

Between Global Economic Shocks and Institutional Capacity: Explaining Fiscal Resilience in Timor-Leste

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Abstract

Timor-Leste faces significant fiscal challenges arising from its heavy dependence on petroleum revenues, exposure to global economic shocks, and the need to strengthen institutional capacity in the post-conflict development period. This study examines the effects of global economic dynamics and institutional capacity on fiscal resilience in Timor-Leste. A quantitative cross-sectional research design was employed using a structured Likert-scale questionnaire administered to 200 academics selected through stratified random sampling from accredited universities in Timor-Leste. The data were analysed using Partial Least Squares Structural Equation Modelling (PLS-SEM) with SmartPLS 4.0. The measurement model demonstrated satisfactory reliability and validity, while the structural model exhibited strong explanatory power ($R^2 = 0.705$). The findings reveal that global economic dynamics have a significant negative effect on fiscal resilience ($\beta = -0.715$, $p < 0.001$), whereas institutional capacity has a significant positive effect on fiscal resilience ($\beta = 0.459$, $p < 0.001$). Together, both variables explain approximately 70.5% of the variance in fiscal resilience, indicating that external economic conditions and institutional quality are key determinants of fiscal sustainability in Timor-Leste. These findings highlight the importance of reducing dependence on petroleum revenues while strengthening public financial management, governance quality, and institutional effectiveness to enhance fiscal resilience. The study contributes to the literature on fiscal resilience in resource-dependent small states and provides evidence to support policy reforms aimed at improving long-term fiscal sustainability.

INTRODUCTION

The relationship between natural resource wealth and long-term fiscal sustainability remains one of the most important issues in development economics. Countries endowed with abundant natural resources often experience a paradox in which substantial resource revenues coexist with persistent fiscal vulnerability and slow economic (Sachs et al., 1995). Institutional quality has also been identified as a crucial determinant of whether resource wealth contributes to sustainable economic development or reinforces long-term dependence on extractive industries (Acemoglu & Robinson, 2012). These challenges are particularly evident among Small Island Developing States (SIDS), which are characterized by narrow production structures, limited domestic markets, and high exposure to external economic shocks (Briguglio, 2016). Such structural conditions increase their susceptibility to fluctuations in global commodity prices and international financial markets (Lim & Moreno, 2021).

Timor-Leste represents one of the most distinctive examples of these structural vulnerabilities. Since achieving independence in 2002, the country's economy has relied heavily on petroleum revenues, which have historically contributed more than 70% of total government

revenue (IMF, 2023). At the same time, the Petroleum Fund, valued at approximately USD 19 billion at the end of 2022, has been subject to withdrawals exceeding the Estimated Sustainable Income (ESI), raising growing concerns regarding long-term fiscal sustainability (La'o Hamutuk, 2022). Although petroleum revenues have supported public expenditure and economic reconstruction, non-oil economic growth has remained relatively modest, leaving the country highly dependent on a single commodity whose price is determined by global market conditions (World Bank, 2022).

Recent studies have highlighted the importance of fiscal resilience in resource-dependent economies. Fiscal resilience is increasingly viewed as a government's capacity to withstand external economic disturbances while maintaining fiscal sustainability (Collier et al., 2010). Research has also emphasized the importance of institutional quality, including effective public financial management, accountable governance, and efficient revenue administration, in strengthening fiscal performance under conditions of uncertainty (North, 1990). In the context of Small Island Developing States, institutional effectiveness has been recognized as a key factor in reducing vulnerability to commodity price volatility and external economic shocks (Lim & Moreno, 2021). Meanwhile, previous studies focusing on Timor-Leste have primarily examined Petroleum Fund governance, fiscal policy, and economic development from descriptive or policy-oriented perspectives (Drysdale, 2007). Other studies have discussed public expenditure management and development challenges without empirically examining the structural relationships among global economic dynamics, institutional capacity, and fiscal resilience (Wright et al., 2011). Likewise, broader analyses of economic transformation have concentrated on development policy rather than quantitatively evaluating fiscal resilience (Coxhead, 2014).

Despite these contributions, several important research gaps remain. First, empirical studies simultaneously examining the influence of global economic dynamics and institutional capacity on fiscal resilience in Timor-Leste remain scarce. Second, limited research has incorporated recent economic events, including the post-2016 oil price decline, the COVID-19 pandemic, and global inflationary pressures, into an integrated analytical framework. Third, perception-based evidence obtained from academics with expertise in economics, public finance, and governance has rarely been employed to evaluate fiscal resilience using advanced multivariate approaches such as Partial Least Squares Structural Equation Modelling (PLS-SEM).

