



TIMOR-LESTE BUSINESS ENABLING ENVIRONMENT

ROOT CAUSE ANALYSIS AUGUST 2018

The findings, interpretations and conclusions expressed in this material are those of the material's author, Dalberg and are not necessarily those of the Millennium Challenge Corporation.

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Acronyms

ANZ	Australia and New Zealand Banking Group
AACTL	Timor-Leste Civil Aviation Authority
ADB	Asian Development Bank
ADR	Alternative dispute resolution
AEMTL	The Women's Business Association
ASEAN	Association of Southeast Asian Nations
BEE	Business Enabling Environment
BizCLIR	Business Climate Legal and Institutional Reform
BNCTL	The National Commercial Bank of Timor-Leste
BNU	Banco Nacional Ultramarino
CA	Constraints Analysis
CCI-TL	Timor-Leste Chamber of Commerce
DFAT	Australian Department of Foreign Affairs and Trade
DNTFSC	National Directorate of Land and Property and Cadastral Services
EIA	Environment Impact Assessment
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GoTL	Government of Timor-Leste
IADE	Institute for Business Development Support
IFC	International Financial Corporation
JICA	Japan International Cooperation Agency
JSMP	Judicial Sector Monitoring Program
LFS	Labor Force Survey
LRC	Law Reform Commission
LTC	Legal Training Center
MCC	Millennium Challenge Corporation
MDF	Market Development Facility
MECAE	Coordinating Ministry of Economic Affairs
MFI	Microfinance Institution
MOJ	Ministry of Justice
MSME	Micro, Small and Medium Enterprises
NGO	Non-Governmental Organization
NPL	Non-performing loan
PPP	Public-Private Partnership
SEA	South East Asia
SERVE	Services for Registration and Verification of Entrepreneurs
SIA	Special Investment Agreement
SME	Small and Medium Enterprises
UNCITRAL	United Nations Commission on International Trade Law
UNDP	United Nations Development Programme
UNTL	National University of Timor-Leste
USAID	United States Agency for International Development

Executive Summary

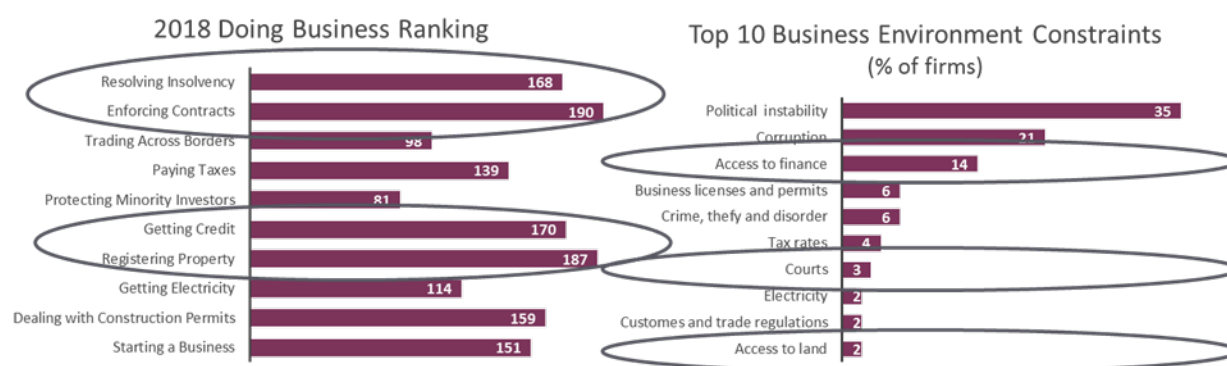
Background and Purpose

In December 2017, the MCC Board of Directors graduated Timor-Leste from a Threshold Program to a Compact Program. As a first stage in the development of a Compact Program, MCC conducted an integrated Constraints Analysis (CA) in collaboration with the Government of Timor-Leste. The analysis identified four binding constraints to growth: low sustainability and effectiveness of fiscal expenditures; an uncompetitive real exchange rate (Dutch disease); weak policies and institutions to enable market transactions (Business Enabling Environment); and low human capital as a result of lack of high skilled workers and poor nutritional outcomes. Within the business enabling environment (BEE) constraints, the report noted that Timor-Leste lacks a legal framework and judicial institutions to support contracts and their enforcement. This leads to inefficiencies and limits the number of business transactions that can occur, especially within the finance and land markets. Though noted as a secondary issue behind improved commercial contracts law, the report also cited the lack of an insolvency law as a challenge constraining the business environment. These constraints were reinforced based on an analysis of access to finance in Timor-Leste conducted by Dalberg. The report concluded that access to finance itself was not a binding constraint in itself, but that the aforementioned elements of the business enabling environment were degrading the ability of firms to access finance, as the absence of a stronger legal, regulatory and institutional environment in these three areas increased the risk for banks to lend.

This analysis presents a deep dive, root cause analysis into these BEE constraints identified in the CA.

Approach and Methodology

Standard analytical tools used to assess the business enabling environment presented somewhat of a contradiction with respect to the challenges for businesses in Timor-Leste (see figures below).



The World Bank's Doing Business methodology, structured to benchmark countries' ease of doing business based on the legal, regulatory, and institutional environment supports the conclusions of both the Constraints Analysis and the Dalberg study, suggesting significant weaknesses in the enabling environment with respect to the CA-identified areas, and the associated area of access to finance. However, the World Bank's Enterprise Survey¹ presents a different picture. When asked to indicate the top constraint to running their business, most firms surveyed selected political instability or corruption. Only 14% selected access to finance; only 3% selected courts; and only 2% selected access to land. So

¹ The World Bank Enterprise Surveys provides firm-level data from over 125,000 establishments in 139 countries. Data are used to create over 100 indicators that benchmark the quality of the business environment across the globe. Each country is surveyed every 3 to 4 years. In Timor-Leste, the last enterprise survey was conducted in 2015.

though relatively weak in all 3 areas, as measured by Doing Business, firms did not report these as the most pressing problems. Many factors could explain this difference. Doing Business is premised on standard cases that may not be relevant to all of the firms surveyed. For instance, they typically focus on domestic SMEs, so the experience of foreign or larger businesses is not captured. Further, by focusing on the de jure environment, it may not capture the de facto realities. As an empirical analysis, the Enterprise Surveys captures de facto perspectives and realities of firms. Further, with the Enterprise Surveys, we only can survey firms that exist. These firms have likely figured out how to operate in the current context, so though the business enabling environment may not represent leading practice, or even good practices, the firms surveyed have clearly figured out how to stay in business. If there was a way to survey firms that exited the market, or chose never to enter, the constraints considered by these firms might be quite different.

Given the perceived contradiction highlighted by juxtaposing these analytical frameworks, it was critical to apply an analytical method that allowed both an analysis of the legal, regulatory and institutional perspective, but also a method that included the voice of the private sector. We utilized USAID's BizCLIR methodology, which allows for a 360 degree view of the business enabling environment through stakeholder analysis of a given economy. It starts with a questionnaire organized around the topics covered in Doing Business, and analyzes the laws and regulations, implementing institutions, supporting institutions, and social dynamics associated with each. Per the scope of work, for this analysis, we concentrated specifically on the topics of "Registering Land" and Enforcing Contracts" and "Closing a Business". A key benefit of using this method is the inclusion of the voice of the private sector. By speaking with many firms across sectors, firm size, and market orientation, BizCLIR not only presents a view on the laws, regulations and institutions, but how the private sector interacts with them and perceives them. Though a typical BizCLIR report is structured with the key sections 'laws and regulation', 'implementing institutions', 'supporting institutions', and 'social dynamics,' the report structure was amended to focus instead on the key root causes of the constraints in each of the topical areas (while still incorporating the insights from each of the framework dimensions).

To complement the BizCLIR analysis, we also conducted 6 case studies of recent investments in Timor-Leste, with the intent to provide a broader view of the main challenges facing Timorese businesses (outside of the three focus areas of the BizCLIR analysis). Included among these 6 were both small and large investments from both domestic and foreign investors. The inclusion of the case studies was premised on a hypothesis that large foreign investors would not be constrained in the same way as smaller domestic firms. It was felt that not only could they avail themselves of foreign capital, thus not facing local access to finance constraints, but could also avail themselves of international dispute resolution mechanisms. By including the deeper case studies (which focused on a broader set of issues than the specific topics focused on through the BizCLIR methodology), in addition to the firms interviewed as part of the standard BizCLIR process, the analysis should help characterize the degree to which these weaknesses in the enabling environment are constraining operations and growth.

The fieldwork was conducted over a two week mission in Timor-Leste during which the team conducted interviews with 80+ stakeholder organizations and over 100 individuals, including 40 firms across sector and size class. Stakeholder consultations included:

- 40 businesses (including foreign and locally owned, and ranging in sizes between large and SME)
- 19 donor organizations
- 20 government stakeholders
- 4 banks/financing institutions

The team consulted with private companies across a range of sectors, sizes, and demographics, providing a rounded perspective of the BEE challenges faced by firms and enabling the team to better understand how challenges differently impacted different types of firms. Firms were from a range of sectors, with retail/trading, tourism, and hospitality being the most common. Similarly, firms interviewed were well disbursed across different firm typology. Almost a quarter of the private sector firms were women owned or managed. It should be noted that the sample of firms interviewed was not representative of the economy, where it is estimated that 90+% of businesses are domestic SMEs, with the majority micro firms.² This was done as the team wanted to understand the varying challenges and experiences of different size and sector firms, especially recognizing the important catalytic role that large, foreign firms can have on economic growth.

Firm Typology	Total	Sector*						Owner/ Managing Director	
		Tourism/ Hospitality	Services	Manufacturing	Construction	Retail/Trading	Extractives	Male	Female
Large foreign firm	10	2	0	1	3	2	2	9	1
Small foreign firm	11	2	8	0	0	1	0	11	0
Local firm with foreign partners/ connections	10	4	2	0	2	6	0	8	2
Local SME	9	3	1	0	1	5	0	3	6
Total	40	11	11	1	6	14	2	31	9

*Note that a number of businesses in Timor-Leste are conglomerations of multiple businesses. We have documented above the various industries that the firms participate in, when firm activities in those industries were covered during the interview. As such, the sum by business type adds to more than the total number of firms.

Six firms were selected for the case study transaction analysis. Selection of the large-scale transactions utilized a multi-criteria analysis approach that allowed for the consideration of various criteria for long-listing of cases, including:

- Potential Economic benefits
- Social, Political and Environmental Factors
- Practical considerations (including availability of stakeholders and supporting information)

The specific criteria considered was heavily dependent on the public information available during desk review and narrowed down through consultation with various stakeholders in country.

Key Insights

Our analysis showed that both commercial dispute resolution and access to land were binding constraints to firm growth, and served as a deep dive into the root causes of those constraints. These

² http://buildingmarkets.org/sites/default/files/pdm_reports/business_community_in_timor-leste_part_one.pdf

issues are closely interlinked, as unlocking the barriers to land access and effective use is dependent upon strengthening the capacity for commercial dispute resolution, such that cases can be more effectively and efficiently adjudicated through the judicial system. Similarly, limitations in access to finance are heavily dependent upon land and commercial dispute resolution, as constraints within these areas disincentivize banks from lending. The weak commercial dispute resolution practices means that banks stand little chance of recovering their money should debtors default on loans. In addition, lack of clear land rights limits banks' ability to accept land as collateral. As such, the perceived challenges with access to finance are at least partially the result of the constraints relating to land and commercial disputes.

Also in line with the initial CA, the analysis did not conclude that insolvency was a binding constraint. Though significant opportunity for improvement exists relating to insolvency policy, which could positively impact access to finance, it was not top of mind for either firms or banks. In addition, other constraints were noted, most prominent of which was access to skilled labor. As this was not a key focus of the analysis, further due diligence is required to reach a conclusion relating to this topic. Below we provide a high-level overview of the insights related to each of the BEE topics we sought to investigate.

Commercial Dispute Resolution

The ability to execute complex, enforceable commercial agreements between unrelated parties is an essential element for strong economic growth. Formal written contracts and a fair and efficient forum for the resolution of contractual disputes enable more sophisticated business relationships and promote investment. In the absence of this culture of contracts, trust-based contracting has long served as the basis for commercial relationships in Timor-Leste, and, perhaps in part because of Timor-Leste's size, the strength of those ties continues to serve a surprisingly large part of the business community, even in Dili. Nonetheless, economic growth and investment will require the ability to form relationships based on accepted norms that are enforceable beyond the local business community. Timor-Leste currently ranks 190 out of 190 for the Enforcing Contracts indicator of Doing Business, clearly there is room to adopt stronger practices in this regard. Below we highlight some of the key insights:

The legal framework for commercial transactions is largely absent, limiting the ability of courts to effectively adjudicate commercial disputes, and thus increasing the risk to operate a business in Timor-Leste. The country lacks a basic contract law or commercial code governing commercial transactions. Critical gaps exist in other areas of law relating to commercial transactions, such as competition law, intellectual property law, and the legal framework for secured transactions. The legal reform process has been slow. The challenges of limited legal proficiency in the country and the reliance on a variety of foreign advisors from varying legal traditions has created complications, as local authorities lack the knowledge and ownership of some of the laws being drafted. The absence of a clear owner of the legal reform process will continue to hamper progress until remedied. Without a formal functioning legal framework for commercial transactions, firms will continue to depend on informal mechanisms for resolving disputes opening them up to higher operational risk than experienced in countries where these mechanisms exist. This higher operational risk will factor into decisions of investors, though is less likely to impact SMEs who have fewer options.

The legal education system in Timor-Leste does not adequately prepare legal professionals to handle cases involving commercial law. This results in the reliance on foreign-owned legal firms established in Timor-Leste, who are more costly and not always accessible to smaller businesses. Further, the limited pipeline of professionals limits the capacity of the judicial system to efficiently adjudicate cases, disproportionately impacting the private sector, as the commercial cases are deprioritized over criminal cases. The National University of Timor-Leste is considered to be rigorous, where classes are taught exclusively in Portuguese. The failure rate is extremely high with only 15-20 out of a class of 160

graduating. At private local universities and universities in Indonesia, the courses tend to be in Tetum or Indonesian and are not considered to adequately prepare students, though 30-40% of Timorese lawyers receive their training via this channel. The Legal Training Center is a requirement for all students post law school with a heavy focus on Portuguese language training. As with the National University, a large percentage of students fail, attributed both to language and legal aptitude.

The court system in Timor-Leste is not viewed as a true option for dispute resolution, leading foreign firms to seek expensive international arbitration and leaving local firms with little recourse for resolving commercial disputes. There is insufficient capacity to support commercial dispute resolution. The court system has 32-34 judges in the country, yet the target was 47. Filling the vacancies is challenging given the thin legal profession and demands that are often placed on judges relating to reform. Further, the lack of familiarity with commercial law poses a challenge for judges in civil cases, requiring more preparation and education on specialized topics. Without a specialized commercial court, it is challenging to develop familiarity. Further weak case management and ineffective enforcement further erode confidence in the judicial system to effectively resolve commercial disputes. As an example of the impact of lack of ability to effectively adjudicate commercial cases, a foreign bank reported spending over three years attempting to recover defaulted loan obligations in 120 cases. Of these, only 7 reached a decision on the merits and only 1 received enforcement decision. After significant effort and cost by the bank, nothing was recovered. While foreign firms have access to international arbitration and use it for significant commercial issues, local firms and smaller disputes lack recourse.

