) century that a seat of government was established there. On the whole, this period of colonisation in Timor-Leste’s history is often characterised as one of neglect as Portugal did little to assist Timor-Leste to develop until the 1960-70s. Dunn (2003) reminds us to keep Portugal’s size in mind, and also that their power declined over the period they colonised Timor-Leste. These factors affected their ability to provide for Timor-Leste\(^{36}\). As their most distant colony, Timor-Leste was a low priority for Lisbon (the seat of Portuguese government) to attend to, and received little attention or resources.

Portuguese management of Timor-Leste’s forest resources, particularly sandalwood, was indicative of its lack of concern for the long-term welfare of the colony and its local communities. Timor-Leste’s sandalwood was renowned and highly lucrative, and Portugal did not hesitate to plunder the reserves ensuring that revenue from this resource dwindled to a trickle (McWilliam 2003)\(^{37}\). Essentially the Portuguese managed the forest resources in exactly the opposite way (i.e. unsustainably) to which Timor-Leste needs to manage its petroleum resources (i.e. sustainably). Dunn (2003) writes that with the decline of the trade in sandalwood, and Portugal’s position in Europe in the 19\(^{th}\) century, that Timor-Leste became more and more isolated and investment in the colony declined further.

The Portuguese lack of enthusiasm for Timor-Leste’s welfare is illustrated by their feelings about going to live there. ‘A posting to Dili was a kind of penance… seldom visited by top-ranking officials...’ and Timor-Leste was seen as ‘a poor, backward territory with an uncertain

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\(^{35}\) The Portuguese were not the first *malae* (foreigners) to set foot in Timor-Leste. The sandalwood trade bought the Chinese to Timor-Leste some decades earlier and thus the seed of a Chinese-East Timorese community was born (Dunn 2003). The Chinese have played a significant role in the economic development of the country throughout the years. Despite Chinese people having lived in Timor-Leste for generations, they are still distinguished as foreigners today.

\(^{36}\) Dunn (2003) writes ‘If we take account of Portugal’s small size and weakness as a European power after the seventeenth century, it is remarkable that Lisbon was able to maintain an empire, let alone an outpost like East Timor... no funds available for its social or economic development. In Lisbon, Timor was known for its modest production of high-quality coffee and as a safe, distant place of exile for opponents of the Salazar regime... On the eve of World War II the capital Dili, had no electricity and no town water supply; there were no paved roads, no telephone services (other than to the houses and offices of senior officials) and not even a wharf for cargo handling’ (Dunn 2003 :18).

\(^{37}\) McWilliam (2003) reported ‘Sandalwood continued to figure in revenues from the Portuguese colony and was sold in declining quantities into contemporary times. However, the reputed great forests of sandalwood disappeared long ago... Sandalwood never accounted for more than 10 per cent of the colony's exports after 1920 and in 1926, the colonial forestry service officially prohibited the cutting of the tree’ (McWilliam 2003 :312).
future’ (Dunn 2003 :31). Yet Portugal’s influence in Timor-Leste has left lasting legacies and Dunn, in his very detailed account of Timor-Leste’s history, notes that Timor-Leste was, in many ways, ‘better off than the neighbouring Indonesian province’ (Dunn 2003 :37). Unfortunately, the benefits of Portuguese colonisation were limited to an elite East Timorese. Education was available to only a few, but even then the quality of government schools was poor.

A better education was available from the Catholic schools, which further solidified the idea of a connection between the Portuguese and an elite East Timorese. Catholicism remains one of the greatest institutional legacies of Portuguese times. The first Europeans to arrive in Timor were Portuguese monks (Anon. 1930) and thus began the rise of the Catholic church in East Timorese culture. The lack of contact between the Portuguese and the wider population is evident in the fact that, by the end of colonisation, the number of baptised East Timorese Catholics was only about one third of the population (Dunn 2003). This is much lower than the 98% of East Timorese that are Catholic today (World Bank 2005b), which suggests that the rise of the Catholic Church during Indonesian times was significant politically, as well as culturally, and also shows that Catholicism no longer exists just within the realm of the elite.

The imbalance, between Portugal’s interactions with the East Timorese elite and the local community, is also illustrated by the way in which Timor-Leste was administered. The Portuguese ruled the territory through the local kings and that rule was at least partially administered via the military. Hohe (2002) provides analysis of the interaction between the East Timorese and the Portuguese (as well as the Indonesians and the United Nations). Most contact between local communities and the Portuguese government was for the purpose of

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38 Some direct benefits from Portuguese times can be seen today. People whose parents or grandparents were civil servants during Portuguese times are relatively well off because their parents collect pensions from the Portuguese government.

39 Dunn (2003) explained further, citing the experience of a visitor to Timor-Leste, who described a ‘hospital in Dili [as] a “first-class institution, with a well-equipped operating room and a full staff of doctors... successful vaccination campaigns” ... Whatever the shortcomings of the Portuguese system, health and nutrition conditions appeared to have been no worse than in the adjacent Indonesian islands’ (Dunn 2003 :37-38).

40 In a UNESCO/Oxfam Report, Victorino-Soriano (2004) wrote ‘During the Portuguese time, only a few boys and girls went to school… mostly the children of the Liurai and chef de suco [Chief of the Village] were sent to school… The few that benefited from the Colonial education system were the Assimilados (East Timorese who were assimilated into a higher standing) and Mesticos (those of mixed blood), while the Chinese and the Moslems ran their own [schools]’ (Victorino-Soriano 2004 :26).

41 Hohe (2002) found: ‘A Portuguese commander headed each district, with civilian and military tasks, and a small number of soldiers. The commanders were responsible for peace in their districts and had to work with the local kings. The idea was to strengthen Portuguese rule by influencing the local kings and pacifying them... the choice of a new king had to be approved by the colonial government... The king’s position was now replaced by the Portuguese administration at the sub-district level... Only at the very top level, the kings established relations with the Portuguese... the Portuguese were never in frequent contact with the population’ (Hohe 2002 :573-574).
collecting taxes and often this was implemented via government-appointed East Timorese officials.\textsuperscript{42}

The way in which Timor-Leste was governed by the Portuguese may have ramifications for the wise management of petroleum revenue today. The Portuguese perpetrated a system that distinguished between an ‘elite’ and the people\textsuperscript{43}. Today the distance between those in power and those in the villages is perceived to be great. Many of those with the power to make decisions continue to have strong links to Portugal and other Portuguese colonies (Phillips 2004; Toohey 2004). Mari Alkatiri (the former Prime Minister), Madalena Boavida (the Minister of Planning and Finance) and Anna Pessoa (the Minister of State Administration), are sometimes referred to as the Mozambique clique or the Mozambique mafia because they spent time in that country (also a former Portuguese colony) as East Timorese diaspora escaping the Indonesian occupation. During the crisis in April 2006\textsuperscript{44}, when Ana Pessoa was tipped to take over from Alkatiri as the Prime Minister, one critic said ‘She's very Portuguese, very formal and it will be difficult for her to be accepted by the people’ (Tigor Naispolos quoted in Kearney 2006). Some East Timorese are critical of the decision-makers and those with power in the Government because they did not fight in the local resistance during the struggle against Indonesian occupation.

As a result of these personal connections with Portugal, some recently created institutions also link to Timor-Leste’s Portuguese colonial past and this has alienated critics further. The most notable of these is the choice of Portuguese as one of Timor-Leste’s two official languages (the other being Tetum, a widely-spoken local language). Portuguese is the official language of instruction in schools, although teachers often rely on Tetum (or Indonesian) to explain things (World Bank 2004a). This language decision has alienated a large portion of the East Timorese community, mostly young men, who do not speak Portuguese because they were educated in Indonesian times and thus speak mainly Indonesian\textsuperscript{45}. A discussion of the merits of Timor-Leste’s language policy is not pertinent here. Rather, it is necessary to acknowledge that a

\textsuperscript{42} Dunn (2003) also wrote about the relationship between the Portuguese and local East Timorese communities: ‘Until the 1970s most of these people had only infrequent direct contact with representatives of the metropolitan power. Official dealings, such as they were, amounted to little more than the annual collection of population figures, levying a head tax on the adult males, and collecting levies on livestock. In most cases these onerous and, in hard times, unpleasant tasks were not the lot of Portuguese officials, but of the chefe de suco (head of the tribe), an East Timorese appointed by the Government to carry out administrative duties at the tribal level, but his responsibilities were fairly limited, with other aspects of social and political authority remaining in the hands of the traditional local rulers’ (Dunn 2003 :4).

\textsuperscript{43} Hohe (2002) and McWilliam (2005) both explain, in detail, how Portuguese (and Indonesian) attempts to subvert the local social order to their gain were not very successful.

\textsuperscript{44} A crisis erupted in Timor-Leste in April 2006, which resulted in 38 deaths and around 150,000 internally displaced people in the months that followed. The crisis is explored in section 3.1.3.

\textsuperscript{45} Kingsbury (quoted in Kearney 2006) suggested that one of the problems with Ana Pessoa taking the position of Prime Minister was that she did not speak Tetum.
common language is necessary to communicate, and therefore crucial to the relationship between government and civil society.

Timor-Leste has also utilised its links to Portugal as it develops new institutions. One example is that Timor-Leste’s constitution is ‘loosely based’ on that of Portugal’s (Shoesmith 2003). Most notably executive power is exercised by the Prime Minister, and not the President of the Republic. During the April 2006 crisis this problem (with the Constitution) became apparent; the conflict between the (then) Prime Minister and the (then) President ultimately led to the resignation of the Prime Minister. The failings of the Constitution will not be explored further, but its similarities to the Portuguese system are noted. Further links are illustrated by the current Portuguese government’s bi-lateral commitments to Timor-Leste (significant amounts of aid, particularly in the form of Portuguese teachers and police assistance). Such institutional, social and cultural associations confirm that Timor-Leste’s ties to its former coloniser are still strong. By and large the formal links and donor relations are beneficial, but the informal associations, like an elite connected to Portugal, may be problematic (or perceived to be).

