

## **Chapter 8           TIMOR-LESTE'S PETROLEUM REVENUE MANAGEMENT CHALLENGES**

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The challenges of managing petroleum revenue are many and varied. This chapter discusses what will jeopardise, and what will sustain development in Timor-Leste. Participants' concerns about how Timor-Leste's petroleum revenue will be managed in light of the quality of its institutions are explored. Chapter Four described some mechanisms that the Government of Timor-Leste has in place to manage its petroleum revenue. These mechanisms have not been tested over time, and thus the strength of the institutions is yet to be revealed. Chapter Six and Seven illustrated participants' opinions about those plans, and highlighted some potential weaknesses. Further, Chapter Three concluded that Timor-Leste's institutional landscape is not ideal for wise petroleum revenue management. The discussion indicated that levels of human and social capital in Timor-Leste are low. Chapter Two concluded that as the 'two caps' are essential to wise petroleum revenue management and, ultimately, sustainable development, so the low levels of the 'two caps' in Timor-Leste are particularly problematic.

There is not one simple way of addressing Timor-Leste's petroleum revenue management challenges. Through exploring participants' comments about the quality of Timor-Leste's institutions, a range of ideas about how Timor-Leste can avoid the curse has developed. This chapter explores the participants' thoughts about whether Timor-Leste will be a victim of the resource curse, and then focuses on what is considered to be the main objective in managing Timor-Leste's petroleum revenue challenges; enhancing accountability and responsibility. The 'two caps', human and social capital, are essential to enhancing accountability and responsibility. Government and civil society both have a role to play, and both are yet to grow into those roles. This chapter closes with brief insights into the way forward for Timor-Leste's petroleum revenue management. There are three key aspects that require attention if Timor-Leste is to avoid the resource curse; foreign advisers, investment in people, and transparency and information.

### **8.1 Timor-Leste's institutions and the resource curse**

There is risk that Timor-Leste will be a victim of the resource curse. To avoid the resource curse, the Government has established institutions to manage Timor-Leste's petroleum revenue including, most significantly, the Petroleum Fund Law. But, these institutions have not been tested over time. They may turn out to be strong, or they might not prevent mismanagement of Timor-Leste's petroleum revenue. Some of the potential weaknesses in the institutions were identified, in Chapters Six and Seven. Participants made other comments about the quality of

Timor-Leste's petroleum revenue management institutions, some of which are presented in Box 8.1. The comments indicate that they thought the necessary institutions had been established, but that those institutions needed to be strengthened. The former Prime Minister, Mari Alkatiri, who was ultimately responsible for the design of Timor-Leste's petroleum revenue management institutions was aware that his government could do little to ensure that Timor-Leste's petroleum revenue would be managed wisely in years to come, rather they could just 'establish the conditions' (see Box 8.1). His and other participants' comments suggest institutions alone will not prevent the resource curse, and that Timor-Leste's success in managing their petroleum revenue depends especially, if not more, on the intentions of the individuals in power.

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**Box 8.1            Participants' comments about the quality of Timor-Leste's petroleum revenue management institutions**

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My Government will establish the legal framework, the policy, based on the Norway model as a reference, which is one of the best in the world. Tomorrow there will be others in power. We will have an election in a few years. We will establish the conditions. (Mari Alkatiri, Former Prime Minister)

You can't ensure it. You can implement World's Best Practice but you can't insure against bad decisions or systems failing when immediate needs occur versus long term interests... The institutions are still evolving and there are a lot of glib salesmen to sell you rubbish. (Male Foreign Adviser)

The institutions are there, we need to build on what we've got. (Male Foreign Adviser)

We are still very weak in controlling revenue from petroleum. (Male NGO)

Firstly the Tax Revenue Service and the TSDA can ensure wastage or misuse, leakages, don't occur. Second, the MoPF develop the savings policy. They can ensure the BPA [Timor-Leste's Central Bank] deposits the revenue in the right account, and doesn't go off overseas with it. They can also ensure that the BPA is working well... Then there are the oversight institutions. A Ministry of Petroleum would have responsibility for ensuring petroleum policy is sensible. Then there are the other oversight institutions such as the Office of the Prime Minister and the Inspector General. There is also the Audit Court function of the Constitution. These are broad based supports. The question is what happens if one of these institutions goes bad. (Male Foreign Adviser)

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During the semi-structured interviews, participants were asked 'Will Timor-Leste avoid the resource curse?' Their responses are presented in Box 8.2 and revolve around the quality of Timor-Leste's petroleum revenue management institutions and the intentions of the decision-makers. Some of the responses indicated determination to avoid the resource curse. Jose Teixeira's (the Minister of Natural Resources, Minerals and Energy Policy) response indicated his intention was that Timor-Leste would avoid the resource curse, and comments of some of the foreign decision-makers indicated they were impressed with the former Prime Minister, Mari Alkatiri's intentions in this regard. Leadership from decision-makers on this issue is essential and politically necessary if they wish to retain power. However, a balance between

**Box 8.2**      **Participants' responses to 'Will Timor-Leste fall victim to the resource curse?'****Decision-Makers**

No! I am committed to [avoiding the resource curse]. It's not going to. As much as one can read the future. No. It will be a hell of a struggle. Perhaps a bigger struggle than the last 24 years. (Jose Teixeira, Minister of Natural Resources, Minerals and Energy Policy)

This is a very hard question. It depends on the system of the Government and the morals of the Government. Then it [the resource curse] can happen. It is like you said, the rich can get richer and the poor can get poorer, it depends on the system. (Male Decision-maker)

No. I hope not. Because we are learning from the experience of other countries. We understand what is going on. I am aware of that. (Male Decision-maker)

**Foreign Decision-Makers**

I doubt it. There is no perceivable enemy. If anything they will get the Dutch disease. The Petroleum Fund might help to prevent this. (Kadhim Al-Eyd, Former Resident Representative, IMF)

There are ways to avoid it. If Alkatiri has his way, they are heading in the right direction. (Male Foreign Adviser)

To some extent, it can't be untouched by it. There is a lot of good will from the international community – they could be a success story. Then there is the negative – they have a history of institutionalised corruption from the Indonesian administration, they are newcomers to nationhood. (Male Foreign Adviser)

**Participants without a decision-making role**

Depends. There are ways leading to it [the resource curse]. We are a weak democratic country... I hope that we can learn from the experience of other countries such as Nigeria, Angola and others... We do think we can avoid. We can turn it into bless (sic) instead of a curse. (Male NGO)

No. The problem for us is we don't want to be cowardly. How can we stand up and say we will be victims? ... Yes, but we won't stand up and wait to die. How absurd for us to do that when we have fought for so long. This is a silly question. We need to go and get good knowledge. If we don't use this knowledge then it is a problem. We can be victims of something else – globalization for example, yes. But we shouldn't be victims of something if we have the knowledge. Not this. No. Not victims from natural resources. We must see things with a deeper heart, with knowledge and references and information. 100% No. (Male Bureaucrat)

leadership and acknowledging the risks, which the foreign advisers do, rather than silencing dissent is another challenge for the decision-makers.