Limited alternative dispute resolution mechanisms exist, leaving firms with no ability to resolve disputes outside of international arbitration (largely only available to large firms) or the ineffective court system. Traditional methods dominate at the village level, but there is no tradition of handling commercial disputes in this manner. A draft of an alternative dispute resolution law has been prepared based on the UNCITRAL model, but has not been passed. Even with passage of the law, significant assistance will be required with implementation. Some firms and institutions leverage foreign arbitration bodies foregoing reliance on the local system.

The culture of formal contract use is limited, resulting in many firms, particularly SMEs, doing business only within their known networks and preventing expansion opportunities. Contract enforcement, or enforcement of agreements, is primarily based on reputation. For small, local agreements, these methods can work. These types of businesses often resort to informal agreements based on existing connections and networks. However, it opens them up to risk. For example, a local agriculture SME noted that while they have contracts with their downstream customers, they maintain informal, non-contractual relationships with suppliers, potentially opening them to risk should suppliers not meet their commitments. While this practice is common among SMEs, these practices impede growth potential. When engaging with unknown parties and expanding to where values increase, enforceable contract mechanisms are critical. As the number of foreign businesses increase, and interest from foreign investors grows, the private sector will require a contract enforcement mechanism in which they can have confidence. For example, a large company with foreign connections is prevented from realizing franchising opportunities due to a lack of reliable supply/quantity that a culture of contracts and enforceability through the courts would enable. Clearly, all business has not halted due to the challenges of contract enforcement, but to unlock the economic growth potential of both foreign and domestic investors, the framework for commercial dispute resolution must be strengthened to encourage businesses to embrace new partnerships, clients and growth opportunities.

Land

The establishment of a land tenure system that clearly defines, registers, and has a mechanism to protect individual land rights has a direct impact on the private sector's ability and willingness to invest and expand businesses. An effective land administration and management system is based on the establishment of cadastral mapping of land parcels, a comprehensive and transparent land title registry, valuation mechanisms and a functioning land market, and land dispute resolution mechanisms. In Timor-Leste, access to secure land and the ability to use land as collateral is highlighted by stakeholders as one of the key issues inhibiting economic growth. Below we highlight some of the key insights:

Ownership restrictions and the lack of an active land market make accessing land for commercial purposes a significant challenge, increasing the transaction costs for both large and small investors in Timor-Leste. The land law (both current and new law) prohibit foreigners owning land. Thus, foreigners must utilize long term leases, either from public or private holders. Even with government support, securing the land can prove difficult with squatters or other occupiers posing a challenge. This results in wasted time and increased cost for firms. Further, Timor-Leste lacks an active private land market. Prospective local buyers (or leasers) face both a lack of available land and a high price volatility. Without any record of land transactions, it can be difficult to assess the true value, beyond one's willingness to pay. Private sector stakeholders indicated that this has led to higher land prices in the market, which most SMEs cannot afford.

With multiple historical title regimes, the lack of a formal and legally valid registration process, and incomplete cadastral mapping, security of land rights is a risk for firms which results in increased risk (and potentially cost) for businesses, and can limit expansion and growth opportunities. Given its history, the country has been exposed to a number of land regimes with various and often overlapping land titles. Pre-independence Portuguese and Indonesian titles, communal titles, USAID Project Ita Nia Ria land titles, and now the in-process cadastral mapping certificates (from the National Cadastre System project), all exist in today's environment, yet none of these represent a legally accepted land title under the current land system. As a result of this, firms often take dramatic measures to gain 'security.' One large firm with foreign connections requires up to four different 'proofs' of land ownership through various titles to feel secure prior to land purchase or lease. The newly passed land law provides a framework that will facilitate registration of land, but the necessary decree legislation has not been passed and thus no process is in place. Ultimately, this will rely on the updated cadastral mapping process, which will take several more years to complete. Given the challenges associated with land rights security and the aforementioned issues with dispute resolution, it's unsurprising that land dispute resolution is weak. No data exists on number of land cases or time to resolve, but anecdotal evidence from stakeholders indicated resolution can take 3-4 years. Resolving the barrier around land security will also require strengthening of the commercial court system, as outlined above.

Even upon passing of the legal and regulatory framework, the capacity of the Land and Property Department to administer the land system is limited, as they do not yet have the systems and staff in place to effectively allocate land or enforce title rights. Firms find the process of accessing government land excessively time consuming, as government is slow to identify and provide land. This is a particular challenge for local SMEs which have no support in the process. One local retail/trading firm noted having to visit the DNTPSC numerous times over the course of months in an attempt to find government land to lease, to no avail. The inefficiency represents an opportunity cost for firms. These firms typically obtain property through their local networks, at a rate higher than they would have paid for government land. For large firms, TradeInvest plays a coordinating role, but still can take 1-2 years to allocate and secure land for investment, based on recent experience. When their role is better defined as the new land law (and underpinning regulatory changes come in to force), the demands placed on this entity will increase. Processes, roles & responsibilities, and related institutional infrastructure will need to be

established, as there is a perception among firms that currently DNTPSC lacks authority and ownership, often deferring to SNC for issues that should be under their purview.

Though not the only barrier to finance, the overlapping title regimes and inability for foreign banks to own property (if repossession is required) inhibits access to finance for Timorese SMEs. Currently, the lack of an official title makes leveraging land for collateral purposes challenging. Further, as most of the banks in Timor-Leste are foreign, the limitations on ownership of land keeps foreign banks from lending on land, as they cannot currently repossess land. Clearly, land policy issues are not the only barriers to credit in Timor-Leste, but resolving these challenges would certainly be expected to increase access to finance on the margin. While the lack of lending appetite affects all businesses operating in Timor-Leste, local SMEs are hit hardest as they have no ability to tap into the external funding sources that are available to larger or foreign firms. The importance of land for Timorese, as one of their main assets and often the only source of collateral for finance, makes resolving land tenure security critical.

Insolvency

A strong legal regime for the fair and efficient reorganization or dissolution of a company in financial trouble can have reverberating effects far beyond the company and its creditors. Clear insolvency procedures promote innovation and investment, providing new entrepreneurs with the space to risk failure. Importantly, the legal framework for insolvency also protects the rights of creditors, particularly secured creditors such as banks, and thus unlocks access to finance across the business community. Though a barrier to growth, insolvency was not viewed among the key constraints to growth for businesses and investors in Timor-Leste. That being said, below are high-level insights of the analysis.

No Timor-Leste insolvency regime exists, inhibiting Timorese firms from employing insolvency practices to protect business interests and creditors. No laws relating to insolvency has been passed. As a result, the Indonesian law in force at the time of independence remains in effect. This law is obsolete, as Indonesia implemented comprehensive insolvency reform in 2004. Further, it has never been formally translated from Indonesian to either of the official languages of Timor-Leste. Without an insolvency regime, the typical institutional framework and complementary laws are also absent. A draft Insolvency Code was developed under the former Coordinating Ministry of Economic Affairs (MECAE), however these efforts have since stalled. Insolvency procedures presuppose the existence of other aspects of the business environment, including an effective court system to oversee the work of bankruptcy administrators and a level of sophistication in business dealings that make the existence of multiple creditors a challenge when companies default. Given weaknesses in the judicial system, and the current contracting practices of firms in Timor-Leste, there is little need for a modern insolvency regime nor is there likely to be much uptake in the medium term.

Other BEE Issues

Overall, the BEE constraints identified in the CA were echoed by most, if not all of private sector interviewees. Other issues were also frequently cited, including issues around lack of human capital, access to finance, language, and weak public administration. Though a deep dive assessment was not conducted in these areas, we captured these perspectives in our analysis. On human capital, a skills gap was noted. The gap was at several levels. First, tertiary and business skills was a significant gap noted by larger foreign firms, and is reflected in the preponderance of work visa requests, and their frustration with that process. As noted in the constraints analysis, this gap can also be seen in the high return to tertiary education in Timor-Leste. Beyond tertiary and business skills, smaller firms mentioned basic numeracy and financial literacy as challenges. Work ethic was also noted as a concern. Access to Finance consistently came up as a challenge for businesses, though as noted in the Dalberg analysis, much of this can be attributed to the enabling environment relating to land and disputes, though certainly other

issues persist, such as credit information infrastructure. Other themes that emerged were the challenges associated with linguistic diversity and history in the country and the implications for legal and regulatory reform. Weak public administration was also noted, but rarely cited as a key barrier.

Insights by Firm Type

As hypothesized at the outset, our analysis noted a significant divergence of how constraints impacted various business types. Though policymakers tend toward a more simplistic framework focused on firm size, many correlates of size exist that can further illuminate one's analysis. For instance, though highly correlated with size, foreign ownership often has implications that may not be applicable for large domestic firms. Firm age is another correlate that is often overlooked especially relative to job growth. Target market (i.e. local, national, regional, international) is also highly correlated with size and reflects growth orientation and sophistication.

Below we present a simple firm categorization and table providing topical insights into how the enabling environment is perceived by the different types of firms interviewed. Noted in parentheses are the number of firms interviewed within each size type to provide a perspective on the sample size.

Categorization:

- **Large foreign firm:** Large foreign firms bring capabilities and capital from abroad, and are thus not constrained by some of the factors that hamper local firms. Given the potential impact on the economy, they are often supported by government (e.g. TradeInvest); however, even with this support, the high-profile nature of their investments often makes securing land difficult, due to the incidence of squatters. These firms have the ability to use international arbitration mechanisms, and therefore are not as hampered by the weak commercial judicial system. For large firm, lack of adequate local skilled workers and challenges in expeditiously obtaining work visas poses a significant challenge.
- **Small foreign firm:** Though few, many of the professional services firms (e.g. law and accounting) fit in this category, as well as some retail/trade. Similar to large firms, these firms are able to take advantage of international arbitration mechanisms as well as financing from abroad. However, they lack the government support structures from which larger foreign firms benefit.
- **Local firm with foreign partners/connections:** Local firms with foreign partners or connections have enhanced capital or influence which allows them to overcome basic enabling environment challenges. In particular, these firms tend to have strong networks and government connections that local SMEs lack. However, they still face a number of challenges associated with securing land rights, finding adequately skilled labor, and resolving disputes through domestic courts.
- **Local SMEs:** Local SMEs are often the most impacted by BEE constraints, as they do not have the capital or influence to overcome some of the more significant enabling environment challenges. These firms lack the support structures afforded to larger investors and typically conduct business within their local networks, where there are existing relationships and trust built. In particular, SMEs have difficulty finding land (both through the market place where it is unaffordable and through the government) and lack viable recourse to resolve disputes, both of which contribute to their challenges with respect to access to finance.


































	Contracts and Commercial Dispute Resolution	Land	Other
Large foreign firm (10)	<ul style="list-style-type: none"> • Access to international arbitration mechanisms • No recourse in local disputes not falling under international arbitration • Limited local business conducted on credit 	<ul style="list-style-type: none"> • Unable to own land • Lack of local networks to identify land for lease • Government facilitation is slow/inefficient • Acquisition can be costly due to settlers • Additional cost associated with “ensuring” rights 	<ul style="list-style-type: none"> • Lack of local skilled labor availability • Foreign labor use hampered by work visa process • Limited local supplier quantity/quality resulting in external sourcing of inputs
Small foreign firm (11)	<ul style="list-style-type: none"> • Access to international arbitration mechanisms • No recourse in local disputes not falling under international arbitration 	<ul style="list-style-type: none"> • Unable to own land • Lack of local networks to identify land for lease • Additional cost associated with “ensuring” rights 	<ul style="list-style-type: none"> • Limited support in navigating processes around registration and licensing compared to large foreign firms supported through TradeInvest
Local firm with foreign partners/ connections (10)	<ul style="list-style-type: none"> • May be able to access international arbitration • No recourse in local disputes not falling under international arbitration • Lack of contract culture limits expansion opportunities 	<ul style="list-style-type: none"> • Limited active land market with high price volatility – difficult to identify/acquire land • Inability to use land as collateral for local finance • Additional cost associated with “ensuring” rights 	<ul style="list-style-type: none"> • Lack of local skilled labor availability • Foreign labor use hampered by work visa process • Limited local supplier quantity/quality resulting in external sourcing of inputs
Local SME (9)	<ul style="list-style-type: none"> • No recourse for disputes • Lack of contract culture limits expansion opportunities 	<ul style="list-style-type: none"> • Limited active land market with high price volatility – difficult to identify/acquire land • Difficulty accessing government land for lease • Inability to use land as collateral for local finance 	<ul style="list-style-type: none"> • Access to finance • Limited support in navigating processes around registration and licensing

Constraint Prioritization




Interventions must prioritize those constraint areas which can have the biggest impact on unlocking investment, be realistic for short-to-medium term implementation, and have limited risk and momentum for movement. These factors were mapped by the team below using a stop-light approach to ranking. Note that this approach is based on the team’s subjective assessment of these areas.

All investments must be realistic and tailored to the human capacity available in Timor-Leste. This challenge may require a phased development of the business enabling environment in keeping with the culture and capacity of public servants who must implement new laws and the desire and ability of the

private sector to use these institutions. This has been taken into consideration in the relative ranking of “short-to medium-term implementation”.

Constraint	Expected impact on unlocking Investment, if resolved*	Realistic for short to medium-term implementation	Low risk and momentum for movement
Commercial Dispute			
Lack of a clear legal framework for commercial disputes			
Ineffective judicial resolution of commercial disputes			
Lack of alternative dispute resolution mechanisms			
Land			
Limited access to land			
Lack of land rights security			
Limited capacity for land administration			
Inability to effectively use land or movable property as collateral for finance			
Insolvency			
Inability to resolve bankruptcy through formal insolvency procedures			

* Note that for a number of these constraints, “resolution” is dependent upon alleviating other constraints as well. For example, constraints around land access and land rights security will require that appropriate capacity for land administration is built such that these systems can function properly.

Legend	Expected impact on unlocking investment, if resolved	Realistic for Short- to Medium-term intervention	Low Risk/momentum for movement
	Strong direct impact on unlocking investment if resolved	Realistic for implementation of an intervention in short- to medium-term	Low risk, with perceived political will and support from civil society
	Would indirectly impact investment	Expected gains could be made in short- to medium-term, however full implementation might require a longer timeframe	Potential for risk, including questionable political will and potential for civil society resistance
	Limited or no clear impact on unlocking investment	Requiring longer-term intervention	High risk, with lack of political will and/or strong resistance among civil society

Further, the fit with the programs and activities of other donors operating in Timor-Leste is important, such that there is not a duplication of effort, but also so that there are donors who may continue the work after the Compact ends. The table below summarizes donor activities in each of the BEE areas.