Although this description of Timor-Leste’s history is brief, it is important to mention that conflict was a part of East Timorese society well before Indonesian occupation. East Timorese living today remember the occupation of Timor-Leste by Japan, who invaded during World War II. More than 20,000 Japanese troops landed in Timor-Leste and fought Australian and other allied forces. The Australian troops were protected and assisted by many East Timorese and this was perhaps the first significant connection in the Australia Timor-Leste relationship. After the Australian troops withdrew, allied bombing and reprisals from the Japanese left farms abandoned, buildings destroyed, many East Timorese and Portuguese starving, and upwards of 40,000 East Timorese dead (Dunn 2003). Conflict amongst local groups was also apparent during Portuguese times (sometimes orchestrated by the Portuguese). Gunn (1999) provides a thorough analysis of the last 500 years of Timor-Leste’s history, including a litany of rebellions. The Viqueque rebellion of 1959, which Gunn (1999) describes as ‘extremely bloody with between 500 and 1,000 killed’ (Gunn 1999: 260) would also remain in the minds of East Timorese today.

### 3.1.2 Occupation by Indonesia

A coup in Lisbon in 1974 bought the end of the Salazar-Caetano regime in Portugal and the release of its colonies, including Timor-Leste. At this time two East Timorese political parties, UDT (Timor Democratic Union) and Fretilin, formed a coalition for independence, but later

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46 Shoesmith (2003) analysed the semi-presidential system and saw the ‘fault-line’ between the then Prime Minister (Mari Alkatiri) and then President (Xanana Gusmão, Citizen of Timor-Leste) back in 2003.

47 McWilliam (2005) has reported ‘there was a long history of enmity and inter-group warfare’ (McWilliam 2005:28).
split. In August 1975 conflict between the parties erupted, and on 28 November 1975 Fretilin declared Timor-Leste independent\(^{48}\). Shortly thereafter, Indonesia invaded Timor-Leste. Regardless of the motive, Indonesia did not enter Timor-Leste unwillingly\(^{49}\). Dunn (2003) attributes the conflict amongst the East Timorese political groups to ‘the culmination of months of subversive actions by the Indonesian military, operations designed to destabilise the situation in the colony’ (Dunn 2003 :v).

Indonesian times can be characterised as a period of violent oppression. Estimates of the number of East Timorese killed vary. Dunn (2003) estimated that during 24 years of Indonesian occupation 200,000 East Timorese people were killed. In 2005, the Commission for Reception, Truth and Reconciliation reported:

The minimum figure for the number of conflict-related deaths during the Commission's reference period 1974-1999, is 102,800 (+/- 12,000)… [This figure includes] (i) an estimated 18,600 total killings (+/- 1000)… and (ii) an estimate of 84,200 (+/-11,000) deaths due to hunger and illness. (Commission for Reception Truth and Reconciliation 2005 :44)

That Timor-Leste was able to overcome twenty four years of occupation by the Indonesians and form an independent state is an indication of the strength and determination of its people. There are several papers, prior to 1999, that explored Timor-Leste’s options in terms of how their situation would be resolved (e.g. Salla 1997). A crucial turning point was when President Suharto resigned and B. J. Habibie took over as the President of Indonesia. Early in 1999 Habibie declared that the East Timorese would have the opportunity to vote for or against ‘proposed special autonomy for East Timor within the Unitary State of the Republic of Indonesia’. The United Nations Mission in East Timor (UNAMET) was established to assist the people of Timor-Leste to carry out a free and fair consultation. On 28 August 1999, under intimidation and the threat of violence, 78.5% of 451,792 registered East Timorese voted against autonomy, leading to Timor-Leste’s independence (United Nations Security Council 1999a). When the result was announced, groups of militia and Indonesian military commenced a rampage throughout Timor-Leste as part of a ‘scorched earth policy’ (United Nations Security Council 1999b) and the United Nations subsequently withdrew. Indonesian orders were to kill

\(^{48}\) Some (e.g. Shoesmith 2003) suggest that the conflict from this period has had a long-term affect on relationships and is the cause of some of the conflict seen today.

\(^{49}\) Indonesia is reported by some (e.g. Leifer 1976) to have been invited by East Timorese to restore peace in the territory. Way et. al. (2000) suggest Indonesia felt obliged to intervene lest Timor-Leste became a communist haven, and Viviani (1999) reported that Indonesians ‘were concerned that an independent Timor would be weak and constitute an open invitation to meddling by China, USSR, and the United States, and a stimulus to East Indonesian secessionist movements’ (Viviani 1999: 87). Others are mindful that Australia did not object to Indonesia’s annexation of Timor-Leste at the time and this author believes it is significant that this occurred pursuant to Australia’s discussion about the exploitation of petroleum resources in the Timor sea with Indonesia. Munton (2006) provides insight into these negotiations in his thesis, *A Study of the Offshore Petroleum Negotiations between Australia, the UN and East Timor*, when he explores the history of the seabed dispute.
Those 15 years and older, including both males and females, without exception’ (Chopra 2000).

Some claimed that the atrocities had been carefully conceived and planned by the Indonesian army in the preceding year. The Guardian newspaper reported ‘the aim, quite simply, [was] to destroy a nation’ (Anon. 1999). Estimates of destruction of the country’s physical infrastructure vary between 70% (Hill and Saldanha 2001; World Bank 2005b) and 85% (Havely 2001), with some (e.g. Chopra 2002) suggesting some areas had 95% of their buildings partially or completely destroyed. Dili lost one third of its electricity-generating capacity and government buildings as well as the files that constituted the formal institutions of government (such as titles to land, and records of civil registration and education) were destroyed (Hill and Saldanha 2001). Timor-Leste was left with only two power engineers, 20% of its secondary school teachers, 23 medical doctors, one surgeon and no pharmacists (World Bank 2005b).

Estimates of deaths from the Indonesian rampage in 1999 vary from 1,000 (World Bank 2005b) and 1,500 (Gorjão 2002) to over 2,000 (Commission for Reception Truth and Reconciliation 2005). The Commission for Reception, Truth and Reconciliation (2005) reported:

1999 marked a high point for estimated killings 2,634 (+/-626)... Of the killings and disappearances reported during the Commission’s statement-taking process, 57.6% (2,947/5,120) of the perpetrator involvement in fatal violations was attributed to the Indonesian military and police, and 32.3% (1,654/5,120) to East Timorese auxiliaries of the Indonesian military (such as the militias, civil defence forces and local officials who worked under the Indonesian administration). (Commission for Reception Truth and Reconciliation 2005 :44)

In August-September 1999 some 250,000 East Timorese were deported to West Timor and around 200,000 East Timorese abandoned their homes and fled to the mountains risking starvation with ‘hundreds of cases of wounding, torture, sexual assault, and abduction’ (Dunn 2003; Gorjão 2002).

Timor-Leste does have a traumatic history, but because of its proximity in time, the trauma from Indonesia’s occupation is felt the most acutely today. With one fifth of the East Timorese population killed during Indonesian occupation many East Timorese bore witness to the atrocities. Byrne (2006) wrote:

A survey in 2000 by the International Rehabilitation Council for Torture Victims found that 96.6 per cent of those surveyed had suffered trauma during the Indonesian occupation. Three-quarters had experienced a combat situation, more than half had come close to death, and more than a third had symptoms of post-traumatic stress disorder. (Byrne 2006)

50 Chopra (2002) explains further, that ‘The independence vote triggered a three-week campaign called “Operation Clean Sweep”, in which Indonesian armed forces and locally-organized militia reduced buildings to rubble and executed hundreds, possibly upwards of 2,000, East Timorese (the final figure remains to be determined). More than three-quarters of the country's population of 890,000 were displaced’ (Chopra 2002:983).
The Commission for Reception, Truth and Reconciliation was established to ‘inquire into human rights violations committed on all sides, between April 1974 and October 1999, and facilitate community reconciliation with justice for those who committed less serious offences’ (Commission for Reception Truth and Reconciliation n.d.) Thus, the East Timorese were provided with an opportunity to establish the truth of what happened. However, justice at a formal level has not been achieved. Xanana Gusmão, the former President of Timor-Leste, has repeatedly asked the East Timorese people to ‘forgive, in the spirit of reconciliation, the Indonesian military and East Timorese militia who committed crimes against them’ (Byrne 2006). The result of a process, administered by the United Nations, was to charge 339 Indonesians in relation to serious crimes, but none of the Indonesians have been prosecuted, and only a handful of East Timorese militia have been jailed for their crimes (Byrne 2006). The lack of justice for serious crimes remains a thorn in the side for many East Timorese and the consequences of the trauma are still felt.

In terms of government administration during Indonesian occupation life for the East Timorese was, in some ways, easier than during Portuguese times. With the benefits of the relative wealth of the Indonesian government, such as subsidised fuel and local infrastructure works (e.g. roads and irrigation) some development did occur. One of the downsides of the Indonesian Government administration was that the Indonesians held the majority of the senior positions in the Government, so when independence arrived there were few East Timorese with the skills to run, let alone establish a government. This lack of capacity was even more acute when it came to establishing the petroleum industry, its laws (particularly negotiations with Australia over maritime boundaries) and institutional mechanisms to manage petroleum revenue.

The way in which local communities were governed also changed during Indonesian times. Unlike the Portuguese, the Indonesians did not honour the local kings and village chiefs. Several authors (e.g. Hohe 2002; McWilliam 2005) explore these dynamics in detail and note that Indonesian efforts to destroy these traditional power structures were fruitless, as they simply morphed into informal power mechanisms and the local kings continued in their roles informally. In 1999 the Indonesians deliberately burned the sacred houses (uma luliks) of the East Timorese because the strong bonds of family and East Timorese social life are embedded in them (McWilliam 2005). Fortunately, in this case, these traditional power structures are strong informal institutions that have withstood colonial and occupying efforts to diminish them. Unfortunately, Timor-Leste’s resources were not as resistant.

