

EAST *Timor*

Development Challenges
for the World's Newest Nation

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EAST *Timor*

Development Challenges
for the World's Newest Nation

Edited by
Hal Hill & João M. Saldanha



Institute of Southeast Asian Studies, Singapore

First published in Singapore in 2001 by
Institute of Southeast Asian Studies
30 Heng Mui Keng Terrace
Pasir Panjang
Singapore 119614
<http://www.iseas.edu.sg/pub.html>

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ISEAS Library Cataloguing-in-Publication Data

East Timor: development challenges for the world's newest nation/ edited by Hal Hill and João M. Saldanha.

(ISEAS current economic affairs series, 0218-2114)

1. Timor Timur (Indonesia)—Economic conditions.
2. Timor Timur (Indonesia)—Economic policy.
3. Timor Timur (Indonesia)—Politics and government.

I. Hill, Hal, 1948—

II. Saldanha, João M.

III. Series

HC448 T5E132

2001

sls2001025053

ISBN 981-230-140-2 (soft cover)

ISBN 981-230-141-0 (hard cover)

For North America and Europe, a hardcover edition is co-published by Palgrave Publishers Ltd, United Kingdom.

Copy-edited, typeset, and indexed by Beth Thomson, Japan Online.
Printed in Singapore by Seng Lee Press Pte Ltd.

Contents

<i>List of Tables</i>	viii
<i>List of Figures</i>	x
<i>List of Maps</i>	xi
<i>List of Contributors</i>	xii
<i>Acknowledgments</i>	xiii
<i>Preface by Xanana Gusmao</i>	xvi
<i>Preface by Carlos Belo</i>	xix
<i>Preface by José Ramos Horta</i>	xxii
<i>Preface by Asian Development Bank</i>	xxv

PART I Introduction

1	The Key Issues	3
	<i>Hal Hill and João M. Saldanha</i>	

PART II Managing the Macroeconomy

2	Currency and Monetary Arrangements for East Timor	39
	<i>Gordon de Brouwer</i>	
3	Folly or Foresight: Strategic Options for Fiscal Policy in East Timor	52
	<i>Jay K. Rosengard</i>	

PART III International Economic Relations

4	Trade and Commercial Policy	71
	<i>Hal Hill</i>	

- 5 East Timor's Economic Relations with Indonesia 84
Hadi Soesastro

PART IV Agriculture and the Rural Economy

- 6 Food Policy in East Timor: Linking Agriculture, Economic Growth and Poverty Alleviation to Achieve Food Security 99
C. Peter Timmer
- 7 The Rural Economy and Institutions in East Timor 110
Colin Barlow
- 8 Coffee and the Economy in East Timor 125
Jacqueline Pomeroy
- 9 Agriculture, Comparative Advantage and the Macroeconomy 140
Helder da Costa
- 10 Diversity and Differential Development in East Timor: Potential Problems and Future Possibilities 155
James J. Fox

PART V Institutions

- 11 Property Rights in East Timor's Reconstruction and Development 177
Daniel Fitzpatrick
- 12 Future Political Structures and Institutions in East Timor 193
J.A.C. Mackie

PART VI Banking and Finance

- 13 Finance Policies for East Timor 209
Ross H. McLeod
- 14 Transport and Power 222
Chris Cheatham and Sirpa Jarvenpaa

PART VII Social Policy

- 15 Poverty, Equity and Living Standards in East Timor: Challenges for the New Nation 241
Anne Booth

- 16 Social Policy Issues in East Timor: Education and Health 256
Gavin W. Jones

PART VIII Lessons from International Experience

- 17 Country Size and Economic Performance: A Commentary 275
 with Implications for East Timor
João M. Saldanha and José Tavares

- 18 Reconstruction of War-torn Economies: Lessons for East Timor 288
Jonathan Haughton

- 19 Lessons for Development from Pacific Island Countries 306
Satish Chand

- 20 The Papua New Guinea Experience: Some Issues for the 321
 Early Years of East Timor
Andrew Elek

- 21 Aid, Shocks and Trade: What East Timor Can Learn from 336
 African Experience
Paul Collier