Topic	Summary of Donor Engagement		Considerations for the Design of the Compact
	Prior Engagement	Current Engagement	
Commercial Dispute Resolution	<ul style="list-style-type: none"> • ADB supported MECAE in the development of the legal framework for commercial transactions (This was an activity under the ADB's Business Law Reform Program, which started in 2011 and still ongoing) • USAID and Asia Foundation conducted surveys of attitudes towards law and justice (ended 2012) • Oxfam provided continuing legal education for judges and prosecutors around suspended sentencing 	<ul style="list-style-type: none"> • Australian DFAT is currently funding a legal advisor to evaluate the status of civil cases in the court system under the NGO Judicial Sector Monitoring Program • UNDP is providing capacity building, policy making and coordination throughout the justice sector 	<ul style="list-style-type: none"> • Some engagement by donors in supporting judicial sector • Limited engagement in court reform for civil matters, as well as ADR
Land	<ul style="list-style-type: none"> • USAID's Ita Nia Rai land titling project titled 50k land parcels in urban areas (ended 2011) • ADB supported drafting of secured transactions law (This was an activity under the ADB's Business Law Reform Program, which started in 2011 and still ongoing) 	<ul style="list-style-type: none"> • JICA is supporting Dili urban master planning • Oxfam is providing capacity building to civil society institutions around land • Asia Foundation is providing leadership around policy dialogue and research on land 	<ul style="list-style-type: none"> • Limited donor engagement, with activities primarily focused on dialogue/research • Highly sensitive area, with strong civil society engagement • Reports of skepticism from civil society of 'outsider involvement
Insolvency	<ul style="list-style-type: none"> • ADB conducted a legal diagnostic of Timor-Leste's insolvency laws and supported drafting of an updated law (This was an activity under the ADB's Business Law Reform Program, which 	<ul style="list-style-type: none"> • N/A 	<ul style="list-style-type: none"> • Gap in donor engagement, but also not viewed as a priority area

Topic	Summary of Donor Engagement		Considerations for the Design of the Compact
	Prior Engagement	Current Engagement	
	started in 2011 and still ongoing)		

1. Introduction

Since gaining independence from Indonesia in 2002, Timor-Leste has faced high rates of poverty and extremely low levels of human development. The country's development has been shaped by the discovery of oil, which allowed Timor-Leste to reach the highest level of government capital expenditures in the world, as a percentage of GDP. Spurred by government spending, GDP, poverty, and health indicators saw significant improvement. However, private investment has remained flat and economic growth of the non-oil sector has been stagnant since 2011. Timor-Leste has announced an ambitious goal of becoming an upper-middle income country by 2030. However, to achieve this, significant private-sector led growth will be critical.

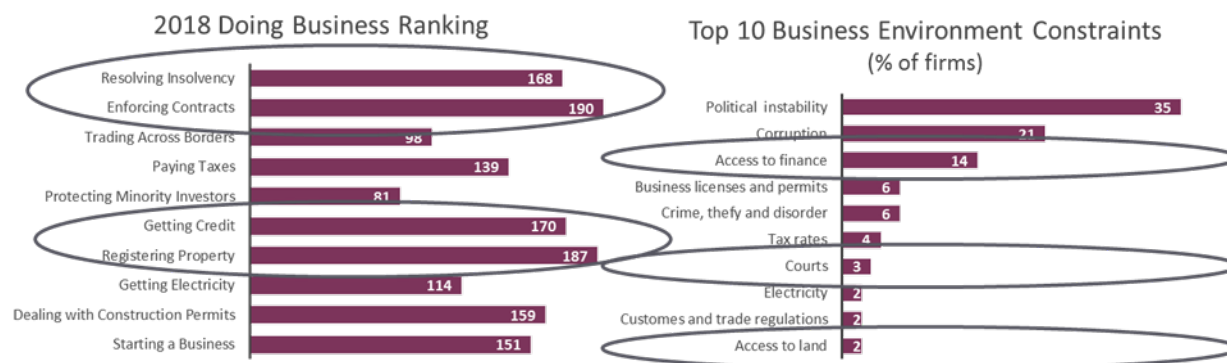
In December 2017, the MCC Board of Directors graduated Timor-Leste from a Threshold Program to a Compact Program. As a first stage in the development of a Compact Program, MCC conducted an integrated Constraints Analysis (CA) in collaboration with the Government of Timor-Leste (GoTL). The analysis identified the following binding constraints to growth: Public Financial Management, Human Capital, Dutch disease, and the Business Enabling Environment (BEE).

1.1 Background

The MCC's Constraints Analysis provided an initial effort to identify factors in Timor-Leste's business environment that adversely impact potential investors (both foreign and domestic) and businesses in a variety of markets and sectors. The initial analysis identified weak policies and institutions to enable market transactions as one of the key binding constraints to growth, citing that Timor-Leste lacks a legal framework and judicial institutions to support contracts and their enforcement. This leads to inefficiencies and limits the number of business transactions that can occur, especially within the finance and land markets. Though noted as a secondary issue behind improved commercial contracts law, the report also cited the lack of an insolvency law as a challenge constraining the business environment. While the Constraints Analysis did not identify access to finance as a binding constraint, it did identify some of the critical ecosystem-level issues impacting access to finance as gaps in legal framework and the inability to secure collateral (e.g. nascent land law), enforce contracts (e.g. judicial system challenges), and conduct credit appraisals.

1.2 Methodology and Approach

Standard analytical tools used to assess the business enabling environment presented somewhat of a contradiction with respect to the challenges for businesses in Timor-Leste (see figures below).



The World Bank's Doing Business methodology, structured to benchmark countries' ease of doing business based on the legal, regulatory, and institutional environment supports the conclusions of both the Constraints Analysis and the Dalberg study, suggesting significant weaknesses in the enabling environment with respect to the three CA-identified areas, and the associated area of access to finance. However, the World Bank's Enterprise Survey presents a different picture. When asked to indicate the top constraint to running their business, most firms surveyed selected political instability or corruption. Only 14% selected access to finance; only 3% selected courts; and only 2% selected access to land. So though relatively weak in all 3 areas, as measured by Doing Business, firms did not report these as the most pressing problems. Many factors could explain this difference. Doing Business is premised on standard cases that may not be relevant to all of the firms surveyed. For instance, they typically focus on domestic SMEs, so the experience of foreign or larger businesses is not captured. Further, by focusing on the de jure environment, it may not capture the de facto realities. For the Enterprise Surveys, we only can survey firms that exist. These firms have likely figured out how to operate in the current context, so though the business enabling environment may not represent leading practice, or even good practices, the firms surveyed have clearly figured out how to stay in business. If there was a way to survey firms that exited the market, or chose never to enter, the constraints considered by these firms might be quite different.

Given the perceived contradiction highlighted by juxtaposing these analytical frameworks, it was critical to apply an analytical method that allowed both an analysis of the legal, regulatory and institutional perspective, but also a method that included the voice of the private sector.

The EY/Dalberg team's approach to the engagement had two facets, an assessment of the Timor-Leste Business Enabling Environment, complemented by a transaction case assessment to provide a more practical perspective to the issues and constraints identified in the BEE analysis. In carrying out these two aspects of the assessment, our approach followed a three step process:

- Document Review & Mission Planning
- Stakeholder Engagement (In Country)
- Assessment and Report Development

Below, we will provide a brief overview of each step.



The root cause analysis leveraged BizCLIR, a standard USAID methodology for assessing the business enabling environment, which allows for a 360 degree view of the business enabling environment through stakeholder analysis of a given economy. The assessment focused primarily on the sections on Registering Property (Land only), Enforcing Contracts (Commercial Dispute Resolution) and Closing a Business (Insolvency) to assess the identified constraints from the CA. However, where other aspects of the BEE were identified as constraints by stakeholders, these were also included in our analysis. Per the BizCLIR methodology, constraints were assessed through a framework of four key dimensions: the legal framework, implementing institutions, supporting institutions, and social dynamics. Though a typical BizCLIR report is structured with the key sections 'laws and regulation', 'implementing institutions', 'supporting institutions', and 'social dynamics' the report structure was amended to focus instead on the key root causes of the constraints in each of the topical areas (while still incorporating the insights from each of the framework dimensions).

The topical constraints deep dive was complemented with six case studies of actual investments in Timor-Leste, 3 large, foreign transactions and 3 domestic transactions. The case studies attempted to identify the constraints, both perceived and actual, that those investors encountered. Recognizing that all investments may not be bound by the same constraints, the case analysis sought to provide additional perspective on how the key constraints are impacting different types of firms and investments, and how firms are doing business in light of those constraints.

The case studies were conducted utilizing a set of guiding questions around general areas, the three BEE focus areas, and other BEE challenges, broken down by stakeholder, including:

- Project Developer/Transaction Advisor
- Financier
- Regulator/Government Support

1.2.1 Stakeholders consulted

During the two week mission in Timor-Leste from March 12-23, the team conducted interviews with 81 stakeholder organizations and over 100 individuals. Appendix 1 contains a full list of stakeholders consulted. Stakeholder consultations included:

- 40 businesses (including foreign and locally owned, and ranging in sizes between large and SME)
- 19 donor organizations
- 20 government stakeholders
- 4 Banks

The team consulted with private companies across a range of sectors, sizes, and demographics, providing a rounded perspective of the BEE challenges faced by firms and enabling the team to better understand how challenges differently impacted different types of firms. Firms were from a range of sectors, with retail/trading, tourism, and hospitality being the most common. Similarly, firms interviewed were well disbursed across different firm typology. Almost a quarter of the private sector firms were women owned or managed. It should be noted that the sample of firms interviewed was not representative of the economy, where it is estimated that 90+% of businesses are domestic SMEs, with the majority micro firms.³ This was done as the team wanted to understand the varying challenges and experiences of different size and sector firms, especially recognizing the important catalytic role that large, foreign firms can have on economic growth.

Firm Typology	Total	Sector*						Owner/Managing Director	
		Tourism/ Hospitality	Services	Manufacturing	Construction	Retail/Trading	Extractives	Male	Female
Large foreign firm	10	2	0	1	3	2	2	9	1
Small foreign firm	11	2	8	0	0	1	0	11	0
Local firm with foreign partners/connections	10	4	2	0	2	6	0	8	2
Local SME	9	3	1	0	1	5	0	3	6
Total	40	11	11	1	6	14	2	31	9

* Note that a number of businesses in Timor-Leste are conglomerations of multiple businesses. We have documented above the various industries that the firms participate in, when firm activities in those industries were covered during the interview. As such, the sum by business type adds to more than the total number of firms.

Six firms were selected for the case study transaction analysis. Selection of the large-scale transactions utilized a multi-criteria analysis approach that allowed for the consideration of various criteria for long-listing of cases, including:

- Potential Economic benefits
- Social, Political and Environmental Factors
- Practical considerations (including availability of stakeholders and supporting information)

A long list of case studies for potential small-scale transaction was derived from input from stakeholder consultation in-country. Six firms were selected based on their ability to present experiences from a variety of sectors, diversity of sizes and ownership demographics, and had known challenges. For reasons of confidentiality, the details of these case studies will not be made public.

³ http://buildingmarkets.org/sites/default/files/pdm_reports/business_community_in_timor-leste_part_one.pdf

1.2.2 Analysis limitation

Though the team consulted with a wide range of stakeholders during our two weeks in country, there are some limitations to the data obtained which may impact the analysis conducted. *Section 6.4* outlines recommendations for further data gathering and follow-on research, based on the limitations outlined below and other gaps identified during our research.

As noted in the section above, a diverse group of firms by sector and firm size/typology was consulted. Interviews were conducted with stakeholders and firms located in Dili. As such, the perspectives of other urban areas outside of the capital, such as Baucau or Suai were not reflected. The perspective of the rural areas was provided in that agriculture wholesalers were able to comment on different experiences in rural areas; however the team did not visit these areas in-person. Further, the team did not focus specifically on those firms which are government contractors, limiting ability to comment on differences in constraints experienced by those firms with government

Other data limitations arose from the inability to connect with some key stakeholders until relatively late in the mission schedule. Access to the court system (Dili District Court and the Court of Appeals) was only gained during the last days of the mission. This limited ability for follow-up consultations which may have provided more insight into the details on how the courts operate (including case load of commercial, land and other disputes), better understanding of length of time various court procedures take, and the type of training provided and required of judges and other court employees.

Finally, the focus of the assessment with regard to land was on land as it related to the business enabling environment. Though other aspects of land including social and environmental aspects may have an impact on the country's development, these were not the focus of this study. The team's understanding of communal land and local dispute resolution capacity with regard to land was limited by a lack of fieldwork in rural areas.

1.3 Overview of the Economy

While not intending to present a comprehensive assessment of the Timorese economy, we reflect below on some of the key economic factors which were identified during our assessment as having strong impact on the business environment and inhibiting increased investment and private sector growth.

Over reliance on government spending: Outside of oil revenue, economic activity has largely been tied to government spending (value added from government consumption and investment corresponds to 75% of GDP).⁴ The government is the largest source of employment and income, as many businesses target government contracts. This has left significant vulnerability of the economy. As oil production has declined in recent years, so too has government spending. This, coupled with the political deadlock that left Timor-Leste without a state budget, has resulted in contracts not getting paid and a state that is facing substantial recession. The World Bank March 2018 economic update estimated a 1.8% decrease in GDP in 2017,⁵ acknowledging that this was a very conservative estimate.⁶ This is also met with a decline in public and private investment, and FDI has virtually dried up. Overall, gross fixed capital formation is projected to have fallen by some 20% in 2017. Several businesses interviewed reflected upon the impact of the recession. As an example, a large private firm in Timor-Leste, reported that their sales were down significantly in 2017, a result of stagnating consumption.

⁴ <http://documents.worldbank.org/curated/en/889001521523777495/pdf/124434-WP-P165266-PUBLIC-TLERMARCHFINAL.pdf>

⁵ Additional research might be necessitated better understand the impacts of slowdown on SMEs specifically.

⁶ <http://documents.worldbank.org/curated/en/889001521523777495/pdf/124434-WP-P165266-PUBLIC-TLERMARCHFINAL.pdf>

In one form or another, almost all private sector business is tied to government business and payments, whether directly or indirectly.⁷ Without government spending, there is, at the moment, limited movement of money in the economy. Many SMEs rely on government contracts. While larger firms have better ability to float credit and wait out this period of stagnation, these smaller firms are particularly hard hit. Further, lending by banks is most often tied to government salaries or contracts; preventing businesses from obtaining credit.

Need for diversification: With the decline of oil and gas revenues, there is a need for new sources of revenue, which has led to new focus on and political will for diversification of the economy. Tax revenue is low, and sustainability of the Petroleum Fund will depend on the ability to raise domestic revenue. Currently, there are only a few large taxpayers. In addition, the government's focus on providing large tax exemptions to attract FDI contributes to the erosion of government revenue. Expansion of the tax base will have to be phased along with the development of the economy.

In its Strategic Plan 2011-2013, the government has outlined programs and projects in strategic economic sectors including petroleum, agriculture and tourism, as well as in infrastructure, health, education and public sector management that will support greater global competitiveness as the GoTL undertakes regional and economic development.⁸ However, there is concern within the donor community that recent movement on the Greater Sunrise oil and gas fields, may result in a loss of the sense of urgency and motivation for diversification.

