

Chapter 1 INTRODUCTION

This thesis explores the institutional choices available to Timor-Leste to manage their natural resource wealth wisely and avoid the resource curse. Timor-Leste is a poor country and its challenge is to use its large per capita resource wealth to alleviate poverty and enable sustainable development. This research examines the Petroleum Fund Law, and other mechanisms to manage petroleum revenue that the Government of Timor-Leste has established. These mechanisms appear to be resilient, but remain untested. Based on field interviews in Timor-Leste, the study offers insights into the opinions of East Timorese and foreign advisers about how Timor-Leste's petroleum revenue should be managed, and how a poor country can raise the living standards of its people.

1.1 Timor-Leste and the resource curse

Timor-Leste's petroleum revenue could be used to enhance a range of government services, like health and roads, and, in contrast to many poor countries, use their natural resource revenue wisely to achieve sustainable development. This inability to convert resource wealth into sustainable development is what Auty (1993) describes as the 'resource curse'. The resource curse occurs when an influx of revenue from the exploitation of natural resources hinders development, leading to stagnation or a decline in economic growth. Expenditure of natural resource wealth can have detrimental effects on the foreign exchange rate, and on other sectors (such as manufacturing and agriculture). The resource curse literature reveals that natural resource revenue affects institutions. For instance, countries with natural resource revenue are more likely to experience conflict, corruption and to have weak formal state institutions. By contrast, nations that have avoided the resource curse are those whose productive institutions are strong.

To address some of these challenges and avoid the resource curse, the Government of Timor-Leste established a Petroleum Fund in 2005, based on Norway's petroleum revenue management model. Like Norway's, Timor-Leste's Petroleum Fund is designed to finance the State's budget and save some revenue for future generations. The Petroleum Fund Law institutionalizes a range of mechanisms to manage petroleum revenue that assist decision-makers to decide how much to save, how much to spend, how to save, and when to spend. What to spend natural resource wealth on is another important decision that Timor-Leste makes in conjunction with these decisions. In this way, the Government of Timor-Leste believes the Petroleum Fund will 'contribute to the wise management of petroleum resources, [for] the benefit of both current and future generations' (Office of the Prime Minister 2004).

The institutions associated with petroleum revenue management are supposed to help Timor-Leste avoid the resource curse, but its history (Portuguese colonialisation, Indonesian occupation, and United Nations administration) has weakened its formal institutions and strengthened its destructive informal institutions. The Government is determined to improve the quality of life for all East Timorese with the benefits from exploitation of its petroleum resources (Timor Sea Office 2004b), but corruption and violence are accepted ways of doing business and in April 2006 a crisis erupted in Timor-Leste which highlighted its institutional inadequacies. As a result of the crisis and the ensuing violence, more than 70,000 people remain internally displaced in Dili, the capital of Timor-Leste (Ministry of Labour and Community Integration 2007). Petroleum revenue does not appear to be sustaining development in Timor-Leste, let alone meeting current needs.

1.2 Research overview

This thesis researches the problem of how to manage natural resource revenue wisely, and provides insights that are specific to Timor-Leste. The relationship between natural resource wealth and the potential for sustainable development is evident. Natural resources provide an opportunity for a country to generate wealth and, depending on how that wealth is managed, either create sustainable development, or render a country resource cursed (or somewhere along that continuum). Timor-Leste is not yet resource cursed. The decision-makers have choices, and thus the opportunity, to avoid the mistakes of some other natural resource rich, poor countries and use their petroleum revenue to create sustainable development.

The Government of Timor-Leste has plans for managing their petroleum revenue. They have a Petroleum Fund Law that should ensure that the petroleum revenue is only spent via the State's budget. The Offices of the Inspector General and the Ombudsman for Human Rights and Justice have been established to hold the Government and people to account but, Timor-Leste's institutions are fragile and gangs can render the State virtually immobile as they plunder the streets and burn houses (Scambary et al. 2006). Thus, the central question answered by this research is 'Does the Government of Timor-Leste's management of petroleum revenue enable Timor-Leste to avoid the resource curse and enable sustainable development?' In response to this question, a number of sub-questions were answered. Each sub-question is answered by each subsequent chapter. Overall, the thesis contains nine chapters and answers seven sub-questions, as follows:

- (i) What are the challenges in managing natural resource wealth?
- (ii) Which informal and formal institutions, and background information, are relevant to an understanding of how Timor-Leste might manage its petroleum revenue?
- (iii) How does the Government of Timor Leste manage its petroleum revenue?

- (iv) What are the methods used in this research?
- (v) How do a selected group of East Timorese people and decision-makers (East Timorese and Foreign Advisers) think their petroleum revenue should be saved and invested?
- (vi) How do a selected group of East Timorese people and decision-makers (East Timorese and Foreign Advisers) think their petroleum revenue should be spent?
- (vii) According to a selected group of East Timorese people and decision-makers (East Timorese and Foreign Advisers), what will jeopardise and what will sustain development in Timor-Leste?

