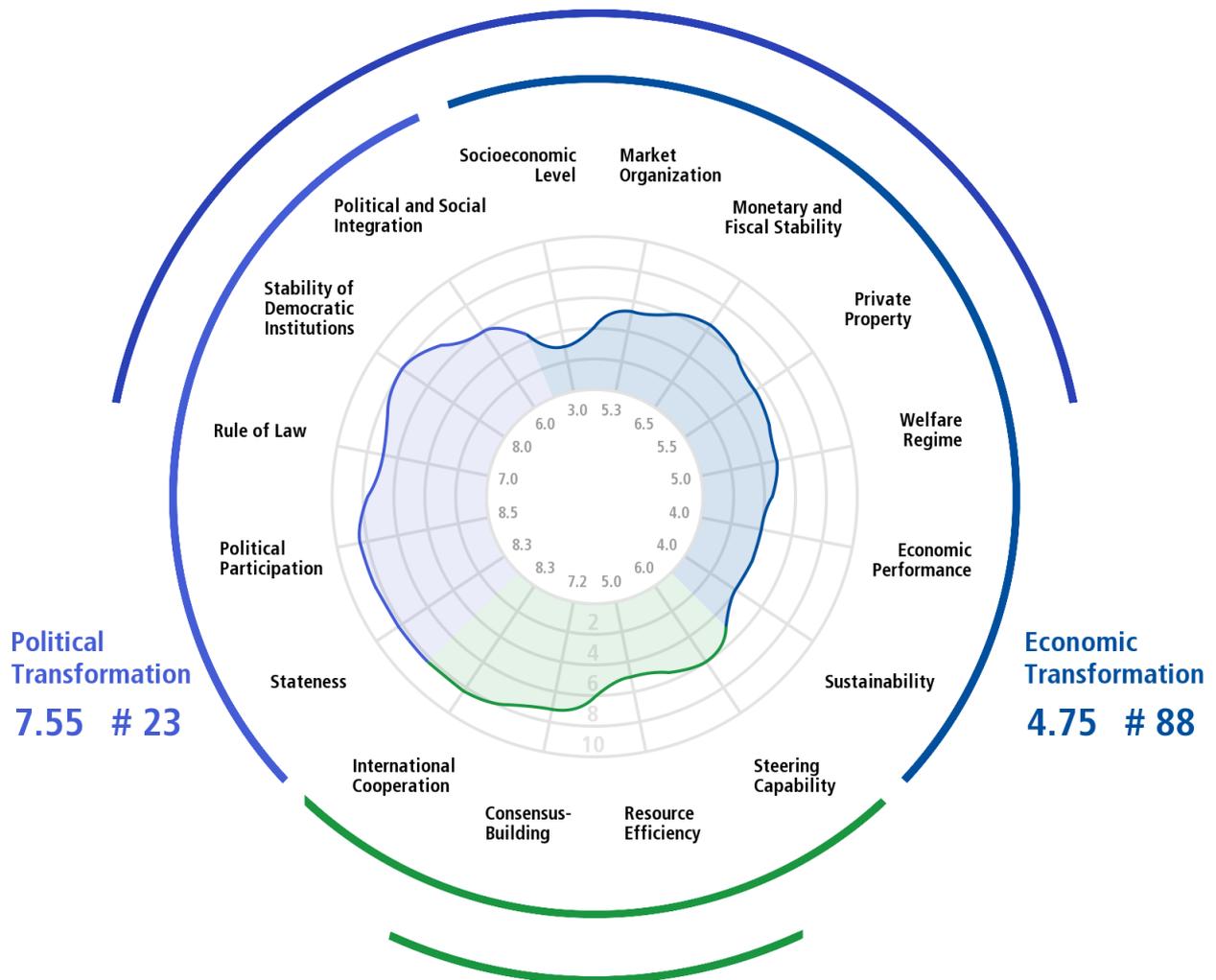


Timor-Leste

Status Index

6.15 # 52

on 1-10 scale out of 137



Political Transformation
7.55 # 23

Economic Transformation
4.75 # 88

Governance Index

5.93 # 31

on 1-10 scale out of 137

This report is part of the **Bertelsmann Stiftung's Transformation Index (BTI) 2020**. It covers the period from February 1, 2017 to January 31, 2019. The BTI assesses the transformation toward democracy and a market economy as well as the quality of governance in 137 countries. More on the BTI at <https://www.bti-project.org>.

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Key Indicators

Population	M	1.3	HDI	0.626	GDP p.c., PPP \$	7645
Pop. growth ¹	% p.a.	2.0	HDI rank of 189	131	Gini Index	28.7
Life expectancy	years	69.0	UN Education Index	0.496	Poverty ³	% 73.3
Urban population	%	30.6	Gender inequality ²	-	Aid per capita \$	186.6

Sources (as of December 2019): The World Bank, World Development Indicators 2019 | UNDP, Human Development Report 2019. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.20 a day at 2011 international prices.

Executive Summary

In the March 2017 presidential elections, voters chose FRETILIN (Frente Revolucionária de Timor-Leste Independente) chairman Francisco Guterres “Lu-Olo,” who stood with the support of CNRT (Congresso Nacional de Reconstrução Timorense) and Xanana Gusmão. Four months later, FRETILIN received a plurality in parliamentary elections. However, the majority coalition, which formed following the elections and chose former Prime Minister Mari Alkatiri as prime minister of the seventh government, collapsed after a small party – KHUNTO (Kmanek Haburas Unidade Nasional Timor Oan) – withdrew, giving the opposition enough votes to control the parliamentary agenda. The president appointed the first minority government in Timor-Leste’s history. As a result, the main parliamentary opposition, the AMP (Aliança Mudança ba Progresso), a three-party coalition led by former Prime Minister Xanana Gusmão’s CNRT, which had a majority in the parliament, claimed the right to govern. After months of partisan squabbling, the president exercised his constitutional power to call new parliamentary elections, which were held in May 2018. In the elections, the AMP won 34 out of 65 seats and subsequently appointed former President Taur Matan Ruak (head of the junior coalition partner Partidu Libertasaun Popular, PLP) as prime minister of the eighth government.

Differences between the executive and the president soon became apparent. Lu-Olo declined to swear in 11 ministerial nominees that Taur Matan Ruak had proposed for government portfolios, citing criminal charges or credible accusations of corruption. At the time of writing, most of the vacant ministerial positions had still not been filled. Therefore, key ministries (including the ministries of finance, health care and petroleum) have been led in the interim by deputy ministers or other ministers. “Cohabitation” between the president and the eighth government has been marked by intermittent tension, with the president vetoing legislation, but later signing it after reconsideration by the parliament. So far, no bill required a two-thirds majority, but the likelihood that this may happen increases the risk of a severe crisis. As of February 7, 2019, all legislation proposed by the government has been promulgated by the president, however reluctantly.

Lu-Olo, elected with 57% of the vote, was the first president strongly tied to a political party. The three previous presidents had claimed to exercise their mandate above partisan politics (although

two formed political parties when they stepped down and later became prime ministers). Although the president often has different views to the government and sometimes vetoes legislation, the state budgets for 2018 and 2019 as well as other legislation have been enacted, albeit after an initial presidential veto that was overturned by the parliament. Timor-Leste weathered this “constitutional crisis” without violence, and with all parties complying with the legal and constitutional provisions.

Constitutional provisions regarding the powers of caretaker governments prevented the parliament from considering the 2018 budget proposed by the seventh government. Furthermore, until the new eighth government and parliament enacted a 2018 budget in September 2018, the country operated under a duodecimal system, which meant that monthly government spending was capped at a 12th of the previous year’s budget. The proposed 2019 budget was passed by the parliament after a last-minute floor amendment adding a \$300 million investment in a petroleum project that was vetoed by the president. The parliament then revised the budget to remove the \$300 million and another \$350 million for the same purpose on the last day of January 2019. Following the parliament’s revision, the president promulgated the 2019 budget on February 7, 2019.

Partisan dysfunction and budgetary constraints reduced government spending during most of 2017 and 2018, and – because state spending dominates the economy – economic indicators fell. The economic slowdown has been mainly felt in the formal sector of the economy, especially in Dili. Some small- and middle-sized enterprises have gone out of business, often due to further delays in the payment of government arrears accumulated over previous years.

The Petroleum Fund, a sovereign wealth fund, ended in 2018 with \$15.8 billion, \$1 billion less than it had at the start of the year (owing to the sharp decline of stock markets worldwide, which led to a decline in the value of the fund’s investments, and substantial withdrawals).

In March 2018, Timor-Leste and Australia resolved a long-standing dispute by signing a maritime boundary treaty, which is pending ratification by both parliaments. Australia’s belated recognition of Timor-Leste’s maritime sovereignty will allow the country a larger share of offshore petroleum wealth, as well as removing an obstacle to developing the Greater Sunrise oil field that straddles the border.

In late 2018, Timor-Leste Special Representative Xanana Gusmão signed two agreements worth \$650 million to purchase 57% in the consortium that holds the right to explore the Greater Sunrise oil field. The government hopes this investment will form the cornerstone of the multi-billion-dollar Tasi Mane Project. However, the government has attempted to keep the \$650 million outside of the state budget by investing capital from the Petroleum Fund rather than the state budget in the TimorGAP national oil company. However, the new legislation, which the government enacted over a presidential veto in order to draw on the Petroleum Fund, is currently being challenged in court.