Missing Middle: The non-oil business sector comprises approximately 10,000 registered business entities; the majority small, locally owned and one- and two-person shared companies.⁹ Companies are based primarily in Dili and are mainly involved in construction, retail, and wholesale activities (these sectors account for 78% of the total business income and 62% of total employment in 2012).¹⁰ This missing middle (medium-sized firms comprise only 1.2% of all firms), limits the pool of economically active companies that can drive growth. Further, a large number of micro and small enterprises operate in the informal sector.¹¹

Young and Underdeveloped Labor Market: The 2013 Labor Force Survey (LFS) indicated that around 60% of Timor-Leste's population is of working age (15-64); however less than 31% participate in the labor force.¹² The labor force is expected to grow in the coming years, as Timor-Leste is a very young nation.¹³ In 2010, over 44% of the population was below 15 years old and just under one fifth of our population is aged between 15 and 24 years.¹⁴ These young people experience high rates of unemployment and many that do have work are engaged in unskilled jobs or unstable employment situations. According to the 2013 LFS, youth unemployment is double that of regular unemployment (21.9% to 11%). On donor estimated that youth unemployment may be much higher – around 40-50% of

⁷ The team did not specifically meet with government contractors as part of this activity, and as such cannot provide insight on the types of companies that have greater access to government contracts or any benefits they may derive from this that would allow them to circumvent the BEE constraints.

⁸ <http://timor-leste.gov.tl/wp-content/uploads/2011/07/Timor-Leste-Strategic-Plan-2011-20301.pdf>

⁹ While recent data does not exist, data from 2009 indicates that roughly 82% of Timorese firms are micro firms, 17% small, 1.2% medium and .3% large (Source: http://buildingmarkets.org/sites/default/files/pdm_reports/business_community_in_timor-leste_part_one.pdf). According to SERVE estimates, 45 percent of registered businesses are SMEs. The team was able to get two local definitions of SMEs. Per the Chamber of commerce, a micro business has 1-4 employees and annual profit of less than or equal to \$10,000; a small business has 5-20 employees and annual profit of less than or equal to \$29,000; and a medium-sized business has around 40 employees. IADE's definition differs slightly: micro business (1-2 employees); small business (5-10); medium (10-50).

¹⁰ Growing the Non-Oil Economy: A Private Sector Assessment. Asian Development Bank. 2015.

¹¹ <http://timor-leste.gov.tl/wp-content/uploads/2017/07/National-Employment-Strategy-2017-20301.pdf>

¹² <http://timor-leste.gov.tl/wp-content/uploads/2017/07/National-Employment-Strategy-2017-20301.pdf>

¹³ A result of unrest during the occupation by Indonesia, the country is largely missing the generation of 40-60.

¹⁴ Growing the Non-Oil Economy: A Private Sector Assessment. Asian Development Bank. 2015.

those in the 16-25 age bracket (not including self-employment). There is some evidence that youth engagement is a key focus area for growth, with organizations like the Junior Chamber International working with the Chamber of Commerce (CCI-TL) to increase opportunities for youth employment.

While labor market trends have shown an increase in productive activity, informal employment still remains high. According to 2015 census statistics, 18.7% of males and 8.4% of females are employed in the formal sector; whereby 42.7% of males and 35.4% of females were engaged in the informal sector (of these agriculture accounted for 36.6 and 28% respectively).¹⁵ The public sector is the main provider of formal employment.

Competitiveness of Timorese businesses: As Timor-Leste seeks to expand the private sector and identify key sectors where they could compete internationally (e.g. tourism and some agriculture sub-sectors), a number of stakeholders addressed concerns about Timor-Leste's competitive advantage. The link to the dollar means that the cost of labor is very high, and lack of skilled labor means productivity is low. Especially in light of the commitment to joining ASEAN, there are concerns that Timorese firms will not be able to compete against the Chinese or other countries in the region.

Further, small, locally-owned Timorese businesses have a hard time competing against large investors, which are seen to be the main focus of the government. Local firms, particularly SMEs, lack the access to finance, tools, and benefits that larger investors receive, hampering the growth of SMEs, who can't compete against foreign-owned businesses when they try to expand. One of the large business organizations in Timor-Leste highlights this situation as a concern, noting that there is no competition law in place to protect these firms. Supporting the SME sector can have a tremendous impact on employment and poverty reduction. Given that SMEs often face greater constraints, due to the lack of ability to avail themselves of work-arounds that large or foreign firms have available, alleviating BEE

Primary Business Support Institutions

Two key business support institutions that play central roles in facilitating investment and business set up are: TradelInvest (for larger foreign and domestic investments) and SERVE, the business registration one-stop-shop.

TradelInvest is Timor-Leste's Investment and Export Promotion Agency. Its goal is to facilitate and support potential investors located in Timor-Leste and to assist foreign companies in identifying projects and business opportunities that are emerging in Timor-Leste. The agency directly interfaces with investors and seeks to provide streamlined access to relevant ministries. The agency's main functions are:

- Promoting and facilitating investment and exportation
- Ensuring the improvement of the business environment
- Being a One-Stop-Service to local and foreign investors and exporters, facilitating an end to end process to get Investor/Exporter Certificate and/or Special Investment Agreement
- Monitoring and evaluating the progress of investments
- Providing post-investment assistance

Services for Registration and Verification of Entrepreneurs (SERVE) was created in 2012 to integrate, in a "One-Stop-Shop", all services related with business registration and licensing, which were before handled by the Ministry of Justice, Ministry of Finance and by the Ministry of Commerce, Industry and Environment, respectively.

¹⁵ Timor-Leste Systematic Country Diagnostic: Pathways for a new economy and sustainable livelihoods. The World Bank 2018

constraints can be expected to have a greater impact on these firms, and increase competitiveness of Timorese businesses. Ultimately, the Timorese government needs to do both – to continue to attract foreign direct investment while building the capacity of their domestic economic base which together can create robust value chains. Balancing the two will be a challenge, but is a necessity.

2. Commercial Dispute Resolution

The ability to execute complex, enforceable commercial agreements between unrelated parties is an essential element of a developed economy. In many developing economies, most trade is small-scale and local, occurring between community members or even extended family. These relationships are bound by trust and the reputational risk that comes from defaulting on an obligation in a small community. The use of formal contracts is often deemed unnecessary, and businesses rely on verbal or very simple written agreements. The same level of trust does not extend to outsiders, however, and trade beyond the community is often limited to spot transactions. The inability to effectively do business outside of one's local community can cause businesses to misallocate resources by continuing to operate at a suboptimal scale or creating barriers to the promotion of qualified individuals from unskilled labor to executive or managerial positions.¹⁶

Formal written contracts and a fair and efficient forum for the resolution of contractual disputes enable more sophisticated business relationships and promote investment. Court reforms in other countries have been tied to firm growth, more established credit markets, and more complex, large-scale production and trade. A 2004 study found that the ability to effectively enforce contracts is more important than the availability of skilled labor and physical capital combined in explaining the pattern of trade.¹⁷ By allowing greater specificity in business relationships, effective contract enforcement allows the production of specialized goods to flourish. The quality of a country's judicial system has also been tied to more robust credit markets, expansion of small and large firms, and overall economic growth.¹⁸

In Timor-Leste, the judicial system fails to provide an adequate forum for the resolution of commercial disputes. Timor-Leste ranks last in the world (190 out of 190 economies) for the Enforcing Contracts indicator of the World Bank's Doing Business index. According to Doing Business, enforcing a commercial contract in Timor-Leste takes on average 1285 days and costs 163.2% of the value of the claim.¹⁹ The courts are hampered by an incomplete legal framework for commercial transactions, inadequate training across all legal professions, and an inefficient case management system that often sees civil cases sink to the bottom of the docket. In practice, only large multinational companies and

KEY LAWS

- Civil Code (2011)
- Civil procedure code (2006)
- Companies law (2017)
- Law on business registration
- Draft secured transactions law (not yet passed)
- Draft ADR law (not yet passed)
- Draft recovery and insolvency code (not yet passed)

KEY IMPLEMENTING INSTITUTIONS

- District Courts*
- Court of Appeals*
- Ministry of Justice*
- MECAE (no longer existent)*

KEY SUPPORTING INSTITUTIONS

- Law schools
- Legal Training Center (LTC)*
- Foreign legal advisors*
- Law Reform Commission

¹⁶ Quintin, Erwan 2001. *Limited enforcement and the organization of production*. Center for Latin America Working Papers 0601, Federal Reserve Bank of Dallas.

¹⁷ Nunn, Nathan 2004. *Relationship-specificity, incomplete contracts, and the pattern of trade*. The Quarterly Journal of Economics, Vol. 122, No. 2, Pages 569-600.

¹⁸ Dam, Kenneth W. 2006. *The Judiciary and Economic Development*. John M. Olin Law & Economics Working Paper 287 (Second Series), University of Chicago Law School, Chicago.

¹⁹ Doing Business 2018. The World Bank. <http://www.doingbusiness.org/data/exploreeconomies/timor-leste#enforcing-contracts>. By contrast, the average time and cost in the East Asia and Pacific region are 565.7 days and 47.3% of the value of the claim.

banks can afford to pursue contractual claims in court, and Timor-Leste lacks a formal system for alternative dispute resolution through arbitration. Most businesses must resort to trust-based contracting relationships, restrict their interactions to spot sales, or rely on informal mediation or strong-arm tactics to enforce agreements.

Current contracting practices lower efficiency, reduce the size and complexity of commercial transactions, and place vast restrictions on access to finance. For example, a local food and beverage chain reported a desire to establish long-term supply contracts with quality and quantity specifications but is currently restricted to small-scale daily purchases of vegetables at the local market. The inability to enforce international brand standards has also restricted the use of franchising. The high level of risk associated with lending in the absence of effective contract enforcement mechanisms has resulted in an estimated \$700 million in potential financing remaining in offshore banks. Trust-based contracting serves as a basis for only micro-credit, and there is a general suspicion of providing supplier credit or other forms of value-chain financing.

As the economy expands and traditional cultural ties erode, businesses will need an effective fast-track forum for the legal resolution of disputes backed by a clear legal framework for commercial transactions.

2.1 Legal Framework for Commercial Transactions

To have an agreement enforced in court, there must first be clear legal rules guiding the interpretation of that agreement and the rights of the parties. In Timor-Leste, the law governing commercial transactions is incomplete, which significantly inhibits investment and limits the ability of courts to effectively adjudicate commercial disputes.

Lack of a basic contract law or commercial code: Timor-Leste lacks a basic contract law or overarching commercial code to govern commercial transactions. Aspects of contract law are covered in the Civil Code (Law 10/2011). The Civil Code is based on the original Portuguese Civil Code, which distinguished between civil and commercial (or economic) activities. Commercial contracts are subject to different legal presumptions and formalities than civil contracts. For example, civil contracts are subject to much more stringent requirements in terms of the use of notaries, which are considered too formal for commercial transactions.

Although the Civil Code distinguishes between these types of contracts, it does not provide a definition of what constitutes commercial activity. As commercial law reforms have progressed in recent years, new laws governing companies and business registration have been promulgated that also reference this distinction, but an overarching commercial law has not yet been enacted.²⁰ To resolve this problem, Timor-Leste could choose to follow the traditional civil law approach reflected in the current Civil Code, which would require providing the missing definition through future legislation, or could follow in the footsteps of other civil law countries such as Indonesia that have dropped this distinction, which would require amendments to the Civil Code.

Legal experts in Timor-Leste disagree as to whether a full commercial code is required or whether something less comprehensive, such as a basic contracts law, would be sufficient. Yet all agree that a

²⁰ In the absence of a Timorese code, the Indonesian commercial code in force at the time of independence technically should still apply. This code, originally enacted in 1848 during the Dutch colonial period to govern maritime trade with Venice, bears little resemblance to modern economic activity, and the part of the code that defined the distinction between civil and commercial activities was repealed in 1995.

clear framework for business transactions must be established that adequately covers the sale of goods and is in line with existing law.²¹

Critical gaps in other areas of law relating to commercial transactions: In addition to basic contract law, Timor-Leste lacks legislation governing many other critical areas of commercial law. There is no competition law, no intellectual property law, and no legal framework for secured transactions. The country also lacks complementary institutions to facilitate business relationships and access to credit, such as the establishment of effective land, collateral, and credit registries. As the economy becomes more sophisticated, an effective framework for insolvency will become important, as well as sector-specific laws such as a food safety regime to facilitate the export of agricultural products.²²

Process of commercial law reform: Many of the new laws passed since independence have been heavily influenced by the presence of Portuguese legal advisors, whose expertise derives from the Portuguese civil law system. As time progressed, Timor-Leste has slowly adopted aspects of the common law system brought by advisors from the US, Australia, and other common law countries. The result is a hybrid legal system that is part civil law and part common law, based loosely on the Portuguese and Indonesian systems²³ but with Anglo-Saxon elements.²⁴ For example, the proposed moveable property registry would adopt the common law practice of recording all liens in one central registry instead of separate registries for different types of moveable assets (e.g., vehicles, leased assets, etc.).²⁵

This heavy reliance on foreign advisors has at times led to conflict and delays in the reform process, as legal advisors must work together across differing languages and legal traditions. For example, a recent slew of commercial law reforms took place under the auspices of the Coordinating Ministry for Economic Affairs (MECAE), which was housed within the Prime Minister's office under the previous government. MECAE's mission included spearheading legal reforms for the economy, which were tasked to three legal advisors: two from Portugal and one Timorese. MECAE collaborated with the ADB and the International Finance Corporation (IFC) to hire legal consultants to support research and drafting of new commercial laws.²⁶ In general, the ADB or IFC would support the initial policy research to inform the drafting of new commercial laws, and MECAE (or a consultant hired by MECAE) would draft the law.

²¹ For a full analysis of the contract provisions under the Civil Code and remaining gaps, see Comissão para a Reforma Legislativa e do Sector da Justiça (CRL), Relatório Especializado: Quadro Legal da Legislação Comercial (August 2017), available at http://www.crl.gov.tl/sites/tlcrf/files/docs/2017/Business%20Framework%20Review%202017%20-%202022.final_s.pdf.

²² A more detailed review of existing gaps in the legal framework for commercial transactions can be found in Comissão para a Reforma Legislativa e do Sector da Justiça (CRL), Relatório Especializado: Quadro Legal da Legislação Comercial (August 2017).

²³ Indonesian law is largely based on the civil law system adopted from the Dutch.

²⁴ Extensive research and disagreement exists regarding the relative merits of a civil law or common law system, and stakeholders in Timor-Leste had widely divergent views on this topic. We decline to opine on the issue beyond stating that ultimately, the system chosen must fit with the culture and capacity of the local environment. One area in which this distinction has impacted Timor-Leste, however, is with respect to regional knowledge sharing. As a civil law, Portuguese-speaking country, Timor-Leste has benefitted far less from regional legal reform projects than many of its neighbors, as most of the legal systems in the region are based on the common law tradition and share English as their common working language.

²⁵ Note that there are no implications of this hybrid code for ASEAN ascension. The legal systems of the ASEAN members include common law, civil law, and hybrid jurisdictions. See: Wong, Joanne, On Legal Harmonisation Within ASEAN, Singapore Law Review, Vol. 5 (2013/14).

²⁶ The ADB supported development of the new companies law, the draft insolvency code, and the draft secured transactions law. The IFC provided similar support for the licensing law, private investment law, and creating a one-stop shop for customs, immigration, and quarantine.

Initially donor financed consultants also supported the drafting process, but as the advisors did not speak Portuguese, this structure quickly ran into difficulties of translation.²⁷ For example, for the draft secured transactions law, a consultant completed the first draft of the law in English, which was then translated into Portuguese. The translation used the Brazilian legal terminology, however, which is quite different from that used in Portugal and did not align with the existing Timorese Civil Code. MECAE and the ADB then had to form a task force to revise the draft, a slow process that was still under development at the time of the last elections. In later efforts, the legal drafting was left to the Portuguese attorneys at MECAE or consultants hired by them.