1.3 Scope

The resource curse literature is mainly economic in nature. This research examines the institutional aspects of the resource curse, specific to Timor-Leste. The research examines the Petroleum Fund Law and other mechanisms put in place by the East Timorese Government to manage their petroleum revenue. The examination covers the themes of saving and spending petroleum revenue, transparency and accountability, and the strength and capacity of East Timorese institutions to manage petroleum revenue. The literature review covers some of the economic aspects of the resource curse in order to explain the problem. The review then broadens to include the institutional aspects of the resource curse, and the social capital literature. The review of the academic and grey literature covering Timor-Leste's institutions is comprehensive. The review of petroleum revenue management institutions is, however, limited, for the most part, to those of Timor-Leste¹.

The empirical component of the research is limited in two ways. Time and human resources were the main constraints which defined the participants sampled. The details of the sample are provided in Chapter Five. The results of the empirical research are also time-specific. In particular, the results of the research indicate a perspective from the participants at a time when Timor-Leste enjoyed relative peace. The research was conducted in 2004 and 2005, by which time the East Timorese government had assumed full responsibility for governing the country, and precedes the time when the country fell into crisis.

1.4 Thesis outline

The thesis is divided into two main parts, with an introductory and concluding chapter. An overview of the thesis structure is provided in Figure 1.1. The first part explores the academic

¹ A comparative review of other countries' petroleum revenue management institutions would enlighten this research, but was not its purpose.