- References* 351

- Author Index* 369

- Subject Index* 373

Tables

1.1	Economic Indicators for East Timor, 1997–2001	8
3.1	Public Spending and Growth, 1980–97	56
3.2	Consolidated Budget for East Timor, FY2000/01	58
3.3	Composition of East Timor’s Income, FY1994/95	59
7.1	Agriculture in East Timor, 1970–95	112
8.1	The Role of Coffee in the East Timorese Economy, 2001	126
8.2	Coffee Output of the World’s Main Coffee Producers and East Timor, 1998	129
8.3	Coffee Exports from East Timor, 1995–2001	129
9.1	Economic Development Policy in East Timor, 1958–99	142
9.2	Land Area, Population and Relative Resource Endowments of East Timor and 13 other Economies, 1998	150
10.1	Agro-climatic Zones of East Timor	157
10.2	East Timorese Population Distribution by Regency from West to East, 1990	161
10.3	Irrigation Systems of East Timor: Estimated Design Capacity and Functioning Area	167
14.1	Road Maintenance Budget Estimates, 2000/01–2002/03	226
14.2	Port Sector Recurrent Budget Estimates, 2000/01–2002/03	229
15.1	Population below the Official Poverty Line, 1993 and 1996	242
15.2	Consumption Expenditure, Headcount Poverty and Relative Poverty in Urban and Rural Areas of Eastern Indonesia, 1993 and 1996	243
15.3	Gini Coefficient of per Capita Consumption Expenditure, 1993 and 1996	244
15.4	Agricultural Productivity Indicators, 1995	245
15.5	Agricultural Holdings by Size Category, 1993	247

15.6	Agricultural Labour Force by Employment Category, 1995	248
15.7	Sources of Farm Household Income, 1993	249
16.1	Educational Attainment of Population Aged 15–69 Living in Household with Head Born in East Timor, 1995	258
17.1	Small Countries and Economic Growth	282
17.2	Indicators for East Timor and Other Small Countries	284
18.1	East Timor Compared with Other War-torn Economies	290
18.2	Economic Change during the Move from War to Peace	292
19.1	Basic Indicators for 14 Pacific Island Countries and East Timor	308

Figures

9.1	Taxonomy of Foreign Aid Inflows to a Developing Country	143
9.2	A General Equilibrium Model of Aid Inflows	145
9.3	Relative Endowments of Natural Resources, Labour and Capital in 14 Economies, 1998	149
16.1	Age and Sex Distribution of Population Living in Household with Head Born in East Timor, 1995	259
19.1	Hysteresis and Lock-in	312

Maps

10.1	The Agro-climatic Zones of East Timor	156
10.2	Regional Divisions of East Timor	160
10.3	A Linguistic Map of East Timor	162

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Acknowledgments

It is a great pleasure to thank the many people and institutions who have contributed to this volume, and to the Dili Economic Forum on which it is based. We began to plan this exercise seriously at a conference on East Timor in Washington DC in August 2000. The basic rationale then was that East Timor was moving swiftly towards independence, that there was likely to be plenty of international goodwill and support, and that what was critically important was the development of a coherent set of development policies to guide the new nation forward.

We therefore began to identify what we considered to be the key development policy challenges, and to invite a group of leading thinkers and practitioners to set out the policy options and issues under each topic. We wanted to cast the net widely, examining not just ‘mainstream’ economic issues but the political and legal framework, social policy and the special challenge of relations with Indonesia. Moreover, we thought it highly relevant for East Timor, as a latecomer, to absorb the lessons from other countries and regions.

We began talking to potential donors and contributors shortly thereafter. The Asian Development Bank (ADB) expressed interest in our proposal and quickly provided the necessary support. We are most grateful to the ADB for its funding and flexibility, and for giving us a completely free hand in organization and implementation. In particular, Etienne van de Walle was with us all the way in this endeavour, sharing our vision and providing unswerving support. We also wish to single out the head of the ADB’s East Timor mission, Robin Boumphrey who, despite many onerous duties, provided staunch support throughout.

Although this enterprise is funded by the ADB, it will be obvious that it does not necessarily share or endorse any of the views expressed in the volume.