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51 Byrne (2006) reports that ‘339 suspects charged under the Serious Crimes process, which ran parallel with the CAVR [The Commission for Reception, Truth and Reconciliation], remain in Indonesia. It [Indonesia] refuses to co-operate with extradition requests.’ (Byrne 2006)

52 This apparently contrasts with the end of the Portuguese times, as Dunn (2003) reported that many East Timorese held senior positions in the Military and the Government then.
Like Portugal, Indonesia set poor examples of sustainable resource management. Indonesia continued to exploit what was left of Timor-Leste’s sandalwood and teak and further destroyed much of the forest cover by regularly burning and using chemical warfare to destroy forest that may have been hiding *Falantil* (the resistance) forces. McWilliam (2003) suggests that forest cover was reduced by 30% between 1972 and 1999. Indonesia also proceeded with plans for the exploitation of Timor-Leste’s petroleum resources in the Timor Sea (in conjunction with Australia) without the resolution of maritime boundaries or legitimate authority to govern the country. Both Portugal and Indonesia exploited Timor-Leste’s natural resources with little regard for the communities that depended on them, providing the perfect illustration of how natural capital can be depleted with no benefits for future generations.

The Indonesians did not only pillage Timor-Leste’s human and natural resources, but most of the formal institutions (e.g. buildings and records) were destroyed by the Indonesians as well. At the same time, they strengthened the insidious and destructive informal institutions, such as corruption and conflict resolution through violence. These informal institutions, entrenched in Indonesia at the time, became embedded in the East Timorese way of life. Many report that corruption was rife during Indonesian times (e.g. Hill and Saldanha 2001) and this informal and destructive institution remains evident today as a notorious and problematic legacy of Indonesian times. Xanana Gusmão, the former President of Timor-Leste, often cites corruption as an issue:

> Let us not forget that our nascent nation is faced with poverty – a major cause for corruption. Worse is when our situation is difficult, because then corruption is great. I have often stated that corruption is the worse social disease imaginable. Unlike any other conventional disease, corruption destroys whole societies and tears at the very fabric of our way of life. (Gusmão 2004a)

> I often say to society and to the people that the Indonesians left our Homeland, however their practices and mentality of system still live in our minds and in our actions. We all have the duty to change mentalities to improve our practices - and this is the most difficult struggle... This is what we need to do – we need to combat corruption, collusion and nepotism. (Gusmão 2003)

The East Timorese people’s determination won the nation its independence, but its journey to statehood was cursed from the outset. Chapter Two explained that resource revenue can impact on institutional quality. But, more importantly in Timor-Leste’s case, institutional quality can affect wise management of petroleum revenue. If Timor-Leste fails in the task of managing its petroleum revenue wisely, this will most likely be the reason. As a result of Indonesian occupation and Portuguese colonisation, Timor-Leste is cursed with corruption, the legacies of

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53 The role of *Falantil* resistance forces during Indonesian times is not explored in this thesis.
conflict such as trauma, and weak institutions. With an influx of petroleum revenue Timor-Leste has all the hallmarks to find itself a resource cursed state.

### 3.1.3 Independent growing pains

The East Timorese took a stand in 1999 and proved their determination to be independent, but few realised how difficult the journey to true freedom, in the form of self-administration, would be. Amidst Indonesian and militia violence in early September 1999, the majority of the United Nations (UN) personnel (who had monitored the referendum) withdrew. The UN Security Council then took some time to achieve agreement from the Indonesian government to allow international assistance to end the violence. On 20 September 1999 the International Force for East Timor (InterFET) led by Australian troops arrived in Timor-Leste, and thereafter, Indonesian troops and many of the militia withdrew. On 28 September 1999 UNAMET returned, and on 25 October 1999 the Security Council resolved to establish the United Nations Transitional Administration in East Timor (UNTAET). At its peak, the UNTAET mission had 9,000 uniformed and civilian personnel responsible for peace-keeping operations, and the administration of East Timor during its transition to independence. The personnel of the mission had a staged departure until, on 20 May 2002, Timor-Leste celebrated its true independence and a follow-on support UN mission was established; the United Nations Mission of Support in East Timor (UNMIS). UNMIS had 900 personnel, whilst the United Nations Office in Timor-Leste (UNOTIL), established on 20 May 2005, had 120 civilian and police advisers. Following the crisis in April 2006, personnel numbers rose again (to around 3,000 personnel) with the establishment, on 20 August 2006, of the United Nations Integrated Mission in Timor-Leste (UNMIT). Timor-Leste was, and remains, a country seriously in need of assistance. That support came from all over the world, not just from the United Nations, but also in the form of bi-lateral and multi-lateral assistance and support from international non-government organisations (NGOs).

Several authors (Chopra 2000, 2002; Gorjão 2002; Gunn and Huang 2006; Hohe 2002; Traub 2000) have analysed and critiqued the work of the United Nations in Timor-Leste and much has been said about the failings of the UN mission. Gorjão (2002) suggests that UNTAET ‘began on the wrong foot’ as no East Timorese were involved in the planning phase of the mission, conducted by the United Nations Department of Peace-Keeping Operations (who had little experience of governance) in New York. The initial period of United Nations administration focussed on rehabilitation and reconstruction, and large amounts of aid flowed into Timor-Leste in the early years of the mission. João Saldanha (2003) posits that the amount of aid was excessive and not spent wisely. As mentioned previously, during Indonesian times, most of the senior administrative positions were held by Indonesians (Hill and Saldanha 2001; Traub
2000). One of the roles of the UN, and also bi-lateral personnel, was to train counterpart East Timorese to run the Government. Unfortunately, the success of that skills transfer and capacity development was limited, and the East Timorese government remains dependent on foreign advice and assistance for many of the tasks of administration, particularly at senior levels.

The East Timorese have witnessed much change in the seven years since the referendum and have struggled to meet the challenges of building a nation. In 2001, Hill and Saldanha estimated that the economy had declined (since Indonesian times) by almost 40% (Hill and Saldanha 2001). In 2003, Suara Timor Lorosae (a local East Timorese newspaper) reported that ‘40 per cent of East Timorese say they feel worse off now than under Indonesian rule’ (Anon. 2003b).

Given the East Timorese government have had neither the resources nor the intention to re-establish the paternalistic state maintained by the Indonesian occupation, citizen satisfaction was bound to be lower. Following the post-referendum destruction, many farmers were left without tractors, farm animals or irrigation, and fishermen’s boats had been destroyed. Many East Timorese who had held jobs in the Government had lost them. The size of the civil service decreased from 32,000 during Indonesian times (Hill and Saldanha 2001) to 17,000 today, yet the role of the civil service had changed from running a province (of Indonesia) to running an independent country.

Although the literature focuses primarily on the failings of the United Nations in Timor-Leste, given the level of destruction (power, irrigation and buildings were destroyed, telecommunications were rendered non-existent, most government documents were destroyed) a great deal has been achieved in this short time frame. The amount of work it would take to build a nation in these circumstances could not have been estimated and was a task the United Nations had never undertaken on that scale before. Critics focus on the lack of laws, particularly land title administration, and donor dependence, but there were some positive achievements. A Constituent Assembly election was held in August 2001, and the Constitution was written as a result. A Parliamentary system was developed and although Fretilin won 55 of the 88 seats (providing them with a majority), 11 parties in total won representation (World Bank 2005b).

In 2005, Timor-Leste’s first census was conducted. Systems, such as those to register cars and businesses, have been put in place. The Government of Timor-Leste’s Health department has

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54 Traub (2000) explained: ‘The Indonesians took all the good jobs for themselves. Elementary-school teachers were East Timorese, for example, but high-school teachers were Indonesian. Police clerks were East Timorese, but the officers were Indonesian. East Timorese were permitted neither a professional class nor a political one.’ (Traub 2000:76)


56 In Indonesian times the Ministry responsible for Agriculture, Forestry and Fisheries had a staff of 6,000. The number of that Ministry’s staff is now 400. (World Bank 2005b)

57 Kingsbury (2007) describes Timor-Leste’s electoral system as ‘probably the most open and genuinely democratic in Southeast Asia’ (Kingsbury 2007:21).
reported that immunisation campaigns have occurred with great success (Anon. 2003c) and, despite some concerns about the Department of Education ‘Today more children are in school than under the Indonesian occupation’ (World Bank 2005b). There are many more examples of institutions that have been established, such as the Petroleum Laws and the Petroleum Fund (which will be explored in Chapter Four).

Unfortunately, many of these successes of the administration did not reap direct or tangible benefits for the person in the street. Creating strong institutions takes time and, in some cases, progress is glacial (hardly apparent). Conflict commonly occurs in post-conflict states. The World Bank (2005b) remarked that ‘most countries emerging from conflict, especially new countries, relapse into violence within five years’ and added that ‘Timor-Leste has avoided that fate, maintained peace and political stability, and established security’ (World Bank 2005b :2). Unfortunately, Timor-Leste did not avoid that fate. The tension and trauma amongst the community has resulted in several instances of conflict, such as the riots of December 2004, in which several businesses and houses were burned. Then, in April 2006, a civil crisis erupted in Timor-Leste. The extent of the conflict took some by surprise, including the horror of an armed confrontation between Defence Force of Timor-Leste (FDTL) soldiers and East Timor Police, which left nine people dead and 27 injured (United Nations 2006). At the Timor-Leste and Development Partners meeting held just prior to the crisis on 3-4 April, donors sang the praises of Timor-Leste’s successes and achievements with little caution about the potential for violence or acknowledgement of the simmering discontent. Yet the tell-tale signs of disruption were there and some had acknowledged them:

current stability fragile... vulnerable to conflict... internal fault lines contributing the risk of renewed violence including declining income, increasing poverty, high unemployment, and emerging corruption... high youth unemployment... expansion in martial arts groups.