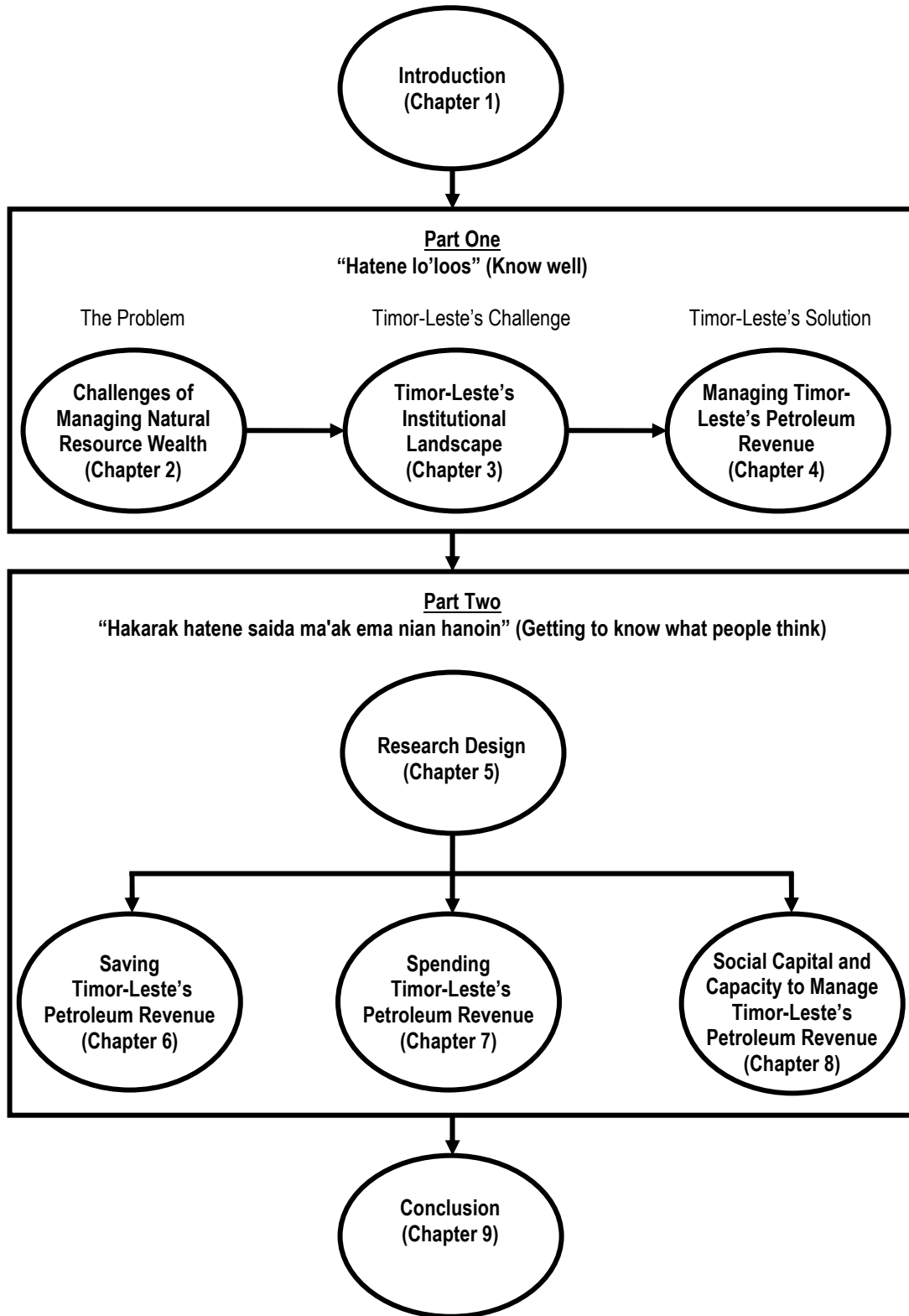


Figure 1.1 Thesis Structure

and grey literature, and includes three chapters. Part One is titled 'Hatene Lo'loos' (*Tetum*² words meaning 'know well') and is dedicated to understanding the problem of the resource curse and its potential and relevance to Timor-Leste. Part Two of the thesis, 'Hakarak hatene saida ma'ak ema nian hanoin' (*Tetum* meaning 'getting to know what people think') is dedicated to the explanation and results of the empirical component of this research.

Chapter Two begins with an exploration of the challenges of managing natural resource wealth. The literature on the resource curse is reviewed and the relationship between institutions and resource revenue management is discussed. Throughout the evaluation a framework for understanding that relationship is developed. This framework distinguishes three possible outcomes when a state exploits its natural resource wealth; a state is either cursed, resource cursed, or enables sustainable development. Social and human capital (the 'two caps') are fundamental to institutional quality, and therefore fundamental to the outcome under this framework. Thus, the empirical component of the research is designed cognisant of the need to enhance participation in making decisions about petroleum revenue management.

Chapter Three describes Timor-Leste's institutional landscape in terms of the framework developed in Chapter Two. Timor-Leste's history is central to an understanding of its institutions today, and the state of its institutions today provide an indication of the potential outcomes of Timor-Leste's natural resource revenue boom. This chapter also provides an overview of Timor-Leste's potential petroleum wealth and illustrates the enormity of its contribution to the future of Timor-Leste as a sustainable state.

Chapter Four describes the Government of Timor-Leste's plans for managing its petroleum revenue. The Petroleum Fund Law is central to the Government's plans but it is not the only institution responsible for managing petroleum revenue. Managing Timor-Leste's petroleum revenue includes saving, spending and monitoring it. Thus, petroleum revenue management in Timor-Leste is everyone's responsibility; the President, the Parliament, the Bureaucracy, the Courts, and civil society. This chapter provides a comprehensive analysis of the details of the Petroleum Fund Law and other mechanisms that govern the management of petroleum revenue.

Part Two of the thesis presents the results of the field research and begins with a review of the research design. Chapter Five explains the methods for both collecting and analysing the data, and reflects on the efficacy of the chosen methods. The data comes from 28 semi-structured interviews (conducted in 2004) and 47 interviews (conducted in 2005) using multi-criteria decision analysis (MCDA) software called Point*Wizard (Hansen and Ombler n.d.). A total of 67 people took part in this research (eight people participated in both methods). The methods were designed to elicit opinions about key decisions in managing Timor-Leste's petroleum revenue. The sample was designed to include decision-makers and people outside of

² *Tetum* is a widely spoken local language of Timor-Leste.

government, both East Timorese and foreign advisers. The objective was to seek a broad range of opinions to broaden and illuminate the discussion about petroleum revenue management in Timor-Leste. The data is presented in three chapters which each focus on a different aspect of petroleum revenue management.

Chapter Six explores how participants think Timor-Leste's petroleum revenue should be saved and invested. Point*Wizard software was used to generate a ranking of which aspects of saving and investing Timor-Leste's petroleum revenue were most important to participants. The method also generated discussion themes, which include choices about Timor-Leste's revenue potential (in terms of whether the Government uses its petroleum revenue or seeks international finance, and how soon petroleum fields should be exploited), whether expenditure of natural resource wealth is sustainable (in terms of the amount that is withdrawn from the petroleum fund), and three aspects of petroleum revenue investment (the level of risk, where revenue is invested and in what currency).

Chapter Seven is concerned with how participants think Timor-Leste's petroleum revenue should be spent. The semi-structured interviews generated a vision for Timor-Leste expressed by the participants and this, in turn, informed the design of the Point*Wizard research which asked participants to choose how petroleum revenue should be spent. One part of the Point*Wizard research elicited a ranking of the choice between spending on social services, infrastructure, individual payments and consumable capital. Another component of the Point*Wizard research asked participants to rank 14 budget sectors in terms of their priority to increase budget expenditure. The results of the research in this chapter provide an understanding of the links between sectors in terms of budget priorities, and the ultimate goal of sustainable development.