Our authors made this volume what it is. We wish to thank them all for their participation. They are all busy people. They were contacted at very short notice

– many as they were about to take their summer vacation! – and given an exceptionally tight deadline. They all prepared high-quality, thoughtful and policy-relevant pieces for the Dili Forum, and they all revised their papers promptly for the book. The majority of contributors had not been to East Timor before, but all had extensive knowledge of the region and shared a commitment to wanting to help the new nation.

Planning for the Forum, held in Dili on 26–28 March 2001, was a major logistical challenge. We thought initially of holding it nearby, in Darwin, which would have been easier. But this would have lacked the immediate local impact. In addition we thought that the Forum could be an exercise in institution building, to show the world what East Timor could do in difficult circumstances.

The East Timor Study Group assumed responsibility for organizing the Forum, and we wish to place on record our debt to the many individuals who, in very difficult circumstances, together made the Forum a great success. The core planning was in the hands of Helder da Costa, Francisco da Costa Guterres and Francisco da Costa Soares – all members of the East Timor Study Group. Their commitment, efficient organization and generous hospitality made all the difference, and we appreciate very much their good work. Two other members of the East Timor Study Group, Edmundo Viegas and João Cancio Freitas, were also instrumental in organizing the Forum. We spent much time working over the plan for the Forum and the volume with Helder da Costa and Jay Rosengard, whose wise counsel was always invaluable.

We feel greatly honoured that several distinguished Timorese supported the Forum, and took time out from busy schedules to address the gathering. These include Xanana Gusmao, Bishop Carlos Ximenes Belo and José Ramos Horta, whose speeches to the Forum are reproduced in modified form as prefaces to this volume. In addition, Bishop Basilio do Nascimento, Minister Mari Alkatiri, Mrs Maria Federer and Mr Mariano Lopes da Cruz all addressed the Forum at some stage, and contributed much with their insights.

We also wish to thank the many Timorese and others who chaired sessions and acted as commentators. These include José Abel, Rui Maria Araujo, Benjamin Corte Real, Manuel Countinho, Jan van Houten, Felipe Mesquita, Domingos Sousa, José Teixeira and Sofia Borges.

Our appreciation goes to the National Council of Timorese Resistance (CNRT) for allowing us to use its conference facilities, and for the strong support we received from its leadership and staff. Mr Virgilio Smith and his team from the Secretariat helped to ensure strong logistical support.

Beth Thomson managed the production of this volume, working well beyond the call of duty, and to a very tight timetable. As always, she edited the papers with her customary care and efficiency. She also prepared the indexes. It is always a pleasure to work with Triena Ong and her friendly and capable editorial staff at the Institute of Southeast Asian Studies. We also thank our

co-publishers – Asia Pacific Press (Canberra) and Palgrave (London/New York) – for their interest in and support of this volume.

It is obvious that events are changing very quickly in East Timor, and so inevitably parts of this volume will begin to date almost immediately. However, while the very short term is critically important, we are also looking beyond it in this exercise, by attempting to draw attention to major elements of a coherent long-term development strategy for the new nation.

It is also obviously the case that the country's socio-economic database is seriously deficient (though not to the extent that is sometimes assumed), and that political parameters are in the process of being formed, and institutions developed. We could have waited several years for all this to be worked out. But that would have resulted in a very different kind of volume. Vital decisions are being made now, and we thought it important to participate in the process. As was mentioned by one of the participants, in a remark attributed to Lord Keynes, 'it is better to be approximately correct than precisely wrong'. We have approached the many complex and delicate issues addressed in this volume with such a proposition in mind.

Our audience is first and foremost a Timorese one: the politicians, officials, academics and students, and anybody with an interest in policy issues. To maximize local impact, this volume will be translated into Portuguese and Bahasa Indonesia, and summary policy briefs of all the chapters are being prepared.

In addition, East Timor attracts much more international attention than is common for such a small, poor and isolated country. We hope that this volume will also be of service to the international community with an interest in the country. We take this opportunity to thank several international friends, from Japan, Sweden, Portugal, Indonesia, Australia and the United States, for contributing to the Forum.

The people of East Timor are about to embark on the huge task of nation building. If, in some very small way, this volume helps to make this journey a success, we will all feel very satisfied. Bon voyage in the new millennium.

