

## BRIEFING NOTE

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## Contracts, Land Tenure and Rural Development in Timor-Leste

■ By Rod Nixon\*

## Introduction

As in other societies in Southeast Asia and the Pacific, customary social organization features strongly in rural Timor-Leste. As well as providing avenues for conflict resolution, the influence of customary systems extends to land tenure. As the state, development partners, private investors, NGOs and others seek to promote rural development in Timor-Leste, they will be forced to engage in some way with customary ownership and use claims which prevail in the districts. A further dimension of the subsistence nature of the Timor-Leste economy is the fact that the use of contracts in connection with agribusiness transactions is rare. This presents a further challenge to the objective of increasing private sector investment in the rural economy. Based on field visits, this Justice for the Poor (J4P) briefing note looks at the rural economy of Timor-Leste and considers approaches that could help promote productive and equitable relationships between communities and other rural development partners and contribute to mutually beneficial rural development outcomes.

## Rural Development and Employment

Timor-Leste joined the international community seven years ago as the 'poorest country in Asia'.<sup>1</sup> Although now in receipt of petroleum income, Timor-Leste is a post-conflict state with a mostly subsistence population and severe infrastructural challenges. It is also experiencing demographic trends placing stress on the country's economy, political processes and farming systems.<sup>2</sup> The government has identified rural development and job creation as a critical area, and this has been reflected in the 2009 rural development conference and preparation of the draft National Employment Strategy Paper.

The latter paper notes the difficulties posed by the nexus between demographic growth and the infrastructural, institutional and technological limitations of the rural economy, and describes economic conditions in Timor-Leste as characterised by 'small markets, high costs, low skills base, poor physical infrastructure and incomplete legal institutions'.<sup>3</sup>

Encouragingly, increased public expenditure since 2006–2007 has contributed to higher economic growth, with mid-2009 International Monetary Fund (IMF) data indicating that 'in per capita terms, real non-oil GDP has expanded by more than 14 percent over the last two years.' However, the IMF warns that 'private investment in the non-oil sector...remains at very low levels, complicating the prospects for broad-based growth'.<sup>4</sup>

## Historical Factors

Rural development challenges in Timor-Leste are linked to the minimal transformation of the subsistence economy of the territory during the Portuguese and Indonesian periods. This is reflected in figures indicating that at the very end of the Indonesian period, the Province of Timor Timor was the least urbanised of all Indonesian provinces, with only 10% of the population urbanised.<sup>5</sup> Furthermore, with 414 of its 442 villages considered underdeveloped in 1995, the territory was considered among the least developed regions.<sup>6</sup> The unsustainable harvesting of Sandalwood is a well-know fea-

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<sup>1</sup> 'East Timor is the Poorest Country in Asia'. UNDP press release dated 13 May 2002 (<http://www.undp.east-timor.org/links%20for%20nhdr/main%20release%20long.pdf>).

<sup>2</sup> See R.A. Bulatao, *Policy Note on Population Growth and its Implications in Timor-Leste*. 2008, World Bank: Washington. Based on 2004 Census data, Bulatao refers (pp. 5, 16–17) to a 'main' scenario in which the estimated mid-2005 population of 994,500 may increase to 1,780,000 by 2025, resulting in a crude population density of 120 people per square km. Other scenarios predict higher levels of population growth.

<sup>3</sup> Draft Timor-Leste National Employment Strategy Paper (p. 6). Rural development bottlenecks referred to (p. 9) include the limited skills of farmers and the difficulty of accessing credit, markets and modern cultivation and processing supplies and technologies (from fertilizers and irrigation systems to processing equipment).

<sup>4</sup> IMF, Timor-Leste, 'Staff Report for the 2009 Article IV Consultation', 8 July, 2009 (pp. 4–5).

<sup>5</sup> Ministry of Health Republic Indonesia, *Indonesia: Health Profile 1999*, 2000, Jakarta, p. 11, Figure II.A.3. The province with the second lowest rate of urbanisation was Lampung (Southern Sumatra) with 16.8%.

