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Timor-Leste Public Financial Management: Progress And Challenges

Olinda Da Cruz Alves
School of Business and Management, DIT Timor-Leste

Desni Mariani Oematan
School of Business and Management, DIT Timor-Leste

Address: Aimetin laran, Dili, Timor-Leste
Corresponding author: lindacruzalves75@gmail.com

Abstract. *Since gaining independence, Timor-Leste has demonstrated suboptimal public financial management in handling oil revenues. Over the past two decades, Timor-Leste has relied on oil funds as the backbone of its economy, accounting for up to 80% of the national budget each year. As a consequence, Timor-Leste faces issues arising from this dependency on oil revenues. This research aims to determine the effectiveness of public financial management in Timor-Leste in managing the national budget to support the livelihoods of its citizens. This study employs a qualitative descriptive method to comprehensively describe the existing data. The results indicate public financial management by the Timor-Leste government in handling oil funds. The government has even invited foreign investors from countries such as Indonesia and China to develop infrastructure in Timor-Leste. However, despite these foreign investments, Timor-Leste has yet to create job opportunities that can absorb the existing labor force and sustainably drive the economy.*

Keywords: *Oil Revenue, Qualitative Descriptive, Financial Management*

INTRODUCTION

In 2002, following the referendum in which 78.5% of voters chose to separate from Indonesia, the Democratic Republic of Timor-Leste (RDTL) officially became an independent nation and began governing itself like other countries (Tempo, 2023). The formation of a country is fundamentally linked to the obligation to enhance the welfare of its people, protect them, and fulfill various other interests. These responsibilities have been carried by this 14,874 km² nation since its inception. From that point on, all governmental affairs, including economic authority, have been managed independently. One of the first economic policies implemented by the RDTL government focused on poverty alleviation and the consolidation of stability and security as the foundation for building state institutions. Furthermore, the initial economic policies of the RDTL included efforts to establish peace, which was deemed crucial since, without peace and stability, a country struggles to attract investment, making it difficult to create job opportunities and consequently impacting the poverty levels of the population (Saputro & Merinaldi, 2019).

These economic policies were implemented to restore national stability post-conflict, as countries affected by conflict generally require ten to fifteen years to recover. This process was further complicated for Timor-Leste (RDTL), which faced significant challenges in

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*Olinda Da Cruz Alves, *lindacruzalves75@gmail.com*

building effective state institutions due to the extensive destruction of basic infrastructure and the limited number of trained human resources (Timor-Leste Strategic Development Plan, 2011). Consequently, since gaining independence, RDTL has been striving to rebuild its infrastructure, strengthen civil administration, and create job opportunities for its citizens entering the workforce (Ministry of Finance of the Republic of Indonesia, 2024).

In line with this, the Timor-Leste Planning Commission in 2002 set the direction for its economic policy in the early period of independence. The policies included financial independence, effective management of state revenues, efficient management of oil and gas natural resources, banking management, and ensuring responsible, efficient, and productive state budget expenditures to promote economic growth and poverty alleviation. To achieve these goals, the Timor-Leste government enacted the Constitution of Timor-Leste in the same year. This Constitution comprises 7 chapters and a total of 170 articles, with the third chapter specifically addressing finance and the tax system (Oxford University Press, 2002). This Constitution has since served as the foundation for the RDTL government's economic policies.

In carrying out the mandate of the constitution, the first elected Prime Minister, Mari Alkatiri, faced a multitude of complex issues. These included a poorly functioning economy, a limited number of skilled human resources, high poverty rates, infrastructure devastated by post-referendum conflict, inadequate access to healthcare and education, political instability, and security issues. The challenges encountered by Prime Minister Mari Alkatiri's administration were not matched by the availability of adequate budget. Consequently, the problems became increasingly difficult to resolve. Therefore, it is crucial to recognize that every country needs sufficient funds to carry out various activities in serving its people and achieving national development goals (Ikhsan, 2021). These funds are managed through Public Financial Management.