History and Characteristics of Transformation

Timor-Leste was a Portuguese colony that started its march toward self-determination in 1974 without any previous experience in anti-colonial struggle. The country declared unilateral independence from Portugal on November 28, 1975. However, Indonesia invaded 10 days later, beginning 24 years of brutal military occupation, which led to the deaths of a quarter of the population. The United Nations organized a referendum in 1999 in which 78% voted for independence; departing Indonesian troops inflicted massive devastation. After a period of transitional U.N. rule, Timor-Leste's independence was restored on May 20, 2002.

Following 1999, Timor-Leste had to recover from violence and trauma (including people displaced to Indonesia, and the near-total destruction of infrastructure and buildings), write a constitution and enact all its laws, and construct a state administration and public services almost from scratch. Having experienced war and oppression, the Timorese embraced peace, pluralism, democracy and human rights.

FRETILIN, created in 1974 to support independence, was the strongest political force, winning the first free elections in August 2001 (for the Constituent Assembly, which wrote the constitution and formed the first parliament, which nominated FRETILIN head Mari Alkatiri as the first prime minister). Resistance leader Xanana Gusmão, who had left FRETILIN in the 1980s, was elected president in April 2002 with 83% of the votes.

The constitution stipulates a semi-presidential regime, with both the president and the parliament (which chooses the prime minister) elected by direct, universal suffrage. In Timor-Leste, the prime minister is dependent both on the president and on parliament, creating a system that operates well when there is no clash between the president and the parliamentary majority.

The new government has few financial resources beyond donor support. Neither Timor-Leste's leaders nor people have ever lived under a government that even pretended to address the public interest.

In 2006, the country experienced a "crisis" with clashes between the military and police, which forced the resignation of Prime Minister Alkatiri, and resulted in around 250 deaths and displaced more than 100,000 people. Timor-Leste asked an Australia-led military force to help stabilize the situation, but it took several years and significant government compensation for victims before IDPs could return home.

Nevertheless, the 2007 elections went smoothly, with diplomatic resistance leader, non-partisan José Ramos-Horta elected president. A few months later, voters chose a new parliament, and a coalition led by CNRT, a party created by Xanana Gusmão, won a majority and named Xanana Gusmão prime minister. At the next election in 2012, CNRT retained control of the parliament but Ramos-Horta was defeated by another independent, former military commander Taur Matan

Ruak. Over the next five years, Taur Matan Ruak tried to bridge between the people and the state, visiting every village and often dissenting from the governing CNRT coalition.

From 2007, FRETILIN was the main opposition in the parliament and not much changed in 2012. However, in 2014 Xanana invited FRETILIN into a power-sharing arrangement, offering money and authority to manage the Oecusse special zone. In 2015, Xanana turned the position of prime minister to FRETILIN member Dr. Rui Maria Araujo. For the next two years, a “national unity” government prevailed, although Xanana continued to make major policy decisions.

Former military officer and speaker of parliament, attorney Francisco Guterres “Lu-Olo,” a FRETILIN leader, won the 2017 presidential election in the first round, with 57%, backed by the two main parties that supported the sitting government (FRETILIN and CNRT). The unity government ended prior to the July 2017 parliamentary elections, and once again, a sitting president (Taur Matan Ruak) created a new political party (PLP). In the parliamentary elections, FRETILIN won a plurality, but their majority coalition was short-lived, leading to functional paralysis until an early election was held in May 2018. At present, the AMP coalition of CNRT, PLP and KHUNTO controls 34 of the 65 seats in parliament and chose Taur Matan Ruak as prime minister. FRETILIN, with 23 seats and support from several smaller parties, leads a vocal parliamentary opposition, often allied with the president. This has led to serious rivalries and unexpected developments (e.g., the survival of a government without key ministers)

Timor-Leste started nationhood as the poorest country in Southeast Asia. Although some social indicators (maternal and child mortality, TB, malaria) have improved markedly from pre-independence levels, they are still among the worst in the region. Child malnutrition is one of the highest in the world and more than 40% of people live below the poverty line.

Significant income from offshore oil and gas began in 2006, and Timor-Leste’s state budget grew fourfold over the next six years, no longer relying on foreign assistance. About two-thirds of oil revenues have been saved in the Petroleum Fund. Revenue from oil (which peaked at \$3.3 billion in 2012, but dropped to less than \$0.5 billion per year between 2016 and 2018) pays for about 80% of state spending. Five years ago, Timor-Leste was one of the most petroleum-export-dependent countries. However, since 2016, returns from investments of the Petroleum Fund (which currently holds \$15.8 billion and hasn’t grown since 2014) have been greater than petroleum revenues. Most state spending is on infrastructure (national roads and electricity), with less for education, health care, water supply or agriculture (the main livelihood of two-thirds of Timorese households, with most households engaged in subsistence agriculture). Unfortunately, decisions are often afflicted by the resource curse, with little interest in preparing for the inevitable post-petroleum future.

Coffee, the only significant non-oil export, brings in about \$20 million per year. The country has an extensive informal sector. It is heavily dependent on imports, with goods imports valued at more than 25 times non-oil exports. More than half of the imports come from ASEAN (32% from Indonesia) and another 16% from China. Timor-Leste could face severe shortages when the Petroleum Fund is exhausted, which could be within a decade unless new domestic policies rapidly

sustain a diversification of economic activities away from oil-dependency, and/or new fossil fuel fields enter production.

Regional integration is decisive for economic prospects. The Timorese elite took a *realpolitik* approach and established good relations with Indonesia, although boundary negotiations have not been concluded. Relations with Australia were marked by disagreements over the maritime boundary until 2018, when they signed a treaty. In addition, Timor-Leste has applied to become a full member of ASEAN, but the process is still pending.

The global framework of the economy is amiable to market institutions. However, public spending dominates the economy, and it is subject to manipulation and, sometimes, corruption. Governments have supported the emergence of new entrepreneurial groups and a modern middle class, which is dependent on public funds, and has focused less attention on the poorer rural majority. Government policies often prioritize incentives for foreign investors over developing local productive capacity.

Timor-Leste's UNDP Human Development Index score rose as oil income rose. However, between 2010 and 2017, the country's average annual HDI growth was 0.13%, far below the 0.85% average for developing countries and the 10th lowest in the world.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 1 (worst) to 10 (best).

Transformation Status

I. Political Transformation

1 | Stateness

Since independence in 2002, stateness has been fragile in Timor-Leste. Restrictions on the state's monopoly on the use of force used to be a major source of concern. However, in the past 10 years or so, the government, with support from international actors, has been successful in establishing its monopoly on the use of force throughout the entire territory, at least in principle. Nonetheless, the state remains somewhat reliant on ongoing external support for its security sector forces, including the police and non-state actors (e.g., "martial arts groups") tend to be a potential risk. Martial arts groups are popular among the urban youth, especially in Dili and Baucau, and are subject to special legislation. In the recent past their activity has been suspended by the government due to the risks involved. However, the martial arts groups do not have or use firearms, and the targets of their actions are almost always members of their own or another martial arts group, so they pose little danger to uninvolved citizens.

In Timor-Leste, there is no pending issue relating to the acceptance of the nation-state as legitimate. There is no discrimination regarding citizenship based on ethnicity, religion or other grounds. Only a small minority of former guerrillas (CPD-RDTL and KRM) dispute the legitimacy of the "regime" claiming it ought to revert to the 1975 constitution.

The state is, by virtue of its constitution, secular. Various religions are free to express themselves and national holidays reflect the plurality of religions in the country. More than 97% of the population is Catholic and a special protocol – a Concordat – has been established with the Vatican. This agreement sustains special facilities granted to the Catholic community. Religious dogmas exert some influence on public policy (e.g., legislation on abortion). There have also been calls from some leading politicians to turn the public school system over to the Catholic Church to manage, as Catholic schools and universities generally provide better education than public ones.

Question
Score

Monopoly on the
use of force

9

'06 '20
9 10

1

State identity

10

'06 '20
10 10

1

No interference of
religious dogmas

8

'06 '20
8 10

1

Timor-Leste's people remain very poor and are still recovering from a long history of autocratic foreign rule and war. Although the state has received and spent significant money from its limited, non-renewable petroleum wealth, the results are rarely visible in rural areas (70% of the population live in rural areas).

The administrative structures of the state claim to provide basic public services throughout the country (e.g., schools, health care, roads, water, sanitation, electrical supply), but the quality of services is modest, and significant segments of the rural population cannot access clean water, sanitation, electricity or health care facilities. Even where schools or health care services exist, staffing, resources and facilities in rural areas are often inadequate.

Local governments' lack of powers and resources means that services and infrastructure in the capital, where decision-makers are located, receive more attention and resources than in rural areas.

Although some corruption exists, most of the neglect is legal.

2 | Political Participation

Since 2001, free and fair multiparty elections have been held regularly in Timor-Leste. As officials and voters gain experience, the systems have gradually improved, and voter turnout in the two hotly-contested national elections in 2017 and 2018 was higher. In the 2017 and 2018 elections, there were no reports of violence and fewer reported irregularities than in previous elections. Universal suffrage is ensured and all political parties are able to run. Political posts are filled according to the electoral results.

The political system, with members of parliament running on national party slates and with better-funded parties having advantages, may influence electoral outcomes. Members of parliament owe their seats to their party leadership, rather than to the voters in the national constituency.

Recent changes in the electoral legislation, affecting the composition of the National Electoral Commission, has slightly reduced the commission's capacity to act as an independent body because the number of members appointed by the government and its parliamentary majority has become dominant.