Another theme in the participant's comments was the idea that Timor-Leste could avoid the resource curse because they had seen, or knew, what happened to other countries that exploited their natural resources and fell victim to the resource curse. Participants thought that they would learn from those countries' experience and avoid the resource curse. But, as Xanana Gusmão pointed out when he made opening remarks at the Workshop on Transparency and Accountability in the Governance of the Oil Sector, learning from others is not an easy journey:

Sometimes we commit a folly in thinking that, because we know of other cases of corruption in other countries, this is already sufficient for us to feel immune against these social and political diseases. And when people from other countries help us by reminding us of this so that we can prevent it, we feel uncomfortable as though they were insulting us... Unfortunately, to create a culture of transparency and accountability, whether in state

or private institutions, will always take longer than to build platforms for oil and gas explorations and pipelines. (Gusmão 2004b)

Gusmão's comment confirms the need to acknowledge the challenge of managing Timor-Leste's petroleum revenue and highlights the danger of being too sure.

The sentiment of other participants' responses ranged from hopeful to passionate. Timor-Leste becoming a victim of the resource curse was considered an absurdity to one participant, given the struggle Timor-Leste had been through to gain its independence. The passion of some of the other participants' comments was reminiscent of the East Timorese peoples' struggle for independence as if both were part of the evolution of their identity. Viewed in the context of participants' comments elsewhere in this thesis it appears that, having won that struggle, the East Timorese energy and drive have been re-directed towards fighting (Australia) for their rights to the petroleum resources. That determination is entwined with their struggle for true financial independence and their desire to avoid the resource curse. In other words, the determination of the East Timorese people, including the decision-makers, to ensure Timor-Leste's viability as a state, and to avoid the resource curse, is fierce.

The participants' comments about the resource curse reiterated statements made about the quality of Timor-Leste's institutions. The institutions are in place, but still weak being 'newcomers to nationhood', and in some cases over burdened. But, no matter how strong the institutions are, some rent-seeking<sup>171</sup> individuals may disregard the rule of law, or those in power may change it to meet their rent-seeking ends. Kadhim Al-Eyd explained that no matter what systems are put in place, the law can be changed, as he experienced in his home country of Iraq in the 1950s:

Iraq is my country of birth. Oil and gas production began there in the late 1920s. The revenue went into the capital budget. Every penny went into that account – the money was spent on bridges and roads... In 1958 there was a coup and the king was killed. They began to buy weapons from Russia. All the money was being spent. The lesson here is that the law can be changed. (Kadhim Al-Eyd, Former Resident Representative, IMF)

But, Al-Eyd added that having the Petroleum Fund might help Timor-Leste to prevent the Dutch disease. Thus, the participants' comments suggest Timor-Leste's institutions alone will not prevent the mismanagement of petroleum revenue, or the resource curse. As one participant said, 'It depends on the system of the Government and the morals of the Government. Then it [the resource curse] can happen' (Male Decision-maker). Timor-Leste's institutions that have been established to enable accountability and responsibility in managing petroleum revenue depend on the intentions of the decision-makers for their success. Thus, whether Timor-Leste

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<sup>171</sup> Rent-seeking was explained in Chapter Two, and is when an individual, or a group, searches for ways of benefiting by manipulating the institutional environment to their own (usually financial) advantage, as opposed to participating in established and legitimate means of creating wealth.

can avoid the resource curse depends on the human and social capital that is needed to strengthen and support those institutions.

## **8.2 Accountability and responsibility**

Accountability and responsibility are key factors in the wise management of petroleum revenue. Timor-Leste's Petroleum Fund Law is an example of an institution established to avoid the resource curse, but without measures to ensure accountability and responsibility, the Petroleum Fund Law and other institutions designed to manage Timor-Leste's petroleum revenue will remain weak. Holding the decision-makers accountable is the responsibility of civil society, but a challenge for Timor-Leste is how to develop accountability and responsibility. The success of petroleum revenue management, in this regard, is dependent on stocks of human and social capital. This section begins by exploring participants' comments about problems that could be resolved by enhancing accountability and responsibility. Then, the relevance of human and social capital to an understanding of how Timor-Leste's petroleum revenue is managed is explained.

When participants discussed the kinds of problems that may negatively impact on the wise management of Timor-Leste's petroleum revenue they gave examples of both weak productive institutions and strong destructive institutions. Their comments are presented in Box 8.3 and Box 8.4 and they revolve around poor financial management and corruption, respectively. In terms of the relationship between natural resource revenue and the quality of institutions described in Chapter Two, such a scenario (having weak productive and strong destructive institutions) has the potential to render Timor-Leste resource cursed.

Box 8.3 presents some examples of poor financial management identified by participants. They identified problems with spending Timor-Leste's petroleum revenue because the State institutions are too weak to execute the Budget, and that the economy is not well developed enough to absorb expenditure. Chapter Three explained that, because of the weaknesses in government ministries, the Government has been unable to execute the Budget in its entirety. This has caused the State's liabilities to grow each year such that the 2006-2007 financial year began with US\$48 million remaining unspent from previous years. Other participants were concerned about the ability of Timor-Leste's economy to absorb the revenue. Until Timor-Leste's economy develops further, there is only so much spending that can occur. The problem of budget execution means that the Government has a problem spending the petroleum revenue, but the problem of absorption means that spending too much would be detrimental. As one Foreign Decision-Maker pointed out it will be some time before spending too much becomes a problem. These kinds of problems indicate that some of Timor-Leste's productive institutions are weak.