(World Bank 2005b :4)

A detailed exploration of the crisis and ensuing instability that occurred in 2006 is worthy of far greater analysis than will be offered here. For the purposes of this thesis a brief summary of the events focussing on the institutional weaknesses will suffice. The reasons for the instability are many and varied. The flash point was the culmination of unresolved tensions, based on ethnic divisions (between the Kaladi and the Firaku, or Easterners and Westerners), both within and between the Defence and Police forces. Several authors had pointed out this tension earlier (Rees 2004; Saldanha and Guterres 1999; Shoesmith 2003)58. Yet, as many observers have pointed out since (e.g. Lowry 2006) the institutions of security were too weak and unable to

58 Shoesmith (2003) had explained previously: ‘The senior commanders and most of the Falantil recruits in the first battalion were drawn from the area collectively referred to as ‘Firaku’ in the eastern districts... The Firaku-Kaladi ethnic divide is a potential fault-line in East Timorese politics. The core of the new defense force is identified, then, not only with the president and commander-in-chief, rather than the Government, but with one ethnic collectivity rather than another... From its inception it was clear that FDTL [Defence Force of Timor-Leste] was not to be a neutral professional force…’ (Shoesmith 2003 :246-247).
address the problems. Rogerio Lobato, the Minister for Internal Administration, and a known trouble-maker\textsuperscript{59}, had allegedly contributed to the havoc by providing guns to civilian militias and instructing them to eliminate political opponents. Lobato was found guilty and sentenced to prison for seven years and six months. Attempts to link the former Prime Minister Mari Alkatiri to the crime have not been realised to date.

A United Nations enquiry was established and reported a litany of inadequacies in the ways in which senior figures in the East Timorese government responded to the crisis situation. Following are some examples:

There is no evidence before the Commission of Inquiry that the dismissal [of the 594 petitioning soldiers] was officially executed. The Commission notes that approximately 200 of the personnel dismissed were not petitioners, but officers and other ranks who had been chronically absent without leave in the months and years prior to March 2006. (United Nations 2006 :21)

In a report to the President of the National Parliament dated 11 May 2006, Prime Minister Alkatiri styled the decision of this meeting to deploy F-FDTL [Defence Force of Timor-Leste] as one of the Crisis Cabinet pursuant to article 20 of Timor-Leste Decree-Law 7/2004 and section 115(1)(c) of the Constitution of Timor-Leste. The legality of this decision is considered elsewhere in this report. Here it is sufficient to note the following.

No orders were given in writing. No formal declaration of the state of crisis was made. During the meeting no contact was made or attempted with the President. Prime Minister Alkatiri telephoned the President the following day. The Minister for Foreign Affairs did not attend. Colonel Lere telephoned the Minister the following morning to inform him of the Prime Minister’s orders, having been too busy to do so on the evening of 28 April. (United Nations 2006 :27)

These examples illustrate the weaknesses inherent in some of Timor-Leste’s institutions, and the unfortunate reality that the violent form of dispute resolution, preferred by the aggressive male-dominated factions, was well-entrenched in Timor-Leste’s culture. The United Nations’ Inquiry concluded:

The crisis which occurred in Timor-Leste can be explained largely by the frailty of State institutions and the weakness of the rule of law. Governance structures and existing chains of command broke down or were bypassed; roles and responsibilities became blurred; solutions were sought outside the existing legal framework. (United Nations 2006 :52)

The Judicial System Monitoring Programme or JSMP (2006a) noted that in previous cases in which commissions have provided recommendations in Timor-Leste (citing the report of the Commission for Reception, Truth and Reconciliation as an example) the President, the Government and Parliament have not followed recommendations. ‘Rather, political decisions

\textsuperscript{59} Shoesmith (2003) writes that, in 1983, Rogerio Lobato was convicted of diamond smuggling in Angola and jailed for several years.
are often used to resolve criminal cases, a practice which has a negative impact on democracy and the rule of law’ (JSMP 2006a). The Commissioners of the Inquiry recognised the weaknesses of the justice system, and warned:

> It is vital to Timor-Leste that justice be done and seen to be done. A culture of impunity will threaten the foundations of the State. The Commission is of the view that justice, peace and democracy are mutually reinforcing imperatives. If peace and democracy are to be advanced, justice must be effective and visible. This will require a substantial and long-term effort on the part of the Government and its international partners. (United Nations 2006:3)

Unfortunately, the problems that generated the ongoing violence and instability are symptomatic of social tensions that are larger than the problems between the Defence and the Police Forces. The crisis was an opportunity for a whole range of political and social complaints to be aired. Thousands of people took to the streets protesting against the Government and the then Prime Minister Alkatiri. The ‘fault lines’ of the Constitution that Shoesmith (2003) predicted became clear. Gusmão, then President, gave Alkatiri, then Prime Minister, an ultimatum and, under pressure, Alkatiri resigned. Whether the series of events that occurred during the crisis were unconstitutional is debatable. But, certainly the tension between the roles of the Prime Minister and the President was evident. As suspected, by the author, Alkatiri’s resignation and the appointment of Jose Ramos Horta as interim Prime Minister did not end the violence.

The violence and destruction of 2006 was reminiscent of 1999, with 38 people killed during the crisis (and more since), 1,650 homes destroyed and around 150,000 people displaced (United Nations 2006). Some commentators (e.g. Da Silva 2006) suggest that the East-West distinction did not exist prior to the crisis, at least not with such negative ramifications. There was no mention of such a distinction in any of the thousands of testimonies heard by the Commission for Reception, Truth and Reconciliation. An analysis of the history of the East-West distinction will not be undertaken here. But, it is noted that the East-West distinction became the basis on which violence was perpetrated, predominantly by young men, some belonging to local gangs or martial arts groups. Youth representatives had long claimed they are ignored by their leaders. In October 2006 there were media reports that locally made ‘ice’ (methamphetamine) was fuelling the gang violence (Wilson 2006). Scambary, Gama and Barreto’s (2006) report on gangs and youth groups in Dili explained it is ‘impossible to generalise about these groups’;

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60 The UN acknowledged, during its inquiry, that a full explanation of the crisis could only be understood fully in the historical and cultural context of the country. (United Nations 2006)

61 Shoesmith (2003) linked the problems between then Prime Minister Mari Alkatiri and then President Xanana Gusmão back to a 1980s crisis in the resistance movement.

62 Alkatiri was reported to say ‘I declare I am ready to resign my position as Prime Minister of the Government… so as to avoid the resignation of His Excellency the President of the Republic.’ (Kearney 2006)

some are involved in socially responsible activities such as street cleaning and helping the poor. However, Scambary, Gama and Barreto (2006) noted that individuals from some martial arts groups had aligned themselves with political groups, infiltrated the security forces, and some had received guns distributed by the police, whilst others had aligned with former resistance figures and manipulated local youth to perpetrate crimes or violence.

There are many lessons to be learned from the crisis and the ensuing violence. The first is to acknowledge that ‘political competition within Timor-Leste has been historically settled through violence’ (United Nations 2006). For this reason it is disconcerting to know that there are many weapons remaining in civilian hands. Second, despite the then Prime Minister, Jose Ramos Horta’s (2006) protestations that Timor-Leste is stable and open to foreign investment, it may be difficult to imagine any serious business developers being interested in investing in a country where taxi drivers are too scared to work after dark. Third, the crisis highlighted strong resentment of the political leaders and a very large divide between the decision-makers and the community, a lack of bridging social capital. Fourth, the concepts discussed in Chapter Two, such as distrust of outsiders, lack of confidence in national institutions, a problematic relationship between civil society and government, were all evident in Timor-Leste at the time of writing. Finally, the state of Timor-Leste, as a nation, is very fragile, and in desperate need of building on its small reserves of social capital. Understanding the machinations of this phenomenon and these matters are crucial to the central question of this thesis; whether Timor-Leste can avoid the resource curse.

### 3.2 Timor-Leste today

Timor-Leste today reflects the institutional legacies of its past in many ways. This section explores some aspects of Timor-Leste today to indicate the status of its social geography, the economy and the capacity of individuals and institutions. These details illustrate how Timor-Leste is the poorest country in Asia and why, in the short time since independence, the Government has been unable to achieve success in providing for the needs of its people.

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64 The UN Inquiry reported that 219 PNTL [East Timorese Police] weapons remain outside PNTL custody and control and further that it is impossible to know where those weapons are now. The report of missing F-FDTL [East Timorese Defence Force] weapons is even more concerning: ‘The Commission notes with concern the irregularities in the F-FDTL weapons holdings spanning several years. The baseline of 1,200 M16 weapons issued to F-FDTL by the Government is established by 2002 records. The recently conducted international weapons audit established that in February 2004 F-FDTL held 1,230 M16 weapons. The additional 30 weapons were not provided by the Government. By November 2005 the F-FDTL could account for only 1,073 M16 weapons. Although F-FDTL has stated that in 2006 they hold 1,200 M16 weapons, the records reveal that 45 M16 weapons are missing. Additionally, three FN-FNC semi-automatic rifles, three SKS semi-automatic rifles and two Uzi weapons previously within the custody and control of F-FDTL are missing. F-FDTL is also in possession of one Minimi, one .38 Special, one Browning 9 mm, two G3 semi-automatic rifles, one M16 A1 rifle and one M2 .50-calibre firearm, the provenance of which is unexplained. Also unexplained is the pedigree of 342 ex-FALINTIL weapons in the possession of F-FDTL.’ (United Nations 2006:41-42)

65 This is an observation of the author’s on a visit to Timor-Leste in November 2006.
3.2.1 Social geography

Timor-Leste is a small country both in terms of its size (15,007 km$^2$) and population. In 2004, Timor-Leste’s first census counted a population of 924,642 (Chandran 2004). Although the population is small, it will grow quickly. In 2003, it was estimated that every fertile woman would have 7.8 children (Hull et al. 2003). Indeed Timor-Leste’s annual population growth rate of 4.7% is the highest (by far) of 177 countries listed in the Human Development Index or HDI (UNDP 2006a). In 2005, more than 50% of the population were under the age of 15 (World Bank 2005b :18). This population boom is assumed to be a response to the conflict in 1999, and thus is expected to be short-lived. Reasons for the boom may be that people had been delaying having children because of the insecurity, however there is no data or research that confirms this. Some research indicates that conflict has an impact on fertility rates. The World War II baby-boom is often given as an example (see Curlin et al. 1976; Hirschman 2005). However, it remains to be seen how long it will take for Timor-Leste’s fertility rate to decline. Timor-Leste’s population growth is an important factor in managing petroleum revenue, because high population growth means a dramatic increase in spending, particularly on social services such as health and education.