The Law Reform Commission

Headed by a well-known Timorese jurist, Dr. Jorge Graça, the Law Reform Commission (LRC) was established in December 2015 with a broad mandate to review existing legislation and evaluate the status of the justice sector with the goal of developing a comprehensive strategy for future reforms. Despite a small budget and limited staff, the LRC issued reports on a wide range of issues, including traditional justice, land reform, criminal law and procedure, the justice sector, and commercial laws. The LRC's tenure overlapped with MECAE's reforms, and the LRC provided comments on draft legislation produced by MECAE. The LRC presented its findings and recommendations, including a strategy for reforms through 2022, through public seminars and reports, which were presented to the new government in August 2017. It is left to be seen if the work of the LRC will be renewed after the next elections.

The final report of the Law Reform Commission is available in Portuguese on the LRC website at <http://www.crl.gov.tl>. Other reports are available in Portuguese, English, and Tetum.

Lack of clear ownership of reforms: The recent elections and subsequent changes to the structure and competency of government ministries have left many ongoing legal reforms in limbo. Under the new government structure, put in place after the elections last July, MECAE no longer exists, and its advisors have moved to new ministries or taken positions overseas. Similarly, despite public statements of support from the new Prime Minister, the Law Reform Commission's budget could not be extended, and its staff have been let go. Those reforms still underway at the time of the last elections, including the draft insolvency code, ADR law, secured transaction framework, and commercial code have been transferred to new ministries, whose commitment to the reforms is not clear.

Legal reforms frequently take longer than one election cycle. The regular reshuffling of government structures in Timor-Leste disrupts reforms and results in a lack of clear ownership over the process. Addressing this challenge will be essential to building a clear and consistent legal framework that promotes private sector investment and economic growth in Timor-Leste.

2.2 Legal Education and the Legal Profession

Inadequate legal education: The legal education system in Timor-Leste does not adequately prepare legal professionals to handle cases involving commercial law, nor to effectively perform their roles in the Timorese judicial system.

Law school: Anyone wishing to work in the judicial system must first attend law school. In addition to the National University of Timor-Leste (UNTL), which is considered quite rigorous, students attend private universities and Indonesian law schools. Classes at UNTL are taught exclusively in Portuguese to

²⁷ No specific costs were cited by the government or donors as to the cost of translation, and the private sector is not permitted to provide their own translators in court proceedings.

prepare students for working in judicial system. The failure rate at the UNTL is extremely high: of the approximately 160 students that begin law school, only 15-20 will graduate. At private universities and in Indonesia, courses are taught in Tetum or Indonesian, often using unofficial translations of Timorese law or even Indonesian law. An estimated 30-40% of Timorese lawyers receive primary legal education in Indonesia, and there is a general perception that these schools do not adequately prepare students to work in the judicial system, nor to succeed in passing the final stage of legal education at the Legal Training Center (see below).

These schools have only recently begun to provide background in commercial law. The UNTL was founded with the support of the UN in the period after independence. Given the post-war context, the curriculum originally focused on human rights, and corporate and commercial law has not traditionally been a priority. In the past four years, the UNTL has begun offering commercial law modules, taught by a Portuguese lawyer, but the courses are limited by the gaps in the legal framework identified above.

Legal Training Center: After law school, all students must attend the *Centro de Formação Jurídica* or Legal Training Center (LTC). In the absence of a national bar association, the degree received from the LTC effectively serves as the national bar exam. The LTC's mandate, defined in Decree-Law 18/2016, includes the initial training of new judges, prosecutors, public defenders, private attorneys, and notaries, as well as continuing legal education for all legal professions. This broad mandate is the responsibility of just 25 permanent staff, including only three full-time professors. The curriculum primarily includes a general review of civil law and procedure and criminal law and procedure, with 50% of class time dedicated to Portuguese language training. Short 2-3 day modules on specialized areas of the law, such as land, administrative law, family law, labor, public contract law, companies law, constitutional rights, and gender equality have begun to be offered where resources allow or are provided by outside donors. The LTC also occasionally arranges seminars for sitting judges and other legal professionals at the request of the Court of Appeals. A seminar on the land law is expected to be held in August of 2018.

All legal professions are taught together for the first year, after which the best students get first choice of profession from the list of job vacancies determined by the Superior Councils of the Judiciary, Public Prosecution, and Public Defender. Students then complete on-the-job training via a six-month practicum and one-year probationary period with the support of a tutor or mentor. As at the UNTL, a large number of students fail to pass the program. In the current class, of the 48-49 students who began the course, only 33 remained at the end of the first year. Failure is attributed partly to language issues and partly to legal aptitude.

Low access to legal representation: Of the 200 registered attorneys in Timor-Leste, only 70-80 live in the country. Many of these are foreign-trained lawyers working at local offices of foreign law firms or a handful of prominent Timorese firms. These firms primarily serve large companies and banks and charge fees in line with the legal market in their home countries. The quality of legal representation available to those who cannot afford these high fees is limited to Timorese attorneys who did not succeed in securing jobs with high-paid firms, or prosecutors and public defenders who have limited authority to take on civil cases but prioritize criminal work. There are neither courts nor attorneys in most rural areas.

Timor-Leste does not have a bar association to support lawyer education, professional ethics, or pro bono services. The International Bar Association has been working on establishing a domestic bar association, but the status of that project could not be ascertained.

2.3 Judicial Dispute Resolution

For commercial cases, the courts in Timor-Leste are viewed as a last resort, “praying for a miracle,” or an opportunity to advance one’s settlement position, not as a true option for dispute resolution. One estimate was that the average contractual dispute adjudicated through the courts takes 10 years from filing to enforcement. Many cases never reach a final execution of the judgment, and lawyers and companies both stated that they have little to no expectation of receiving final compensation through the court system. For one firm, of the 15-20 cases taken to court, on average it took 3-4 years from filing to the first ruling, and not one of the decisions has been enforced. The costs to business are staggering: one company reported spending \$1 million on legal fees for one case and up to \$600,000 on a second due to multiple adjournments and costs associated with the use of foreign counsel. In rural areas, the court system is virtually nonexistent, and these citizens have little exposure to formal law and justice.

Insufficient capacity to provide accessible and timely justice to all: The judicial system in Timor-Leste consists of four district courts in Dili, Suai, Baucau, and Oecusse and the Court of Appeals, which serves as the sole appellate court in the country. The Constitution of Timor-Leste envisions the establishment of the Supreme Court of Justice (to serve as the highest appeal court for the nation), military courts, and

Lack of ability for contract enforcement has resulted in 95% of a large service company operating nationwide require pre-paid service plans from customers. The remaining plans are blocked after 2 months of missed payment and every client is given a historic review. According to the company, justice in the courts is not an option due to the time and cost associated with going to court, without any proven results in the past. While the model of pre-payment appears to work well for some firms, other smaller firms indicated that they found their need to require pre-payment to be burdensome to the business, as it restrict business activity. Unless the other party has sufficient access to capital, they cannot move forward with a deal or end up doing work in stages which is time and cost inefficient for both firms.

additional specialized courts covering tax, audit, and administrative matters, but these courts have yet to be established. The existing court system was put in place under regulations passed by UNTAET following independence. These regulations provide for additional district courts, but the judicial system currently lacks the capacity to expand further.

Mobile courts, supported by the UNDP, have expanded access to justice to some rural areas in recent years. The initial pilot project included justice clinics and training in four municipalities of the Suai district. The initiative has since been scaled up nationwide. While popular, the mobile courts have had only a limited impact on civil cases. Of the 510 cases handled by mobile courts in the first half of 2017, only two percent were civil cases.²⁸ The courts also draw resources from the local district courts, which are already overburdened. The UNDP recently completed a review of the program, which will be presented to the GOTL in the spring of 2018. It is unclear if the program can continue without the support of the UNDP. A full discussion of other donors and the risks of intervention around judicial dispute resolution are

discussed in the recommendation regarding establishment of a commercial division.

Timor-Leste has a total of 32-34 judges in the country, which amounts to approximately 2.5 judges per 100,000 inhabitants.²⁹ Under the existing court structure, the Court of Appeals stated that the target number of judges is 47, which would bring the number of judges per inhabitant in line with averages in

²⁸ Data from UNDP.

²⁹ By comparison, a 2010 comparative study of 16 European countries recorded averages from 3.5 to 25.9 judges per 100,000 inhabitants. Council of Europe, CEPEJ 2010 report: Study on 16 comparable countries (2010), available at https://www.coe.int/t/dghl/cooperation/cepej/evaluation/2010/2010_pays_comparables_en.pdf.

developed countries such as the UK and Scotland. Filling the vacancies is difficult, as new judges must be drawn from the ranks of the LTC graduates and experienced jurists are often appointed to new political positions or have additional obligations outside of their courtrooms.³⁰ For example, the Prime Minister will soon appoint six legal experts to the new Land Commission, at least some of which are expected to be sitting judges. The new director of the LTC is a former Dili District Court Judge, and the President of the Dili District Court also serves as Vice-President of the Electoral Commission. The low capacity of the courts adds to delays experienced by litigants. One company reported that a hearing was delayed for a year due to an insufficient number of judges on the panel. The number of land disputes, including appeals from the Land Commission and those outside of its jurisdiction, is expected to increase in the coming years, which will further magnify the problem.

In addition to judges, the courts require a large number of translators to make proceedings accessible to all litigants. While Portuguese and Tetum are the two official languages of the judicial system, litigants speak a wide range of local dialects, Indonesian, English, and, increasingly, Mandarin. According to the President of the Court of Appeals, there are four translators working at the Court of Appeals and six at the Dili District Court. It is not uncommon to need to translate across multiple languages in the course of court proceedings.

Overall, it is of little surprise that a 2013 justice survey found that law and justice are not available to a vast part of the population, neither physically accessible nor in a language they can understand.³¹

We found no evidence of differential treatment of women in courts in commercial matters. However, we did not get the chance to speak with communities outside of Dili, nor did we examine handling of criminal matters such as domestic violence through the courts. It is likely that in community-level justice, even through the mobile courts (where proceedings are held publicly), women may well feel constrained by cultural norms and unable to assert their rights.

Lack of familiarity with civil law and procedure: As discussed above in the section on legal education, most Timorese judges graduate law school and the LTC without receiving a firm grounding in commercial law. Judges apply the Civil Code, but the complexity of commercial cases requires much more preparation on the part of the judge than a standard criminal case. Litigants report having to spend a substantial amount of time in hearings educating the judge on the applicable law. In addition, the civil procedure code is more demanding in terms of the level of proof required and the process of assessing documents presented by the parties. In general, judges simply are not comfortable in civil cases, unless the issues at stake relate to family matters.

Moreover criminal cases dominate the docket. One lawyer estimated that on average 9 out of 10 cases on the daily docket will be criminal in nature. Since there is no commercial court or division in Timor-Leste, all judges must have general competency. Judges have little opportunity to develop familiarity with civil cases in this environment.

Poor case management: The case management system further incentivizes prioritization of criminal cases. Deadlines under the penal code are stricter than for civil procedure, particularly if a defendant has been detained. Litigants suspect that civil cases, which require much more preparation, are often simply moved to the bottom of the file in favor of the high number of simple, small-scale petty criminal cases that are easier for the judges to decide. Although there are some procedural deadlines in civil

³⁰ Please see Legal Education Section above for the process and length of time that it takes to become a judge.

³¹ See Asia Foundation, Law and Justice Survey 2013. The survey found that only 50% of women and 69% of men had heard of a court. Of those who had been to court, 30% said they did not understand the legal proceedings.

cases,³² judges appear to have discretion setting the dates for hearings and ruling on adjournments. The delays in civil cases are so common and so extreme that many lawyers did not believe that judges were subject to any deadlines. The court clerks have little capacity to set or monitor time standards for ongoing cases. An electronic case management system has recently been introduced in the district courts and will soon be operational in the Court of Appeals. Internet service is poor at the courts, however, and stakeholders did not feel that the system has been maintained up-to-date.

Ineffective judicial enforcement of judgments: In Timor-Leste, only decisions involving public deeds or other types of enforceable titles, such as documents signed by a notary, are enforceable at the time of the initial decision on the merits of the case. Other judgments must go through a second court proceeding to enforce the judgment if the losing party does not voluntarily comply. After this second step, the judge can authorize a judicial sale of assets or seize bank accounts.

In practice, lawyers and companies reported few, if any, cases that had managed to clear this second stage of the process. Estimates of the amount of time it takes to clear this procedural hurdle varied widely from 1-2 years to “never.” For example, one law firm filed a case in 2003, received an initial decision in district court in 2008, finished the appeal in 2010, and then spent 5-6 years trying to execute the judgment.

Even those that succeed in enforcing a judgment often find that the assets to be seized have disappeared. One law firm reported waiting 1-1.5 months to have the court notify the bank regarding accounts to be frozen. Lawyers sometimes resort to creative solutions to avoid losing the assets in question. For example, a law firm has been waiting for 2-3 years to place a lien on a piece of property awarded in a court decision. The firm is pursuing a judicial sale of the property to satisfy the claim but ran into difficulty since the client is foreign and thus cannot legally have the property registered in his or her name. To avoid sale of the property by the defendant, the lawyers notified all notaries of the dispute and asked them to refrain from issuing any public deeds related to that property.

2.4 Alternative Dispute Resolution

In the absence of functional courts, litigants have few alternative fora for the resolution of commercial disputes.

Limited capacity of traditional dispute resolution methods: Timor-Leste has a strong tradition of informal mediation at the village level, usually guided by the *chefe de suco*, or village chief. Traditionally the *chefe de suco* handles family and land issues, not commercial disputes, but cases can extend to issues related to informal money lending and payment for services. Practices vary across the country, but in general, the local leader acts only as mediator, not as judge or decision maker. Mediation involves long discussions with the parties in an attempt to reach a settlement. The knowledge of the *chefe de suco* is limited, and local mediation does not provide a realistic option for the resolution of complex commercial disputes.

Lack of a legal or institutional framework for Alternative Dispute Resolution (ADR): The wide-ranging commercial law reforms tasked to MECAE included alternative dispute resolution. Dr. Jorge Graça wrote the initial draft of the ADR law in 2015 before his tenure with the Legal Reform Commission. Based on the UNCITRAL model, the draft envisions a private ADR industry with final appeal of arbitral awards in the courts. Lawyers and legal advisors familiar with the law spoke highly of it. The Council of Ministers approved the draft law, but Parliament did not vote on it before the elections.

³² For example, according to the Dili District Court, judges have 10 days to conduct an initial review of the pleadings and issue a summons, and they must make a final decision on the merits within 20 days of the end of a trial.

The draft law originally covered all types of disputes but ran into opposition from the Ministry of Justice, which felt it encroached on their jurisdiction and an ongoing mediation project involving JICA. To avoid derailing the process, MECAE opted to amend the law to cover only commercial disputes. When MECAE disbanded after the elections, the files concerning ADR were transferred to the Ministry of Justice. The draft will be open to revision and re-approval by the Council of Ministers under the next government, but it is not yet clear which ministry will be tasked with the reform.