Chapter Eight draws the discussion throughout the thesis together. Further findings from the field research underpin the basis of the framework from Chapter Two. Participants' comments about Timor-Leste's institutions and the themes of accountability and responsibility are discussed. Social and human capital are essential to wise petroleum revenue management and, ultimately, Timor-Leste's sustainable development. This chapter explores the 'two caps' in terms of their role in enhancing accountability and responsibility. Finally, this chapter looks to the way forward for Timor-Leste and highlights three aspects of petroleum revenue management that will require attention if Timor-Leste is to avoid the resource curse. Chapter Nine concludes the thesis by highlighting the contributions that the thesis has made to understanding the problem of managing natural resource wealth in Timor-Leste.

1.5 Research contribution

This research contributes to the literature on the resource curse, and provides practical insights to further sustainable development in Timor-Leste. This thesis also provides a deeper, more complex understanding of the institutional aspects of the resource curse and the role of social capital in managing petroleum revenue. Finally, it provides the first institutional analysis of sustainable development in the context of Timor-Leste and petroleum revenues. This research is unique as it precedes Timor-Leste having the resource curse. Until now, the literature has been primarily based around economic theories, and analyses countries which are already resource cursed. By contrast, Timor-Leste has an opportunity to learn from those countries' mistakes.

This research provides a holistic picture of petroleum revenue management in Timor-Leste, and in-depth insights into a country that has put mechanisms in place to avoid the resource curse and enable sustainable development. A comprehensive analysis of Timor-Leste's institutions, both formal and informal, with particular regard to petroleum revenue management has never been conducted. Extensive field work, over six months, brings insights to petroleum revenue management in Timor-Leste from people working both inside government and outside. Sixty-seven people contributed to the empirical data set, from the Prime Minister and President of Timor-Leste to health workers, teachers and students. This research also asks what people, other than the decision-makers, think about petroleum revenue management and compares those views with the decision-makers. Thus a broader sense of what is important in terms of how petroleum revenue should be saved, how it should be spent and how the exploitation of petroleum resources may jeopardise or enhance the sustainable development of this new country, imbues this research.

Understanding the problem of the resource curse in an East Timorese context is crucial as the decisions being made in this current period will impact on the well-being of both current and future generations of East Timorese. To learn how petroleum revenue can sustain Timor Leste is of the utmost importance to the people of Timor Leste who are relying on this source of income in order to avoid aid-dependency, and to fund many government programs, including education and health services. Thus, income from petroleum revenue has the potential, if managed well, to improve the quality of life for the people of Timor Leste. But, conversely, it also has the potential to make life much worse.

The author has contributed directly to both the policy development process, and the process of community learning about petroleum revenue management in Timor-Leste. During the candidature, the author contributed the following documents to the consultation on the development of the Government of Timor-Leste's Petroleum Fund Law:

- (i) Comments on the Timor-Leste Petroleum Fund Draft Act (Submitted to the Petroleum Fund Steering Group, Democratic Republic of Timor-Leste in February 2005);
- (ii) Analysis of the changes to the Petroleum Fund Draft Act, identifying additions to the Petroleum Fund Law Bill, and recommendations about issues to be raised with the Parliamentary Committee C (responding to a request by Oxfam and the Office of the President on 30 May 2005);
- (iii) An individual submission regarding the proposed Petroleum Fund Law (a letter to the Honourable Members of Parliamentary Committee C on 8 June 2005)

Aspects of the research have been presented in academic fora, including a proposal seminar at the Australian National University (ANU) in March 2004 witnessed by the (then) Secretary of State for Natural Resources, Sr. Jose Teixeira, and at a Conference at Victoria University (in June 2005), witnessed by the (then) Prime Minister of Timor-Leste, Sr. Mari Alkatiri.

Two publications have resulted from this research to date. They are:

Drysdale, J. (2007) 'Portrait of a Petroleum Fund consultation' in *East Timor: Beyond Independence*, D. Kingsbury and M. Leach (Eds), Melbourne, Monash University Press.

Drysdale, J. (2005) 'Managing petroleum revenue in Timor-Leste: A brief explanation,' *Development Bulletin* **68** October.

To further disseminate the results of this research with the aim of practical application both the publications and the consultation submission were translated into languages spoken by the relevant audience. The Comments on the Timor-Leste Petroleum Fund Draft Act were translated into Indonesian. The Letter to Committee C was translated into Portuguese, the official language of the Government of Timor-Leste, and both the publications were translated into *Tetum* (to encourage discussion within civil society). The publications and the Comments on the Timor-Leste Petroleum Fund Draft Act remain available on the internet.