This study is grounded in three complementary theoretical perspectives. Dutch Disease Theory explains that excessive dependence on natural resource exports may weaken other productive sectors and increase fiscal vulnerability through structural economic distortions (Corden & Neary, 1982). New Institutional Economics argues that institutional quality including governance, public financial management, accountability, and regulatory effectiveness determines how efficiently public resources are managed and how governments respond to external economic shocks (North, 1990). In addition, Fiscal Sustainability Theory emphasizes that governments must maintain the capacity to finance public expenditure and absorb economic disturbances without compromising long-term fiscal stability (Blanchard, 1990). Together, these theoretical perspectives suggest that global economic dynamics may reduce fiscal resilience, whereas stronger institutional capacity contributes positively to maintaining sustainable fiscal performance.

Based on these research gaps and theoretical considerations, this study aims to examine the influence of global economic dynamics and institutional capacity on fiscal resilience in Timor-Leste using Partial Least Squares Structural Equation Modelling (PLS-SEM). Specifically, this study tests the negative effect of global economic dynamics on fiscal resilience and the positive effect of

institutional capacity on fiscal resilience. The novelty of this research lies in integrating Dutch Disease Theory, New Institutional Economics, and Fiscal Sustainability Theory within a single empirical framework while introducing the concept of institutional fiscal buffer capacity as a perspective for explaining fiscal resilience in a resource-dependent Small Island Developing State. The findings are expected to contribute to the development of fiscal resilience literature and provide evidence-based policy recommendations for strengthening long-term fiscal sustainability in Timor-Leste.

METHODS

This study employed a quantitative research approach using a cross-sectional survey design to examine the relationships between global economic dynamics, institutional capacity, and fiscal resilience in Timor-Leste. A quantitative approach was selected because it enables objective measurement of latent constructs and statistical examination of the proposed relationships among variables. The cross-sectional design allows all variables to be measured simultaneously at a single point in time, providing an efficient approach for analysing respondents' perceptions regarding fiscal resilience. The study adopts a post-positivist research paradigm and applies Partial Least Squares Structural Equation Modelling (PLS-SEM) using SmartPLS 4.0, which is appropriate for analysing complex relationships among multidimensional latent variables measured through perception-based indicators (Hair et al., 2019).

The target population comprised academic staff from accredited higher education institutions in Timor-Leste whose teaching or research expertise relates to economics, public finance, governance, development studies, and institutional analysis. The accessible population consisted of approximately 300 eligible academics. The minimum sample size was determined using the Slovin formula with a 5% margin of error, resulting in a minimum requirement of 172 respondents. To improve statistical precision and analytical power, questionnaires were distributed to 200 respondents selected through stratified random sampling based on institutional affiliation. All distributed questionnaires were returned and considered valid for analysis.

Primary data were collected using a structured self-administered questionnaire consisting of 30 measurement items evaluated on a five-point Likert scale ranging from 1 (strongly disagree) to 5 (strongly agree). The questionnaire operationalised three latent constructs. Global Economic Dynamics (GED) was measured through ten indicators reflecting commodity price volatility, international trade disruption, external financing conditions, changes in global demand, and financial market uncertainty. Institutional Capacity (IC) was measured using ten indicators covering public financial management quality, revenue administration, accountability, transparency, regulatory governance, and public-sector human capital. Fiscal Resilience (FR) was measured using ten indicators representing fiscal shock absorption, fiscal adjustment capability,

non-oil revenue diversification, expenditure sustainability, and long-term fiscal planning. The measurement indicators were developed from established theoretical frameworks and previous empirical studies to ensure content validity.

Before estimating the structural model, the measurement model was evaluated to assess indicator reliability, internal consistency reliability, convergent validity, and discriminant validity. Indicator reliability was examined through outer loadings, while internal consistency was assessed using Cronbach's Alpha and Composite Reliability. Convergent validity was evaluated using the Average Variance Extracted (AVE), whereas discriminant validity was assessed through the Fornell–Larcker criterion and the Heterotrait–Monotrait Ratio (HTMT). Collinearity was examined using Variance Inflation Factors (VIF), and overall model fit was assessed using the Standardized Root Mean Square Residual (SRMR) and the Normed Fit Index (NFI) (Hair et al., 2019).