Public Financial Management (PFM) is defined as a system designed to generate and control public financial resources to ensure effective and efficient public service delivery (Bastian, 2021). This process encompasses planning and budgeting, accounting and reporting, internal control, auditing, and external oversight. The goal is to enhance benefits for the broader community, support good governance, and help achieve the three main budgetary objectives: aggregate fiscal discipline, effective resource allocation based on priorities, and efficient service delivery.

Public financial management is the process of planning, budgeting, managing, and overseeing the financial resources used by the government to achieve its economic and social objectives. In Timor-Leste, public financial management encompasses several key elements designed to ensure the efficient and effective use of public funds:

Planning and Budgeting

1. Budget Planning:

This process involves preparing the budget based on national development priorities. In the 2024 State Budget, the Timor-Leste government focuses on increasing capital expenditure and infrastructure investment.

2. Participatory Budgeting:

Engaging the community in the budgeting process to ensure that the budget reflects the needs and priorities of the populace.

Budget Implementation

1. Budget Execution:

Once the budget is approved, funds are allocated and used by various ministries and agencies according to the established plan.

2. Expenditure Monitoring:

The execution of the budget is monitored to ensure that funds are used for their intended purposes and to avoid budget misuse.

Revenue Management

1. State Revenue Management:

Involves the collection of taxes and other revenues necessary to fund the state budget. Timor-Leste, for instance, relies heavily on revenue from the oil and gas sector.

2. Debt Management:

Manages both foreign and domestic debt to ensure fiscal sustainability and the government's ability to meet its debt obligations.

Audit and Evaluation

1. Financial Audit:

Conducted by independent audit bodies to ensure transparency and accountability in the use of public funds. In Timor-Leste, institutions like the *Tribunal de Contas* are responsible for auditing the government’s financial reports.

2. Program Evaluation:

Assesses the effectiveness and efficiency of programs funded by the budget to ensure that development goals are achieved.

These elements are critical for ensuring that public financial resources are used effectively to support national development goals and improve the welfare of the population. Public Financial Management (PFM) is crucial for achieving sustainable development, as careless management of state finances would make growth difficult to attain. The focus of public finance includes the following aspects (Ikhsan, 2021):

1) Studying the bodies or institutions and decision-making processes that influence the behavior of individuals working through the government.
2) Using public finance as a tool to predict economic potential and financial impacts on public sector activities.
3) Understanding that public sector activities are a significant component of the macroeconomy.
4) Recognizing that government spending and taxation have substantial effects on national income levels, prices, and interest rates.

In broad terms, the various activities conducted by the government in the public sector encompass three main aspects (Arsjad et al. in Ikhsan, 2021). Firstly, the transactions carried out by the government, both at the central and regional levels. Secondly, the activities of state-owned enterprises owned by the central or regional government. Thirdly, government regulations, both at the central and regional levels, that influence the economic, social, and political life of the people in a country. All of these activities must be carried out simultaneously according to predetermined priorities. Simply put, the scope of public finance encompasses all governmental activities themselves.

The funds required to finance government activities are undoubtedly substantial. The available funds must be allocated effectively, efficiently, and transparently through various predetermined methods. Therefore, this research will analyze the development of Public Financial Management in the government of Timor-Leste (RDTL) and the challenges it faces in its administration.

RESEARCH METHOD

The research method employed in this study is a qualitative descriptive approach, where the author comprehensively describes and explains the Public Financial Management of the government of Timor-Leste (RDTL) in managing the national budget. Furthermore, this research also utilizes a literature review method to collect, read, and analyze research data.

FINDINGS AND DUSCUSSION

As a newly independent nation, Timor-Leste (RDTL) faces challenges such as low state revenues and a tendency to rely on oil revenues. In the first three years after independence, from 2002 to 2005, Timor-Leste still encountered difficulties in balancing its financial accounts. This is evident in the Financial Reports issued by the Ministry of Finance of Timor-

Leste, which showed that in the first year after independence, state revenues amounted to only US$ 60.7 million, of which approximately 82.2% or around US$ 49.9 million of the budget was allocated to employee expenses, constituting routine government expenditure. Based on this financial report, one can imagine the difficulty the Timor-Leste government faced in managing public finances, as it could not even allocate a budget for development purposes. Consequently, Timor-Leste had to make a concerted effort to stabilize the country, including focusing on addressing various issues such as poverty alleviation.