In Timor-Leste, democratically elected officials have the power to govern. There is no "veto player" that does not have electoral legitimacy. The government system, however, is semi-presidential, which means that power is shared between the directly elected president of the republic and the prime minister (and his cabinet), who is chosen by the parliament. The president disposes of veto powers, which can be exercised both on a political basis or when the legislation is deemed unconstitutional. Parliament may revert the presidential veto, but in some cases, it requires a two-thirds majority.

Basic administration

6

'06 _____ '20 10

6

1

Free and fair elections

9

'06 _____ '20 10

9

1

Effective power to govern

8

'06 _____ '20 10

8

1

In addition, after the 2018 elections, the leader of the largest party, former guerilla leader, president and prime minister Xanana Gusmão, declined to sit in parliament (despite having been elected) or on the Council of Ministers (for reasons that pertain to rivalry with the current president of the republic). Nevertheless, most people believe that Xanana Gusmão has significant influence over government decisions, as he possesses charisma, which may generate confusion over the workings of political institutions. With most major leaders (including the current president and prime minister, as well as Xanana) having been military officers in the guerilla resistance, hierarchical patterns and deference to the heroes of national liberation sometimes brings informal types of legitimacy to play in the institutional arena, to which all seem to adhere.

Association rights are protected by the constitution and generally observed in the country. The law on the formation of political parties was amended in 2016 in order to raise the number of subscriptions required, therefore raising the barrier to establish new parties. Still, the barrier remains low.

The government has often intervened to restrict the activities of “martial arts groups” due to their specific nature and the threat they pose to the state monopoly on the use of force.

Many NGOs exist. Although there are requirements for government registration of civil society organizations, they are not enforced in a discriminatory or restrictive manner. Therefore, civil society organizations can carry out their work without significant interference from government, although their influence over political decisions is limited.

The constitution guarantees freedom of expression and access to information. There are public and private media in the country providing for a plurality of expression, although investigative reporting is limited and media outlets often unquestioningly echo the views of prominent people.

Freedom of expression is generally accepted. However, the Penal Code article on “defamatory false information” undercuts full freedom of expression. Journalists exert self-censorship and a few cases of legal prosecution have resulted from inaccurate articles, although no journalists have been imprisoned.

A potentially restrictive “media law” requiring licensing of journalists and publications was enacted in 2014. However, its provisions, which could be used to intimidate or censor media, have not yet been enforced.

However, during the past year, there have been threats and occasional police summons in response to Facebook postings (the main source of news for many citizens) and some political leaders have suggested that social media should be controlled or censored.

Association /
assembly rights

9



1

Freedom of
expression

8



1

A law on Access to Official Documents was enacted in 2016, but many officials are still unaware of their duties to comply with freedom of information and documents are often hard to get.

Nevertheless, Timor-Leste has been a world leader in transparency relating to revenues from extractive industries.

3 | Rule of Law

The constitution provides for checks and balances, and the separation of powers. This is not only the classic separation of executive, legislative and judicial, but also within the executive there is a separation between presidential and cabinet powers.

As an adolescent democracy, officials and citizens are still learning about and experimenting with this and other aspects of constitutional rule of law.

The exercise of mutual checks and balances sometimes generates clashes and led to an early election in 2018, when the parliament elected in 2017 failed to produce a government acceptable to the president of the republic, who sided with the minority in the House. Currently, the president and the prime minister (himself a former president) represent different political perspectives. In addition, the government sometimes disrespects judicial power, a legacy of overt interference in 2014.

The judicial branch is less developed than the other classic powers, and it struggles with inadequate conditions to discharge its functions, both in terms of human resources and in material conditions.

The fundamental problem is the lack of judges, with many candidates having been educated under Indonesian rule and trained to apply Indonesian law. Foreign aid has been important in this field, but then the language barrier is felt more acutely and translation programs have been implemented with very limited success. The training of new judges able to operate under a new legal system is being pursued, but so far with limited success.

The constitutional provisions are adequate for a democratic polity, but implementation of all aspects is slow. Lack of adequate human resources limit the capacity to expand the system to all levels of the constitution.

The last clear case of interference in the judiciary was in 2014.

Separation of powers

7

'06 _____ '20 10

7

_____ 1

Independent judiciary

8

'06 _____ '20 10

8

_____ 1

Timor-Leste faces problems with corruption, including of public officeholders. The Anti-corruption Commission (CAC), formed in 2009 in response to public demands, and appointed by the parliament has investigative but not prosecutorial powers. Furthermore, Timor-Leste has yet to enact a law to implement the U.N. Convention Against Corruption, which it signed in 2003 and ratified in 2008, although such draft laws have been on the parliament's agenda for many years.

There have been several cases of public officeholders brought to court and sentenced for corruption – sometimes, heavily, although most of the cases involved relatively small amounts of money. Large-scale cases of corruption, involving tens or hundreds of millions of U.S. dollars, are too sensitive to bring to court. Politically influential people often escape prison. In 2017, the minister of finance, who had been convicted of corruption, was allowed to flee to Portugal before sentencing.

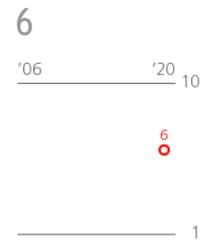
The limited capacity of prosecutors and courts does not guarantee the speedy resolution of cases. Public opinion is highly critical of corruption, but seems to accept it in some cases of well-connected people. Some cases brought to trial have resulted in acquittal, verifying the independence of the judiciary.

Sentencing has occurred frequently and those who have been convicted are not expected to return to public office

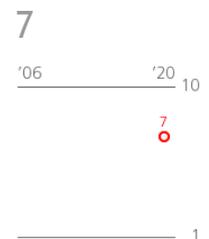
Civil rights are guaranteed in the constitution, but not always adequately protected by the institutions. The police force sometimes uses excessive force verging on the torture of individuals in custody. The fragility of the judicial branch is another source of concern regarding the full protection of civil rights. There is no death penalty and no extrajudicial executions have taken place since 2015.

Women's civil rights are often not respected and domestic violence is endemic. Although the legal system has good provisions to address this problem, enforcement is intermittent.

Prosecution of office abuse



Civil rights



4 | Stability of Democratic Institutions

The ensemble of democratic institutions reveals a significant difference in their capacity to discharge their functions. Whereas the government has access to personnel and financial resources to sustain its activity, the parliament and judiciary have limited experience, staff and money, and are not seen as equally legitimate.

The semi-presidential system involves the president and the prime minister (or the majority in parliament) to share power.

Differences between the president of the republic and the parliamentary majority prevented the approval of the 2018 state budget until October 2018

In the period after the 2017 elections, parliament was stripped of important competences as the speaker of the House decided not to put to a vote two motions tabled by the three parties that formed a parliamentary majority, thus revealing a weakness in its functioning.

The eighth government, formed after the 2018 elections, represents a different political constellation than the president and has different programmatic ideas, so there is give-and-take between the president and parliament. Although political polemics are occasionally heated, no one has used violence, or violated constitutional or legal processes.

When the eighth government was formed, the president declined to swear in several of its key ministerial nominees because he said they had been credibly accused of corruption and other crimes. The prime minister has refused to replace them with other nominees, and the posts are being filled on an interim basis by other ministers or deputy ministers. This polarized situation has continued into 2019 with no end in sight, although it has not had a major impact on the functioning of the state.

All democratic institutions are accepted by the most relevant actors. A very small number argue that Timor-Leste's democratic institutions are illegitimate and should be replaced by the 1975 constitution, but on the whole this is not a socially relevant group.

However, military leaders often comment on issues outside of their mandate and the military (which is constitutionally limited to external defense) occasionally gets involved in internal situations.

The deadlock in 2017 negatively affected the working of the democratic system, but – when the president dissolved parliament and called new elections – the president acted as provided for by the constitution.

Performance of democratic institutions

7

'06 _____ '20 10

7

_____ 1

Commitment to democratic institutions

9

'06 _____ '20 10

9

_____ 1

5 | Political and Social Integration

The party system in Timor-Leste includes established parties (FRETILIN and PD) and others created by former presidents in order to pursue the executive powers allocated to the prime minister (CNRT, PLP). CNRT (formed in 2007 by resistance leader Xanana Gusmão) and the historic independence party (FRETILIN) are the two largest parties. FRETILIN has a grassroots base, while CNRT is supported largely by those who are loyal to Xanana or benefit from CNRT's use of state resources. Two other parties (PD, which emerged in 2001 out of the student resistance movement during Indonesian occupation), and PLP (formed by former president Taur Matan Ruak in 2017) have significant parliamentary representation. PLP and CNRT, together with a new smaller party associated with youth movements and related to a "martial arts group" (KHUNTO), comprise AMP, the current majority coalition. Apart from these, there are many smaller parties, which sometimes win parliamentary representation by exceeding the 4% threshold from the single national, proportionally-represented electorate. Internal democracy is limited in all parties, and many are dominated by strong leaders and have limited capacity to represent grassroots interests. Voter volatility is moderate and changing demographics has reduced the percentage of the electorate comprised of FRETILIN loyalists. Polarization has traditionally been strong, although in 2015 to 2017 Xanana and FRETILIN reached an entente resulting in a "government of national inclusion." Currently, polarization is high again.

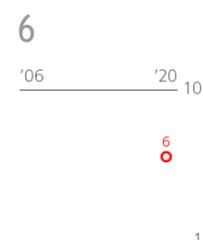
Some Dili-based NGOs try to capture and defend societal interests, with limited effectiveness, in part because many depend on government funding. Interest groups representing the rural majority are scarce. Student and church groups are vocal and sometimes influential. Because most people work outside the cash economy or for themselves, trade unions are mostly irrelevant. The representation of social interests is most often made through personal or informal channels.