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**Box 8.3**      **Participants' comments about poor financial management**

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**Problems with budget**

No. As you can see from the last budget. Some Ministers use less than 50%... That means that others spent over 50% because they ended up with a deficit. This shows we don't have the capacity for implementation. (Fernando 'Lasama' de Araujo, Partido Democratico)

In the last budget the National Electoral Commission was completely omitted because the Minister forgot to include them in the Budget. (Foreign Adviser Female)

**The ability of Timor-Leste's economy to absorb expenditure**

Money is not the problem. We will have a lot of it. The question is how to absorb it. (Jose Teixeira, Minister of Natural Resources, Minerals and Energy Policy)

In terms of spending, the proportion of what is to be spent needs to be determined... The best way to go is to spend as much as you can get up to the absorptive capacity of the economy and the Government. That is, as much as they can spend before money is being wasted... Right now, in Timor, consumption is not at the desired level. There is quite a large space in which spending can continue to occur before inflation occurs. How long that would last is another question. It takes about 1-2 years before money begins to be wasted. After that, absorptive capacity grows more slowly. At which point it is time to save some of that money. (Male Foreign Adviser)

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According to participants, corruption is also a problem in Timor-Leste and thus, potentially, a problem for petroleum revenue management. Participants' comments about corruption, including examples of corruption, are presented in Box 8.4. Most of the participants were aware of the role of the Office of the Inspector General and mentioned that 51 cases of corruption had been investigated<sup>172</sup>. But, the existence of the Office of the Inspector General will not prevent corruption.

Participants gave many examples of corruption they had heard about. Institutions, such as Police, Defence, Border Control and the Justice system, were singled out as being vulnerable to corruption. Some of the examples were small-scale, but some participants indicated that corruption was large scale. Regardless of the scale, participants were concerned that the mentality of corruption is detrimental to Timor-Leste. The notion that corruption is an institutional legacy of the Indonesian occupation, as discussed in Chapter Three, was reiterated by participants. One participant said that a culture of corruption, collusion and nepotism (KKN) was developed during Indonesian times and to have 'someone at a high level doing favours for

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<sup>172</sup> The Inspector General was a participant in this research and he said 'The Office of the Inspector General was established in July 2000... Since the beginning we wanted to guarantee transparency and accountability. The main objective of the Inspector General's office is to ensure transparency and accountability in the Government of Timor Leste. The functions of the office include: to make investigation, to make inspection, to conduct outreach (campaign, workshop, to show what happens when there is corruption, to conduct training). We are very optimistic.' (Mariano Lopes da Cruz, Former Inspector General)

**Box 8.4**      **Participants' comments about corruption****Examples of corruption**

Police as law enforcement – some are involved in trafficking, smuggling, goods, cigarettes, mobile phones, women... Border control. Some are involved in bribes. The law would put them in jail for 2.5-5 years but then they would be free again. FDTL are like the Indonesians, involved in business. (Male NGO)

Yes, it [corruption] is large scale... Bad governance. I have a fear that the institutions will be further weakened. The courts, the parliament – they don't have the necessary checks and balances. Trafficking will increase. East Timorese women will be trafficked out of the country in the future. An issue, now, that has the potential to be resolved is the abuse of power within the police force. They have organised sex rings within the police and there has been harassment of prostitutes. (Foreign Adviser Female)

The judicial system is bad. The rule of law sees cases as projects. They manage cases according to their own interests/point of view. The courts are not a place for selling truth and justice. They are corrupt people from the prosecutors to the judges. They are all corrupt. (Male Church Leader)

**Scale of Corruption**

If in the tender those that are in power facilitate family members or friends impeding or causing those who have the right to tender... this is corruption and this is creating the mentality of corruption. If a container arrives at customs. If there is a delay in clearing and there is another \$200. Creates a corrupt society. Now we can't say corruption is millions of dollars but this form of life, will come to produce all of this in the future. (Xanana Gusmão, Citizen of Timor-Leste)

Its like blood – it is in everyone? We can't cut it out completely but we can make it close to zero. There are regulations. I think the possibility is 50/50. (Male Bureaucrat)

Corruption is going to be a continuing problem and associated with that is reduced opportunities for equality and as a result an increase in the gap between rich and poor. The upper middle class will have opportunities but others won't. (Foreign Adviser Female)

**Indonesian Mentality**

Corruption is the most important issue. This problem came from Indonesian times. It is generational. We must talk openly to resolve this issue. (Female Bureaucrat District)

Timor is a new country. Transparency measures are not yet in place. Let me see into the mentality of the people. Indonesia is the most corrupt country. A patriarchal society. Bad things were carried out by them. (Male NGO)

Because of the heritage of Indonesian occupation, culture was developed around having a patronage, someone at a high level doing favours for you, not following the proper process – KKN [corruption, collusion, and nepotism]. (Foreign Adviser Female)

**The Limits of Legislation**

Corruption is related to mentality. Even if there is good legislation. (Male NGO)

Corruption starts at the bottom and goes right to the top. Enforcement is required. If they do it and they get caught then there should be penalties. It is the only way. To show that you are not immune. What has happened to these everyday Jo Bloggs? The Customs Officers that have been caught? Have they been prosecuted? Or did they just lose their job? (Decision-maker Female)

you' was common in the past and has carried through to independence. Despite the Government's talk about addressing this problem of corruption, and that they have established mechanisms such as the EITI, participants were concerned that not enough was being done to address the problem. Xanana Gusmão was concerned that even small-scale corruption perpetuates this mentality of corruption and could create a corrupt society. Another participant felt corruption would be an ongoing problem that had flow-on effects and would reduce

opportunities due to an increasing gap between rich and poor. Thus, there is little doubt from the participants' perspective that corruption is a strong destructive institution that needs to change.

As discussed in Chapter Two, corruption is one of the destructive informal institutions, and these are often the most difficult to change. Participants noted that it will take time to change the mentality of corruption ('it is generational'), but expressed optimism that corruption would be prevented. They acknowledged that legislation, alone, can not prevent corruption, particularly if the institutions responsible for prosecution are weak, and some participants were concerned about the lack of justice in this regard. Two participants made comments that indicated they did not have faith in the justice system to prosecute instances of corruption, and they were not sure that the penalties were appropriate. Their comments suggested that they were unsure whether abuses had been prosecuted and that they thought corruption would not be addressed unless prosecution was meaningful. As noted in Chapter Four, only ten of 78 reports of maladministration have been prosecuted. Overall, the participants' comments and the quality of the institutions of the Office of the Inspector General, and the Office of the Ombudsman for Human Rights and Justice (discussed in Chapter Four) do not instill confidence that allegations of corruption are being responded to adequately. Enhancing accountability and responsibility may weaken the destructive institution of corruption and strengthen Timor-Leste's productive institutions over time. Human and social capital are essential to that transformation. Without them the Government and civil society do not have the necessary knowledge and desire to ensure that the Government is accountable and that civil society has a responsibility to hold them to account.