During the early years of Timor-Leste's independence, the Timor-Leste National Budget until 2010 remained highly dependent on oil revenues (petroleum fund). This can be seen from the sources of funds for the Timor-Leste National Budget formation from the fiscal year 2005/06 to the fiscal year 2010, where it was dominated by oil funds. In 2006, oil funds dominated the sources of funds for the Timor-Leste National Budget, accounting for 82%, followed by taxes (9%), non-oil revenues and aid each at 3%, and autonomous revenues at 2%. Although the percentage of oil funds in the Timor-Leste National Budget decreased to 34% in 2007, in the following three years, oil funds again dominated and even experienced a surge. In 2008, the contribution of oil funds to the Timor-Leste National Budget reached 87%, a significant increase compared to previous years. Furthermore, in 2009, oil funds contributed the same as in 2008, at 87%. Meanwhile, in 2010, the contribution of oil funds to the Timor-Leste National Budget reached 90% of the total budget.

The dependency of the Timor-Leste National Budget on oil funds has not changed significantly up to the present. From 2010 to 2024, Timor-Leste consistently ratified its annual budgets with oil funds contributing at least 80% to the total Budget. This reliance on oil funds should be a concern for the Timor-Leste government, as oil is a non-renewable commodity that will deplete if its exploitation is not controlled. The oil reserves in Timor-Leste are predicted to be depleted around 2030. This should serve as a warning for the Timor-Leste government to seek alternative sources of funding for the Budget besides oil. Additionally, the Timor-Leste government needs to practice good public financial management so that the current oil funds are not only used for non-productive purposes but also stimulate the country's economy, ensuring long-term impact and sustainability.

Based on the investigation conducted by BenarNews titled "Jalan Terjal Timor Leste 25 Tahun Merdeka" (2024), one-third of the total 1.3 million population of Timor-Leste still live below the poverty line and suffer from malnutrition. Furthermore, the infant mortality rate in Timor-Leste is notably high, reaching 38.3 per 1000 live births. In the industrial sector, the labor force participation rate in Timor-Leste is relatively low, standing at only 30.5% (World

Bank, 2021). This figure is significantly below the Southeast Asian (ASEAN) average of 66.1%. Moreover, the rate of 30.5% has remained stagnant since 2013. The low employment absorption is attributed to Timor-Leste's economic dependence on the oil sector, which has failed to create many job opportunities. These figures reflect poorly on the management of public finances by the Timor-Leste government, especially considering the utilization of oil funds over the past two decades.

Oil is a non-renewable natural resource, and therefore, the funds obtained from oil should be managed carefully, taking into account sustainability principles. This is intended to ensure that the impact of oil revenues can be utilized continuously. It's crucial that the Timor-Leste government manages oil funds maturely. They must allocate oil funds to stimulate economic activity in the industrial sector. With the development of the industrial sector, job opportunities are created, and production of goods continues. Workers have sufficient income to live, and communities around the factories can also start businesses to meet the needs of workers. Moreover, the government collects income tax from workers and companies, contributing to the circulation of money and boosting economic growth. This is not an easy task, but it's essential to ensure the country's sustainability after the oil reserves are depleted, considering Timor-Leste's heavy dependence on oil funds. If industrial stimulation is not implemented as early as possible, there is a risk of being too late once the oil reserves start to dry up.

The World Bank predicts that the economic growth of Timor-Leste in 2024 and 2025 will only reach 4.1%. Currently, the Timor-Leste government is actively promoting infrastructure development. However, the World Bank warns the Timor-Leste government that infrastructure is not the right solution to increase employment absorption. Infrastructure projects are temporary in nature; once completed, the jobs associated with them also end. This issue is exacerbated by the significant number of foreign contractors hired by the Timor-Leste government to carry out infrastructure projects. These foreign contractors bring their own workforce, including laborers. Consequently, this further narrows employment opportunities for local residents. According to one interviewee cited by BenarNews (2024), the labor force, particularly laborers, is dominated by Indonesian and Chinese nationals.