Social media and online publications are increasingly influential, providing a channel for public influence inside and outside of organizations.

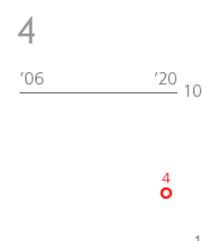
In Timor-Leste, there are few opinion polls or surveys to support a robust answer to this question, and historic and cultural traditions (e.g., telling questioners what the respondent thinks they want to hear) means that the few existing polls and surveys are unreliable. For example, the country is not included in the World Value Survey, the Asian Barometer Survey or any other international comparative survey. Asia Foundation conducts polling in Timor-Leste, but those surveys do not cover the majority of aspects covered by this indicator.

However, people in Timor-Leste value constitutional democracy, because of the tremendous struggle and suffering they have had to endure in order to achieve it. Voter turnout is high and major political disputes are resolved through elections,

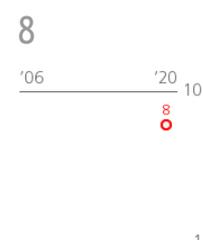
Party system



Interest groups



Approval of democracy



demonstrating that most citizens approve of democratic procedures. Conversely, there is no formal opposition to those rules and no significant social movement questions the processes by which the country has been governed since the restoration of independence in 2002. This was tested in the 2006 “crisis,” which displaced 10% of the population and forced the prime minister to resign, and that stressful experience reinforced the citizenry’s appreciation that democratic procedures are essential.

Many people participate in civil society organizations, including church-affiliated ones. In addition, traditional networks from extended families, clans, and regional or language groups are strong, as are organizations that are based in networks or were created to resist Indonesian occupation. However, these associations are often not visible through public opinion surveys.

Social capital

6

'06 '20 10

6

1

II. Economic Transformation

6 | Level of Socioeconomic Development

In 2014, 41.8% of the Timorese population lived under the national poverty line (government Living Standards Survey). Poor people reside predominantly in rural areas and poverty is even worse among women. Urban areas offer somewhat better opportunities and also show a marked imbalance in the distribution of income and wealth. Although no sound statistical data is available, first-hand contact with Timor suggests that a small class of rich people are increasing their share of the national wealth. The most recent figures for the Gini index (2014) placed Timor-Leste on 26.7, a relatively low level of inequality.

About a quarter of the working-age population works in the cash economy, while a larger portion are subsistence farmers and fishers. Employment in the public and private sectors is about the same, with the public and private sectors each employing around 10% of the working-age population.

The HDI for Timor-Leste improved significantly until 2015, due to a rising GNI from petroleum income, but has begun to drop as oil revenues decline. It is now at 0.625 in position 132 (UNDP 2017), having risen from 0.507 (in 2000). Timor-Leste’s average annual HDI growth between 2010 and 2017 was 0.13%.

Question

Score

Socioeconomic
barriers

3

'06 '20 10

3

1

Economic indicators		2015	2016	2017	2018
GDP	\$ M	3092.6	2503.5	2487.3	2581.0
GDP growth	%	20.6	0.7	-9.2	2.8
Inflation (CPI)	%	0.6	-1.3	0.6	-
Unemployment	%	3.3	3.0	3.0	3.0
Foreign direct investment	% of GDP	1.4	0.2	0.3	1.9
Export growth	%	12.8	-9.4	-9.1	-
Import growth	%	-15.4	-5.1	-3.3	-
Current account balance	\$ M	224.8	-533.1	-339.1	-
Public debt	% of GDP	1.5	3.1	4.3	6.1
External debt	\$ M	116.7	80.9	124.5	158.1
Total debt service	\$ M	0.8	0.8	1.8	3.2
Net lending/borrowing	% of GDP	4.2	-34.6	-7.8	-
Tax revenue	% of GDP	18.6	9.9	12.9	-
Government consumption	% of GDP	30.3	36.4	35.2	-
Public education spending	% of GDP	4.3	5.3	3.8	-
Public health spending	% of GDP	2.3	2.2	-	-
R&D expenditure	% of GDP	-	-	-	-
Military expenditure	% of GDP	1.2	1.0	0.9	0.6

Sources (as of December 2019): The World Bank, World Development Indicators | International Monetary Fund (IMF), World Economic Outlook | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database.

7 | Organization of the Market and Competition

Timor-Leste has a substantial informal sector, namely in rural areas where around 70% of the population live.

The ownership of land is constitutionally reserved for Timorese nationals. In this context, foreign investment must always assume forms of land tenure other than full ownership (long-term leases are frequent). Market access is otherwise devoid of significant barriers, although there are limited domestic markets and few entrepreneurs or skilled workers.

Timor-Leste consistently scores low on the aggregated Doing Business reports, currently ranking 178 out of 190 countries, due to the widespread inability to enforce contracts, and difficulties in accessing land and infrastructure. Starting a business takes 13 days and six procedures, with a cost of 0.6% of GNI per capita. The starting a business score of Timor-Leste amounts to 89.1 out of 100 (rank 68 out of 190). The World Bank identifies weak and inefficient institutions as the main causes for the low evaluation of Timor-Leste's business environment.

In spite of a significant public sector, private enterprises are welcome to operate in Timor-Leste, whether national or international, and the country recently passed laws that encourage foreign direct investment. The country uses U.S. dollars as its currency, guaranteeing full convertibility.

Levels of poverty provide few domestic markets for locally-produced goods, which limits opportunities for "market-based competition." Since most consumers are in rural areas and have little money and few choices about where to obtain goods, market principles are often not important.

The state subsidizes a few major economic projects, including a cement factory project (with the factory to be built in the Baucau area), a container port, petroleum industry infrastructure and the special economic zone in Oecussi. However, few foreign investors have shown interest. State regulations are not detrimental to the establishment of private enterprises. They do not, as a rule, interfere with market prices.

Market
organization

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Sophisticated legislation to regulate competition and prevent monopolistic practices has not been enacted in Timor-Leste. The state, however, is supportive of competition and has dismantled monopolies (e.g., there are now several telecommunications operators in contrast to the monopoly situation from 2000–2012). Foreign companies, as a rule, are not discriminated against and have a fair share of the internal market.

Clientelistic practices often determine decisions on public tenders and well-connected local businesspeople win the majority of state contracts, sometimes acting as fronts for foreign companies. Many tenders are single source.

In 2016, Timor-Leste applied to become a member of WTO and it applied to join ASEAN in 2011, although both applications are still pending. The country joined the International Centre for the Settlement of Investment Disputes in 2016. It has an open economy, with low tariff barriers (average 2.5%) and low tax rates. However, trade is virtually unidirectional, with most containers leaving empty after unloading their cargo.

Timor-Leste is highly dependent on imports (\$520 million in goods imports in 2018) and exports very little (\$22 million in 2018) other than offshore oil. There is a similar imbalance in the trade in services. Indonesia supplies 32% of goods imports, followed by China, Singapore and Hong Kong, with ASEAN members providing about 56% of goods. Most natural gas exports go to Japan after being liquefied in Australia, oil is sold at sea to various partners, and non-oil exports (coffee) are primarily sold to the United States, Canada, Indonesia, Germany and China.

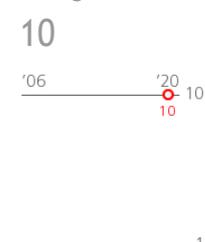
There are low non-tariff barriers to international trade, and the government is spending a lot of money on improving infrastructure for international shipping, road transport and air travel.

Timor-Leste has only one national commercial bank, which is state-owned. Foreign banks operate in the territory: one Portuguese, one Australian (which recently closed all personal accounts) and two Indonesian. All are under the supervision of the central bank of Timor-Leste. There are few bank branches or ATMs available outside major cities. The national banking system is small, although a number of microcredit programs operate across the country. Capital markets are poorly differentiated, and banks are reluctant to offer loans due to previous patterns of default.

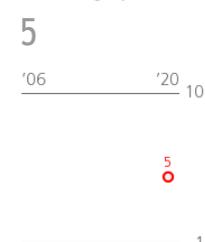
Competition policy



Liberalization of foreign trade



Banking system



8 | Monetary and fiscal stability

Timor-Leste uses U.S. dollars as its currency. Thus, there is no issue regarding the foreign exchange rate, although effective exchange rates vary in this import-dependent economy.

The country has established an independent monetary authority. Within the limited scope for action derived from the use of U.S. dollars as the national currency, the independence of the monetary authority is positive.

The inflation rate was more than 10% between 2011 and 2012 due to the rapid growth in government spending and profit-taking by importers. It has averaged under 1% since 2014 after public spending stabilized, but increased slightly (to 2.1%) in 2018.

Because of declining oil income, Timor-Leste has recently seen its positive current account balance become negative. From a positive balance of \$2.390 billion in 2013, the current account balance dropped to -\$533.1 million in 2016 and -\$339.1 million in 2017. There is also a huge trade imbalance: imports of goods during 2018 totaled \$520 million, while non-oil goods exports (nearly all coffee) totaled \$22 million. Many of the importers extract significant margins, especially when selling goods to the state, and rent-seeking is common among local businesses.