### **8.2.1 Human capital**

Timor-Leste's stocks of human capital are limited, and this is a challenge which, if not addressed, could lead to the resource curse. Chapters Three and Four highlighted several examples of a lack of human capital within Timor-Leste's institutions. Chapter Two explained that human capital, in the form of a group of highly competent senior bureaucrats, is common to countries that have successfully avoided the resource curse (see page 26). Thus, Timor-Leste's apparent lack of human capital may be detrimental to its plans to avoid the resource curse. The participants in this research also talked about the lack of human capacity in responding to questions about how Timor-Leste should manage its petroleum revenue. As explained in Chapter Two, human capital is the stock of knowledge, skills, experience, and training within individuals. When participants in this research talk about a lack of human capacity, the assumption has been made that they do not mean that individuals do not have the ability to learn, but that Timor-Leste's stock of knowledge and skills, or human capital, has not yet been developed.

Participants referred to a lack of human capital, or capacity, in general. But, there are different forms of human capital which will need to be developed in different ways. In order to manage Timor-Leste's petroleum revenue wisely, stocks of human capital must be developed throughout the Government bureaucracy so that petroleum revenue can be spent wisely. Small stocks of human capital in the Government are a reflection of the lack of experience of most of the civil servants. Rarely have civil servants worked in positions where they have held responsibility or authority for the management of government programs and expenditure (as discussed in Chapter Three). There are also very few individuals who have experienced working as a Parliamentarian or a Minister. So, most East Timorese are on a steep learning curve in their respective positions. Human capital is also needed in terms of investing Timor-Leste's petroleum revenue, as discussed in previous chapters. For example, the people responsible for managing the Petroleum Fund's investments on behalf of the Central Bank require the capacity to do that. Some participants identified the current level of skill as basic, and some recognised that a more technical set of skills and knowledge will be required to run the country, specifically in regard to petroleum revenue management. During the semi-structured interviews, participants were asked if the Government had the capacity to manage Timor-Leste's petroleum revenue and their responses varied. Box 8.5 presents a selection of the participants' responses. Some thought the Government lacked the capacity, whilst others recognised that the capacity to learn exists and were optimistic that even if individuals did not have the skills and experience, they had the appropriate intentions and that leadership was important. Some participants suggested that human capital would be created through experience, and one participant said 'I think if there is money there they will have the capacity to manage it' (Female Bureaucrat), thereby intimating that a demand for human capital would somehow create a supply of it. Overall, participants gave the impression that they were determined to manage Timor-Leste's revenue well because it belonged to them, and they were responsible for the outcome.

Human capital is also required more broadly, in terms of an understanding of the management of petroleum revenue within civil society. The development of human capital amongst civil society is important because individuals outside of the Government have a responsibility to hold the Government to account. The low levels of literacy and poor formal education services mean that stocks of human capital (particularly in terms of understanding petroleum revenue management) in civil society are even smaller than within government. But, if Timor-Leste is to avoid the resource curse, greater knowledge and understanding of petroleum revenue management in civil society, both within NGOs, the media and more generally, is needed. As at March 2007, Timor-Leste has US\$1.2 billion in the Petroleum Fund. The chance that this revenue will be mismanaged will be much diminished if the media and civil society pay attention to what happens to it, and what is happening to the institutions and individuals that make decisions about it. The problem of a lack of human capital in civil society is more difficult

to address because donors are not as interested in supporting and training non-government organisations, local media or the public in general, as they are state institutions.

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**Box 8.5**      **Participants' responses to 'Do you think the Government has the capacity to manage the petroleum revenue?'**

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Leadership is the most important thing. Good policies and good procedures. We can develop the capacity of institutions and we also need to develop the capacity of individuals – their integrity, skills, knowledge and courage. (Male Foreign Adviser)

You must understand this is a new government. They don't have the experience. But 'they make an effort'. (Male Bureaucrat)

Yes, I believe that they have. I believe in the good will of each person. But the mechanism has to be worked out. (Male NGO)

I believe [they have the capacity]. I have confidence in them, in Alkatiri. They are working hard to rebuild the system because it was destroyed. From '99 until the transition. This is the first time the people have managed on their own. We are the owners of this country. It is a learning process. (Male Decision-maker)

This is a hard question because I like to give people the benefit of the doubt. I have question marks. On the one hand I would like to think they could manage the funds well. They are still at a learning phase in terms of capacity. (Foreign Adviser Female)

When we have experience it is a good teacher (Male Decision-maker)

The funds from the donors are transparent so we have a lot of experience to manage this issue. (Female Bureaucrat District)

They misuse the money because of lack of capacity. They don't have any accountability. (Male Church Leader)

Before no one cared about money because it came from elsewhere. Now we are responsible for our own funds. (Mariano Lopez da Cruz, Former Inspector General)

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The danger of a lack of human capital, particularly in the Government, is that petroleum revenue is more likely to be mismanaged or misappropriated (as per the examples at the beginning of this section). Participants suggested that the lack of human capital (of all kinds) should be considered before decisions are made about Timor-Leste's petroleum revenue. When participants talked about decisions, such as 'when should Greater Sunrise be exploited?', 'should a pipeline be built to Timor-Leste?', and 'should a National Oil Company be established?' they referred to the State's capacity to do those things being an essential prerequisite. There were some participants who doubted the Government's capacity to manage the revenue from petroleum resources successfully and they thought it might be better to wait until capacity had developed, and corruption had been dealt with, before some projects proceeded. For example, Xanana Gusmão said the best time to exploit Greater Sunrise 'would be when the State has the capacity to manage that money' (Xanana Gusmão, Citizen of Timor-Leste), and Mari Alkatiri said 'If we had \$1.2 billion it could be a disaster for this country. I say could, not would. The management capacity is weak. There would be corruption' (Mari Alkatiri, the former Prime Minister). As it turns out, the Petroleum Fund now has well over

US\$1 billion, and despite that the State does not have the local human capital to manage the money to the extent that it would like, and Xanana Gusmão recently advocated spending more of it (Fitzpatrick 2007).