The dominance of foreign workers in infrastructure projects in Timor-Leste is a result of the Timor-Leste government's decision to collaborate with other countries, such as the visit of Prime Minister Xanana Gusmao to the Republic of Indonesia in January 2024. The meeting was held to sign a Memorandum of Understanding (MoU) regarding cooperation in infrastructure development in Timor-Leste. During the meeting, it was agreed that Indonesian State-Owned Enterprises (BUMN) would undertake several infrastructure projects in Timor-

Leste, including the construction of the Oecusse Road and the expansion of the Dili International Airport.

Not only did Prime Minister Xanana Gusmao visit Indonesia to collaborate on infrastructure development, but he also visited China in September 2023. This visit resulted in a strategic partnership agreement and opened up investment opportunities for China. Professor Kingsbury outlined that the cooperation between Timor-Leste and China includes investments related to the Belt and Road Initiative (BRI). The BRI, also known as the One Belt One Road, is an infrastructure development strategy initiated by the Chinese government in 2013. It includes the construction of roads, railways, energy projects, digital infrastructure, and ports. The BRI aims to enhance trade and economic cooperation, hence it is often referred to as the modern Silk Road.

In implementing the BRI projects, China has been entrusted by Timor-Leste to construct roads, energy infrastructure, and ports, including the construction of the Suai Highway, the Tibar Deep Sea Port, and even given authority to manage the electricity network in Timor-Leste. Similar to Indonesia, China has also sent its companies to Timor-Leste to undertake BRI infrastructure projects. Companies such as China Railway Group and China Harbour Engineering Company have been directly dispatched to build highways, railways, and ports.

Based on the actions taken by the Timor-Leste government, it can be interpreted that the government is aware, or at least perceives, that the human resources (HR) available in Timor-Leste are not yet capable of leading infrastructure development in their own country. This situation is actually caused by the Timor-Leste government itself failing to implement effective public financial management. The Timor-Leste government has failed to build a strong education system that would produce high-quality human resources. Currently, approximately 8,000-10,000 new graduates enter the job market (BenarNews, 2024). However, the mismatch between the needs of the existing industries and the skills of these new graduates has led to their failure to be absorbed into the workforce, resulting in an increase in unemployment rates in Timor-Leste.

In addition to the mismatch between the needs of industries and the skills of new graduates, another issue is the underdeveloped state of industries in Timor-Leste. Timor-Leste received significant assistance from China during its early years of independence, with China being one of the first countries to recognize Timor-Leste's sovereignty and independence.

In fact, since Timor-Leste's independence, China has sent approximately 4,000 of its citizens to help boost Timor-Leste's economy post-independence. It is evident that by 2019, there were 300 to 400 companies established by Chinese nationals. Moreover, nearly all the shops in Timor Plaza, a major mall in Timor-Leste, are owned by Chinese nationals. This indicates Timor-Leste's continued reliance on foreign investment. Timor-Leste has still not succeeded in stimulating its own industries. The absence or minimal presence of industries has led to new graduates, who are ready to enter the workforce, being unable to find suitable employment opportunities matching their competencies due to the lack of growing industries.

In Timor-Leste's flagship industry, the oil and gas sector, its business partner, Woodside Petroleum, has cited the lack of infrastructure and skilled human resources in Timor-Leste, as well as technical challenges in carrying out the Greater Sunrise development project. It can be said that the Timor-Leste government was late in realizing and investing in oil funds, leading to an economic stagnation and difficulties in resolving existing problems.

Obstacles

Throughout its journey since independence until now, Timor-Leste has never managed to break free from its dependence on oil revenue. As discussed earlier, over time, Timor-Leste has consistently relied on oil funds, with more than 80% of its national budget coming from oil revenue. The Timor-Leste government is not unaware that oil funds cannot be used excessively; it planned to only use the interest from the oil fund to finance governmental activities. However, in reality, 80-90% of Timor-Leste's economy is supported by oil revenue, making it one of the most oil-dependent countries (Kingsbury, 2017).

The ambitious infrastructure development projects have also become a hindrance. Initially, the Timor-Leste government aimed to provide electricity access to 80% of the total area of Timor-Leste, supplemented by repairing and rebuilding damaged roads. Thanks to these infrastructure development projects, government spending quickly doubled from the safe and sustainable withdrawal threshold of oil funds.