Babies born in Timor-Leste are likely to struggle through life. Timor-Leste is affected by El-Nino weather patterns and also experiences severe droughts and floods. Timor-Leste’s terrain also makes agriculture difficult. Over 40% of Timor-Leste has a slope of greater than 40% which, along with the heavy rainfall, results in severe erosion (UNDP 2006b). The 2001 Suco Survey (East Timor Transitional Administration 2001) found that agriculture was the main source of income in 94% of sucos (villages). These terrain and weather conditions have a profound effect, particularly in the rural areas, where three quarters of the population of Timor-Leste live (International Federation of Red Cross And Red Crescent Societies 2005). There are huge disparities between those living rurally and those living in the urban areas. School enrolments, quality of teaching, access to health services, markets, clean drinking water and sanitation are all of lower number or standard in rural areas. The 2001 Suco Survey (East Timor Transitional Administration 2001) found that more people travel to schools and to health facilities on foot, take more than 20 minutes (on average) to reach a vehicle passable road, more than 30 minutes to reach a paved road, and 70 minutes to reach a health post or community health centre. The United Nations Development Program (UNDP) found that 64% of the population suffer from food insecurity (UNDP 2006b). Many people live in basic accommodation made from bamboo, grass or leaves and earthen floors. The quality of life is very basic for most East Timorese and Table 3.1 indicates that the prospects of the average East

66 Uganda has the second highest annual population growth rate (3.7%) of the 177 countries listed in the HDI.
67 The main floor of 67% of all houses in Timor-Leste is made of earth or bamboo. (UNDP 2006b)
Timorese person are not at all good compared with its nearest neighbours (Australia and Indonesia). However, compared to Nigeria, a country known to be resource-cursed, Timor-Leste fares well. São Tomé and Príncipe, another country with huge petroleum resources, rates marginally better than Timor-Leste in some indicators.

<table>
<thead>
<tr>
<th>Human Development Index Rank (of 177 countries)</th>
<th>Nigeria</th>
<th>Timor-Leste</th>
<th>São Tomé</th>
<th>Indonesia</th>
<th>Australia</th>
</tr>
</thead>
<tbody>
<tr>
<td>159</td>
<td>142</td>
<td>127</td>
<td>108</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>Life expectancy at birth (years)</td>
<td>43.4</td>
<td>56.0</td>
<td>63.2</td>
<td>66.5</td>
<td>80.2</td>
</tr>
<tr>
<td>Probability at birth of not surviving to age 40 (%) 2000-05</td>
<td>46.0</td>
<td>25.5</td>
<td>17.1</td>
<td>11.2</td>
<td>No data</td>
</tr>
<tr>
<td>Under-5 mortality rate (per 1,000 live births) 2004</td>
<td>197</td>
<td>80</td>
<td>118</td>
<td>38</td>
<td>6</td>
</tr>
<tr>
<td>Maternal mortality (per 100,000 live births) 2000</td>
<td>800</td>
<td>660</td>
<td>No data</td>
<td>230</td>
<td>8</td>
</tr>
</tbody>
</table>

Table 3.1 Selected Human Development Indicators for Timor-Leste and other countries (UNDP 2006a)

Timor-Leste fares comparatively better in the HDI than when GDP alone is compared. Timor-Leste’s non-oil GDP per capita is just US$367 (MOPF 2006b). Although its human development levels are almost the lowest in Asia, Timor-Leste sits in the group of medium human development countries (not the group of low human development countries that are predominantly African countries). This is because the HDI provides a ‘broader definition of well-being’ derived from three dimensions; living a long and healthy life, being educated and having a decent standard of living (UNDP 2006a). Timor-Leste’s per capita income may not be as high as others, but its public expenditure on health (7.3% of GDP) is the highest of the medium human development countries and the sixth highest in the HDI ranking. Assuming this revenue is spent wisely on health, high hopes could be held for the future of Timor-Leste, but as Table 3.1 shows, Timor-Leste has a long way to go.

Despite Timor-Leste’s medium HDI ranking, babies born in Timor-Leste are also likely to encounter a range of social problems. Approximately one third of East Timorese children do not attend primary school. ‘Out of every 100 children, 80 will start primary school’ (Clifton 2005:30). The 2004 census (National Statistics Directorate 2006) found that only 15.3% (or 70,663) East Timorese had graduated from High School. In one particular sub-district (Passabe in Oecussi) only 1.5% of the population over the age of 18 (just 55 people) held a high school diploma. (National Statistics Directorate 2006).

In Ermera they are the highest at 71.1% whilst in Dili illiteracy is the lowest at 25.8%. ‘In Timor-Leste, 27% of people between the ages of 15 and 24 are illiterate; the rate rises to 54% for people aged 6 and older’ (National Statistics Directorate 2006:72).

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68 In one particular sub-district (Passabe in Oecussi) only 1.5% of the population over the age of 18 (just 55 people) held a high school diploma. (National Statistics Directorate 2006).

69 Illiteracy rates vary across the country and age. In Ermera they are the highest at 71.1% whilst in Dili illiteracy is the lowest at 25.8%. ‘In Timor-Leste, 27% of people between the ages of 15 and 24 are illiterate; the rate rises to 54% for people aged 6 and older’ (National Statistics Directorate 2006:72).
dissemination of information, which means attempts at civic education and community consultation are difficult. The implications of this problem are evident in the levels of health and social awareness. For example, ‘Four out of five women have never heard of HIV/AIDS with the ratio only slightly lower for men’ (World Bank 2005b :16). To date, Timor-Leste appears to have eluded the AIDS epidemic, but numbers are increasing. In 2004 the Ministry of Health reported a total number of 24 HIV/AIDS cases (Anon. 2004b). In 2005 the Vice Minister for Health, Luis Lobato, reported 33 people being positively identified as HIV-positive and 200 others suspected of being infected (Anon. 2005). Civic education is also important in addressing issues of child abuse, domestic violence and sexual assault, which are prevalent in the East Timorese community (De Sousa 2005). The UNDP says that around half the women in relationships suffer from some form of violence (UNDP 2006b). De Sousa (2005) talks about the suffering of East Timorese women and how ‘the mentality of [a] patriarchal system is ingrained’ (De Sousa 2005 :34). Byrne (2006) suggests that much of the domestic violence in the community is connected with the trauma experienced during Indonesian times. The resolution of these kinds of problems is difficult, with the lack of education and high levels of illiteracy that hamper awareness, and the strength of informal institutions within the family and local community, which hinder social change.

According to De Sousa (2005), domestic violence is hidden from public view because of ‘family pride and status’ (De Sousa 2005 :34)70. The concept of the family in Timor-Leste appears to be strong, and central to community life. Niner (2003) talks about the family unit and its importance in traditional ceremonies, whilst McWilliam (2005) analyses the important bonds between families and communities expressed through the traditions associated with uma luliks (sacred houses), which have great social and cultural importance. There is high regard, particularly in rural areas, for traditional East Timorese customs and beliefs, such as their traditional animist spirituality, or Lulik71. In Timor-Leste, the trust and social capital within the family, and between family members, and at the local level (bonding social capital) outweighs the social capital at other levels (e.g. between government and civil society; bridging social capital). As discussed previously in this chapter, these bonds have withstood the external influences of the Portuguese, Indonesians and the United Nations. Hohe (2002) explains:

Centuries of Portuguese rule and decades of Indonesian rule over East Timor did not manage to eradicate local socio-political structures that have proved resilient... a state-

70 Tradition dictates that it is more important to maintain the appearance of family than to ‘secure justice for individual women’ (UNDP 2006b :17).

71 Dunn (2003) explains that ‘Social and religious life in the East Timorese village continued to be strongly influenced by traditional animistic beliefs... the spirits of the dead are an essential element in the living environment and their presence as evil or good spirits must always be taken into account... Luliks, or sacred objects, symbols of good, evil, or of the unknown ... Christianity weakened, but did not destroy these beliefs.... Christian and animist prejudices and practices came to coexist with a degree of harmony.’ (Dunn 2003 :5)
The strength of the bonds between family members and community (i.e. good bonding social capital), and conversely the distrust of outsiders, can have negative consequences. For example, members of government may wish to benefit their own extended family members over others by allocating jobs or tenders to them (nepotism), or using their power to bring about financial gain (corruption). The bonds between community members are also used to exert influence and these bonds have been a destructive force in the recent East-West conflict.

Unfortunately, the relationship between government and civil society is tenuous and there appears to be a dearth of bridging social capital in Timor-Leste. The World Bank (2005b) reported ‘increased dissatisfaction with government performance’ and believes that ‘communication between the Government and the population is inadequate and often ineffective, resulting in limited mutual understanding’ (World Bank 2005b :i). Many of the calls for the Prime Minister to resign (both of Mari Alkatiri and Jose Ramos Horta) are a reflection of the dissatisfaction and distrust of the Government by members of the community. Building a nation is a difficult task and begins with the development of institutions that, even if successful, may bring no immediate direct benefit to the community. The longer term successes of the Government, such as improvements in education and health, are yet to be seen, although they are beginning. For example, infant and under-five mortality, although high, has dropped from 87 to 64 and from 124 to 80 (respectively) in the last year (UNDP 2005, 2006a). Some (e.g. World Bank 2005b) claim that the Government has not done enough to reach out to the community yet there are several examples of the Government taking extraordinary steps to work, and communicate, with the community such as the Petroleum Fund consultation (which was analysed by Drysdale 2007) and the consultation that preceded the National Development Plan (Planning Commission 2002), of which 38,293 people participated. Unfortunately, it is perception, rather than reality, that fuels most of the criticism and the kind of conflict that has occurred in recent times.