<sup>6</sup> *Op. cit.*, p. 17, Figure II.B.3.



ture of the colonial period, and while the Portuguese sought to establish a coffee industry in the late 19th Century, only an estimated 48,000 hectares (approximately 3% of the land area) was ever planted with coffee. Modern plantations appear to have contributed less than 45% of production, even in the final years of colonial administration.<sup>7</sup>

Although some areas of primary industry (notably teak) expanded in Indonesian times, many coffee leases had been abandoned by the end of the Portuguese period<sup>8</sup> and the industry was strictly controlled during the Indonesian occupation by the military company P.T. Salazar, which paid those who harvested the crops a fraction of the value of the produce. The limited extent to which pruning and replanting occurred during these decades is only now being addressed by donors. As discussed below, however, there remains little private sector investment in the rehabilitation of coffee plantation or in other areas of the primary industry sector.

## Doing Agribusiness in Rural Timor-Leste

Recent J4P field visits highlight the extent to which the rural Timor-Leste business culture remains bound to the largely unmodernised rural economy. Not only is the struggling post-subsistence sector burdened by poor infrastructure, low levels of technology and a limited market, but there is as yet little familiarity with institutional arrangements commonly associated with more advanced agriculture. Based on interviews with over 20 domestic agribusiness actors in the districts of Aileu, Baucau, Dili, Ermera, Manatuto, Liquiça and Manufahi,<sup>9</sup> some characteristic features of the rural economy can be identified.

Firstly, it is clear that neither the leasing of land nor the use of contracts play much role in agribusiness in Timor-Leste, since transactions are typically negotiated between producers and buyers at the time of sale. Personal relationships, meanwhile, are an important (but not decisive) element. A farmer, for example, may travel to a district centre, possibly with as little as several kilograms of a cash crop (coffee, candle nut, peanuts, maize, mungbean, green bean or copra) and offer the produce to a locally based buyer. Often the producer and the buyer will have a long-standing personal relationship, based perhaps on marriage or *suco* of origin, that increases the likelihood of a transaction. This will not guarantee a sale, however, unless the buyer (a) meets any higher offers, and (b) has sufficient cash on hand.

Concerning the links between a district-based buyer and the broader market, the buyer may sell independently to bigger traders in Dili or Indonesia, or act as an agent for a larger Dili-based trader. If the buyer is an agent for a larger trader, he/she may expect access to interest-free loans for the purchase of equipment (typically trucks). Again, written

contracts between traders and district agents appear rare, although traders report few problems having their loans repaid. Central to some agreements between traders and their district agents is the trader's first right of purchase to the produce collected by his/her agents, a similar but significantly more formalised version of the arrangement that prevails between farmers and district-based buyers. One Dili trader explained how, after lending money to agents, he would provide updates on the prices he would pay for various commodities. In the event an agent is tempted by a higher price from a rival trader, the agent is expected to inform his Dili-based sponsor of this offer. The trader then contacts associates in Surabaya (where much Timor-Leste produce goes for processing) to determine if the higher price is realistic. If so, the trader will pay it; if not he will allow the agent to sell to the rival.

While one large Dili-based trader lends out (via agents) pulping machines in order to expedite early stages of coffee processing by villagers, almost none of the private-sector agents visited have invested directly in the modernisation of agriculture by leasing and improving land or engaging in contract farming activities in which investors provide farmers with key components of intensified agriculture (for example, seeds, fertilizers, training) in return for the right to purchase the crop at an agreed price. This suggests that developments in the areas of leasing customary land and registering contractual agreements are necessary if the Government of Timor-Leste (GoTL) is to realise its goal of increasing private investment in the rural economy and expanding export-oriented production.<sup>10</sup>

To be fair, infrastructural challenges have discouraged both farmers and investors from committing to post-subsistence agriculture, and one buyer in Manufahi referred to the risks, until recently, of trucking produce to market, especially in the wet. Given road conditions, a misjudgement about when to transport produce could result not only in a stalled

<sup>7</sup> The Timor-Leste coffee industry has traditionally been smallholder-dominated. See W.G. Clarence Smith, 'Planters and Smallholders in Portuguese Timor in the Nineteenth and Twentieth Centuries', 1992 ([www.gov.east-timor.org/MAFF/ta000/TA051.pdf](http://www.gov.east-timor.org/MAFF/ta000/TA051.pdf)), and M.H. Soesastro, 'East Timor: Questions of Economic Viability', in *Unity and Diversity: Regional Economic Development in Indonesia Since 1970* (ed. H. Hill), 1989, pp. 207–229. Oxford: Singapore.