After passage of the law, Timor-Leste will need substantial assistance with implementation, which will require training new arbitrators and mediators and establishing an ADR center. Despite these hurdles, the private sector has a clear desire to see arbitration become a viable alternative to the courts. Last year, two companies with a construction dispute approached the Chamber of Commerce and Industry of Timor-Leste (CCI-TL) to propose arbitrating the dispute at CCI-TL. The Chamber declined, as the law had not yet been passed, but the incident demonstrates the demand for alternative dispute resolution among the business community. With sufficient support, training, and stakeholder buy-in, an ADR mechanism within the Chamber of Commerce could be set up within 5 years. A similar effort in Bolivia managed to be self-sustaining, allowing the withdrawal of USAID funding, within 5 years.³³

Some companies and government institutions have taken disputes to foreign arbitration bodies including the Singapore International Arbitration Center or Australia for arbitration. For example a foreign-owned firm with key activities in exploration and production has established external arbitration procedures in their production sharing arrangements as well as contracts with other external subcontractors, so as better to protect themselves in the case of a dispute. While a good option for the wealthy, recourse to international arbitration is costly and out of reach for most Timorese businesses.

2.5 Culture of Contracts: How Contracts are Enforced in Practice

In practice, the vast majority of commercial disputes in Timor-Leste are managed without resorting to the formal judicial system.

Keeping business local – Contract enforcement through reputation: By far the most commonly cited solution to a business dispute was to negotiate a mutually acceptable solution. With a population of only 1.3 million, Timor-Leste has a small-town feel, even within Dili, and the business community remains very small. The reputational risk of defaulting on a business obligation is strong enough such that most people negotiate in good faith. Business is often family-based. Extensive familial and community lending can blur the line between social and business obligations. This structure has resulted in what one stakeholder described as “a complex web of inter-related debts.” With new business partners, people start with small transactions and slowly build up trust. Successful foreign firms have become part of the community, offering family days, health services, and job training for staff.

that
is
has

“We prize our credibility. It’s a small country, and we all know each other.” –
Female Business Leader

Incredibly, the trust-based community contracting mechanism extends even to the national bank, BNCTL. The bank issues a certain percentage of business loans backed by collateral that the bank knows it cannot enforce judicially (moveable property and land, instead of government contracts and salaries) and yet reports a non-performing loan (NPL) rate of only 0.70%.

³³ For greater discussion of Bolivia, other country examples, and guidelines for the development of ADR (both private and court-annexed), see World Bank, *Alternative Dispute Resolution Guidelines* (2011), available at http://siteresources.worldbank.org/INTECA/Resources/15322_ADRG_Web.pdf.

For anyone outside of this circle of trust, businesses offer very little credit, rarely use formal contracts, and often insist on spot transactions. For example, one young entrepreneur pays her agricultural workers as day laborers. She sells her produce to shops in Dili on the basis of verbal orders after she has presented them with a sample as proof of the quality of the product. One donor even reported being unable to invoice local suppliers of office supplies or catering services.

Strains on economic growth and access to credit: There are signs that the inability to enforce agreements beyond one's social network is already placing a strain on economic growth. Businesses cited examples of missed opportunities where they would like to expand operations but cannot reliably source specialized goods or enforce brand standards.

"I would love to lend \$2 million to real estate developers in Dili, but I have no appetite for it without proper security."
– Banker, large foreign bank

A purely trust-based contracting environment also places extreme limitations on access to finance. With the exception of the business loans discussed above, banks restrict lending to government salaries and public procurement contracts that are paid directly through the bank and serve as an informal

government guarantee on the borrower. A handful of well-established larger businesses manage to obtain financing on the basis of their cash flows, and wealthier foreign clients can offer foreign assets as collateral.³⁴ The structural constraints within the system thus become a competition issue, as Timorese businesses without government contracts or foreign ties quickly find that their only available sources of financing are microcredit and personal savings.

As one foreign bank explained, the problem is risk, not profitability. Even where the bank has tried to offer a loan to a trusted business partner, the agreements frequently get rejected by their overseas headquarters for failing to pass risk requirements.

Changing cultural norms: the need for a long-term solution: With the influx of increasing numbers of foreign businesses, the cultural ties that reinforce traditional contracting mechanisms are beginning to fall away. Particularly in Dili, a clash between business cultures is causing changes in cultural behavior towards contractual obligations. For example, one donor described a growing practice in which Timorese businesses subcontract government contracts to unregistered Filipino companies, requiring them to front the investment, and then label them illegal and cut them out of the transaction after delivery.

"It's a business strategy."
–Donor, describing a growing practice of Timorese businesses subcontracting to unregistered foreign firms and then refusing to pay for the services after delivery.

At the same time, people are becoming more open to the use of formal contracts, even when they know they currently have no recourse to enforce them. For example, a small restaurant that caters for embassies provides a formal contract including a quote plus a 50% fee in the event of late cancellation.

Some entrepreneurs currently walk a very uncomfortable line straddling between two very different contractual systems. The team met a coffee supplier who has a formal contract to supply a specific amount per year in exchange for services such as maintenance of a water pump. She knows that she has little recourse if her buyer failed to follow through on its end of the agreement. On the other side, she has only informal agreements with growers and thus no guaranteed source of supply to ensure that she can perform her end of the contract with the coffee buyer. To date, this arrangement has worked,

³⁴ This type of financing occurs between the foreign banks operating in Timor-Leste and foreign investors, such that both parties have the means to access courts in the foreign jurisdiction where the assets are located in the event of a dispute.

because the coffee buyer has held up its end of the bargain and the growers have banded together as a community to meet any shortfall in their commitments to the coffee supplier.

A foreign owned company operating in Timor-Leste avoids providing credit to its clients, because experience has taught them to be wary. In one instance, a client paid for \$6,000 of concrete supplies but requested an additional \$1,800 at delivery to complete the job. When the client refused to pay after the fact, the company felt it had few options:

“We threatened to break up the slab. There is no fast-track legal way to enforce.”

Where contractual breaches occur, businesses have no fast-track legal option for the resolution of disputes.

2.6 Conclusions

A large part of the value in access to justice is not in the use of the courts but in their ability to serve as a deterrent to bad behavior. In the absence of courts, a society needs some other institution or community norm to enforce compliance with contractual obligations. Trust-

based contracting has long served as the basis for commercial relationships in Timor-Leste, and, perhaps in part because of Timor-Leste's size, the strength of those ties continues to serve a surprisingly large part of the business community, even in Dili. Nonetheless, economic growth and investment will require the ability to form relationships based on accepted norms that are enforceable beyond the local business community.

The local bank noted that land title, courts, and secured transactions are currently not that important for their business model, because people generally respect and follow through on their obligations. They fear that as the economy grows, that cultural check on behavior may decline. Dili in particular is changing rapidly, with an influx of businesses from all areas of the globe with conflicting business norms and associated ethics. Before the existing norms erode further, it is essential to lay the groundwork for a clear, enforceable legal framework for commercial transactions and institutions that can provide a fair, efficient, and legal resource for the resolution of commercial disputes.

3. Land

Access to secure land and the ability to use it as collateral is highlighted by stakeholders as one of the key issues inhibiting sustainable economic growth in Timor-Leste. The implications of the land tenure system not only have direct impacts on the private sector's ability and willingness to invest and expand their businesses, but also have large-scale indirect impacts on the economy, a result of the insecurity felt by citizens that the land they own will not be recognized as theirs. Clarifying and strengthening the property and land tenure rights of local people is an important component to maintaining ongoing peace and stability in the country. Further, the importance of land for Timorese as one of the main assets, and often the only source of collateral for finance, makes resolving land tenure security critical if Timorese investors are to be able to compete in the market.

At the same time, the issue of land is one of the most sensitive issues among Timorese, amplified by the country's history of colonization and unrest. While handling the issue of land is undeniably important, the slow movement on this issue reflects the political sensitivity involved in it, as well as the risk of doing it incorrectly, and perhaps re-opening old conflicts.

An effective land administration and management system determines, records, and disseminates information about land tenure, value and use of land. It is based on the establishment of:

- A cadastral database which includes reliable information about existing land parcels (including boundaries, characteristics and resources)
- A comprehensive, and transparent land title registry, which includes information on ownership, nature of the interests, and often the value of the parcel (some of this information is often also included in the cadastre)
- Valuation mechanisms for compensation and taxation of land
- Mechanisms to resolve land disputes (ADR as well as through the court system)

Timor-Leste has recently seen significant movement toward the establishment of an effective land system, with the passing of the land law in 2017. However, significant hurdles still remain, particularly around implementation of the law. The land law establishes the framework and intention for implementation of a number of the critical aspects highlighted above, including a land title registry and land dispute mechanisms; however, a number of other necessary provisions (or sub-laws) are required fully implement these measures (see *Incomplete Legal Framework* below). This assessment takes into

KEY LAWS

- Civil Code (2011)
- Special Regime for the Definition of Ownership of Immovable Property (2017)
- The Law on Territorial Ordinance (2017)
- Expropriation Law (2017)
- Draft Decree Law on Definition of Public Domain (not yet passed)
- Draft Decree Law on Definition of Private Domain (not yet passed)
- Draft Decree Law on Land and Property Commission (not yet passed)
- Draft Decree Law on Registering of Land and Property (not yet passed)

KEY IMPLEMENTING INSTITUTIONS

- National Directorate of Land and Property and Cadastral Services, under the Ministry of Justice
- National Cadastre System
- Ministry of Planning and Strategic Development

KEY SUPPORTING INSTITUTIONS

- Law Firms
- Notaries
- Informal Land Brokers

account the plans for implementation of the land reform, as outlined in the new law, as well as the current capacity within existing institutions to implement the law.

The limitations of the current land tenure system and its implications for private sector development and investment, both foreign and domestic, can be broken down into four main areas that will be elaborated upon in the forthcoming sections. These are: lack of access to land, lack of land rights security, limited capacity for land administration, and impact of land on access to finance.

Incomplete legal framework: The 2017 Land Law, *Special Regime for the Definition of Ownership of Immovable Property* (13/2017) lays a legal framework in which the GoTL can begin to address land matters. The law replaces the previous transitional land law (1/2013) and provides a basis for several critical elements of an effective land tenure system, including the intention to title and register property, and the need for a mechanism to resolve property disputes. However, to be fully implementable, the 2017 law requires between 18-22 additional decree laws or regulations (e.g. without the passing of the *Registering of Land and Property* law, the policies, procedures, and authorities for property registration are not defined). Currently, legislators are focused on four initial decree laws that are viewed as most critical for implementation:

- Definition of Public Domain
- Definition of Private Domain
- Land and Property Commission Law
- Registering of Land and Property

It is intended that these four laws will be passed through the Cabinet of Ministers and approved by the President prior to the forthcoming election, so as not to lose momentum. Other decree laws (including a law on Communal Zones and regulations outlining procedures, forms, etc.) are on hold until after the elections. According to a legal advisor, there is no official list of the implementing laws and there is no official plan for the order or prioritization of the drafting of the remaining laws. The Minister of Justice has decided to prioritize the constitution of the Land and Property Commission and the public and private domains legislation because there are currently some widespread issues regarding property and land management that may be solved through legislative intervention. The next batch to be drafted will be decided by the next Minister of Justice, other relevant Ministers, and Parliament, depending on the matter.

The 2017 land law was also accompanied by two other laws. The *Law on Territorial Ordinance* (6/2017) lays the foundation for spatial planning at the national and municipal level and for the promotion and development of sectors and regions. The *Expropriation Law* (8/2017) establishes rules and procedures for cases in which that the state, with a view to pursuing an aim of public utility, and driven by the absence of other viable alternatives, can acquire real estate previously in the sphere of the private domain. This law provides the framework under which public utility, expropriation and resettlement practices are established. Given that the law was only recently passed, it was not clear to what extent it is able to be implemented or whether additional decree laws are required to define additional procedures for expropriation or resettlement.

Guidelines and responsibilities for the day-to-day land decisions including inheritance sale and lease of land continue to be governed by the 2011 Civil Code.

3.1 Limited Access to Land

The accessibility of land and challenges to acquire land differ based on the type of investor that is seeking land. This is both a result of the supporting provided by the government institutions as well as legal restrictions on foreign ownership of land.

Ownership restrictions: The land law (both the current system as well as the new law) prohibits foreigners from owning land. This means that foreign investors have two mechanisms by which they can acquire land: either through long-term government lease (typically for a period of 50 years) or by lease from private Timorese individuals. Additional challenges posed by foreign ownership restriction with regard to acceptance of land as collateral are discussed in *Section 3.4* below.

Challenges in accessing state land: Given foreign ownership restrictions, as well as to support private sector development in general, effective allocation of public land for private investment is crucial. Large investors are able to operate through TradelInvest, which plays a coordinating function and facilitates the access to land through the National Directorate of Land and Property and Cadastral Services (DNTPSC), acting as a one stop shop for investors. This process has been reported to take up to 1-2 years, in part because the government need to find the land to acquire, and also because they typically need to move current occupants and pay them out. However, even after identified, the government's ability to secure the land for investors is limited. Reports indicate that after land has been identified, often squatters or other occupiers will move onto the land and the government has limited capacity to clear them out. This creates significant delays to investors and adds additional costs. For example, one large company reportedly paid themselves to have the occupiers moved off the land, since the government lacked the funding to do so. In one case, the lack of access to secured land is one of the reasons that the investment considered pulling out of Timor-Leste. The team was told that there have been numerous investments that did not move forward because of this issue, however was unable to get specifics on particular investments or volume of missed investment. The issue of land security will be addressed in further detail under *Section 3.2* below. Smaller foreign investors who do not meet the investment threshold to qualify for a Special Investment Agreement, need to work directly with the DNTPSC to find government land, or work through local networks or connections to find private owners to lease land from.

Further, there is a lack of transparency around the valuation of state land. The private sector reported that the lease rates given to them by government lack transparency and that the government maintains the right to increase the lease by up to 50% at its discretion, creating much uncertainty for investors in their long-term financial planning. In the Suai district where the South Coast Development Project is underway, the government established a pricing schedule per square meter which was published in the Gazette. This artificially drove up land pricing for private land transactions. As part of the National Cadastre System (SNC) project (the nation-wide cadastral mapping project), the project is also establishing notional land values base on land characteristics, access to water, electric and sanitation, and presence and type of buildings on the land. This valuation is intended to be used for tax purposes and is not intended to reflect market value.

Government's Role in Identifying Land

For those investors seeking larger parcels of land, working with the government to identify an appropriate parcel is often the best option, as privately owned land tends to be smaller parcels. According to a businessman with multiple holdings, finding 10-20 square meters of land is difficult.

Government can be helpful in identifying land and supporting the process of relocating existing owners/occupants when necessary. However, their capability to be able to quickly identify and supply land to potential investors is limited. Even for an investment viewed as high-priority for the government it still took 2 years to find and secure the land. The experience of one large, foreign investment to obtain land in the location and size needed required numerous rounds of back and forth with the government, over the span of several years. Even now, the land which they have been given is facing issues of occupancy which is restricting moving forward with the investment in the way planned.

The experience of smaller Timorese firms in working with DNTPSC to identify land is reported to be even more challenging.

Lack of an active private land market: Outside of leasing public land, local investors also have the option to access land through leasing or purchase from private owners. Companies report experiencing challenges with both of these avenues.