## 8.2.2 Social capital

Chapter Two confirmed the contribution of social capital to the wise management of natural resource revenue. Social capital is an essential component of both destructive and productive institutions which affect natural resource revenue management. Chapter Three exposed a lack of linking social capital in Timor-Leste. That is, there is suspicion and a lack of trust between the Government and civil society. At the same time, bonding social capital appeared to be well supplied in Timor-Leste. But, the bonds amongst family members and gangs have perpetuated destructive institutions, such as corruption, nepotism and violence as a means of expressing political dissent. Thus, this section explores participants' comments about social capital, in terms of their confidence, or trust, in the Government and decision-makers and the level of engagement between government and civil society.

The participants' comments surrounding the relationship between civil society and government, and the opposition and government, indicate a lack of bridging social capital and, in particular, a destructive sense of differentiation between 'us' and 'them' (the others). In Chapter Two, Offe and Fuchs (2002) were quoted as saying trust is the 'absence of fear or suspicion concerning the likely behaviour of others'. The comments of participants presented in Box 8.6 indicate suspicion, and a lack of trust of others. One participant said it is 'an East Timorese thing' (Decision-maker Female). Although some participants had confidence in the Government, they were mostly bureaucrats. Other participants expressed a lack of confidence in the Government. This is not surprising given Timor-Leste's institutional history. Being colonised by Portugal, occupied by Indonesia, and administered by the United Nations, the East Timorese have a history of being governed by 'others' and the word '*malae*' (foreigner) is often used in a derogatory way. Timor-Leste's history has played a big part in the strengthening of bonds between group members because it was necessary for individuals to generate these kinds of networks of trust in order to survive. At the same time, they learned to mistrust those in power because the vested interests of the decision-makers did not always lie with the East Timorese. These are informal institutions or behaviours which will take time to change.

This mistrust of others has remained and today leads to suspicion, ill-founded accusations, and rumours, particularly from members of political parties opposing each other. Political campaigning requires parties and candidates to differentiate themselves in order to win votes, and thus expressing suspicion or mistrust of other candidates, and instilling fear in voters that causes them to cast their vote in support of the candidate are expected. The election campaigns in Timor-Leste, between April and June 2007, provided a forum for candidates to express

discontent that petroleum revenue had not reduced the level of poverty or improved basic services in Timor-Leste to a large extent. A number of candidates (e.g. Fernando ‘Lasama’ de Araujo and Xanana Gusmão) differentiated themselves from Fretilin, the ruling party, by declaring they would spend the revenue from the Petroleum Fund.

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**Box 8.6**      **Participants’ comments about perception and suspicion**

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It is an East Timorese thing – they are suspicious, they think the money will be spent on a few individuals. (Decision-maker Female)

The interesting thing is that there is the assumption that anyone who has the opportunity to steal will do so. There are questions about the ‘exactness of measurement’. They are very suspicious of the oil companies and have questioned the integrity of the data and information coming from the oil companies. Parliamentarians and others ask ‘How do you prevent oil companies from stealing?’ For example, how do we know that the amount of oil being produced by the oil companies is what they are really taking out of the ground? I explained to them about the technology that is used to monitor these things. That the measurement of the meters is certified. That there are neutral controllers. That there are international companies who specialise in this. That this is a joint activity, one person is paid by both sides. That the joint partners are just as interested in metering. There is tremendous suspicion. They think that everyone who could steal does... This is part of the problem; there is a tendency to think that anyone who has the power to steal will do so. (Einar Risa, Commissioner and former Executive Director, TSDA)

Sometimes what they think is KKN [Corruption, Collusion and Nepotism] is not related to corruption – for example, if they don’t like the Government’s policy they say it’s KKN but I explain to them it’s not KKN. Corruption is when the officer abuses their power for the benefit of others, their relatives or friends. (Mariano Lopez da Cruz, Former Inspector General)

I don’t have confidence in the current government because they will mismanage the revenue. (Maria Paixão, Partido Social Democrata)

Not at all [in response to ‘Do you have confidence in the Government?’]. (Fernando ‘Lasama’ de Araujo, Partido Democratico)

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These elections followed a period of unrest that began with the crisis in 2006. The crisis arose because of the ineffectiveness of some state institutions, such as the Police and Defence, and generated protest marches campaigning for the removal of government, in particular, the Prime Minister Mari Alkatiri, who one participant suggested was ‘very, very good. But he is perhaps not open enough’ (Male Foreign Adviser). The protestors were not pleased with the Government’s progress, but they appeared not to be interested in addressing their concerns diplomatically or democratically. Rather a divisive East-West (of Timor-Leste) distinction was generated and violence was the protestors’ mode of expression. To make matters worse, many of the perpetrators of the violence have not been brought to justice. The lack of resolution and justice for victims of the crisis and many events of the past (including crimes against humanity perpetrated by senior Indonesian officials) encourages criminal behaviour. The way in which formal institutions have been abused or subverted for political purposes has destroyed many people’s respect for the rule of law which does not augur well for Timor-Leste’s future. The

lack of justice perpetuates mistrust of decision-makers and further erodes stocks of social capital. Instead of formal resolution of grievances and open debate about social issues, the most recent period in Timor-Leste's history (2006-2007) has been characterised by a lack of civil society's participation in the formal institutions of state. However, the participants in this research have clearly stated they would prefer government and civil society engage with each other to make decisions.

When participants were asked about the process by which petroleum revenue management decisions should be made in Timor-Leste, their responses overwhelmingly supported the need to include civil society and to improve engagement between citizens and the Government. Box 8.7 presents a selection of the participants' comments about consultation and participation in decision-making. Participants made suggestions that the Government should be open to criticism, respect minority opinions and create space for dialogue with the people. The participants intimated this was their vision of the future, and that this kind of consultation and participation in decision-making did not happen now. Yet, the Government has attempted to involve civil society in making decisions about Timor-Leste's petroleum revenue.