Hal Hill and João M. Saldanha

Canberra and Dili/San Diego

May 2001

Preface

Xanana Gusmao

Since the dreadful destruction of September 1999, East Timor has been undertaking the task of economic reconstruction under the guidance of the United Nations Transitional Administration in East Timor (UNTAET) and with the assistance of the multilateral and bilateral development agencies.

It is obvious that this process, which literally began from scratch, is a gigantic task for UNTAET and for the Timorese people. Amidst the difficulties – ranging from communication between international staff and East Timorese nationals to the slowness of the reconstruction process itself – have emerged some initiatives that will establish the basis for the democratic governance of our country. Other initiatives have also emerged to help us achieve quick economic recovery. These include the rehabilitation of essential infrastructure and the transportation network, the provision of basic health care, the re-opening of schools and, very importantly, the resumption of markets and economic activities.

But a lot more will need to be done to address four important economic and social problems we currently face: poverty, unemployment, inflation and illiteracy. The per capita income of East Timor was already very low, and sank still lower with the destruction of September 1999. Unemployment, mainly in Dili, is very high. Our country has had to cope with high inflation due to the shortages of goods and services and the high transport costs resulting from the remoteness of East Timor from the main international routes.

Looking to the future, one of the main goals of our development will be to create a fair society with an equitable distribution of income, in which those East Timorese with lower incomes have their basic needs for education, health care and public transport met. At the political level, we aim for stability through democratic and orderly elections, and for good governance, with no corruption and with transparency in the decision-making process. The National Council of Timorese Resistance/National Council (CNRT/CN) and UNTAET agreed on the

date of 30 August 2001 for the first Constitutional Assembly elections. The new assembly will have as its main task the framing of the constitution of a democratic East Timor, prior to the proclamation of our independence.

CNRT will dissolve itself in June to give more room for the political parties to organize themselves and compete against each other in the elections. As the main UNTAET interlocutor and partner, CNRT has accomplished part of its task in ensuring that East Timorese have an increasingly important role in the transitional process to independence.

We hope that all this is a positive signal for national and international investors, to attract their involvement in mutually beneficial economic activities in East Timor. To this end, it is important to provide security, to clearly define and publish laws on land and property rights, and to simplify the administrative procedures for investment. We will develop an appropriate fiscal and tax policy to give additional incentives to investment.

In this rehabilitation process, we recognize that our technical capabilities are limited. Despite the best intentions and all the goodwill, the process of Timorization is still too slow. This will pose problems for the future administration of an independent East Timor.

At the CNRT/CN Congress of August 2000 several economic issues were discussed, including strategies for development, investment, the environment and natural resources. Let me share with you some issues that worry us, in the hope that your suggestions may help us find alternatives for the future of an independent East Timor.

We still debate – though in a limited way for the moment – the options regarding the creation of a national currency. Should we have our own currency or should we maintain the present situation of using the American dollar? What other options do we have, considering our small size and other characteristics?

We are concerned about fiscal policy, namely the budget, and whether it should be balanced. This again involves the issue of a national currency. Besides this, what are our options for offering fiscal incentives to investment? Another important discussion has been about the income from the Timor Gap, and the (so-called) ‘good life’ that it can bring to us. Will it be possible to rely only on oil revenues, or will we need to develop other resources that can complement these? Of course, we would like to have a good living standard, relying on our own resources. But the main issue will be to find a way to avoid the bad experiences of other countries and to ensure that our resources will in fact be a blessing for our country and not a source of even worse problems.

We acknowledge that for the time being, during this transitional process, we are living off other countries’ taxpayers. We believe that for at least some time to come, we will benefit from the sympathy and support of the international community. But this support will diminish in the future because we recognize that there are other countries in the world which ask for the attention and sup-

port of the international community – support which, just like that given to East Timor, is well deserved. For all these reasons we wish to develop our non-oil income, thereby ensuring our long-term growth.

We have considered the creation of a 'free economic zone'. Its objective would be to stimulate new jobs for Timorese through the development of an 'off-shore' facility that would include a modern financial centre. What would be the consequences of this for the East Timorese people? Is this a viable option for us, considering our geographic position in the world?