Those seeking to rent or buy from private individuals are hindered by the lack of an effective land market in Timor-Leste. Prospective buyers face two main challenges: lack of land availability and high price of land. As a result, stakeholders indicate that there is no market by which land is actively bought and sold. Particularly in urban areas, land is scarce, with people not looking to sell the land they have.³⁵ A 2016 Asia Foundation Survey which probed deeper into the factors impacting the difficulty of obtaining more land in Dili identified lack of available land as a key constraint. 83% of respondents noted that there was "no more land available", 67% noted that "land is very expensive and I cannot afford it", 25% said that "land owners don't want to give/sell land" and 11% said that "the government does not have a good mechanism to give access to land." Respondents in the districts of Ainaro and Ermera similarly identified lack of land and cost of land as the main constraints.³⁶

The lack of record keeping of land transactions and documentation of sale values, means that the price of land is largely dependent upon willingness to pay, with pricing driven by those few families/individuals in the market which have higher ability to pay. According to one prominent real estate developer, land can go from 50 cents/square meter in rural areas; and \$5-400/square meter in Dili. Outside of Dili, knowledge of land prices is weak, as they are not recorded anywhere.

Further, lack of legal land titles, makes the purchase of land very risky, as the buyer cannot be certain that the seller actually owns the land. Many interviewed reported that finding the right person to buy land from, who has documentation which provides some level of assurance as to their ownership of the land, is a significant challenge and consider buying land a risk for the firm, even if the seller is one that has been on the land for many years, since there is no definitive way to prove ownership. Some, but not all are willing to take that risk.

³⁵ Note that the existence of an informal land market whereby properties are changing hands was not assessed in detail. One local SME noted the acquisition of their property through these means (domestic property from which they also operate their small grocer business), but this was the only instance that this was explicitly mentioned by interviewees.

³⁶ <https://asiafoundation.org/wp-content/uploads/2017/01/Survey-on-Access-to-Land-Tenure-Security-and-Land-Conflicts-in-Timor-Leste-1.pdf>

The institutions that would typically be available to support a land market in an economy do not exist in Timor-Leste. There are no formal real estate brokers or land appraisers in the country. Some interviewees indicated there are some 'informal' brokers operating in Dili who can help find land; however most interviewees who purchased land noted going through family or their own networks (governmental, NGO community, etc.) to find land. Given the lack of land appraisal as practice, pricing is determined based on either buyers' willingness to pay or influenced by government purchase prices.

There are between 8-10 notaries in the country (3 in Dili). Though required under the law to prepare and notarize land sales document in the form of a public deed, reports indicate that people often do not get their land sale documents notarized. Interviewees noted that notaries are overburdened, slow to provide services, and make many mistakes. Further, lack of mechanism to update land rights registered, makes the notarized deed ineffective. As such, the current notary system does not support an effective system of land use and transfer rights.

Lawyers play an important role in helping foreign investees, who might lack local networks, to navigate issues around land. While not having authority to locate land for clients, law firms often conduct due diligence for clients, including historic investigation of land ownership. Law firms also support their corporate clients in taking land disputes to court; however conversations with law firms indicate that such cases are rare and typically not worth the effort and time involved, due to the slow movement of the court and the insecure legal ground for land titles.

A locally registered law firm provides due diligence services to its clients around land which include inheritance certificate investigations and historic title investigation. They estimate that less than 3% of the cases they have investigated have produced any form of land title. Their due diligence process include going out into the communities, talking to Suco municipality administrators, village administrators and neighbors to try and verify ownership claims. This is both costly and time consuming activity, and results in little formal ownership assurance.

Lack of culture of commercialization of land: The issue of land is largely tied to cultural identity and there is a strong sense from the Timorese population that land policies should be established primarily to protect individuals' and communities' rights to land, and rectify past land injustices. Over 90+% of the land is perceived to be communal or customary land.³⁷

As a result, a skepticism exists regarding the concept of land for commercial benefit. Leading Think-Tanks in country argue against prioritization of land for large-scale private sector schemes over the use of land by local people. Particularly given that roughly 80% of the population are subsistence farmers, the understanding of the value of land for private sector development within rural communities is limited.

There is a strong resistance to government taking over what is perceived as communal land to provide it to the private sector. This may account for the occurrence of settlers/occupiers moving into land that has been allocated for private investment (such in the cases of two large FDI projects recently completed and/or pending). The population views large-scale allocation of land for private investment, such as the development of the Oecussi Special Economic Zone, with skepticism. For such large-scale investments, particularly those where land is being provided to foreign investors, there is a need for the

³⁷ Given that there is no mapping of land (this is in process through SNC), it is unclear what this 90+% perception is based in. This appears to be a view widely supported by the donor community, including the World Bank. Source: The La'o Hamutuk Bulletin, Land Justice in Timor-Leste, Vol. 11, No. 1-2 Feb 2010. The World Bank 2010 Justice for the Poor article references a source which projects customary land at as high as 97%. Source: <http://documents.worldbank.org/curated/en/175811468032401006/pdf/560060BRIQJ4P1149468B01PUBLIC1print.pdf>. Further, during the team's interview with Asia Foundation, this 90+ figure was also cited.

government to better make the case to the public that the investment will have a positive societal impact and contribute to poverty reduction. This skepticism is likely also linked to the historical periods of displacement, where people were forcibly removed from their land. Better messaging around this area will help to show people that investing in land for commercial purposes can have value.

The voice of civil society on land is captured largely through Rede Ba Rai, a network of 20 NGOs focused on land. This organization plays a strong role in society, commenting on laws and helping to mitigate disputes around land between the population and the government. The strength of civil society around land should not be undervalued, as civil society opposition was the reason behind the 6 year delay in passing the land law (it was felt that the original version did not adequately protect customary land rights). While overall of the view that the land law passed in 2017 benefits society and is “the best that could have been passed,” there is a distrust of the current SNC process with regards to cadastral mapping among the Rede Ba Rai organizations. Several members vocalized that the SNC has been directed to not engage with civil society. They view the SNC process of cadastral mapping (further described under *Section 3.2*) as lacking transparency and question the implementation of the process as it is outlined in policies.

Oxfam has taken on the role of supporting capacity building of Rede Ba Rai, and is working with the network to better identify how to move forward with its policy goals in a more productive manner.

3.2 Lack of Land Rights Security

Lack of official land titles: Access to land is only an initial challenge for investors. The far greater barrier

To help “secure” against the lack of official land titles, businesses wanting to lease or purchase land often go through extensive measures. One company interviewed requires the seller/lessor to provide as many as 3 forms of ownership: the Ita Nia Rai title, a document from the DNTPSC, and a letter from the Suco Chief. Following this, the contract is notarized under public ownership deed. The owner acknowledges that this burden falls to the land owner and that not all owners want to go through this process for a land transaction. For one block of land, the process took 6 months for the owner to gather this information.

inhibiting development and investment on land acquired is that lack of security of ownership of land. Currently there is no single legally accepted land title that provides full security of ownership. As a result of Timor-Leste’s history of colonization, forcible relocations, and displacements, the country has been exposed to a number of different land regimes, including Portuguese, Indonesian, and communal, all of which have left behind various (and often overlapping) land titles.³⁸

Further, it is estimated that land titles exist for less than 25% of the existing land parcels, with the majority of owners/occupants having no form of title for their claim.³⁹ When they exist, titles provide individuals with some sense that they own the land they have, but in reality do nothing to provide security of ownership.

Prevalence of tenure security concerns appear to be focused in urban areas: Concerns around land rights security is primarily experienced in Dili, where land is both scarce and in high demand, leading to increased competition for land. This is also amplified by the increased migration to the capital, with roughly 39% of new households in Dili established after 1999 (and 21% after 2008).⁴⁰ According to a 2016 Asia Foundation survey “Access to Land, Tenure Security and Land Conflicts”, the majority of respondents believe that they own the land they live on, despite not having land titles (in Dili, while 87% of respondents claim to own the land, only 54% report that having land titles).⁴¹ In contrast, land in rural areas, has largely been passed down through families for generations and there is acceptance of ownership due to these historical ties. Further, customary authority over land appears to be accepted.

The fear of eviction is also more prevalent in Dili, where 59% of respondents expressed fear that they will be dispossessed in the next five years. In contrast, in the regions of Ainaro and Ermera, this was only 3 and 5% respectively. Fear of eviction is largely based in the lack of mapping or definition of what government land is. The law outlines that unclaimed land (those without Portuguese/Indonesian titles after 1999) is government land; however much of this land is perceived by the people to be communal land, especially as there is no formal record of government “owned” land. According to the Asia Foundation, the “initial version of the [land] law established a chapter on protections against evictions to safeguard those that did not fulfil criteria established by the law for recognition of ownership rights or compensation. However, the protection was removed from the version that was passed and was left

³⁸ According to a 2016 Asia Foundation Survey, 20% of households in Dili state starting to use land during the Portuguese administration, 41% during Indonesian administration, and 39% after 1999.

³⁹ USAID Country Profile Property Rights and Resource Governance Timor-Leste. USAID. 2016. https://www.land-links.org/wp-content/uploads/2016/09/USAID_Land_Tenure_Timor-Leste_Profile.pdf. In the disorder during the withdrawal of Indonesian forces in 1999 and transition to independence, many public records (including records of land titles were displaced or destroyed).

⁴⁰ “Can a New Law Help Timor-Leste’s Land Rights Crisis.” The Asia Foundation. Jan 2017. <https://asiafoundation.org/2017/01/18/can-new-law-help-timor-lestes-land-rights-crisis/>

⁴¹ <https://asiafoundation.org/wp-content/uploads/2017/01/Survey-on-Access-to-Land-Tenure-Security-and-Land-Conflicts-in-Timor-Leste-1.pdf>

to be regulated by a lower level ministerial decree.” They estimate that the number of people who are not protected and may face eviction under the new law is as high as 28% in Dili.⁴²

Though donors estimate that the number of families effected by eviction to date has been modest, the stigma and fear of possible expropriation has taken root. Given the strong focus on community rights, and the ability to hold up investments until issues around eviction/expropriation are resolved, make this an important consideration for private investors (particularly large private investors with publicized projects).

The forthcoming public and private domain decree laws may provide some clarity that would help to better define the delineation of public vs private land. Further, the Expropriation law recently passed in late 2017 now provides a framework for expropriation and resettlement, establishing the principles behind public utility and expropriation, processes for expropriation as well as process for valuing the compensation for resettlement. Though it may require some additional Decree Laws to be passed in order to be actionable,⁴³ the law should lay the foundation for establishing clearer processes and security for those who may ultimately face relocation by the government.

Weak land rights security disincentives investment on land, both from SMEs that may not make long-term improvements/investments on their land as well as for larger investments that may lose faith in the ability to resolve disputes or provide clarity over rights.

Lack of formal and legally valid titling and registration process: In the last decade, efforts have been made to move towards establishing an accepted form of land title, first under the USAID-supported Ita Nia Rai project, which registered more than 50,000 claims to urban land, primarily in Dili, but also throughout all 13 districts, and provided “Ita Nia Ria land titles” in conjunction with the DNTPSC. Following the end of the project, however, movement with regard to land titling under the project stagnated and the government initiated a new national cadastre system project, awarded to a Portuguese-Timorese joint venture. The project began a cadastral mapping process of the whole country, issuing “certificates” to land claimants in cases where there were no disputed claims (see Section below on the current status of cadastral mapping). However, while providing one more quasi-title document for the land claimant, this certificate also has no legal bearing for land ownership.

While the new land law sets the foundation to establish a registration process, the decree legislation for implementation of a registry has yet to be passed. As such, there is no defined process in place by which formal and legally valid land titles would be registered and maintained in an independent registry database.

Incomplete cadastral mapping: The registration process that is envisioned is expected to be based off of the ongoing cadastral mapping that is being carried out under the Portuguese-Timorese consortium. Ongoing since 2014, the team has surveyed 200,000 of the expected 350,000 plots in the country. Of the remaining plots to be surveyed include a re-mapping of the 50,000 urban plots already done under the Ita Nia Rai project. The survey process includes documentation of land boundaries, key geographical features of the land, any buildings, as well as information on the claimant, including documentation of any existing titles or perceived ownership documents which the claimant can provide. According to the mapping team, the process allows for the registration of communal land under a group claim. Reports from both donor and civil society communities indicate that the process has not been systematic, nor transparent. The view of donor and civil society stakeholders indicate that the process has been rushed,

⁴² <https://asiafoundation.org/wp-content/uploads/2017/01/Survey-on-Access-to-Land-Tenure-Security-and-Land-Conflicts-in-Timor-Leste-1.pdf>

⁴³ The team was unable to get a comprehensive view of the decree laws still to be passed and whether any of these were related to expropriation/resettlement. This would be an area for further follow-up.

with insufficient outreach to the communities to inform them about the process and intent of the mapping. It is their view that people think the SNC process is more of an audit, rather than a pre-cursor to land registration and are therefore not taking the claims seriously. These stakeholders also highlight that rather than enabling registration of communal land, the program is encouraging individual registration of communal land, leading to inequity within communities. Further, reports indicate that the process leaves insufficient time to review and dispute land claims. After the public posting of ownership claims, respondents have 90 days to dispute ownership claims. Donors and NGOs active in this sector all view this timeframe as insufficient. These factors will likely result in additional disputed claims arising when the move towards land titling and registration based on the certificates begins. Further, the resistance to the process by civil society may pose a potential risk as the state looks to move forward with registration, should civil society move to question the validity of the certificates. The strength of civil society to delay and halt movement on the land issue should not be underestimated, as evidenced by the 6 year delay in passing of the land law, largely orchestrated by the civil society push to include better protection for communal land.

Weak Land Dispute Resolution Practices: While there are some mechanisms to resolve land disputes, the policies and practices around dispute resolution are weak. Currently the majority of land disputes are handled at the local suco level or through alternative dispute resolution mechanisms, such as through the Rede Ba Rai Network. At the suco level, the *chefe de suco* helps to mitigate land disputes between the two claimants; however has no formal decision making authority. If a dispute cannot be resolved through mediation, the case would then be elevated to the court system. Similarly, the Rede Ba Rai Network also includes a function for dispute resolution, having handled roughly 165 land disputes over the last 5 years. Rede Ba Rai's focus is primarily on disputes between communities and government, in cases where the government has made a claim to land and is planning eviction. Again, this organization functions primarily as mediators, but as a strong civil society leader also has some ability to apply pressure to the government. For those cases where mediation is not possible, Rede Ba Rai supports claimants in taking the case to court, providing legal support through some of the NGO members.