The country has substantial reserves in its Petroleum Fund, which peaked in 2014 following its inception in 2005. Since then, the balance has hovered around \$16 billion. About 80% of the state budget is financed through withdrawals from the Petroleum Fund, so no other deficit financing or budgetary loans have been required. The Estimated Sustainable Income formula for Petroleum Fund withdrawals has been exceeded every year except one since 2009. Since 2015, withdrawals have been more than double the sustainable level, with higher amounts projected for the future. The Petroleum Fund could be entirely depleted within a decade unless alternative domestic policies are envisaged or new sources of wealth become active (e.g., the Greater Sunrise gas and oil fields, which have been redefined after the agreement between Timor-Leste and Australia in 2018).

Foreign debt is low, with \$82 million disbursed to date against \$350 million in loan agreements signed with the Asian Development Bank (ADB), World Bank and Japan for national road construction. Since 2017, the government has sharply cut back plans for additional borrowing, although less transparent methods may be used to secure financing for future petroleum projects.

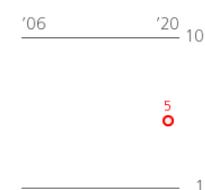
Monetary stability

8



Fiscal stability

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9 | Private Property

The constitution reserves land ownership to Timor-Leste citizens and allows for individual property rights.

Three fundamental land laws were enacted in 2017, formulating the first comprehensive framework for individual property rights. Timor-Leste is saddled with “legal rights” asserted and given by Portuguese colonizers (until 1975), and Indonesian occupiers (1975–1999) together with collective and customary rights based on Timorese culture.

Clarification of property rights will be done through the recognition of prior property rights, with compensation when claims overlap. The laws also establish rules for state expropriation of and compensation for private land. In addition, the laws recognize informal property rights and community ownership. However, subsidiary regulations for the new regime have not yet been developed and it is not yet fully functional.

Private enterprises are legally allowed to operate in Timor-Leste, and the state has made important efforts to offer local entrepreneurs legal security and a substantial share of the opportunities to take public contracts – although this has sometimes been done in a clientelistic fashion.

There has been no privatization of state-owned companies, of which there are only a few. Utilities are mixed: water, roads, ports and electricity are state-owned, petroleum and telecommunications are private, and both public and private actors are involved in TV, radio, health care and education.

In the petroleum sector, the (subsidized) state-owned TimorGAP company has yet to provide any revenues and is likely to greatly expand its operations in the near future.

The state has also created public-private partnerships or bought shares in nominally private companies in sectors including ports, cement production and telecommunications, with more under discussion, including water and health care.

10 | Welfare Regime

Timor-Leste has been constructing a welfare regime based on the public sector.

Social welfare is supported by public spending in three main areas: health care, which will receive approximately 5% of the state budget in 2019; education, which will absorb 10% of the state budget in 2019; and direct payments through social security (e.g., for veterans, young people, mothers and pensions), which will take about 14% of the state budget in 2019.

Property rights

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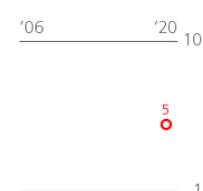
Private enterprise

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Social safety nets

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Among these social security schemes, some are conditional cash transfers, such as the “Bolsa da Mãe” (a grant given to mothers whose children attend school). Some social security schemes, such as veterans’ pensions and pensions for all people over 60 years old, are pure cash transfers.

The system is still being expanded to make it more inclusive. A significant effort has been made to cover the most vulnerable (e.g., the mothers grant), but some others have political motivations (e.g., the veterans’ pensions was designed to buy peace and recognize those who carried out the struggle for national liberation, while a generous pension scheme has been established for former parliamentarians and public officeholders). A contributory social security regime for retired public employees was established in 2017, with corresponding requirements for private employers.

Although most of these systems are not available to non-citizens, the number of foreigners in Timor-Leste is relatively small, and few foreign nationals are as poor as most Timorese citizens and therefore don’t need safety nets.

Timor-Leste is to some extent a dual society. The quarter of the population who live in the main urban areas have greater education, employment and health care opportunities, and exposure to other possibilities, although women have fewer than men. Conversely, in rural areas of the country, “customary” principles that discriminate among gender and age groups are still important factors.

The World Bank figures for the strength of the female labor force (31.7% in 2017) is a clear indication of the inequality of opportunity. (These figures, republished by the World Bank from the government’s Labor Force Survey, leave out the large number of subsistence food producers, many of whom are women).

On the other hand, public policies in education, for instance, are inclusive: the rate is 1 for primary education, 1.1 for secondary and 0.7 for tertiary (World Bank data 2018). However, many girls leave school at puberty due to the lack of school bathrooms and running water. As a result, the literacy rate is higher among men (63%) than women (53%). More affluent and well-connected people have access to state-paid overseas health care and overseas scholarships. A small proportion of the public education system (CAFE schools) operates with aid from Portugal and in Portuguese language with significantly more resources than the rest of the public school system.

There is not much discrimination based on ethnic distinctions, nor – on the whole – on religious grounds or political persuasion, although people and companies affiliated with the political parties in power are more likely to secure jobs and contracts.

Although same-sex sexual orientations were often concealed in the past, the most active and visible LGBT rights movement in Southeast Asia is rapidly changing public attitudes.

Equal opportunity

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Foreigners are accepted (or preferred due to a culture of hospitality and internalized colonialist teachings), although public hostility is growing against the Chinese-Timorese minority and especially against recent immigrants from China.

Since 1999, the extensive presence of U.N. and other international agencies, who pay foreign staff much more than local employees, has generated significant resentment.

Foreign companies operating in Timor-Leste are allowed to employ non-citizens, if they can show that no Timorese citizens with the appropriate skills are available.

11 | Economic Performance

On average, Timor-Leste's economy has been performing and growing well. This is mainly due to the conversion of finite, non-renewable oil and gas wealth in the Timor Sea to monetary assets, which began in 2005. Timor-Leste's fossil fuel resources were responsible for the significant growth in the Petroleum Fund, which is now equivalent to more than 12 times the annual state budget. The significant amount that has been saved cushions the economy against negative fluctuations in oil prices and income.

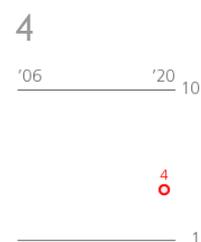
Although government debt and financial balances have been managed responsibly to date, when the oil wealth (60% of which has been saved and invested) is exhausted in about 10 years, things will change drastically – unless alternative domestic policies are adopted or new fossil fuel fields are explored (e.g., the Greater Sunrise, which was discussed in the 2018 agreement on maritime borders between Timor-Leste and Australia)

The domestic economy is overwhelmingly dominated by public spending funded by oil revenues. Most international statistical measures misrepresent Timor-Leste's reality, partly because incoming oil revenues are deposited into the Petroleum Fund and invested overseas, with withdrawals as necessary to finance the state budget.

Some international agencies use “non-oil GDP” as if it was the entire GDP, leading to inaccurate and non-comparable data. Oil GDP comprised 75% of the total GDP in 2013 but had dropped to 33% by 2016 and is lower now. Although real non-oil GDP per capita grew an average of 2.8% per year between 2011 and 2016, nearly all of that growth was in construction and public administration and was driven by government spending. The productive agriculture and manufacturing sectors are shrinking.

When state spending fell by about 25% during 2017 to 2018 due to the political impasse, GDP growth dropped sharply (although official data is not yet available), illustrating the dependence of the economy on government spending.

Output strength



The formal unemployment rate is low (3.4%), although it tends to be significantly higher in urban areas and for young people. However, only about 17% of the working-age population is in formal employment (another 6% are self-employed in the cash economy), and official unemployment figures exclude most of the rest. Prices are stable, but much higher than in neighboring countries.

12 | Sustainability

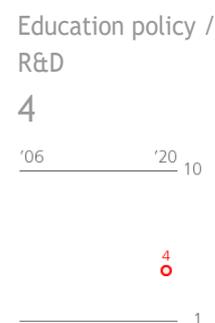
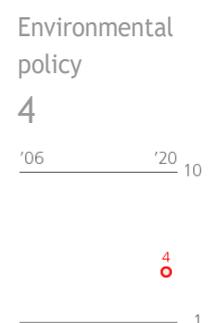
Environmental policy is a cross-cutting policy field for which several institutions have responsibility in Timor-Leste. One is the Secretary of Natural Resources (responsible for natural resources, including gas and oil) under the prime minister; another one is the State Secretary of Energy Policy, which is responsible for renewable and alternative energy sources.

Even though the constitution establishes the importance of protecting the environment, the legal framework concerning the environment remains deficient. In 2012, the Environmental Basic Decree Law came into force, which sets the framework for other environmental legislation, such as the Environmental Licensing Law and the biodiversity law.

Environmental concerns are represented in the law and in official discourse, and some important efforts have been deployed, such as the definition of a national park in the easternmost district of Lautem (Parque Nacional Konis Santana). However, large public policy projects normally take precedence over those concerns and environmental licensing laws are frequently not enforced. The two mega-projects on the south coast (Tasi Mane) and in the exclave of Oecusse (ZEEMS/RAEOA) are examples of initiatives that prioritize economic gains over environmental concerns. NGOs and international agencies encourage the executive to pay more attention to environmental concerns, but real incentives are missing most of the time. Programs for renewable energy have been largely canceled.

The development of an inclusive, high-quality education service in Timor-Leste is a goal of the authorities, but it is unlikely to be achieved in the short term. The U.N. Education Index for 2017 scored the country 0.505 (improving from 2007's score of 0.443).