The structural model was estimated using the bootstrapping procedure with 5,000 resamples to obtain standardized path coefficients, t-statistics, and p-values for hypothesis testing. Two hypotheses were examined in this study. The first hypothesis proposed that global economic dynamics have a significant negative effect on fiscal resilience, whereas the second hypothesis proposed that institutional capacity has a significant positive effect on fiscal resilience. Statistical significance was determined using a significance level of 5% ($p < 0.05$). The explanatory power of the model was evaluated using the coefficient of determination (R^2), while the magnitude of the structural relationships was interpreted based on the standardized path coefficients generated by the PLS-SEM analysis.

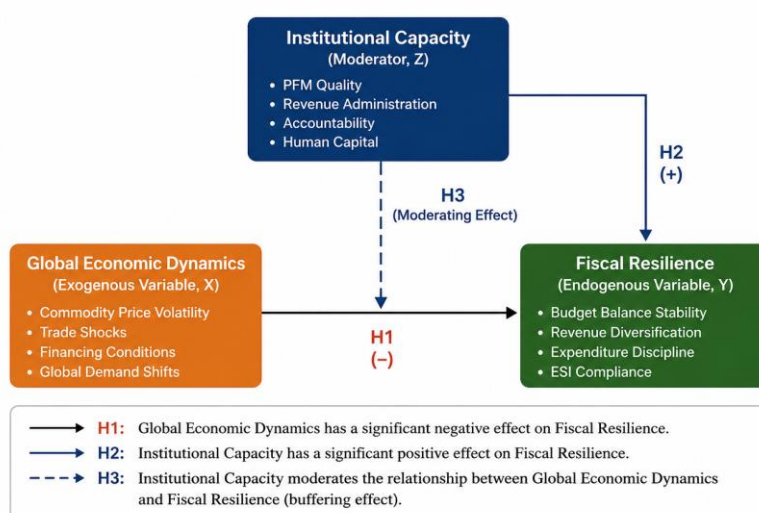


Figure 1. Conceptual Framework
The framework illustrates the hypothesized relationships among Global Economic Dynamics, Institutional Capacity, and Fiscal Resilience, including the moderating role of Institutional Capacity.

Figure 1. Proposed Research Framework

Figure 1. Conceptual Framework. The framework illustrates the hypothesized relationships among Global Economic Dynamics, Institutional Capacity, and Fiscal Resilience, including the moderating role of Institutional Capacity.

RESULTS AND DISCUSSION

RESULTS

Descriptive Statistics

Descriptive statistics were first examined to provide an overview of respondents' perceptions toward the three latent constructs. As presented in Table 1, the mean scores of all indicators ranged from 2.620 to 3.515, indicating that respondents generally expressed moderate perceptions regarding global economic dynamics, institutional capacity, and fiscal resilience in Timor-Leste. Standard deviations ranged from 0.609 to 0.823, suggesting relatively homogeneous responses across the sample. Although the Cramér-von Mises test indicated non-normal distributions ($p < .001$), this does not violate the assumptions of Partial Least Squares Structural Equation Modeling (PLS-SEM), which does not require multivariate normality.

Table 1. Descriptive Statistics

Construct	Mean Range	SD Range	Minimum	Maximum
Fiscal Resilience (FR)	3.150–3.515	0.656–0.791	1	5
Global Economic Dynamics (GED)	2.620–3.090	0.700–0.823	1	5
Institutional Capacity (IC)	2.650–3.070	0.609–0.710	1	5

Note. $N = 200$.

Measurement Model Assessment

The measurement model was evaluated through indicator reliability, convergent validity, and discriminant validity before estimating the structural model.

Indicator Reliability and Convergent Validity

All indicators demonstrated satisfactory reliability, with outer loading values exceeding the recommended threshold of .70. Fiscal Resilience indicators ranged from 0.859 to 0.890, Global Economic Dynamics ranged from 0.839 to 0.899, and Institutional Capacity ranged from 0.813 to 0.894. These findings indicate that every indicator adequately measures its corresponding latent construct.