These projects were also plagued by corruption issues. Initially, the Timor-Leste government introduced a "selective tender" process to address the emergency challenges faced in the infrastructure development process. Under this process, any contractor meeting the government's criteria would automatically be awarded the contract, eliminating competition among contractors. Unfortunately, this practice became the norm in government tender processes, resulting in increased government spending. Without competitive bidding and price proposals, qualified contractors, even if they submitted excessively high bids, still secured contracts.

Currently, the Timor-Leste government is pinning high hopes on the development of the Greater Sunrise liquefied natural gas (LNG) field in the Timor Sea as the backbone of the country's future economy. However, most of the Greater Sunrise oil fields are located outside the existing oil development area, posing a unique challenge for Timor-Leste in preparing new oil refinery infrastructure.

In addition, the Timor-Leste government is also facing demands regarding the dispute over the management of the Greater Sunrise oil refinery with Australia. Previously, Australia and Timor-Leste had agreed to fairly and evenly divide the proceeds from the Greater Sunrise oil refinery. However, Timor-Leste has already initiated arbitration proceedings over the oil refinery in the Timor Sea, and the case is currently underway in the Permanent Court of Arbitration. Timor-Leste hopes that the court ruling will establish the same boundaries between Australia and Timor-Leste.

If the arbitration court ruling favors Timor-Leste and the lateral boundaries are adjusted in accordance with the UN Convention on the Law of the Sea, then Timor-Leste will gain full control over the Greater Sunrise oil refinery.

Although Timor-Leste may eventually gain full control over the Greater Sunrise oil refinery, it will face another set of challenges. This is because Timor-Leste's primary business partner in the development of the Greater Sunrise oil refinery, Woodside Petroleum, has expressed its disinterest in meeting Timor-Leste's requirement to conduct LNG processing on the southern coast of Timor-Leste. Woodside Petroleum prefers floating LNG processing from the Greater Sunrise oil refinery, rather than onshore processing on the southern coast of Timor-Leste. Timor-Leste does not want the floating option, even though it may be more feasible and cost-effective as the infrastructure is already available, thus saving development costs, because the existing floating infrastructure is owned by Australia and is no longer in use. If this option is pursued, Timor-Leste would need to compromise with Australia again, which would reduce the amount of revenue Timor-Leste would receive. However, Timor-Leste's preferred option is not feasible due to the high initial investment costs. Even if Timor-Leste finds a business partner willing to accommodate its preferences, it is estimated that Timor-Leste will not see profits for the next six to seven years (Kingsbury, 2017).

The rush of Timor-Leste in managing the Greater Sunrise oil refinery, including its ambitious management, is not without reason. Currently, Timor-Leste is facing a "fiscal cliff" because the public financial management of Timor-Leste in managing oil funds is not good, causing these funds to be depleted by 2034 (Kingsbury, 2023).

CONCLUSION AND RECOMMENDATION

Since Timor-Leste gained independence, it has faced various challenges in public financial management. As a newly independent nation, Timor-Leste has many needs that its national budget cannot yet fully meet. Fortunately, Timor-Leste is endowed with an oil refinery capable of supporting its economy. However, managing oil funds requires good public financial management because oil funds are not perpetual and require prudent management.

Managing oil funds needs to be carefully planned to avoid exceeding its sustainable threshold. Additionally, the extracted oil funds should be used for productive purposes rather than being depleted unnecessarily. However, since its independence, the Timor-Leste government has relied heavily on oil funds as the main source of funding for its national budget, with over 80% of the APBN's funding coming from oil funds.

Xanana Gusmao, the Prime Minister of Timor-Leste, is striving to address the fiscal crisis. Timor-Leste is facing issues related to its oil funds, which have been the backbone of its economy but are projected to run out by 2034 given the current expenditure rate. Amidst the increasingly uncontrollable economic difficulties, PM Xanana Gusmao has taken steps to reduce government spending while also seeking foreign investors, including strategic partnerships with China and Indonesia. However, the country's future remains uncertain due to struggles with public financial management over the past two decades. Therefore, Timor-Leste is urged to seek new sources of funding because once the oil funds are depleted, its economy could be disrupted.

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