Primary schools exist throughout the country, but their quality is often very poor. A new primary school curriculum was introduced in 2015, withdrawn in 2017 and reinstated in 2018. Although it will lead to better materials and instruction, most schools are grossly under-resourced, with large class sizes, few textbooks and poor conditions. Many teachers require more training and experience. However, a small fraction of public schools receive special assistance from Portugal and higher



government allocations, and therefore have more resources, as do the Catholic and international school systems (for those who can afford them).

Secondary education is concentrated mostly in the district capitals, reducing the capacity of children to attend.

Tertiary education is available only in the country's two largest cities. Tertiary education standards are very far from First or New World levels. Very bright, affluent or well-connected students go abroad, often funded by the government or on other scholarships.

The 2019 state budget for education accounts for only 9% of public expenditure, lower than it was five years ago in spite of a rapidly growing young population.

In 2016, the public education budget was 5.4% of the GDP (bearing in mind that most of the GDP accounts for government spending, as the private sector economy is very small).

The youth (15–24 years old) literacy rate is around 80%, while the adult literacy is about 65% (UNICEF), as many older people were not educated during the Portuguese and Indonesian times.

R&D is virtually nonexistent. No patents have been produced.

Governance

I. Level of Difficulty

Although GDP grew after petroleum production began in 2005, it has been declining over the last seven years as production has declined. Government spending grew very rapidly from 2006 to 2012, but has since then averaged around \$1.3 billion per year, approximately 85% of non-oil GDP. From 2012 to 2018, 84% of state spending was withdrawn from the Petroleum Fund.

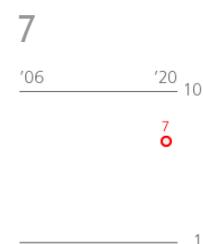
Timor-Leste remains afflicted by very high levels of poverty (more than 40% of the population live below the national poverty line). The country's history of occupation and war has made PTSD endemic, and its people and leaders have only lived under regimes that claim to implement democracy and the rule of law for 16 years. Especially among older people (including the most powerful politicians), habits of clandestine leadership, lack of consultation, resistance and hierarchical command are still visible. Formal democracy is rather stable, although democracy is far from being consolidated and does not represent a solid positive factor. However, the median age of the population is under 20, and the post-war generation is playing an increasing role in society and is being socialized in a democratic environment.

The country's small size, poor educational outcomes and brief peacetime history lead to a shortage of skilled and experienced workers and few entrepreneurs, while rent-seeking is widespread. There are also infrastructural deficiencies (partly due to poor planning, quality control and maintenance, as well as Indonesian destruction in 1999). The majority of the population lives in rural areas and is dependent on subsistence farming.

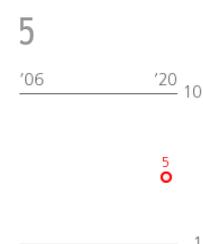
Public administration is centralized, with little authority or resources devolved to regional or local levels.

Timor-Leste is a dual society in which the reality of life in the capital city, exposed to integration in world structures and forms of cosmopolitan life, contrasts sharply with the reality of life across the majority of the country, which is mostly rural and dominated by customary practices. The urban society has absorbed the international impact of cooperation and a significant number of NGOs testifies to the fact that its civil society is capable of self-organization. However, this fact cannot be generalized to the whole country. It is important to bear in mind that the territory was under Indonesian occupation and mostly cut off from the world for 24 years, with Indonesian occupation ending as recently as 1999. The state does recognize the legitimacy of traditional forms of community organization to the extent that

Structural
constraints



Civil society
traditions



community groups do not contravene the constitution or the law. This arrangement offers space to non-state organizations to persist. Traditionally, participation in civic life was limited, and there was clear discrimination against women and young people. This is being actively challenged by the authorities, for example, through the legislation that frames the elections for community leaders (the suco council – or village council – must have at least two female members, one young female member and one male member). Permanent civil society organizations are weak.

The history of Timor-Leste since independence is marked by a few episodes of violence. However, since 2009, the country has been largely peaceful. The 2006 conflict was the most serious one since independence. It arose from the mishandling of land after the widespread displacement of people in 1999, the historical roles of the police and the military, factional disputes between political leaders, regional differences, and other factors. These factors were all magnified by pervasive memories of trauma, which led to tens of thousands of Dili people fleeing their homes. Even so, the homicide rate in Timor-Leste during that crisis was lower than in most major U.S. cities.

There has not been significant political violence, either by the government or the population, for four years. Religion and ethnicity are not factors of significant conflict. The political elite has alternated between periods of convergence and periods of heated verbal confrontation – all within the constitutional framework for debate. The last two years have been marked by significant political polarization among the two largest political parties and their supporters.

II. Governance Performance

14 | Steering Capability

Timor-Leste's government elaborated a Strategic Development Plan 2011 to 2030 10 years ago, while Xanana Gusmão was prime minister. However, this “plan” is primarily aspirational, with many broad goals and no costings or detailed paths to implementation. Like the Bible, it is frequently cited by every political party to justify what they intend to do, while nothing is said about the many sections of the plan that are ignored or discarded.

Since 2009, under four prime ministers, state budget allocations have favored large infrastructure projects. Although every government says that its priorities are health care, education, water supply and agriculture, all together these receive less than a fifth of the state budget (17% in 2017, 16% in 2018 and 18% in 2019).

Conflict intensity

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Question
Score

Prioritization

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Current plans promoted by Xanana and the government involve more than \$10 billion in investments in petroleum infrastructure on the south coast. Public investment is the engine for those plans and thus public contracts are of critical importance. The social and economic value of these projects is questionable, but powerful political forces are moving ahead with them, which is a manifestation of “resource curse” thinking that has resulted from the domination of petroleum over the last decade.

However, the technical capacity of the state to deal with the complexities of those projects is limited, and this leads to a degree of uncertainty and to possible manipulations in the short term. The capacity to resist lobbying is limited and this is reflected in decision-making that does not always coincide with stated goals.

Because state spending makes up the majority of economic activity, rent-seeking by contractors, employees and pensioners is common. As shown over the last two years, a relatively small contraction in public disbursements has widespread economic effects. The Petroleum Fund is being depleted. In the meantime, the lack of domestic private sector economic activity and non-oil government revenue, and the country’s dependency on imports is likely to have serious consequences when the Petroleum Fund is exhausted in about 10 years – unless alternative domestic policies are adopted and/or new fossil fuel fields are exploited (e.g., the Greater Sunrise, which was discussed in the agreement on maritime borders between Timor-Leste and Australia)

Timor-Leste has defined strategic goals and elaborated public policies to respond to them. The fragility of public administration, namely in terms of human resources, implies that the capacity to implement public policies is somewhat limited. Also, the strategic goals of the government imply a mix of public spending and private investment, and some projections regarding the flow of private investment – namely foreign direct investment – seem to have been overstated, creating additional pressure.

However, the stated priorities of all recent governments – health care, education, water supply and agriculture – are not allocated adequate resources or political power to be implemented effectively. Although lip service is given to economic diversification, governments have yet to develop policies that could move the country in that direction. It is much easier to pay for a few overseas scholarships or to send some well-connected people abroad for health care than it is to build a well-functioning education or health care system, which could serve the entire population.

Other problems with the implementation of public policies stem from the need to develop an entire legal system from scratch after independence. These new legal frameworks, especially when influenced by international advisers with limited understanding of Timor-Leste, often require time to adjust to local realities (a case in point is the “Land Law” regulating access to real estate, which generates multiple

Implementation

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local conflicts as it involves disputes with local communities and long-standing customary rights, and delays or postpones decisions).

The main objections to the development plan set out by the government criticize the concentration of investment on mega-projects whose feasibility is not assured and the relative sidelining of other priorities (e.g., in education and health care). The life-expectancy of the oil and gas production fields is another point of contention, as underlying projections for the stated goals are disputed for being far too optimistic.

The strategic plan is based on a mix of public and private investment, and compatible with a market economy, although few foreign investors have been interested. The special zone of Oecusse and Atauro, ostensibly developed as a “social market economy,” has attracted negligible private investment, and consists mainly of publicly built roads, bridges, airports, irrigation and government buildings. The economic development components of its concept have yet to materialize.

Taking into consideration the low levels of experience in the public administration, Timor-Leste has relied on many international advisers since independence, and has sought the support of the international community to foster policy expertise and adopt new forms of organization. International consultants are a familiar presence in many departments, although their number and influence has dropped significantly over the last few years. Moreover, the Timorese relations with those “experts” has not always been easy, as many resent both their very limited knowledge of the country and its sociocultural structures, as their adherence to “politically correct” but often aggressive stances.

However, it is rare for these foreign development workers, many of whom have limited understanding of Timor-Leste’s situation and context, to perform more than an advisory task, as the power to make final decisions rests with Timorese officials, who are sometimes not capable of consulting with the “experts.” The exchange of good practices (e.g., sending public officials abroad to study practices in other countries) and international cooperation are two important tools, which will have medium- to long-term effects. As a younger generation has more opportunities to study overseas, the availability of more diverse knowledge is increasing.

When officials travel overseas to visit, for example, petroleum infrastructure projects, they are shown around by the proponents and owners of these projects, and only hear about the positive aspects. There is little interest or opportunity to learn about the negative social, environmental or community impacts, or about projects that did not meet expectations.

Monitoring past experiences is not systematically done in the country.