Table 2. Outer Loadings

Indicator	FR	GED	IC
FR1	0.859	—	—
FR2	0.889	—	—
FR3	0.875	—	—
FR4	0.890	—	—
FR5	0.876	—	—
FR6	0.875	—	—
FR7	0.865	—	—
FR8	0.882	—	—
FR9	0.872	—	—
FR10	0.865	—	—
GED1	—	0.879	—
GED2	—	0.891	—
GED3	—	0.887	—
GED4	—	0.860	—
GED5	—	0.866	—

GED6	–	0.899	–
GED7	–	0.887	–
GED8	–	0.861	–
GED9	–	0.855	–
GED10	–	0.839	–
IC1	–	–	0.880
IC2	–	–	0.847
IC3	–	–	0.853
IC4	–	–	0.813
IC5	–	–	0.851
IC6	–	–	0.872
IC7	–	–	0.844
IC8	–	–	0.836
IC9	–	–	0.869
IC10	–	–	0.894

Note. All outer loadings exceed .70.

Discriminant Validity

Discriminant validity was assessed using both the Fornell-Larcker criterion and the Heterotrait-Monotrait Ratio (HTMT). The square root of the Average Variance Extracted (AVE) for each construct exceeded its correlations with other constructs. Likewise, all HTMT values remained below the recommended threshold of .85, confirming satisfactory discriminant validity.

Table 3. Discriminant Validity

Panel A. Fornell-Larcker Criterion

Construct	FR	GED	IC
FR	0.875		
GED	-0.704	0.872	
IC	0.441	0.024	0.856

Panel B. HTMT Ratio

Relationship Between Constructs	HTMT
Global Economic Dynamics and Fiscal Resilience	0.728
Institutional Capacity and Fiscal Resilience	0.457
Institutional Capacity and Global Economic Dynamics	0.050

The satisfactory discriminant validity further confirms that Global Economic Dynamics, Institutional Capacity, and Fiscal Resilience represent empirically distinct constructs. The low HTMT values indicate that each latent variable captures different theoretical dimensions, thereby reducing the possibility of construct overlap within the structural model.

Structural Model Assessment

Collinearity Assessment

The Variance Inflation Factor (VIF) values for all structural paths ranged from 1.000 to 1.001, substantially below the recommended threshold of 3.30, indicating the absence of multicollinearity.

Table 4. Inner Model Collinearity

Structural Relationship	VIF
Effect of Global Economic Dynamics on Fiscal Resilience	1.001
Effect of Global Economic Dynamics on Institutional Capacity	1.000

Effect of Institutional Capacity on Fiscal Resilience	1.001
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Model Fit

The overall model fit was evaluated using SRMR, d_ULS, d_G, Chi-square, NFI, and Bayesian Information Criterion (BIC). The SRMR value of 0.033 indicates excellent model fit because it is well below the recommended cut-off value of 0.08. Furthermore, the NFI value of 0.933 exceeds the recommended threshold of 0.90, indicating satisfactory model fit.

Table 5. Model Fit Statistics

Fit Index	Value	Recommended Value
SRMR	0.033	<0.08
d_ULS	0.501	Lower is better
d_G	0.393	Lower is better
Chi-square	428.009	Descriptive
NFI	0.933	>0.90

Table 6. Model Selection Criterion

Endogenous Construct	BIC
Fiscal Resilience	-229.511
Institutional Capacity	9.475

Hypothesis Testing

Hypothesis testing was performed using bootstrapping with 5,000 resamples. As shown in Table 7, Global Economic Dynamics has a significant negative effect on Fiscal Resilience ($\beta = -0.715$, $t = 19.505$, $p < .001$), supporting H1. Institutional Capacity has a significant positive effect on Fiscal Resilience ($\beta = 0.459$, $t = 9.382$, $p < .001$), supporting H2. However, the relationship between Global Economic Dynamics and Institutional Capacity is not statistically significant ($\beta = 0.024$, $t = 0.333$, $p = .739$).

Table 7. Structural Model Results

Hypothesis	Structural Relationship	β	t	p	Decision
H1	Effect of Global Economic Dynamics on Fiscal Resilience	-0.715	19.505	<0.001	Supported
H2	Effect of Institutional Capacity on Fiscal Resilience	0.459	9.382	<0.001	Supported
Control	Effect of Global Economic Dynamics on Institutional Capacity	0.024	0.333	0.739	Not Supported

The structural model explains 70.5% of the variance in Fiscal Resilience ($R^2 = .705$), indicating substantial explanatory power. Meanwhile, the coefficient of determination for Institutional Capacity was negligible ($R^2 = .001$), confirming that Global Economic Dynamics does not meaningfully explain variations in Institutional Capacity.