<sup>8</sup> See R. Nixon: (1) 'Challenges for Managing State Agricultural Land and Promoting Post-subsistence Primary Industry Development in East Timor', in *Crisis in Timor-Leste: Understanding the Past, Imagining the Future* (ed. D. Shoensmith), 2007, pp. 101–115, CDU Press: Darwin; (2) *Non-customary Primary Industry Land Survey: Landholdings and Management Considerations*, USAID/ARD Inc. research report, 2005 ([http://pdf.dec.org/pdf\\_docs/PNADE790.pdf](http://pdf.dec.org/pdf_docs/PNADE790.pdf)).

<sup>9</sup> A total of 50 domestic agribusiness operators were identified using the Peace Dividend Trust Timor-Leste business database ([www.buildingmarkets.org](http://www.buildingmarkets.org)). Some of these businesses, upon closer investigation, were not active in the sector. Others have yet to be interviewed.

<sup>10</sup> These objectives were referred to by Cipriana da Costa from the Ministry of Agriculture and Fisheries (MAF) at the Ministry of Economy and Development (MED) conference on Sustainable Rural Development for Poverty Reduction (27–28 March 2009).

transaction, but also the ‘dead’ fuel costs associated with an unsuccessful attempt at accessing the market.<sup>11</sup>

Regardless of the reasons for existing approaches, the prevailing business culture has presented difficulties to large buyers, including GoTL agencies, which have engaged in contract farming arrangements. In 2006, when the Ministry of Agriculture and Fisheries (MAF) contracted Viqueque farmers to produce mungbean at 35 cents/kilo, farmers sold part of the crop to a rival buyer at 40 cents/kilo, notwithstanding the inputs (including seeds and training) provided by MAF. In this case, MAF was eventually able to purchase the remainder of the crop for the agreed price.<sup>12</sup>

Despite the challenges, opportunities for Timor-Leste agribusiness actors appear to have improved markedly since independence. Some entrepreneurs who formerly sold only to Dili-based merchants have taken advantage of the 1999 exodus of Indonesian businesses, and now export directly to Indonesia. Although there is a question about the extent to which some traders are contributing to expanded production or, as seems more likely, merely competing with one another for a share of the harvest, others aim to climb the value chain and improve the quality, level of value-adding and marketability of local produce.<sup>13</sup> These businesses include the Baucau-based Acelda organic candle-nut oil enterprise, which although the beneficiary of support from international organisations<sup>14</sup> remains a locally-owned business and an example of the benefits of niche approaches tapping into the expanding organic market.<sup>15</sup> Acelda is one of a number of examples (others involve coffee) where businesses have sponsored the organic certification of agricultural land belonging to communities. Interestingly, this process appears to bond investors and farmers in a mutually beneficial relationship requiring neither contracts nor leases. Simply, the premium which businesses can pay for produce from areas for which they have arranged organic certification means that farmers sell to them out of self interest.<sup>16</sup>

In other new initiatives, farmers experimenting in Natabora with agricultural cooperatives are adamant that the cooperative approach is improving labour efficiency and yielding improved rice harvests.<sup>17</sup> Some traders, meanwhile, speak of introducing improved varieties of commercial species. And yet, in the present contractual and land-tenure environment, there is concern among these potential investors about whether they will gain additional return from distributing improved varieties to farmers who have no reciprocal obligations to them.