Given our small production units, we also confront the problem of the commercialization of agricultural production in several regions of our country. We need to know how best to provide access to markets for small producers, including access to credit. Some micro-finance initiatives are available, but they are still very limited.

In considering all this, I salute the Dili Economic Forum and this book as an initiative to help us identify our economic challenges and give us some alternative ideas in our efforts to overcome poverty, unemployment, inflation and illiteracy. I wish the Forum and this book every success, and extend my warmest regards to the organizers – the East Timor Study Group, the Australian National University and the Asian Development Bank (ADB) – for undertaking this important work.

Kay Rala Xanana Gusmao

President, Concelho Nacional de Resistencia Timor
April 2001

Preface

Carlos Belo

Poor economic management in East Timor has resulted in hunger, poverty, unemployment and social instability.

Hunger refers to the shortage of food, which is the most fundamental need of human life. Hunger is also a general indicator of a people's backwardness. The solution requires the development of a broad-based economic development strategy.

Poverty refers to the condition of those human beings who are deprived of what they require to live with dignity. There are various dimensions to poverty – economic, cultural and legal.

The most alarming consequence of economic recession in developed countries is *unemployment*. In underdeveloped countries like East Timor, this is the lack of economic means. Unemployment causes humiliation and depression, leading to drug use, delinquency, family crisis and despair. It causes psychosomatic illnesses, psychological changes and personality disorders. Job creation is the key to addressing all social issues (John Paul II).

Hunger, poverty and unemployment contribute to dehumanization. This often results in social instability, which is one of the major human costs of an economic crisis. The social life of any country cannot function without economic stability.

How are these economic and social ills to be overcome? They have to be tackled by a free and unified people. The core moral solution entails reconstructing human solidarity, both in theory and in practice, given that true economic development must be guided by the criterion of solidarity. In the words of Vatican Council II: 'The economic activity regulated by its own methods and laws has ... exercised itself within the limits of moral order to fulfil God's designs of human beings' (GS, 64).

Economic activity affects all human activities.

Today, more than ever, there are strong reasons to increase our efforts to raise agricultural and industrial production, as well as the level of services, in order to meet the needs and growing aspirations of an expanding human population. Greater efforts should be made to enhance technological progress, foster a spirit of initiative, create and expand business opportunities, and adapt production methods – in sum, develop all the factors that contribute to development.

But the fundamental goal of production is not the mere increase in products, revenues or power, but rather the service of the human being; of the human being in its integrity, that is, taking into account the order of his material needs and the demands of his intellectual, moral, spiritual and religious life. This is true for any individual or group of people, of any race or religion in the world (GS, n.64).

The human being is the protagonist, the centre and the end of the whole of economic and social life (cf. GS, n.63). In view of this, we believe the economy of the new nation of East Timor has to be a planned one. What kind of planning are we talking about? *Democratic planning*. In order to be truly democratic, planning requires the presence of all social groups in the formulation, implementation and control of economic processes. The different points of view, the tensions and conflicts, require the presence of organizations that represent different interests, even those that might be regarded as exploitative.

Participation in economic life requires adequate information and data. Economic development must be under human control; it should not be in the hands of an economically strong few individuals or groups, one political party or a few powerful countries. On the contrary, there is a need to involve as many people as possible, at all levels. Equally important is the need for coordination and harmonious organization between private initiatives and public institutions.

The economy of East Timor is small scale. Most of the population still rely on agriculture, much of it subsistence. Hence there is a need for agricultural planning. In addition, we have been witnessing a flow of people from rural areas to the main towns, particularly Dili, causing labour shortages in agriculture. These outflows are motivated by several factors: the desire to escape from an environment regarded as without future and narrow-minded; the thirst for novelty and adventure; the hope of sudden wealth; the fantasy of a ‘free life’ with the means and facilities available in the city.

What can be done to attract the population back to the villages? It is essential that the authorities provide basic services in rural areas, such as roads, transportation, communications, safe drinking water, housing, health facilities, primary, technical and professional education, and recreational facilities (cf. Mater et Magistra, n.127). There is no industry in East Timor. Efforts are under way to establish small industry. Support should be lent to this sector as well.