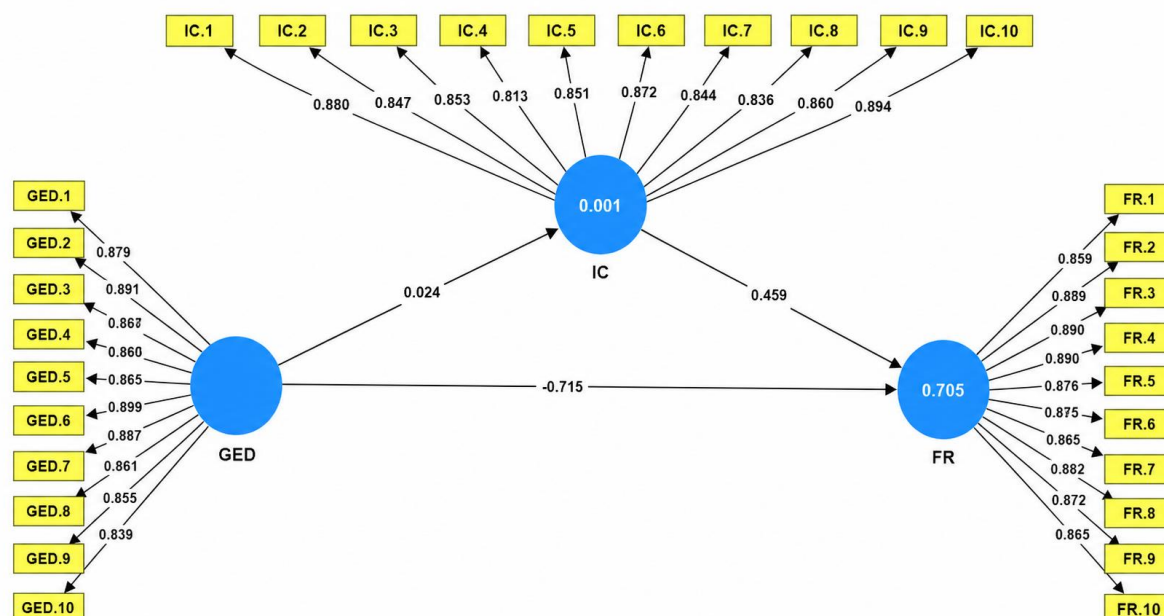


Figure 2. PLS-SEM Structural Model Results

Figure 2. PLS-SEM Structural Model Results. Estimated path coefficients and coefficient of determination (R^2) for the proposed model.

DISCUSSION

The Effect of Global Economic Dynamics on Fiscal Resilience

The empirical findings demonstrate that Global Economic Dynamics exert a significant negative effect on Fiscal Resilience in Timor-Leste ($\beta = -0.715$, $t = 19.505$, $p < .001$). This result confirms Hypothesis 1 and indicates that greater exposure to external economic shocks reduces the country's fiscal resilience. The magnitude of the standardized coefficient also suggests that global economic conditions represent the strongest determinant of fiscal resilience in the proposed structural model.

This finding is consistent with Dutch Disease Theory, which argues that excessive dependence on natural resource revenues increases a country's vulnerability to external commodity price fluctuations and international market instability (Corden & Neary, 1982). Timor-Leste remains highly dependent on petroleum revenues, making government finances particularly sensitive to changes in global oil prices and international economic conditions. Consequently, external shocks directly affect government revenue, fiscal planning, and the sustainability of public expenditure.

The findings also support the Resource Curse perspective proposed by Sachs and Warner (1995), which suggests that economies relying heavily on natural resources tend to experience greater fiscal instability than more diversified economies. Similar conclusions have been reported by Briguglio (2016), who emphasized that Small Island Developing States (SIDS) are structurally exposed to external economic disturbances because of their limited economic diversification and narrow fiscal base. Therefore, strengthening economic diversification becomes an essential strategy for improving fiscal resilience in Timor-Leste.

The Effect of Institutional Capacity on Fiscal Resilience

The results further indicate that Institutional Capacity has a positive and statistically significant effect on Fiscal Resilience ($\beta = 0.459$, $t = 9.382$, $p < .001$), supporting Hypothesis 2. Although the

magnitude of this relationship is smaller than the influence of Global Economic Dynamics, the effect remains substantial, suggesting that stronger institutions enhance the government's ability to withstand fiscal shocks.