## Promoting Rural Development Partnerships

Although the forward thinking of some Timor-Leste agribusiness actors is encouraging, the absence of protocols for

leasing land and observing contracts is likely to constrain the expansion of agribusiness.

### Land

Whereas the GoTL, with USAID support, is addressing the critical area of property rights in urban and peri-urban areas through the *Ita Nia Rai* program, this initiative will not cover the vast amount of the country over which customary systems of authority predominate. According to 2005 survey data, only about 3% of rural land in Timor-Leste appears to have been alienated from customary tenure.<sup>18</sup> Developments in other countries with similar land tenure patterns suggest that state-managed negotiation frameworks for accessing land for development can play a role in both facilitating economic development and reducing the risk of land conflict.<sup>19</sup>

Timor-Leste doesn't have the vast tracts of agricultural land that attract investors elsewhere, but the nation is still likely to become of increasing interest to businesses wanting to invest in such areas as tourism, petroleum infrastructure and primary industry. Cases to date, including the 12 hectare East Petroleum site in Liquiça<sup>20</sup> and the 2008 Memorandum of Understanding between the GoTL and GTLeste Biotech concerning a renewable 50 year lease for 100,000 hectares ‘of unproductive land’<sup>21</sup> suggest that transparent process guiding negotiations between investors

<sup>11</sup> Not surprisingly, some regional buyers indicate that the amount of produce sourced from outlying sub-districts could increase significantly as roads improve.

<sup>12</sup> Interview with MAF Director of Agribusiness, Adelino Durego, 4 March 2009.

<sup>13</sup> Some traders support the introduction of an exports standards organisation as a way of improving the quality of Timor-Leste crops.

<sup>14</sup> These include the University of Hawaii and GTZ.

<sup>15</sup> See M.J. Luzius, ‘Agricultural Firm Export Strategies in Fiji’, *Pacific Economic Bulletin*, Vol.21, No.2., 2006, pp.162-168. Data from the International Federation of Organic Agriculture (*The World of Organic Agriculture: Statistics & Emerging Trends 2008*) places global sales in 2006 at US\$38.6 billion (twice the 2000 figure).

<sup>17</sup> The MED initiated a number of agricultural cooperatives in 2008.

<sup>18</sup> Approximately 47,000 hectares (see Nixon, *op. cit.*).

<sup>19</sup> In PNG and Vanuatu, the improvement of land access negotiation frameworks is ongoing. In PNG the ‘lease lease-back’ system has recently been complemented by legislation facilitating voluntary land registration, following the preparation of the *Review of Incorporated Land Groups and Design of a System of Voluntary Customary Land Registration* by the PNG Constitutional & Law Reform Commission (2007/2008). For an analysis of developments in Vanuatu see M. Stefanova, ‘The Price of Tourism: Land Alienation in Vanuatu’, J4P Briefing Note Vol. 2, Issue 1, Jan. 2008. More broadly, the International Food Policy Research Institute (IFPRI) is promoting a ‘code of conduct for foreign land acquisitions’ featuring principles relating to: transparent negotiations with landowners; respect for customary ownership rights; benefit-sharing; environmental aspects, and; food security (J. von Braun and R. Meinzen-Dick, ‘Land Grabbing’ by Foreign Investors in Developing Countries: Risks and Opportunities.’ IFPRI Policy Brief No. 13, April 2009). Reportedly, the African Union is considering such a code of conduct (‘Outsourcing’s Third Wave’, *Economist*, 23 May 2009, pp. 55–57).

<sup>20</sup> Locals claiming to be landowners (in possession of a letter to this effect signed by the District Administrator, Sub-district Administrator and *Chefe de Suco*) have indicated concern about the process by which this site was leased to East Petroleum by the GoTL.

<sup>21</sup> See <http://www.laohamutuk.org/Agri/08Agrofuels.htm#sugarcane>

and communities, and facilitating the voluntary registration of areas of community land as appropriate, will assist the development of productive and equitable partnerships and help avoid conflict.