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72 The World Bank (2005b) is concerned about the lack of connection between government and civil society: ‘Poor outreach on the part of Government may contribute to Timor-Leste’s vulnerability. Effective communication and genuine participation are critical to shoring up popular support for the national development process, and for avoiding conflict… The Government neither has the resources nor the intention to re-establish the paternalistic State maintained by the Indonesian occupation. Yet the Government is hesitant to collaborate with civil society and maintains a statist style. It has not yet succeeded in engaging constructive critics or in maintaining an effective dialogue with communities.’ (World Bank 2005b :4)

73 For example, there was a very destructive rumour circulating that F-FDTL had massacred sixty people in the demonstration that took place in late April, but the UN Inquiry investigated and could find no evidence of a massacre. (United Nations 2006)
3.2.2 Economy

Timor-Leste is not only small, but a very poor country. The previous section highlighted many aspects of the poverty that East Timorese people endure. Timor-Leste’s petroleum reserves are expected to bring upwards of US$17 billion over the next 20 years, but its non-oil GDP per capita is just US$367 (MOPF 2006b). In rural areas, non-oil GDP is even lower, at US$150 (UNDP 2006b). Surveys in 2001 indicated that 40% of the population lives below the poverty line (MOPF 2006b). According to the International Federation of Red Cross And Red Crescent Societies (2005), 75% of East Timorese live in rural households. Despite the fact that agriculture is the major contributor to the local economy, many people without skills have left the rural areas and are unable to find work in the cities. Unemployment is 8.9% (UNDP 2006b) and higher in urban areas where this problem, along with the high birth rate means there are large, and increasing, numbers of young men that have nothing to do. Youth unemployment was 23.1% in 2004 (UNDP 2006b). These groups of young, unemployed, men have caused much of the violence and destruction over the past year (Wilson 2006).

In 2002, when large numbers of UN and bi-lateral personnel departed from Timor-Leste, the economy significantly contracted. In recent years, there have been signs of recovery with non-oil GDP growing by about 2% and an increase in bank lending to the private sector. Evidently, the Government sees economic growth as the solution to poverty reduction. Yet, there are numerous impediments to business development in Timor-Leste. Electricity supply in the capital reaches 92%, but is intermittent and only 10% in rural areas (UNDP 2006b). The main road system is adequate, but feeder roads are in poor condition and often washed away. There are limited telecommunications and a whole range of regulatory and other barriers as the following excerpts show:

Incomplete regulatory framework, unclear and cumbersome administrative procedures, high costs for labor and electricity, poorly developed infrastructure, and growing corruption pose significant challenges to business development… Business registration is complex and unclear. Customs procedures are lengthy, creating unnecessary admin hurdles... justice system particularly weak. (World Bank 2005b :14)

Key land legislation, the insurance law, and the domestic and foreign investment laws [have] all either [been] approved or submitted to Parliament. However, the overall legal framework is still incomplete, and complex regulations, an ineffective administration and weak judiciary continue to discourage private activity. (IMF 2005a :1)

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74 The Ministry of Planning and Finance reported that ‘Credit to the private sector rose from 2% of non-oil GDP at end 2002 to 25% at end 2005’ (Ministry of Planning and Finance 2006 :13).
In terms of developing local industries Timor-Leste’s options are few, yet if it is to avoid petroleum dependency the options must be expanded. Once the sandalwood declined, the Portuguese established large plantations of coffee, which generated over 80% of Timor-Leste’s exports until the final decades of Portuguese rule (McWilliam 2003). Coffee remains the most significant local industry, but other opportunities for foreign investment (e.g. tourism) are limited, because of the constraints described, and also because Timor-Leste’s wages are higher than that of their neighbouring countries, rendering Timor-Leste’s wages less competitive internationally. The International Monetary Fund (IMF) suggests this is a reflection of the impact of the international presence, including the United Nations (IMF 2005a).

With so few opportunities for, and many challenges to, private investment, revenue from the exploitation of Timor-Leste’s oil and gas appears the solution to many of Timor-Leste’s problems. To make the best use of these funds, the Government has opted to establish macroeconomic policies that are relatively conservative. For example, rather than establishing an East Timorese currency, Timor-Leste uses the United States dollar as its legal tender. Further, Timor-Leste has a policy of remaining debt-free and has not taken a loan from a financial institution to date. The Government has a very strategic approach to economic development that is illustrated by its National Development Plan (Planning Commission 2002). The National Development Plan sets out the priorities for the East Timorese government for the five years from 2002 until 2007. The Sector Investment Programs (SIPs) are the shorter-term strategies used to implement the National Development Plan, which have a budgetary component. The SIPs are used to guide both domestic state expenditure and the funds that donors contribute. In summary, Timor-Leste’s economy is weak, and the amount of domestic expenditure and donations it can absorb is limited. Plenty of work must be done to enable growth and development, but progress will be slow.

3.2.3 The State budget

This section explores the components and size of Timor-Leste’s budget, and discusses one of Timor-Leste’s greatest administrative challenges; budget execution. Given the state of Timor-Leste’s economy, the size of its budget is not a surprise; at US$316 million (in 2006-2007) it is small. The amount of money that is spent is dependent on how much income the State can generate and also its capacity to execute that expenditure. Figure 3.1 provides a breakdown of the Annual State Income last year, and estimates of Annual State Income over the next four years. The figure illustrates Timor-Leste’s dependency on its petroleum revenue, and shows that the Budget has recently increased markedly. Since the last financial year the Budget increased

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55 The IMF (2005a) remarked ‘the pace and quality of Timor-Leste's economic development will depend on the effective management of its new oil/gas wealth and creation of an environment conducive to private investment and activity in the non-oil economy’ (IMF 2005a :2).
by 122% (from US$142.3 million in 2005-2006 to US$315.5 million in 2006-2007). This follows a gradual increase in the Budget over the last four years\(^7\). Timor-Leste raises income by charging taxes and fees for services, such as customs and passports (domestic revenue\(^7\)), and through agencies such as aviation, ports and electricity, which are self-funded (autonomous agency revenue). Donors also contribute funds directly to the State for expenditure via the Budget. The remaining funds required to meet the State Budget are withdrawn from the Petroleum Fund. In this financial year (2006-2007) the State proposes to withdraw 82% (US$259.7 million) of the amount it requires to fund the Budget (US$315.5 million) from the Petroleum Fund. Domestic revenue is very small in comparison, and Direct Budget Support from donors will decline over the coming years. Thus, petroleum revenue is crucial to Timor-Leste’s bottom line, in terms of its Annual State Income.

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\(^7\) The budget in 2002-2003 was US$67.6 million (MOPF 2002), the budget in 2003-2004 was US$74.6 million (MOPF 2003), the budget in 2004-2005 was US$75.1 million (MOPF 2004a), and the budget in 2005-2006 was US$112 million (Ministry of Planning and Finance 2005).

\(^7\) The Government plans to increase income from taxes and user fees (through improvements in administering land and property fees, managing government property and increases in university, water, ID card and passport fees). (Ministry of Planning and Finance 2006)
The next four years of Combined Sources Budget are shown in Figure 3.2. The total income from Combined Sources in this financial year (2006-2007) is US$644.2 million. Figure 3.1 showed that in this financial year, the withdrawal from the Petroleum Fund will be US$259.7 million, which means petroleum revenue constitutes 40% of the Combined Sources income. The contribution from donors in this financial year totals US$339 million\textsuperscript{78}, which constitutes 52% of the Combined Sources income. Thus, in this financial year, Timor-Leste is heavily dependent on both donors and its oil and gas revenue. Figure 3.2 also shows that confirmed donor funding will decline in the next four years, thereby continuing the trend established since 2002 (MOPF 2006b). However, a spike in donor expenditure in this financial year is expected due to the establishment of the new UN mission, which was confirmed after these figures were described in the current budget.

![Figure 3.2 The Combined Sources Budget of Timor-Leste (MOPF 2006b)](image)

Timor-Leste’s budget is divided into six categories of expenditure. Figure 3.3 shows that the largest increases in expenditure, since the last financial year, have been to Capital and Development (an increase of 209%) and Minor Capital (202%). The budget for Goods and Services has also increased markedly (by 97%). The State has also introduced (in 2006-2007) an item called 'Current Transfers' (US$18.2m) which includes public grants (acquitable) for

\textsuperscript{78} This amount includes direct budget support of US$10.3 million (shown in Figure 3.1), confirmed donor funding of US$136.4 million, and further funding required of US$192.3 million (both shown in Figure 3.2).
schools (e.g. for small repairs) and community groups (for organised civil society groups to execute small development projects), and Personal Benefit Payments (non-acquittable) to veterans. Spending petroleum revenue in some of these categories will be less sustainable, or have a shorter-term effect, than others. Spending revenue on capital and development may have longer-term effects, whilst the effect of allocating revenue for goods and services is more short-term, but necessary to administer the Government’s projects.