These findings are consistent with New Institutional Economics, which emphasizes that institutional quality determines the effectiveness of resource allocation, public financial management, and policy implementation (North, 1990). Well-functioning institutions improve fiscal governance through stronger budget management, more efficient revenue administration, greater transparency, and higher accountability. Such institutional improvements enable governments to respond more effectively to external economic disturbances.

For Timor-Leste, this result implies that fiscal resilience depends not only on external economic conditions but also on the government's institutional capability to formulate and implement sound fiscal policies. Strengthening public financial management systems, improving tax administration, and enhancing governance quality may therefore reduce fiscal vulnerability over the long term.

Model Predictive Power

The structural model explains 70.5% of the variance in Fiscal Resilience ($R^2 = .705$), indicating substantial explanatory power. According to Hair et al. (2022), an R^2 exceeding .50 represents a strong predictive capability in PLS-SEM applications. The results suggest that Global Economic Dynamics and Institutional Capacity jointly explain a considerable proportion of respondents' perceptions regarding fiscal resilience in Timor-Leste.

Conversely, Global Economic Dynamics do not significantly explain Institutional Capacity ($\beta = 0.024, p = .739$), as reflected by the negligible coefficient of determination ($R^2 = .001$). This finding indicates that institutional capacity in Timor-Leste is relatively independent of short-term fluctuations in the global economy and is instead shaped by domestic governance quality, administrative reforms, political commitment, and long-term regulatory development. Unlike fiscal resilience, which responds directly to external economic shocks, institutional capacity evolves gradually through sustained improvements in governance and public administration. Therefore, strengthening institutional capacity requires continuous domestic reforms rather than reliance on favorable international economic conditions.

Implications for Theory and Practice

From a theoretical perspective, this study extends the literature on fiscal resilience by integrating Dutch Disease Theory and New Institutional Economics into a single empirical model. The findings demonstrate that external economic vulnerability and institutional quality represent complementary determinants of fiscal resilience rather than competing explanations. This integrated perspective contributes to understanding fiscal sustainability in resource-dependent Small Island Developing States.

From a practical perspective, the findings highlight two major policy priorities for Timor-Leste. First, reducing dependence on petroleum revenues through economic diversification would lessen the adverse impact of global economic fluctuations. Second, strengthening institutional capacity through improvements in public financial management, revenue administration, transparency, and accountability would enhance the government's ability to maintain fiscal stability under adverse economic conditions. These complementary strategies are expected to strengthen fiscal resilience and support sustainable economic development in the post-petroleum era.

CONCLUSION

This study examined the effects of Global Economic Dynamics and Institutional Capacity on Fiscal Resilience in Timor-Leste using Partial Least Squares Structural Equation Modeling (PLS-SEM). The findings demonstrate that Global Economic Dynamics exert a significant negative effect on Fiscal Resilience, indicating that greater exposure to external economic shocks weakens the country's fiscal capacity. Conversely, Institutional Capacity has a significant positive effect on Fiscal Resilience, suggesting that improvements in public financial management, governance quality, accountability, and administrative effectiveness strengthen the government's ability to respond to fiscal challenges. Together, these findings confirm that fiscal resilience in Timor-Leste is shaped by both external economic conditions and domestic institutional quality. The structural model explains 70.5% of the variance in Fiscal Resilience, indicating substantial explanatory power.

The study contributes to the fiscal resilience literature by empirically integrating Dutch Disease Theory and New Institutional Economics within a single analytical framework. The findings provide evidence that external economic vulnerability and institutional capacity function as complementary determinants of fiscal resilience in a resource-dependent economy. These results extend existing knowledge on fiscal sustainability in Small Island Developing States by demonstrating the importance of simultaneously considering macroeconomic exposure and institutional governance.

Several limitations should be acknowledged. First, the study employed a cross-sectional design, which limits the ability to infer causal relationships over time. Second, the analysis relied on perception-based data collected from academic respondents, which may not fully capture actual fiscal performance or government policy implementation. Third, the study focused exclusively on Timor-Leste; therefore, caution should be exercised when generalizing the findings to other resource-dependent countries with different institutional and economic contexts.

Future research is encouraged to employ longitudinal data or panel approaches to examine changes in fiscal resilience over time and to incorporate objective macroeconomic and fiscal indicators alongside perception-based measures. Comparative studies involving other resource-dependent Small Island Developing States would also provide broader insights into the role of institutional capacity in strengthening fiscal resilience under varying external economic conditions. Such studies would contribute to the development of more comprehensive policy strategies for achieving long-term fiscal sustainability.

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