Commerce can be understood from various perspectives, and it is in reality a complex phenomenon. Broadly defined, the ‘market’ constitutes one element of an economic system. Commerce is one of the fundamental processes of eco-

conomic activity, as it helps to distribute the flow of goods. It is also an important social activity, fundamentally related to the distribution of wealth and the regulation of the economic cycle. Ethics and morality need to underpin commercial activity, in order to eradicate fraud, speculation and 'free-riding'.

The price of an economic good is a quantitative expression of the value of exchange, through the medium of money. According to the traditional Christian morality, a price is considered 'just' when it is determined by the 'law of equivalence' between the goods being exchanged; that is, when the price is equal to the cost of production plus a 'reasonable' margin for the seller. But in addition to this simple commercial dimension, prices have a social dimension. The question of prices is a moral issue, and therefore raises questions of social justice.

How should the government address the question of prices? Its regulatory function needs to be balanced in a way which ensures that the economy facilitates the community's access to basic needs, and also prevents speculation in, for instance, housing. Pricing policy therefore needs to take account of the purchasing power of individuals, including that of the disadvantaged groups in the society.

Fiscal policy is one of the most important aspects of economic policy. Here, attention needs to be given both to the structure of the fiscal system (its clarity, simplicity, coherence and legal certainty) and to fiscal objectives. Social and distributional issues are also important. A similar set of ethical and political judgements applies to the expenditure side of the budget. Here, too, clarity and transparency are fundamentally important to ensure equity in the eyes of taxpayers. Finally, expenditure decisions have to be consistent with the broader development objectives discussed above.

Taxation legislation must be subject to moral scrutiny and considerations of justice. Thus, for example, direct taxes should be favoured over indirect ones, and certain products and activities should be exempt (for example, schools and social institutions). On grounds of equity, a progressive tax structure should be developed, including exemptions for those with incomes below a certain level. Finally, there needs to be a public campaign and moral education to encourage taxpayers to fulfil their obligations and not to regard laws merely as punitive devices.

Within this framework, I welcome the Dili Economic Forum. I am glad to know that the proceedings will be published in this book, which should prove useful for anyone interested in the development of East Timor.

Carlos Filipe Ximenes Belo, SDB

Apostolic Administrator, Dili Diocese

Nobel Laureate

July 2001

Preface

José Ramos Horta

East Timor opened a stormy new chapter in its history on 30 August 1999 when its people voted overwhelmingly for independence from Indonesia. More than 98 per cent of registered voters defied intimidation to cast their ballots in an orderly and peaceful manner. The people of East Timor won the world's admiration for their commitment to democracy. The discipline, patience and dignity displayed on that day will be a hallmark of East Timor as it moves towards recovery and independence. Implementation of the results of the ballot should have been an occasion for celebration. Instead, the people of East Timor were forced to watch the birth of their country with tears.

The reconstruction that will accompany the journey towards independence in East Timor, while arduous and painful, will also provide a genuine opportunity to establish appropriate infrastructure, institutions and economic policies at the outset. That will facilitate the rebuilding of this small and devastated land into a viable, self-sufficient, democratic state for the 21st century.

In order to establish a sound macroeconomic framework for East Timor, more hard choices will need to be made. These pose formidable challenges for future policy-makers in this country. The Transitional Cabinet has endorsed policies establishing a framework for macroeconomic stability. This needs to be supplemented by appropriate structural and social policies to increase investment and employment in both the private and the public sector. Growth based on attracting private investment, both national and foreign, requires public policies and investment to provide better infrastructure, well-established property rights, effective governance and the rule of law.

Parallel with this, a future independent East Timor must begin to show its commitment to sustainability by building a sound fiscal framework underpinned by a stable, credible currency. Initiatives to establish a national currency in the

future will include efforts to ensure it has strong financial backing and the credibility necessary to be welcomed by international financial markets.