Policy learning

6



15 | Resource Efficiency

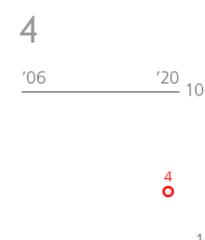
Government administrative personnel represent about a quarter of public spending (in 2017, 16% for salaries and 8% for “professional services”) and comprise about 40% of the total employed labor force, mostly in urban areas. This cost is higher than the benefits of the services performed, as there is a lack of efficiency in many public departments. Recruitment is based on a mix of competitive procedures and clientelistic practices, and a rigid hierarchy often stifles the capacity for the adequate management of human resources. The accountability of civil servants is gradually improving, but accountability of political appointees who head ministries and departments is largely nonexistent, except for those with the power to appoint other political appointees. Political dependency is significant and politically-chosen leaders often don’t listen to technocrats with different perspectives to their own.

The workings of parliamentary life provide for transparency in the development of the state budget after government has proposed it to the parliament (although few changes are made at that stage). There is also good transparency surrounding petroleum revenues. Because of significant income received and saved from exporting fossil fuels, public debt has been kept low, but this could change as oil and gas wealth is depleted.

The Chamber of Auditors, mandated to review contracts over \$5 million before they come into force, has prevented some significant mistakes. However, new legislation exempts petroleum sector-related agreements from the chamber’s purview, which could undermine the chamber’s effectiveness and enable corruption. Furthermore, recommendations by the Audit Court regarding state finances and performance are often not implemented.

Despite constitutional prescriptions mandating the construction of a multi-level public administration, with local and regional levels of decision-making, Timor-Leste remains a very centralized state. Local government exists and is regulated by law, but it is not considered as the lowest administrative level, but more as a formalization of “customary rights.” The decision-making capacity of local leaders is feeble and their only source of funding, the national government, allocates very little. Regional administration has been inscribed in many government programs, but has so far failed to materialize. The result is that the pyramid of decisions is highly centralized and inefficient. The legacies of inefficient administration under Portuguese rule and high levels of corruption under Indonesian rule also hinder the government’s capacity to use resources effectively.

Efficient use of assets



The Timorese government has a difficult task to coordinate conflicting objectives, namely the strategic plan to invest in mega-projects, with significant public spending intended to attract private investment, and the basic needs of a nascent welfare state, which has to build education, health care and social security systems. The fact that recent governments (including the present one) include ministers from different political parties offers the possibility of implementing contradictory and incoherent policies, as partisan interests seek to offer clientelistic rewards to their supporters. The lack of a stable civil service with technical expertise makes it more difficult to obtain adequate coordination.

However, all recent governments (with a brief interruption in 2017) have been unofficially chosen by the former military commander, former president and former prime minister, Xanana Gusmão, and most political appointments and policies comply with his directives, resulting in more coordination than may be expected.

There is a special Anti-corruption Commission. Its mandate, though, is limited to investigation, with decisions about prosecution and judgment left to other authorities. A number of senior figures, including cabinet members, have been tried, and sometimes convicted and heavily sentenced. However, there is generally a degree of leniency toward well-connected people involved in corruption and prosecution is not always effective. At least one person convicted of corruption fled the country.

Although Timor-Leste has been party to the U.N. Convention Against Corruption since 2009, it has not yet enacted legislation to implement its commitments.

State spending is normally audited by the parliament, which must approve the state accounts for the previous year, as well as by a special audits branch in the Court of Appeals. However, the capacity and thoroughness of such audits is limited, and their recommendations are often ignored.

Party financing is limited to the electoral period and does not attract much regulation. There is public financing as well as private donations, and reporting requirements are not effectively enforced.

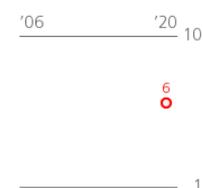
Conflict of interest regulations are not effective.

Public procurement is regulated by law, but the extent to which it is transparent is not certain, as clientelistic practices often intervene in the process. A public procurement website contains information on most (but not all) tenders and awards, but it is difficult to use and shows a large percentage of single-source contract awards.

Although civil society organizations and journalists occasionally bring information on corruption to light, this is unusual and the local media rarely undertakes investigative reporting. There is little will, even among opposition political parties, to pursue possible corruption involving high-ranking public officials, their families or cronies.

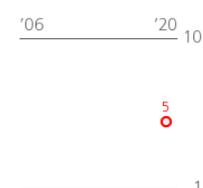
Policy
coordination

6



Anti-corruption
policy

5



16 | Consensus-Building

There is broad consensus on the basic tenets of a democratic polity among the political elite, and democracy is working remarkably well for a 17-year-old nation emerging from centuries of foreign autocratic rule and a generation of brutal war. Some voices have shown sympathy for alternative modes of organizing the state, arguing for the need to limit the expression of “foreign” and sustain “traditional” values. Others have expressed a desire to see a “consensual democracy” replace “belligerent democracy,” (i.e., polarized political competition as performed in parliament). However, these remain minority voices. There was a two-year experiment in “consensual democracy” when a broad coalition formed under the direction of Xanana Gusmão, with support from all major parties, reduced the role of opposition voices within the political system, but that ended in early 2017 and the two main political factions are once again in competition.

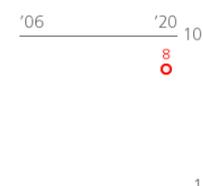
Attitudes toward a market economy are somewhat more nuanced. Although there is little government interference in the private sector today, this could change if the private sector grows enough to become a significant part of the economy. At present, the vast majority of non-subsistence economic activity is driven by state spending, while rent-seeking dominates private sector decisions. In recent years, the first significant non-oil FDI took place (a Heineken beer brewery), while another, for a limestone mine and cement processing, had been unable to proceed without significant government investment.

In Timor-Leste, there are few important actors who assume anti-democratic stances, although Xanana Gusmão – a former military commander, former president and former prime minister, currently without ministerial portfolio – has substantial influence over Timor-Leste’s otherwise democratic institutions. Xanana Gusmão possesses Weberian “charismatic power,” which is sometimes difficult to conjugate with “legal-rational” proceedings. Government policies have favored the emergence of a new entrepreneurial group and small middle-class population, which are linked to the operation of a democratic polity and thus have widened the social basis of democracy, although the rural majority remains largely disempowered.

Former military officers (e.g., Lu-Olo, Taur Matan Ruak and Xanana Gusmão) have been able to don civilian clothes when wishing to compete for electoral positions and do not seriously threaten democratic consolidation. However, as in most states that achieve self-government after a long resistance struggle, the personal power of pro-independence leaders can undercut democracy for as long as they remain on the scene. The disproportionate political power, resource allocation and policy space given to the petroleum sector to support its development also undercuts democracy.

Consensus on goals

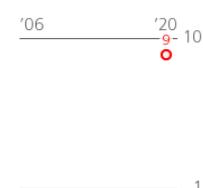
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Anti-democratic actors

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The constitution designed a political system that offers room for the accommodation of different interests and the ensuing institutions have been reasonably capable of managing dissent within democratic rule.

Political polarization is very high, with tensions between the president of the republic (Francisco Guterres “Lu-Olo”) and the parliamentary majority led by Prime Minister Taur Matan Ruak. This is due to the nature of the Timorese semi-presidential system of government and to deep historic cleavages between major political parties. Although polarization has been contained within the normal institutional framework, it is proving to have significant social and economic impacts on the country. The dual nature of presidential and parliamentary legitimacy is crystallizing rather than depolarizing the political conflict.

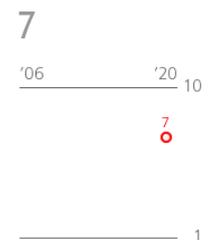
Political polarization was more visible in 2017 to 2018 than in 2015 to 2017. The president continues to refuse to approve several of Taur Matan Ruak’s ministerial nominations, forcing the government to operate without key ministers. The PLP prime minister has said that he understands that the president’s role is to defend the public interest (having done the same thing when he was president). However, the prime minister has criticized the president for not proposing alternative ministerial candidates and for vetoing important pieces of legislation, despite some of the legislative acts having been passed by an absolute parliamentary majority. Even though the conflict between the president and prime minister has been contained within the constitution, there is clear and systematic opposition between the two, which had never occurred previously in the country’s democratic experiment. Although partisan rhetoric can be heated at lower party levels, the political divisions are like those in many other multiparty parliamentary democracies.

Civil society has significant space for self-organization and many people (a fifth of Dili’s population) protested against the maritime boundary with Australia. Students and young people vociferously protest perceived injustices, such as new cars for members of parliament and pensions for senior officeholders. However, poor and rural people are less organized, vocal or influential.

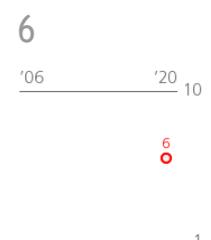
In recent years, feminist and LGBT organizations have significantly shifted public and political discourse and are changing public attitudes. A gay pride march in July 2018 drew thousands and was supported by most political leaders, as was the women’s march four months earlier. Women comprise more than 30% of parliament (the highest in Asia), although their power and representation in leadership positions is lower.

Given that 97% of Timor-Leste’s population is Catholic, the Catholic Church receives respect from the authorities and is capable of influencing important decisions (e.g., in education, abortion or family planning). It has substantial influence in agenda-setting and policy formulation.

Cleavage /
conflict
management



Civil society
participation



Community-level authorities have been integrated, to a large extent, in the democratic process, but have limited capacity to resolve issues locally. They act as proponents of policy decisions to be made by local branches of the public administration. However, local conflict mediation by traditional leaders occasionally bypasses legal justice processes.