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**Box 8.7                      Participants' comments about consultation and participation in decision-making**

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They will have beams of light in their faces because of their participation. (Male NGO)

We will need a few key people as watchdogs. We need an active community that is continually watching government. (Decision-maker Female)

It is necessary to involve the local community... Government should make a public meeting. Listen to the people. Take what they say into account in their decision-making. Inform the people and let them have their say. Informed. Involved... We need to dialogue with the people and respond to their questions. (Male NGO)

A process which involves... not just the Government. It will involve the people of Timor Leste. The most important part is involvement of civil society. The board [for managing petroleum revenue] should be a group of everybody... But the Government itself is not enough. Should be alongside civil society. These are the two key elements. You can't separate them. (Male Decision-maker)

We need to consult with civil society. NGOs. Representations of religion, catholic and others. After their input... How do they input? We will have open consultation. This is done in two ways. In government we can talk to people who you have influence with. You can express your opinion. The other way is like in Portugal it is called *Caixa General* and in Indonesia it is called *Kotak Pos 1000* [a suggestion box]. Citizens can say what he or she thinks about development. (Male Decision-maker)

My party makes participatory democracy. People should be consulted for this decision... Have a draft. Socialise to the people. Hear their comments. Parliamentarians should be alive, talk to the people, and not sit in their office. (Fernando 'Lasama' de Araujo, Partido Democratico)

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The plans outlined in Chapter Four illustrate that the Petroleum Fund Law was developed through a process of consultation, and that the Government responded to the positive feedback from the submissions in support of the Government's proposed Petroleum Fund Consultative

Council (which provides a formal mechanism for consultation in the management of Timor-Leste's petroleum revenue). However, as discussed in section 2.3.3, providing the mechanisms by which citizens can participate in decision-making does not necessarily result in participation. In the case of the Petroleum Fund consultation, there were few East Timorese who had the skills and knowledge to participate in the process (because of a lack of human capital in civil society). Rather, the consultation was a socialisation<sup>173</sup> of the Government's plans for managing Timor-Leste's petroleum revenue (Drysdale 2007). Instead of being open and responsive to civil society's feedback about their plans (other than the Consultative Council) and engaging in a genuine debate about the options for managing Timor-Leste's petroleum revenue, the Government ensured that the process was representative, and that everyone learned about how the Government planned to manage their petroleum revenue. Some participants suggested that consultation was not useful if a lack of human capital meant that civil society was unable to participate in meaningful way. Further, some suggested that the Government should make decisions without consultation if civil society did not understand. One bureaucrat explained that consultation may lead to instability if participants did not have the capacity:

There are two schools of thought [as to whether civil society should be involved in decision-making]. One [is] open management. But not everything can be open. Some has to be closed. In a country like East Timor, 90% don't understand. They will react. There will be instability. So we need to use closed management. There is no need to involve society. We can involve society in the end, in the audit process, through an independent body.  
(Male Bureaucrat)

In this sense, a lack of human capital could impact on the potential to generate social capital and some participants effectively suggested that the imbalance of human capital between government and civil society is potentially destructive. However, if the Government's attempts to consult are not effective as a form of consultation, but do build knowledge about petroleum revenue management in civil society then this positive outcome should be acknowledged. If civil society benefit from the Government's attempts to consult in this way, consultation may have the added benefit of building social capital between government and civil society. Ultimately, the participants' desire is that civil society and government can engage meaningfully and respectfully to openly debate and make decisions about Timor-Leste's petroleum revenue.

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<sup>173</sup> 'Socialisation' is a term commonly used by East Timorese which could be defined as a process of community learning or increasing the capacity and knowledge of the community.

## 8.3 The way forward

This research has highlighted many ways in which Timor-Leste is vulnerable to the resource curse. As of March 2007 Timor-Leste's Petroleum Fund held US\$1.2 billion, which is a relatively huge financial reserve that presents opportunities for Timor-Leste to develop sustainably. But, the Petroleum Fund also presents temptation for those who would divert the resources to meet their own ends, and detract from the benefits to the greater good. The decision-makers, the people that work in government and the people that hold them to account face many challenges in developing the human and social capital necessary to manage Timor-Leste's petroleum revenue wisely. The stakeholders will need to work together to manage the risks inherent in a huge influx of natural resource wealth. This chapter closes by focussing on three aspects of petroleum revenue management that are not the only means for Timor-Leste to avoid the resource curse, but will contribute significantly on the journey; foreign assistance, investment in people, and transparency and justice. These topics are considered in brief but each one is worthy of further research.

### 8.3.1 Foreign advisers

The lack of human capital within Government in Timor-Leste was evidenced in section 8.2.1. One way of temporarily resolving the lack of human capital in State institutions is to employ foreign advisers, to work with, and to transfer their knowledge and skills to, local staff. Timor-Leste's institutions have benefited from foreign assistance of this form for almost eight years, and participants expect that Timor-Leste will require foreign advisers to develop human capital for years to come. However, one indicator of the success of skills and knowledge transfer is a decline in the number of foreign advisers (suggesting that the capacity of the local staff has developed such that they are confident to do the job they were working with the foreign adviser to do). In other words, supplementing local human capital with foreign human capital is only a short-term solution, and should be designed as such.

Box 8.8 presents a selection of participants' comments about the need for foreign assistance to support and develop Timor-Leste's human capital. Timor-Leste can, and has, purchased the assistance of foreign advisers with their own financial capital. One foreign adviser pointed out that with foreign assistance they can increase their human capital, and be more effective in managing their petroleum revenue as a result. Overall, participants recognise that Timor-Leste will benefit from foreign personnel working alongside East Timorese, particularly in technical and managerial areas, but they have some concerns about the quality of the assistance. One participant explained (using an example of providing assistance to agriculture) that they want to ensure the assistance that is provided is sustainable, so that Timor-Leste can manage its own administration one day:

You can give money to agriculture but you also have to increase their capacity. A lot of people come and talk about agriculture, but they make Timor a guinea pig, they are not telling the people how to develop their skills. They have basic capacity but how can they increase it. Not just fisheries and forests. Not only talking. We have to increase the capacity of the people. This is the way to teach people how to be independent. (Female NGO)

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**Box 8.8**      **Participants' comments about foreign advisers**

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**Foreign advisers can support and develop Timor-Leste's human capital**

At the Ministerial level they do [have the capacity to manage petroleum revenue]. We can buy the skills we don't have. And we are doing that. (Jose Teixeira, Minister of Natural Resources, Minerals and Energy Policy)

There is not enough capital in this country. In terms of human resources, they must rely on money and skills from outside<sup>174</sup>. (Einar Risa, Commissioner and former Executive Director, TSDA)