<table>
<thead>
<tr>
<th>Budget Category (Spending Increase)</th>
<th>2006-07</th>
<th>2005-06</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital and Development (209%)</td>
<td>113.3</td>
<td></td>
</tr>
<tr>
<td>Minor Capital (202%)</td>
<td>16.9</td>
<td>5.6</td>
</tr>
<tr>
<td>Goods and Services (97%)</td>
<td>103.6</td>
<td>52.7</td>
</tr>
<tr>
<td>Autonomous Agencies (41%)</td>
<td>26.2</td>
<td>18.6</td>
</tr>
<tr>
<td>Salaries and Wages (30%)</td>
<td>37.4</td>
<td>28.8</td>
</tr>
<tr>
<td>Current Transfers (N/A)</td>
<td>18.2</td>
<td>0</td>
</tr>
</tbody>
</table>

Figure 3.3 Breakdown of Timor-Leste’s State Budget Expenditure and Analysis of Increase between 2005-2006 and 2006-2007 (MOPF 2005b)

Timor-Leste’s budget can also be broken down by sector. Figure 3.4 indicates the portion of the State’s budget allocated to each sector in financial year 2006-2007. The majority of the Budget is allocated to Public Works, which explains why such a large portion of the Budget is spent on Capital and Development (as per Figure 3.3). However, the Ministry of Planning and Finance (MOPF) sets targets for expenditure based on recurrent expenditure (i.e. not including the Capital and Development portion) because Capital and Development can vary significantly from year to year whilst recurrent expenditure generally remains proportionately similar relative to other sectors. Figure 3.5 indicates the portion of the State’s budget allocated to each sector in the same financial year based on recurrent expenditure and reveals different budget priorities. A larger portion of the Budget appears to be spent on Education and Health if only recurrent expenditure is considered. Using targets based only on recurrent expenditure can be misleading.
The General Budget of the State 2005-06 (MOPF 2005b) indicated that the recurrent expenditure for Health and Education (combined total) should be greater than 35% of the total recurrent budget, whilst no more than 25% should be spent on Security (including Police and Defence), and more than 4% should be spent on Agriculture. The Government has been unable to meet some of these targets. Figure 3.5 shows that the target for recurrent expenditure on Health and Education was not met in 2006-07. That target was not met in 2005-2006 either (as shown in Appendix 1, which details the breakdown of the recurrent portion of the State Budget for 2005-2006 and 2006-2007). The portion of the recurrent State Budget spent on Health and Education has fallen 10.2% (from 31.47% in 2005-2006 to 21.27% in 2006-2007). However, the total Health and Education recurrent budget has risen from US$27 million to US$40 million (an
increase of 49%). Spending on Security’s (Defence and Police) recurrent budget has also dropped from 19.5% to 12.3% whilst Agriculture has increased from 4.54% to 5.95%. This means that both the Security and Agriculture targets have been met in both of the years analysed.

The Budget of Timor-Leste is debated and agreed to by the Parliament. This debate ideally precedes the beginning of each financial year (however it has not always in the past). Timor-Leste’s plans for budget expenditure with an emphasis on poverty reduction would appear to be a wise use of petroleum revenue; however the Government of Timor-Leste has a problem with budget execution (the ability to fulfil their spending commitments). The 2005-2006 Annual Financial Report and Accounts of the Treasury (MOPF 2006a) state that overall budget execution in that year was 92%. But, this result is based on the commitments that were made rather than the actual cash payments made. Table 3.2 shows the Appropriation and Actual Expenditure in the 2005-2006 financial year, which reveals that US$38 million was committed but, not spent. This money is regarded as a liability in the current financial year. During the 2005-2006 financial year, US$12 million of US$20 million of liabilities from the previous financial year (2004-2005) was discharged. Thus, the Government began the 2006-2007 financial year with total liabilities of US$46 million (US$8 million of which had been outstanding for at least 12 months). These figures indicate that execution of the Capital and Development portion of the Budget was most problematic. This financial year began with US$23 million worth of Capital and Development expenditure outstanding. The figure also shows that US$17 million of the Goods and Services budget was not realised within the 2006-2007 financial year.

<table>
<thead>
<tr>
<th>Appropriation</th>
<th>Actual Expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Original</td>
</tr>
<tr>
<td>Salary &amp; Wages</td>
<td>US$29.10m</td>
</tr>
<tr>
<td>Goods &amp; Services</td>
<td>US$50.64m</td>
</tr>
<tr>
<td>Minor Capital</td>
<td>US$5.80m</td>
</tr>
<tr>
<td>Capital and Development</td>
<td>US$34.89m</td>
</tr>
<tr>
<td>Total</td>
<td>US$120.43m</td>
</tr>
</tbody>
</table>

Table 3.2 Summary of 2005-2006 Expenditure – Treasury Account (MOPF 2006a)

Some of the problems with budget execution, at least in the most recent financial year, can be attributed to the disruption caused by the crisis in April 2006. However, donors and the MOPF have noted there are problems with budget execution, and a study into the problem was conducted. The World Bank reported:
Slow budget execution is due to heavy centralization of expenditure management, tight expenditure and procurement controls, weak capacity in ministries, and poor communication between the MPF [Ministry of Planning and Finance] and line ministries. (World Bank 2005b:9)

Budget execution is problematic because it means the Government is unable to implement the plans it agreed to with Parliament at the beginning of the financial year. These are not the only issues that prevent revenue (including petroleum revenue) being spent wisely.

Corruption is also a problem in Timor-Leste, as mentioned previously. According to the Office of the Inspector General there have been 51 cases of corruption identified and investigated (Office of the Inspector General 2006). In 2003 the Former Inspector General presented the number of different types of corruption in the public administration as financial fraud (irregularity of salary payment, falsification of invoice, theft of cash, misuse/uneconomical use of money), recruitment fraud (favourtism, falsification of documents, unclear recruitment process), abuse of power (bribery), theft of public goods and procurement fraud (Lopez da Cruz 2003). Indeed the types of corruption heard about most are small scale, such as irregularities at the Port and people using petty cash inappropriately (Anon. 2004c).79

Despite the hangover of a mentality from Indonesian times, the scale of corruption in Timor-Leste is not as grand as that of Indonesia (which would be impossible because the scale of finances circulating in Timor-Leste’s economy is small in comparison). Timor-Leste ranked 111th in the Corruption Perceptions Index (Transparency International 2006), whilst Indonesia ranked 130th (of 163 countries). The word ‘perception’ is important here because in Timor-Leste there is an expectation that those with power will abuse their position for their own gain. Yet, there have been no prosecutions of large scale corruption to date (only rumour and claims80).

The Former Inspector General explained that people often talk about corruption without presenting evidence, and sometimes when the allegations are investigated it is shown that financial resources have been mismanaged rather than corrupted (Anon. 2003a, d, 2004a). Nevertheless, there are several NGOs which try to monitor cases of corruption by government officials (e.g. Lalenok Ba Ema Hotu/Mirror to the People and La’o Hamutuk/Walk Together). The role of the Office of the Inspector General and other institutions in ensuring transparency and accountability will be discussed in the following chapter.

79 In 2004, the World Bank barred four individuals and four firms who colluded to win contracts to purchase desks and chairs worth US$245,000 (World Bank 2004b). However, no other instances of corruption or nepotism of this scale are known.

80 Oceanic Exploration and its subsidiary Petrotimor have filed a lawsuit in the US alleging that former Prime Minister Mari Alkatiri accepted US$ 2.5 million from ConocoPhillips Petroleum to secure their investment in the Timor Sea. The lawsuit also claimed Australia, Indonesia and ConocoPhillips had conspired to steal a concession it [PetroTimor] was granted by former coloniser Portugal, before Indonesia invaded East Timor in 1975. Both Alkatri and ConocoPhillips deny the allegations and the matter has not yet [as of December 2006] been heard. (Barker 2006; East Timor Action Network n.d.)
3.2.4 Human capital

In Chapter Two the importance of human capital in avoiding the resource curse was discussed. In Timor-Leste there exists no single group of highly educated and mutually motivated senior bureaucrats (such as Indonesia’s ‘Berkeley mafia’ or Chile’s ‘Chicago Boys’). Indeed there is a dearth of experience at senior (and all) levels. East Timorese experience of civil servants during Indonesian times has left a bad impression; civil servants are perceived to be low paid and lazy (Babo-Soares 2003b). Thus well-educated East Timorese today prefer to seek jobs in the better paid NGO or private sector. Unfortunately, there are not enough well-educated East Timorese for all sectors, least of all government. In 2003, Babo-Soares (2003b) suggested the number of graduates was then as few as 1,000-2,000 and those with experience in the Indonesian civil service are very small in number. There is, however, a group of 5000-7000 who do not have degrees, but do have some government experience from working during the Indonesian times. Unfortunately they are marginalised and can not get work in the Government because they do not speak Portuguese or English. This lack of both educated and experienced East Timorese means that it is difficult to establish, let alone develop the institutions of State (Babo-Soares 2003b).

The lack of skills and capacity throughout the Government is widely acknowledged and many donors have created ‘capacity building’ projects to address this problem. AusAID’s (Australia’s Aid Program) Australia East Timor Capacity Building Facility is one example (AusAID n.d.). Some development options have been rejected because, without the capacity to implement the projects undertaking the task or accepting the donation is futile, if not destructive. Former Prime Minister Alkatiri was quoted by a local newspaper (Suara Timor Lorosae):

‘It is not that the Government does not want to borrow from the World Bank’. As a new Nation firstly he said ‘Timor-Leste needs to build its capacity to manage, and wisely, budgets in every sector of the society’. He said ‘the important thing is to develop capacity at an administration level’. (Anon. 2003e)

Unfortunately, the attempts to build capacity have had limited success. In some cases, foreign staff have been employed as ‘advisers’, but the majority of their time has been spent completing line tasks either because deadlines prevent taking the time to transfer the skills needed to do the task or, often, the advisers do not have the necessary skills to transfer their knowledge. The Government has reflected on the situation and is trying to learn from its experience of the process of building capacity to date. The Ministry of Planning and Finance has identified that capacity building programs generally include a ‘three pillar approach’ to address skills and

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81 The term ‘capacity building’ is widely debated, but will not be explored here.
knowledge, systems and processes, and attitudes and behaviours. The Ministry recognises that organisations and resources also need to be addressed (MOPF 2005a).