An urgent task in this newly emerging country is to establish a small, competent and transparent government from the beginning. Given the experience of previous administrations, East Timor will have a lean and cost-effective government that will seek to keep aggregate expenditures aligned with the country's absorptive capacity. Domestic revenue sources are expected to provide a solid foundation for financing the country's recurrent budget without resource to donor assistance. Equally fundamental are sound management of public resources and maintenance of a good economic and regulatory environment conducive to efficient private sector activities.

While many doubt the country's economic viability, East Timor is arguably well endowed on a per capita basis with natural resources both on-shore and off-shore. The projected oil and gas revenues for the medium term from the Timor Sea are promising. This export income will be supplemented by earnings from marble, coffee and other agricultural produce as well as tourism, since East Timor has a comparative advantage in these activities. There are strong reasons to believe that the revenues generated from oil and gas will be allocated appropriately. An endowment fund could act as a stabilizing force, safeguarding income from resource sales that rightly belongs not only to the East Timorese citizens of today but also to generations to come.

Given that three-quarters of East Timorese are engaged in agriculture, a future independent East Timor will need to strengthen traditional agriculture by using appropriate technology inputs to increase crop yields. Providing access to rural banking and micro-credit facilities will also help to increase the sector's output growth while improving its ability to market surpluses and build linkages with the private sector. Appropriate policies can provide a sound basis for sustained economic growth and poverty alleviation via export-oriented primary activities.

With its small natural resource base and limited domestic financial resources, East Timor will need to engage actively in trade if it wishes to develop its economy rapidly. Again, a future independent East Timor will welcome sound investment by firms that wish to operate in an environment free of artificial barriers to trade. East Timor's magnificent landscape will be matched by an attractive investment climate, with appropriate laws protecting property rights and contracts, establishing a fair commercial code, codifying labour relations and minimizing the cost of doing business. After all, this strategy is aimed at laying the foundation for good governance based on democracy, accountability, transparency and human rights so as to build East Timor into a modern civil society run by efficient institutions based on the rule of law.

My fervent hope is that this book will contribute in some practical ways to

help East Timor reduce its heavy reliance on foreign aid, achieve sustained economic growth and fight unemployment and poverty effectively.

José Ramos Horta

Cabinet Member for Foreign Affairs, East Timor Transitional Administration

Nobel Laureate

July 2001

Preface

Asian Development Bank

It is recognized that sound economic policies are critical to the socio-economic development of a country. This is a complex task. The policies and strategies need to be ‘owned’ by stakeholders, including government and civil society. It is challenging to implement them and to monitor their developmental impact. Such policies and strategies need to be flexible; they must be able to respond to the changing needs of the society and the economy. East Timor needs to build the capacity and skills required to put it on the desirable socio-economic development path.

The papers presented and discussed at the Dili Economic Forum deal with a comprehensive framework of economic policy and strategy options which are relevant to the emergence of a national poverty reduction strategy for East Timor. Such a strategy needs to be designed and owned by the country.

The critical importance of social development goals in underpinning economic policies needs to be emphasized. Such goals are best pursued by integrating and mainstreaming social development concerns into development planning, and into economic growth and other strategic objectives. This is best done by promoting equality of opportunity, security and empowerment; by bringing social concerns into the mainstream of development interventions; and by mitigating the negative social impacts of development policies. Therefore, economic policies and strategies need to be underpinned by adequate social analysis and assessment of the causes of vulnerability. Vulnerability and poverty are closely linked. Well-directed social development efforts are the backbone of sound economic policies and strategies. They will help to promote social responsiveness to, and the sustainability and ownership of, policies, strategies, programs and projects.

The economic forum publication is just one step in the process through which the East Timorese people will prepare and formulate their development

policy and strategy – not following the usual top-down approach so often practised in the past, but in a truly participatory manner, through an intensive and long-term dialogue with societal groups and organizations. This is a daunting task – and one that will take some time, as the civil society landscape and human resources potential in government agencies will need to be built up. We recommend that working groups be set up under East Timorese stewardship, not only to fine-tune macro and sectoral policies but, perhaps equally important, to formulate shorter-term action programs and concrete projects that would quickly demonstrate progress and have an impact on the ground.

The Asian Development Bank stands ready to provide assistance to the East Timorese people in the realization of a consultative approach. We are committed to facilitate such a process in a sustained manner.

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May 2001