Yes, it can [manage the petroleum revenue], it doesn't matter who does it. (Kadhim Al Eyd, Former Resident Representative, IMF)

Yes, they do [have the capacity to manage petroleum revenue], with help. They will need help for a long time to come. (Male Foreign Adviser)

They will need foreign assistance for many generations to come, based on experience of other countries. In effect, they are starting from a lower position than Korea in the 1950s. Because of their lack of human resources. Yes, this is the key issue [human resources], Education... They will [develop their capacity], with the assistance of foreigners. (Male Foreign Adviser)

**Quality of foreign advisers**

What they are going through now is small relative to what's going to happen. Their national capacity is not big enough. They will need international advice for at least 10 years. I am bothered by short term funding. The grant has been wasted by looking for the next grant... No [they don't have the capacity]... They need experience to have the capacity to implement these programs. They will need a continuing expat presence. Experience is critical. (Male Foreign Adviser)

I hope that those people are not here for their own interests but to make a good program. (Female Bureaucrat)

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Not all foreign advisers are hired on the basis of their ability to train somebody to do their job, but to do that job themselves, and this model does not encourage sustainability. Further, participants explained that foreign advice that does not take into account the local needs and aspirations does not encourage East Timorese independence. Participants made comments of frustration about the quality of assistance, such as 'This system does not reflect the heart and soul of the East Timorese people. Most of the systems are photocopied from other countries. They don't reflect our ideas. We are not politically or economically independent' (Male Church Leader). These ideas and comments expand on a common theme throughout this thesis; that the participants' have a desire for Timor-Leste to be truly independent, culturally, politically and

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<sup>174</sup> In reviewing this comment in 2007, Einar Risa said 'The country is no longer in great need of money from the outside. This statement about money was valid two years ago'.

financially. Thus, a challenge for the donors is to provide assistance and advice that works towards that end.

### 8.3.2 Investment in people

Relying on foreign assistance to develop human capital to manage petroleum revenue within state institutions is one option but using foreign advisers is not the solution to developing human capital more generally. The lack of human capital, discussed earlier in this chapter, will be resolved, partially, by prioritising investment in people and the most obvious way to do that is to invest in the formal education sector. In Chapter Seven, the participants clearly articulated that spending petroleum revenue on education was a priority<sup>175</sup>. The objective here is not to articulate how the formal education sector should be improved, as others have done (e.g. Supit 2007; World Bank 2003b). Rather, the focus is on acknowledging that improvements to the education sector will ultimately enhance petroleum revenue management in Timor-Leste. At the most basic level, improving formal and vocational education services in Timor-Leste will result in a more literate, educated population, which will have the capacity to observe and articulate their opinions about the Government's decisions in relation to petroleum revenue management. As described in Chapter Three, Timor-Leste's low literacy rate and the numbers of East Timorese with a basic high school education affect many aspects of society.

The 2006 crisis highlighted the problem of the large numbers of unemployed young males. Although a high school education would not resolve the unemployment problem (for many reasons including that jobs must be created to meet the demand) it would reduce the problem of these young men having nothing to do whilst they are of school age (which undoubtedly exacerbates their frustration). Improving education would also reduce the potential for instability in this way. Increasing literacy and reducing the potential for instability are key factors in avoiding the resource curse in Timor-Leste.

The benefits that will flow from better education in the tertiary sector will also dramatically enhance the kind of human capital that is needed within government (to manage petroleum revenue) and within civil society (to hold the Government to account). As discussed previously, Timor-Leste is desperately in need of a 'bureaucratic mafia' or a highly-trained and experienced senior civil service. This will take some time to generate, and the tertiary sector in Timor-Leste is far from a priority in the eyes of the Government or donors, who began by focussing on primary education, and are now designing assistance to the education sector around vocational education and tailoring high school education to vocational needs (e.g. Cole 2007). Thus, at this time East Timorese with the ability to undertake tertiary education must suffer poorly resourced

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<sup>175</sup> A desire to prioritise spending on education is not unique to Timor-Leste. On Australia's *Insight* television program (Brockie 2007) a discussion about how the Government should spend its \$10.6 billion budget surplus revolved around the need to fund better education services.

East Timorese universities or seek scholarships to attend universities overseas (primarily in Indonesia and Australia). Timor-Leste's greatest challenge in terms of their human capital, currently, is that the pool of well tertiary-educated is so small that the most talented are highly sought after and often job-transient. That is, individuals with skills and knowledge are drawn in several directions and their investment in organisational knowledge is limited<sup>176</sup>. A number of the participants, particularly talented government bureaucrats, confided that they wanted to leave their position to do further study. This commendable desire for personal development occurs at the short-term expense of the institutions which they serve, but theoretically will benefit the institutions to which they return once they have finished their study. The challenge for government and non-government organisations is to foster that personal development and retain the organisational knowledge concurrently.

Developing human capital within civil society is difficult because the members of civil society are not bound within a small number of institutions, their numbers are greater and their needs are broad. Civil society is made up of many formal and informal institutions. The most relevant to management of Timor-Leste's petroleum revenue include non-government organisations, community organisations and the media (print, radio and television). Donors have contributed to capacity development in civil society by establishing programs which have different approaches and vary in terms of their success (e.g. *Belun* is an East-East Timorese NGO that seeks to bolster civil society in Timor-Leste and is supported by USAID, amongst other donors, and the East Timor Community Assistance Scheme<sup>177</sup>, is a program funded by AusAID). Some programs provide funds, whilst others are more involved in the day-to-day business of supporting NGOs (such as the Australian Volunteers International program). Providing funds assistance to struggling NGOs is welcomed, but to create a vibrant and engaging civil society longer-term programs are needed that target individuals. A program which teaches leadership or one which initiates long-term mentoring relationships would be beneficial in developing human capital on an individual basis (as foreign advisers do in state institutions). This approach contrasts with the short-term funding of organisations approach, but is worth considering given the need for individuals to lead and drive those organisations. Further research into the needs of civil society in Timor-Leste is required to seek creative solutions to the problem of how human capital in civil society can be developed.

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<sup>176</sup> For example, Joao Saldanha and Dionisio Babo Soares, both with PhDs, have turned away from academic endeavours into politics. Saldanha left the Timor Institute of Development Studies (a non government institute for research and training) and heads the Republican Party, whilst Soares was doing research with the Asia Foundation and has since taken up a position as the Co-Chairman of the Commission for Truth and Friendship, and is the Secretary General of the CNRT Party (National Congress for the Reconstruction of East Timor).