The lack of people with the knowledge, skills and experience to manage Timor-Leste’s petroleum industry and petroleum revenue, in particular, is even more acute. The petroleum industry and the associated laws and mechanisms that must be understood (e.g. how royalties and taxes are calculated) are highly technical. Decisions about petroleum revenue management are ultimately ratified by East Timorese ministers and the Parliament, but are generally proposed by international staff or institutions. Most significantly, Timor-Leste’s Petroleum Fund model arose from advice the IMF gave, upon request, to the Government of Timor-Leste. Further, staff in the Macroeconomics Unit of the Ministry of Planning and Finance, tasked with developing the Petroleum Fund Law, were Norwegian and Australian. During the period the Petroleum Fund Law was developed, the Macroeconomics Unit employed only one East Timorese staff member. Norway has a wealth of experience in the petroleum industry, so the Norwegian government provides the majority of advice and assistance in skills and capacity development to the individuals working in the East Timorese petroleum institutions.

Outside of the Government, the skills and knowledge to monitor petroleum revenue management and hold the Government to account in this regard is in even shorter supply. Although many East Timorese women understand the principles of managing scarce resources (evidenced by their high micro-credit repayment rates) it is difficult to translate the Government’s plans for managing petroleum revenue into the simple terms that those without a formal education may understand. Some individuals, from NGOs, have made an effort to increase their knowledge and understanding of the petroleum sector, mostly from government presentations and workshops. Some, like Thomas Freitas from an NGO called Luta Hamutuk, are now astute enough to question the Government, but they can not hold the Government to account alone.

Section 3.2 has described the situation in Timor-Leste today which, like section 3.1, highlights how Timor-Leste is cursed. Timor-Leste is a poor, small country with many social problems, conflict, corruption, and weak institutions. The Government has established some good policies, but is having difficulties implementing them. Timor-Leste is reliant on the revenue from exploitation of the petroleum resources as well as the support of donors, but the capacity of East Timorese civil servants and the institutions in which they work is limited. Progress will occur at a glacial pace and with the nature of the relationship between the Government and civil society the way it is (described in section 3.1.3) the prospects for Timor-Leste’s future are limited.
3.3 Petroleum wealth

Section 3.2 illustrated the desperate need Timor-Leste has for revenue to improve the lives of the East Timorese people and the enormous amount that petroleum revenue contributes to the State’s income now and in the future. The Government aims to reduce Timor-Leste’s petroleum dependency, but, for now, Timor-Leste is petroleum-dependent. This section will explore, in detail, how much petroleum wealth Timor-Leste has, the projections, the factors involved in determining those projections and the factors relevant to how much petroleum revenue Timor-Leste ultimately receives.

3.3.1 How much?

The Government uses forward estimates of how much petroleum revenue Timor-Leste will receive to determine its budget. Figure 3.6 illustrates the amount of petroleum revenue Timor-Leste estimates it will receive over the next 20 years. At the time the 2006-2007 Budget was prepared, the total petroleum revenue Timor-Leste expected was just over US$12 billion. This figure does not represent Timor-Leste’s petroleum wealth in its entirety, only those petroleum fields currently being exploited and providing revenue. The two petroleum fields currently providing revenue are Bayu-Undan and Elang Kakatua/Kakatua North. Elang Kakatua/Kakatua North is in the final stages of production and will soon be exhausted whilst Bayu-Undan began production in 2003, so the projections are almost entirely made up of revenue from Bayu-Undan.

![Figure 3.6 Timor-Leste's Estimated Petroleum Receipts (MOPF 2006b)](image-url)

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72
The goal of sustainable expenditure is achievable if Timor-Leste’s Petroleum Fund never has a nil balance. To achieve this goal, Timor-Leste must only withdraw an amount which, based on current projections, it could withdraw every year in the future. The Petroleum Fund Act (2005) named this amount ‘Estimated Sustainable Income’ (ESI). In this financial year the Government estimates the value of ESI is US$283 million (MOPF 2006b). If the Government chose to withdraw US$283 million every year, based on the current projections, the Petroleum Fund would never have a nil balance. In reality the income will vary from the estimates, but this principle guides the decision-makers in achieving sustainable expenditure.

The State Budget projects revenue and expenditure, in detail, for the budget year in question and the three financial years following that year. Table 3.3 shows that Timor-Leste plans to spend less than ESI (i.e. less than US$283 million) in this and the forthcoming financial years. This scenario indicates that it is possible, in theory, for the Government of Timor-Leste to survive on the proceeds received from Bayu-Undan alone. Indeed, even before revenue from any other fields comes in, the revenue from Bayu-Undan will generate a large balance in the Petroleum Fund.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Withdrawal from the Petroleum Fund</td>
<td>-US$259.7m</td>
<td>-US$203.8m</td>
<td>-US$208.6m</td>
<td>-US$201.0m</td>
</tr>
<tr>
<td>Opening Balance Minus Withdrawal</td>
<td>US$363.7m</td>
<td>US$843.2m</td>
<td>US$1,607.0m</td>
<td>US$2,468.1m</td>
</tr>
<tr>
<td>Petroleum Revenue earned</td>
<td>US$643.7m</td>
<td>US$902.8m</td>
<td>US$953.7m</td>
<td>US$878.9m</td>
</tr>
<tr>
<td>Interest earned on the Petroleum Fund</td>
<td>US$39.6m</td>
<td>US$69.6m</td>
<td>US$108.4m</td>
<td>US$148.7m</td>
</tr>
<tr>
<td>Petroleum Fund Closing Balance</td>
<td>US$1,047.6m</td>
<td>US$1,815.6m</td>
<td>US$2,669.1m</td>
<td>US$3,495.7m</td>
</tr>
</tbody>
</table>

Table 3.3 Projected value of the Timor-Leste Petroleum Fund (based on data from MOPF 2006b)

Figure 3.7 illustrates the balance of the Petroleum Fund over the next few years. Based on what other countries have experienced, as the Petroleum Fund grows and civil society becomes more aware of the problems of budget execution, the Government is likely to be criticised further, and the potential for corruption and conflict over management of Timor-Leste’s natural resource wealth will increase. If the Government achieves its plan and spends less than ESI, the Petroleum Fund will accrue almost US$4 billion by June 2010. However, even these estimates are conservative and the revenue earned is expected to be much greater as the following section will show.

82 ESI will be explained further in the following chapter.
3.3.2 Making projections

One of the difficulties for any country managing petroleum revenue is the lack of certainty of income projections. Many factors including changes in oil price, changes to production plans and the value of the US dollar, can all impact on income projections. Figure 3.8 shows the difference in projections between the last financial year (2005-2006) and this one (2006-2007). A plan for expenditure in 2008-09 prepared (hypothetically) in 2005 may have looked significantly different to one prepared in 2006 as there was a difference of US$2 billion in expected income81. In 2002, when the National Development Plan was written, it was expected Timor-Leste would have earned just US$84 million petroleum revenue by the end of this financial year (2006-2007). Instead, by March 2007 the Petroleum Fund had a balance of over US$1.2 billion (Maria and Vasconcelos 2007). These examples show a huge increase in income in the Government’s favour, but this may not always be the case. The Ministry of Planning and Finance has outlined the reasons why plans for expenditure should be prudent:

There is a risk, however small, of a major disruption in the production, and hence [Timor-Leste’s] revenues. Against this background we should be cautious in taking expenditures up to sustainable income levels as long as Timor-Leste has only one field in production. There

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81 The reason for the difference between the 2005-06 Budget and the 2006-07 Budget is not entirely due to increased production and increased oil prices. The Petroleum Fund was established in the 2005-06 financial year and when it was established the Government decided to deposit an additional US$250 million into the Petroleum Fund.
are a range of risks and uncertainties in any forecast of petroleum revenues. The most sensitive assumption is oil price, meaning that the forecast of petroleum revenues changes substantially even from a relatively small change in assumed oil prices. Other uncertainties include LNG contract volume, and pricing terms, condensate and LNG spot sales price relative to oil prices, operating costs and inflation. The [Ministry of Planning and Finance] has endeavoured to adopt prudent assumptions in all cases. (MOPF 2006b :19)

Figure 3.8 Estimated Balance of the Petroleum Fund at Year End (based on data from MOPF 2005b, 2006b)

There are various reasons why estimated projections may not be met thus there is a need to minimise risk and use conservative principles when projecting revenue. One of the main assumptions used is the price of oil. In order to minimise projection error, the Government of Timor-Leste prepares projections based on different scenarios and Figure 3.9 illustrates these. The Base scenario assumes that oil prices will average US$58 per barrel and this is the scenario which gives an ESI value of US$283 million. If, however, the price of oil dropped to an average of US$48 as illustrated in the low scenario the value of ESI would be US$212 million. The Government plans to withdraw US$259 million in this financial year, which is below ESI if oil prices follow the base scenario (US$58 per barrel), but not if they follow the low scenario (US$48 per barrel). In the latter case, that level of expenditure would be unsustainable. The current (as at 12 December 2006) value of oil is US$61 per barrel. Given the war in Iraq and the instability in Nigeria and Sudan, the price of oil is unlikely to drop and more likely to remain much higher than US$58 (the base scenario) yet the purpose of this discussion is to show that
petroleum prices are volatile. Thus, it is necessary to remain conservative in projecting expected petroleum revenue. In addition to preparing conservative projections, establishing the Petroleum Fund is another way of managing the volatility of petroleum revenue income and attempting to ensure there is always a source of revenue to fund budget expenditure.

![Graph showing petroleum receipts from 2006/07 to 2023/24 (US$ billion), petroleum wealth as at 30 June 2006 (US$ billion), and sustainable income (US$ million).]

**Figure 3.9**  Timor-Leste’s Projected Petroleum Revenue Scenarios (MOPF 2006b)

This chapter presented a detailed analysis of Timor-Leste’s institutions, both formal and informal. Timor-Leste is poor, and its people must struggle to survive. Timor-Leste’s history has rendered its productive institutions weak and some of its destructive institutions strong. A crisis that erupted in April 2006 highlighted some of the institutional inadequacies and a lack of trust between the Government and civil society. The Government is heavily dependent on petroleum revenue to fund its minimal budget and its capacity to manage that revenue, and to execute the Budget is weak. The lack of human capital and the problematic relationship between civil society and the Government may undermine the Government’s efforts to manage Timor-Leste’s petroleum revenue wisely, and to avoid the resource curse.