Since 2015, the government has formed and funded a “social audit” program to involve CSOs in researching and reporting on how government services are functioning.

Academics, scientists and professional institutions have less influence over public policy, although they contribute to educating the media and the citizenry.

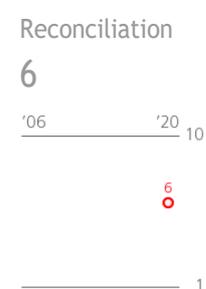
Timor-Leste emerged from a dramatic process of liberation, which began when the Portuguese colonial power accepted self-determination for its overseas territories (1974–1975). This was followed by a brief civil war, and a large-scale illegal invasion and occupation by Indonesia (1975–1999) during which about a quarter of the population were killed. After the U.N.-supervised referendum in 1999 in which 78% voted for independence, Timor-Leste and the United Nations set up a Commission for Reception, Truth and Reconciliation (CAVR), which produced a detailed report and issued many recommendations. However, CAVR did not have the power to grant amnesty for serious crimes (which were turned over to the prosecutor) or pursue perpetrators residing in Indonesia.

During the 1999 to 2002 transitional U.N. government and for a few years afterward, internationally-supported prosecutors and courts dealt with some of the most high-profile crimes committed over the last year of Indonesian occupation. They indicted 391 people, including several senior Indonesian military leaders. However, all of the 87 brought to trial were Timorese, of whom 84 were convicted. None are in prison today. In Indonesia, an ad hoc human rights court conducted some sham trials, which convicted no one.

After the CAVR report was issued, the two governments formed a Truth and Friendship Commission, but Indonesia has declined to fulfill most of the commitments it made.

Some CAVR recommendations have been pursued by successive Timorese governments and reconciliation remains on the government agenda to this day. However, the recommendations directed toward the international community have been largely ignored. Other recommendations (e.g., ending impunity for crimes against humanity) have been neglected due to “realpolitik” concerns regarding relations with Indonesia, which protects alleged Timorese and Indonesian perpetrators.

Timorese governments have set up various schemes to deal with reconciliation. However, some of the schemes, which have attempted to impose a nationally unified



response, have met with difficulties in dealing with locally rooted sentiments and governments' unwillingness to ask Indonesia, responsible for most of the violence, to pay reparations or turn people over for prosecution. Although international officials promised in the first few years after 1999 that there would be no impunity, international attention has turned elsewhere.

Another aspect of this issue is the attention paid to those who died in the struggle for independence, which is required by the customary rules that remain deeply embedded in the country. The authorities have made substantial efforts to pay tribute to their memories, appeasing demands for the prosecution of perpetrators.

17 | International Cooperation

Timorese reliance on foreign aid has declined markedly since oil revenues began in 2006 and aid now comprises about 12% of the Combined Sources Budget. In comparative terms, Timor-Leste ranks 25th in aid as a percentage of the GDP (10%).

The Timorese authorities meet regularly with international donors to plan medium- to long-term development strategies. This means that aid is only given when there is an agreement between recipient and donor countries, which allows for aid to be focused.

However, the Timorese government justifies low domestic funding for certain policy areas (e.g., water supply, education and health care) by arguing that international donors are picking up the slack, even though the combined resources allocated are still far from adequate.

However, on the whole, Timor-Leste has an active voice in the design of the plans. This includes, for instance, the training of medical students (Cuba) or support to foster the technical capacities of national teachers (Portugal, Brazil), which have a medium-term framework.

Donors tend to focus on different sectors, such as water and governance (Australia), agriculture (Germany) or infrastructure (Japan). Many U.N. and multilateral agencies have offices and programs in the country.

The government maintains an Aid Transparency Portal, which makes information on donor programs and spending, and information on annual government budget proposals publicly available.

Effective use of support

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Timor-Leste is a reliable international partner, recognized as such by most relevant institutions, both bilateral and multilateral (e.g., the United Nations and U.N. agencies). It has ratified many international conventions, although its capacity to comply with reporting requirements is sometimes limited. It has joined major multilateral institutions (e.g., the United Nations, U.N. agencies, the World Bank, IMF, ADB and the International Centre for the Settlement of Investment Disputes) and complies with their regulations in most cases. It has also applied to be a member of WTO and ASEAN, and these applications remain pending. Timor-Leste often participates in international conferences on climate change and in U.N. Human Rights Council processes.

Timor-Leste recently used the U.N. Convention on the Law of the Sea to bring Australia to compulsory conciliation on their unresolved maritime boundary, after raising the issue at the International Court of Justice in The Hague. This was a pioneer initiative at a time when other loci of tension may require similar procedures (e.g., the South China Sea)

In addition, Timor-Leste helped set up and continues to lead the G-7+ group of fragile states and participates in regional fora in the Asia Pacific area.

Timor-Leste – a country that benefited from belated international engagement to achieve self-determination and develop its electoral system and institutions – has returned the gesture by leading a group of countries under U.N. supervision to establish similar facilities in Guinea-Bissau, which have proven reliable in two successive elections. A former Timor-Leste president led a U.N. mission in Guinea-Bissau for a few years.

The main exception to the pattern is the country's unwillingness to pressure reluctant international authorities to bring to justice crimes against humanity committed by Indonesia between 1974 and 1999.

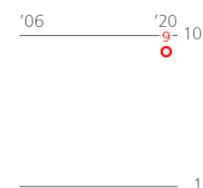
In recent years, domestic political squabbles have hurt the country's international profile. In 2018, the parliament refused to allow the president to join other heads of state at the U.N. General Assembly summit or to attend a scheduled meeting with the Catholic pope in Rome.

The political leadership of Timor-Leste is actively engaged in promoting good relations with its two much larger neighbors (Indonesia and Australia), both of whom supported the massive brutal occupation from 1975 to 1999.

In 2018, Timor-Leste resolved a long-standing dispute with Australia over establishing a permanent maritime boundary through the U.N. Convention on the Law of the Seas (UNCLOS) dispute resolution mechanisms. Good relations are demonstrated by the cross-border movement of people and capital, with Indonesian and Australian goods, contracting companies and workers moving to Timor-Leste, and Timorese nationals studying in Indonesia or working in Australia. Except for one

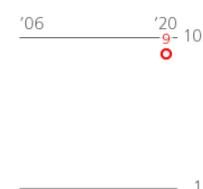
Credibility

9



Regional cooperation

9



weekly flight to Singapore, all commercial air traffic to Timor-Leste departs from Indonesia or Australia.

Timor-Leste is actively engaged in obtaining membership in the most significant regional cooperation and integration organization, ASEAN. Although it has opted to align with Asia rather than the Pacific, it also takes part in fora in the Asia Pacific region.

It is a key member of the Coral Triangle Initiative on marine environmental issues and initiated the TIA-GT (Timor-Leste, Indonesia and Australia Growth Triangle) economic development group.

Strategic Outlook

With the president and the prime minister leading different political bases, more compromise will be required than in the past. However, the dysfunctional situation from mid-2017 to mid-2018 has ended, and Timor-Leste may recover from its negative economic impacts when state spending returns to earlier levels. However, the medium-term (10–15 years) sustainability of state finances and economic performance is endangered by the country's near-total reliance on diminishing oil reserves.

Some of the political conflicts derive from the small political elite, most of whom have known one another since high school more than 50 years ago, accumulating resentments, grievances and rivalries that have become more intractable as the participants have grown older and the state has become wealthier. This is further exacerbated by the dependence of most political parties on their leaders. Ideological or programmatic issues are secondary to the influence of personalities, most of whom matured and excelled in clandestine resistance roles, rather than in consultative, democratic institutions. Although the majority of the population was born after the 1999 referendum, most of the elites were adults before the 1975 Indonesian invasion. It may take a generational change of leadership for the political system to evolve into parties built around constituencies or programs, rather than around individuals.

The next scheduled presidential election will be in 2022, with the parliament facing voters in 2023. With neither faction holding a supermajority, constitutional revision is unlikely. Court rulings will be solicited by the minority if they are unable to prevail in parliament, testing the judiciary's independence and impartiality.

Timor-Leste's second challenge is to balance investments in mega-projects (e.g., along the south coast and in Oecusse) with funding public services (e.g., health care, education and social security). Objective evaluation of expectations and actual results could improve decision-making, considering whether the sustainable benefits of mega-projects outweigh the associated costs, risks and lost opportunities. Redrawing priorities to emphasize the formation of human capital would reinforce the country's capacity to drive economic development.

However, the state should also vigorously pursue the much-delayed program of decentralization in order to be better deal with important regional and community level issues, which have so far received scant attention. High levels of centralization result in lower levels of satisfaction and efficiency.

A serious effort is required to develop non-oil sectors of the economy. Although oil and gas resources might carry the country for another decade following the recent agreement with Australia, it is critical that other sectors of the economy (e.g., agriculture, industry and tourism) receive more public support. Foreign direct investment should be steered toward such ventures, following the examples of the recently built brewery and the planned cement factory.

Unfortunately, the last 12 years of dependency on petroleum exports has nurtured manifestations of the resource curse in policy-making, and many political leaders are unwilling or unable to envision a future without oil money.

Finally, preventing corruption requires decisive action, including increased political will. This will not be possible if the Anti-corruption Commission remains the only investigative body and if prosecutors remain unwilling to confront powerful people. The effective anti-corruption initiatives will require significant government efforts to support the development of the judicial branch and enhance its independence, together with public campaigns to combat the existing culture of acquiescence with corruption.