<sup>177</sup> ETC.AS is a Small Grants Scheme that supports community initiatives throughout East Timor, with a particular focus on building the capacity of community based organisations in financial and activity management. In 2002-03, ETC.AS supported 54 activities. The main sectors supported were water supply and sanitation, education and agriculture. (The Parliament of the Commonwealth of Australia 2003)

### 8.3.3 Transparency and information

The suspicion and mistrust that exists between Government and civil society (highlighted in section 8.2.2) is the most significant challenge that Timor-Leste faces in managing its petroleum revenue wisely. Chapters Two and Four described the importance of transparency, and provision of information, in managing Timor-Leste's natural resource revenue, and avoiding the resource curse. If information is not made available or if the information made available is not genuine, or subverts the truth (or is perceived to), an environment in which the Government is always perceived to be undermining the good of the people will prevail. That environment may lead to ongoing conflict. For this reason it is important to focus on, and to improve, the relationship between the Government and civil society in Timor-Leste.

This research has explained there are several mechanisms by which information, about how petroleum revenue is managed in Timor-Leste, is provided. Those mechanisms need to be tested and strengthened, but there are many other mechanisms and institutions that could be created to enhance transparency and accountability in the wise management of Timor-Leste's petroleum revenue. For example, the flow of information between government and civil society could be enhanced through government information offices, throughout all districts, that are well resourced and networked to supply information and respond to questions and queries about government services, including the process of managing petroleum revenue. Once the mechanisms are in place it is necessary to assist civil society to participate in those mechanisms. For example, the Ministry of Planning and Finance now publishes its Treasury accounts on line so citizens can observe annual budget execution. However, citizens need to develop the knowledge to interpret those reports (which is where the development of human capital is important). Further, the publication of the report is not an end in itself. If the citizen wants to question or discuss the information, who do they approach? The process and the relationship (between Government and civil society) are not static; they will continually transform and will develop over time.

The participants' comments confirmed the importance of transparency and information, as they expressed 'hunger' for information and desired the opportunity to observe the management of Timor-Leste's petroleum revenue. Some of their comments are presented in Box 8.9. The research was conducted prior to the promulgation of the Petroleum Fund Law so some of the participants' concerns have since been addressed. For example, the participants wanted to know how much revenue there was, and how it was being invested. This information is now supplied in the Central Bank's quarterly reports. The non decision-makers were aware of institutions that enhance transparency and accountability, such as EITI and Publish What You Pay, and there was a sense that the participants expected that financial mismanagement, corruption in particular, would be prevented if petroleum revenue was managed transparently.

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**Box 8.9**      **Participants' comments about transparency and information**

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Transparency is necessary. We have to know how much revenue there is. Information should be available to the public... The Ministry of Finance tells us how much revenue in presentations. They need to explain this to the public. What is the distribution? Why is it being used to fund the recurrent budget? Who made this decision? ... It is in the Manhattan Bank. But they don't explain how much interest we get. This should be published... We need indicators to monitor. To count, to assess development. To fix the process. Government has to open the doors. (Male NGO)

Everything is published. Maybe like a book... Again, publish what you pay. That's the way it [financial mismanagement] will be prevented... To be transparent. Every citizen can have access to the accounts. Every penny taken out should be the concern of the people. (Male Decision-maker)

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The keys to the relationship between Government and civil society are a commitment to openness and transparency, and an intention to work together. Open debates and a willingness to discuss options (a two-way dialogue rather than presenting one option for 'consultation') would be significant steps in building trust and creating social capital and the comments of decision-makers, presented in Box 8.10, indicate that the Government intends to manage Timor-Leste's petroleum revenue openly and transparently. However, trust will only be created if the State institutions lead by example, rather than denouncing individuals or groups with alternative opinions and perpetuating an 'us' and 'them' mentality<sup>178</sup>. In recent times there have been several instances when the course of action taken by officials has not instilled confidence in the people. The Government's failure to publicise the IMF's report on the Petroleum Fund is one example, and the former President Xanana Gusmão's speech which exacerbated tensions between easterners and westerners, and was careless if not destructive, is another<sup>179</sup>.

The relationship between government and civil society in Timor-Leste wears the institutional scars of history, but the real protection of Timor-Leste's wealth lies in responding to the challenges that have been outlined. Those challenges are not well understood, difficult to define and require further investigation and research in order to address them. Yet it is clear that the Government must provide the institutions and the mechanisms by which civil society can then accept responsibility and hold the Government to account. How that ultimately happens, how long it will take, and whether they will be successful, is not known. These are Timor-Leste's biggest challenges in avoiding the resource curse and striving for sustainable development.

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<sup>178</sup> Although it is natural in the political arena to differentiate one's party from the opposition, this differentiation should not extend to other relationships.

<sup>179</sup> The United Nations (United Nations 2006) called this speech, by Xanana Gusmão, 'divisive'.

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**Box 8.10**      **Participants' comments about the Government's efforts to provide information**

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It is important to help people understand. Give them information so they can make informed decisions. (Jose Teixeira, Minister of Natural Resources, Minerals and Energy Policy)

We hold meetings at the TSDA and have information sessions on the first Friday of each month. We advertise in the press with an invitation and give a presentation on a particular topic each month... Very many of people's concerns are based on misinformation. The information sessions are very important. The TSDA has never refused participating in public forums, we always go. (Einar Risa, Commissioner and former Executive Director, TSDA)

The way the system works here is very transparent... The Production Sharing Contracts will be public documents. This will be the first country in the world to do this. (Einar Risa, Commissioner and former Executive Director, TSDA)

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This chapter brings the discussion of the problem of managing Timor-Leste's petroleum revenue wisely to a close. The mechanisms for managing Timor-Leste's petroleum revenue may not sustain development in Timor-Leste because wise petroleum revenue management also depends on good governance. Thus, the intentions of the decision-makers are paramount in avoiding the resource curse. As the framework on which this research was based suggests, human and social capital are crucial to the quality of institutions in Timor-Leste and therefore the lack of the 'two caps' will affect management of petroleum revenue in Timor-Leste. For this reason, continued assistance in the form of foreign advice, a focus on investing in people, a whole-hearted commitment to transparency and the open transmission of information are the means by which Timor-Leste should move forward and avoid the resource curse.