The case of a lease issued by the GoTL to Timor Global in 2005 for 3000 hectares of coffee plantation at Fatubesi (Ermera district) demonstrates the advantages of a land access negotiation framework.<sup>22</sup> Although formally state land, Timor Global discovered that the lease provided an insufficient basis for the company to commence crop improvement and management activities. Before the company could begin work, it had to negotiate with community leaders and agree to provide benefits including employment opportunities and security arrangements. Timor Global has now commenced work on a 60 hectare section and employs around 80 members of the local community (including 30 said to have connections to the resistance movement). The company planned to manage the harvest of the site, for the first time, in 2009.

### Contracts

Based on the Fatubesi experience, Timor Global, perhaps the largest agribusiness investor in Timor-Leste, has incorporated a community relations approach into new operations. In Baucau district, for example, the company has leased 1,500 hectares of community land<sup>23</sup> and is introducing intensive cultivation methods on sites in three *sucos* totalling up to 100 hectares. The company is presently using a share-farming approach<sup>24</sup> which it hopes will assist movement towards contract farming in future years. As discussed in this note, the introduction of contract farming in Timor-Leste is likely to present challenges in view of the more flexible arrangements commonly prevailing between producers and buyers.

### What is J4P?

Justice for the Poor (J4P) is a global research and development program aimed at informing, designing and supporting pro-poor approaches to justice reform. It is an approach to justice reform which:

- Sees justice from the perspective of the poor/marginalized
- Is grounded in social and cultural contexts
- Recognizes the importance of demand in building equitable justice systems
- Understands justice as a cross-sectoral issue

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Although formal legal institutions can play a role in the development of contract farming arrangements, international experience suggests that sponsors and producers rarely take each other to court.<sup>25</sup> Still, the preparation of written contracts is encouraged as a means of clarifying the responsibilities of each party and identifying mechanisms for dispute resolution. Contract farming forums with industry and (to a lesser extent) government representation have proved useful in advancing contract farming outcomes elsewhere and there are models which could inform the development of a contract farming body in Timor-Leste.<sup>26</sup> There may be merit in the establishment of a registry in which contracts between producers and buyers can be filed.

### Conclusion

As the government of a largely subsistence economy with an expanding population, the GoTL's rural development focus is an important step in meeting Timor-Leste's future development challenges. In these circumstances, approaches aimed at increasing the productivity of existing crops through agricultural training programs and machinery and the introduction of disease-resistant and high-yield varieties are an essential measure. Nevertheless, the private sector can also make a major contribution to spreading more intensive agricultural technologies to communities, at the same time providing employment opportunities and contributing to export earnings.

While rural development investment has been limited to date, modernisation can be expected in some sectors. Where this occurs, the potential benefits of the private sector will be more easily harnessed if investors and rural communities can be provided with a land access negotiation framework that supports the development of productive and equitable rural development partnerships and reduces the likelihood of crippling land disputes. Similarly, the establishment of a body providing guidance for the development of contract farming agreements and provision for the registration of these agreements could play a role in increasing the confidence of potential agribusiness investors.

<sup>22</sup> Based on discussions with Bill Tan Tjo Kek and Bobby Lay Ming on 23 June 2009. According to these informants the agreement (for a 50 year renewable lease) was signed in 2005 and the lease issued in 2007.

<sup>23</sup> Although Timor Global has leased the land from the community, the right of *suco* communities to lease land to investors is not yet clear.

<sup>24</sup> Featuring written contracts.

<sup>25</sup> M. Doria, 'Contract framing: Legal Considerations on Contractual Design and Enforcement', FAO brief (no date) available at [http://www.fao.org/ag/ags/contract-farming/toolkit/briefs-list/en/?no\\_cache=1](http://www.fao.org/ag/ags/contract-farming/toolkit/briefs-list/en/?no_cache=1)

<sup>26</sup> C.S. Eaton and A.W. Shepherd. *Contract Farming: Partnerships for Growth, a Guide*, 2001, FAO: Rome. Note that Eaton & Shepherd (pp. 60–61) warn against the 'participation of political nominees in such bodies'.