Few land disputes are taken to the courts. There is currently no record of the number of land cases reaching the courts – a request to the Dili District Court for data on the 2017 court cases was not met. An interview with a Dili District Court Judge indicated that land disputes comprise the majority of civil cases, but that on the whole the majority of cases handled by the court are criminal cases(not civil). Anecdotal evidence from a variety of private sector interviews indicate that the court processes are long (with reports of land disputes taking 3-4 years to resolve), largely a result of lack of capacity at the courts and limited motivation to tackle issues related to land. Many attribute the lack of movement in the courts, in part, to the delayed passing of the land law and the desire to wait until a new legal framework was established. Further, companies indicate, that even if the court does make a ruling in their favor, there is an inability to enforce the decision. From a legal perspective, the court does not accept proof of inheritance⁴⁴ or communal land titles, DNTOSC documents or certificates as valid documents; decisions are made based on existing Portuguese/Indonesian titles and in the case of sale, when there is a notarized proof of purchase. The Asia Foundation survey captured the public's lack of confidence in the DNTOSC and court system in resolving land disputes. In response to the question "In case of dispute over your land parcel, who do you think has the ability to solve it fairly", respondents in Dili responded as follows: 83% responded either the suco or village chief and 56% said formal

⁴⁴ Legal rights for land inheritance practices are captured in the 2011 Civil Code, but are also largely handled based on communal practice. Within communal practice, inheritance rights and practices are based on whether the community is matrilineal or patriarchal.

institutions. Outside of Dili, confidence in DNTPSC and the courts was even lower. In Ermera district, only 23% felt that formal institutions could solve it fairly, while 94% and 87% preferred the village or suco chief.

A Land Commission is being established to resolve land disputes captured under the process. Decree legislation to establish the Commission passed through Council of Ministers on March 20, 2018 and is currently with the President for signature. This is an attempt to shift the focus of dispute resolution from the overburdened courts to the Commission; however it will only be in place for the disputes that were documented under the activity (currently reported at 5% of land claims). The decisions of the Commission are intended to have the same weight as the court system,⁴⁵ but can be appealed in the district court. Other sources are skeptical of the Portuguese-Timorese consortium's land disputes estimates, placing total land disputes at closer to 10% of all claims. Given the reports of lack of transparency and understanding of the SNC process, is very likely that additional claims will arise during the move toward registration (and in the mapping and claims of parcels in Dili, which is still to come).⁴⁶ It is currently planned that such new disputes arising after or outside of the SNC process would continue to be resolved through mediation or go to the Dili District Court.

The process of establishing the Commission, including passing legislation, and appointing Commissioners is moving at a rapid pace, with the intention to have all judges appointed prior to the upcoming election. However, there is some concern that the President may not sign the legislation giving the political climate and upcoming elections. If the decree law is not signed, the legislation would go to the new Council of Ministers under the next government for approval. Further, given that the Commission will only focus on recorded disputes, it still does not address the fundamental gap in the court's capacity to handle land disputes in a timely and effective manner.

3.3 Limited Capacity for Land Administration

Weak administration capacity within DNTPSC: Though the primary government institutions tasked with handling land and property issues, there is a perception among firms that the Department of Land and Property has very weak capacity to execute its functions.

Further, some in the donor community who have worked closely on land issues believe that the volume of required legislation to implement the land law will be a struggle. Currently the MoJ legislative unit is in charge of drafting laws, with guidance and input from the DNTPSC. The legislative unit currently only has one legal advisor, and DNTPSC has none. This may pose a challenge for the drafting of additional decree laws.

⁴⁵ The Commission will be comprised of 6 Timorese legal officers who will have legal background (though it is unclear if they will come from the pool of existing judges in the Dili District Court of Court of appeals). Commissioners will also be supported by three land experts.

⁴⁶ Note that at the time of reporting, a large portion of Dili had not been mapped. It is expected that the number of land disputes will increase as cadastral mapping of Dili takes place.

Real Property Use

Urban and spatial planning is still at a very early stage in Timor-Leste. JICA is working with the government to develop a Dili Urban Master Plan and is providing an Integrated Planning Advisor to the Ministry of Planning and Strategic Development. Stakeholders interviewed, including donor agencies and private sector, note that there are a lack of authorities to license or regulate the specific uses of real property (including zoning authorities, construction authorities, etc.). This results in people building houses right next to public utilities or building across property boundaries without any recourse. Municipal authorities lack comprehension of zoning and construction codes and therefore are not in a position to help regulate property use.

Some legal experts consider that the lack of spatial planning and zoning limits the value of recently passed Expropriations Law, as there is no sense of what areas are planned for commercial vs. residential use, where roads will be built, etc.

Initial stage of data on land: The SNC mapping has laid the foundation for a database on land claims in Timor-Leste; however this is only an initial step and the comprehensive registry that also captures historical claims and records of sales of land is still needed.

Further, there is very weak data regarding land disputes. The district court notes that it has information on disputes; however, we were unable to obtain these. The DNTPSC does not appear to capture data around land disputes. This type of data, if captured by the DNTPSC, could better help to understand if there are issues around the cadastral mapping (e.g. volume of boundary disputes); whether the current government method of re-locating individuals to make way for investments is a significant issue (e.g. disputes between citizens/communities and government regarding expropriation) and perceptions of the public around land.

3.4 Implications of Land as a Contributing Barrier to Finance

There are several barriers to finance in Timor-Leste, particularly for SMEs.

While it is not expected that enabling land use as collateral will impact access to finance in all cases, on the margin it should improve access to finance. In addition, it may encourage expanded lending by international banks operating in Timor-Leste, which currently have very low loan to deposit ratios and low risk appetite (Lending is most frequently done against government contracts).

Inability to use land as collateral: The implementation of the land law (which calls for the registration of land titles) is an initial step in helping to enable the use of land as collateral, by providing assurance to Banks over the borrower's ownership of the land. However, some additional constraints around land/property were highlighted through stakeholder interviews that will continue to pose barriers to finance. The primary issue cited by foreign banks is the lack of foreign ownership rights. These banks note that they are unwilling to lend against land as they would not be able to take ownership of the land in the case of default. As such, even use of registered land as collateral is still perceived by foreign banks as 'unsecured lending.' Further, the lack of an active land market creates concern among lenders that even if they had ownership, they would not have confidence that they could sell the land, lacking a pool of potential buyers and a formalized, transparent valuation practices to have confidence in the value of the land. The only bank currently lending against land is the national bank, BNTCL (which is not restricted by these ownership laws). Though foreign banks were highly vocal on the issue of ownership, per the discussion in *Section 3: Commercial Dispute Resolution*, it is worth noting that even if foreign banks could own land, it is questionable whether these banks could take ownership of a land asset in case of default in a timely and cost effective manner, due to the weaknesses in the legal system.

Further, lenders indicate that a secured transaction law (which is in draft but has largely stalled) will not have a significant impact on lending. International banks appear to have little interest in lending against movable property and BNTCL is already lending against movable property.

Foreign banks indicated that, should the government provide a mechanism by which they would have the authority to use or transfer land without assuming ownership, or alternatively the authority for a temporary ownership, this would reduce their risk and they would have the potential to increase lending in the country.

3.5 Conclusions

The land law provides a foundational basis for land tenure security, however proper implementation of the law is critical for enabling a land regime that brings both security and encourages investment. There appears to be commitment and motivation within the government to push forward in finalizing the remaining legislation required for implementation, with some of the most central decree laws already in draft. However, a critical gap remains in the planning for and capacity to carry out registration of property claims, arguably the most important aspect of developing a transparent and stable system by which land can be claimed, owned, and used.

For the DNTPSC to be the owner of the land titling and registry, as is currently envisioned, this department will require significant capacity development. Additional skills are needed in terms of understanding of the land law as well as in building administration skills within the department. Further, to set up a registry which is easily updatable and accessible to the public, will require a technology solution that should be fully integrated with the ongoing cadastral mapping activities being executed by the SNC, as well as any future databases on land sale.

While the Land Commission is being established to settle land claim disputes that have arisen as part of the certificate process, there is still no strong judicial capacity to resolve land disputes that arise outside of the current process (of which there are likely to be several). This stems from the lack of judicial capacity to handle civil cases (see the *Section 3: Commercial Dispute Resolution* for more detail).

As a result of the lack of a land titling and registration system, the land market has remained underdeveloped, with lack of significant buying and selling of land, and difficulty accessing new land. This, coupled with the lack of land rights security upon acquisition increases risk of investment, and given implications for access to finance, can act as a deterrent for starting and growing business. Resolving these issues and developing a transparent and accountable land tenure system will go a long way to fostering private sector development.

4. Insolvency

A strong legal regime for the fair and efficient reorganization or dissolution of a company in financial trouble can have reverberating effects far beyond the company and its creditors. Clear insolvency procedures promote innovation and investment by providing new entrepreneurs with the space to risk failure. Insolvency measures prioritize the reorganization and sale of productive assets, which puts resources and employees back to work. Perhaps most importantly, the legal framework for insolvency protects the rights of creditors, particularly secured creditors such as banks, and thus unlocks access to finance across the business community.

KEY LAWS

- Indonesian Bankruptcy Law (1998)
- Draft recovery and insolvency code (not yet passed)

KEY IMPLEMENTING INSTITUTIONS

- Courts

Insolvency reforms in other countries have increased access to finance, decreased interest rates, and been correlated with stronger economic growth and entrepreneurship rates. In Brazil, insolvency reforms led to a 10-15% reduction in the cost of debt financing and a corresponding increase in the total amount of debt held by firms.⁴⁷ In Mexico, a new corporate insolvency law nearly doubled the average recovery rate for creditors and shortened the duration of insolvency proceedings by two-thirds.⁴⁸ In Tunisia, a variety of business environment reforms, including amendments to the insolvency law, resulted in a 5.2% increase in the real growth rate, a halving of the poverty rate, and an eight percent increase in the export of manufactured goods.⁴⁹ According to the World Bank, the average recovery rate percentage for creditors under the Doing Business index's Resolving Insolvency topic has been correlated with the availability of domestic credit as a percent of GDP.⁵⁰

An insolvency regime is a sophisticated system for the necessary winding down of business activities when a company fails. It can protect jobs, put productive assets back to work more quickly, and promote further entrepreneurship. However, insolvency procedures presuppose the existence of other aspects of the business environment, including an effective court system to oversee the work of bankruptcy administrators and a level of sophistication in business dealings and accounting practices that make the existence of multiple creditors a challenge when companies default. In Timor-Leste, the absence of these preconditions reduces the need for an insolvency regime in the short or even medium term. While not a top priority right now, the issue should be revisited as the economy develops.

4.1 Legal and Institutional Framework for Insolvency

Outdated legal framework: Since independence, no laws have been enacted in Timor-Leste to address bankruptcy.⁵¹ In the absence of Timorese law, the Indonesian law in force at the time of independence remains in effect. Indonesian Bankruptcy Law (Law 4/1998) provides basic provisions for the rights of debtors and creditors in a bankruptcy. The law itself is obsolete, even in Indonesia, which implemented comprehensive insolvency reforms in 2004. The law also cannot be effectively implemented as it references institutions that do not exist in Timor-Leste. Moreover, the law has not been formally translated from Indonesian⁵² to either of the official languages of Timor-Leste, and, as noted in the discussion of language issues elsewhere in this report, judges are generally reluctant to apply Indonesian law. Local lawyers confirmed that there are no cases in the court pursuing formal reorganization or liquidation of a company in bankruptcy. Under the World Bank's Doing Business methodology, without actual bankruptcy practice, Timor-Leste scores a zero on the measure of the strength of the legal framework for insolvency despite the technical existence of bankruptcy procedures.

Nonexistent institutional framework: Given the lack of insolvency practice, Timor-Leste has never needed nor invested in the development of various institutions and industries necessary to support a robust insolvency regime. There are no bankruptcy trustees or administrators, few valuation or auction professionals who could assist with the liquidation of corporate assets, and judges lack the capacity and expertise to enable them to effectively supervise insolvency proceedings. In an environment with very low financing to business, there is also little to no practice of creditor collaboration that could lay the

⁴⁷ Araujo, Aloisio P.; Ferreira, Rafael V. X.; Funchal, Bruno 2012. *The Brazilian bankruptcy law experience*. Journal of Corporate Finance, Volume 18, Issue 4, Pages 994-1004.

⁴⁸ Menezes, Antonia 2014. *Debt resolution and business exit: Insolvency reform for credit, entrepreneurship, and growth*. World Bank Journal of Public Policy.

⁴⁹ Nasr, Joanna 2009. *Tunisia: Transition to open markets and an improved insolvency process*. World Bank, Celebrating Reform.

⁵⁰ Menezes 2014.

⁵¹ The terms bankruptcy and insolvency are used interchangeably throughout this report.

⁵² Information on the rights and responsibilities of debtors and creditors described in the Doing Business report was drawn from survey responses provided to Doing Business by attorneys in Timor-Leste who are familiar with the laws.

foundation for the use of creditors' committees as is common in insolvency proceedings in other countries.

Lack of complementary laws and institutions to promote access to finance: One of the primary benefits of an insolvency regime is facilitating improved access to finance. However, any eventual insolvency code will require a host of complementary institutions and legislation supporting the finance community before it could see substantial uptake as a mechanism for debt enforcement. At present, Timor-Leste lacks a legal regime for secured transactions, a well-implemented land law, and registries for land or moveable property that could enable secured financing. Banks and other creditors also lack a centralized means for assessing the creditworthiness of loan applicants. While a credit registry has been established at the Central Bank, its use is voluntary and has not yet been adopted systematically by banks. Debt enforcement must be authorized by judicial decision and carried out through the courts, which substantially hinders the ability of creditors to legally seize collateral. Without the resolution of these issues, an insolvency code would likely have little impact.

Stalled legislative reform efforts: As part of a range of commercial law reforms, the GoTL contracted the drafting of a new insolvency code. The background research was conducted by a consultant with support from the ADB, while the draft code was completed by a Portuguese lawyer and law professor from Coimbra, Portugal. The draft *Código de Recuperação e Insolvência* (recovery and insolvency code) proposed wide-ranging reforms, requiring amendments to the civil procedure code, criminal penalties under the penal code, and downgrading the priority of fiscal creditors and claims in bankruptcy proceedings.

Although it uses slightly simplified language, the draft code has been criticized for adhering too closely to the Portuguese model (which is based on the German system) without regard for local conditions and capacity. In particular, it proposes strict timelines on the court, insolvency agency, administrator, debtor, and creditors that aren't feasible in Timor-Leste and requires setting up a new insolvency unit with the resources and capacity to oversee the industry. Sessions were held at TradeInvest in English and Tetum for comment from the legal and business community, including law offices, banks, and private companies. Despite objections, the draft code was sent to Parliament in 2017, which failed to vote on it prior to the elections.

4.2 Insolvency in Practice

As discussed in the *Section 2: Commercial Dispute Resolution*, parties generally limit their exposure to insolvent trading partners by conducting business with trusted partners or through spot sales. Many business transactions take place with no provision of credit, promise of a specific quantity to be delivered, nor warranties regarding the quality of the product. In this environment, a business can disappear or reopen under a new name with few repercussions for trading partners. The general consensus among stakeholders was that the barriers for businesses in Timor-Leste relate more to entering the formal sector than exiting it.

When issues do arise, businesses tend to work out any disagreements through negotiation. One party may ultimately accept to write off a loss, but both parties work in good faith to resolve the issue and the overall financial exposure is generally low. For example, a landlord may float 1-2 months of rent or a business may advance delivery of goods or services without pay to help a business partner get back on their feet. With no true judicial recourse for trading partners, businesses can continue operating at a loss for some time without going out of business. Stakeholders referenced restaurants and hotels that are technically "trading insolvent."

The reputational risk of default is such that when businesses do cease operations at a loss, they will go to lengths to negotiate an acceptable settlement with employees and business partners. This situation is particularly acute for western NGOs and businesses who may foresee future operations in the country or risk to their reputations back home.

If a business negotiates a good faith settlement, there does not appear to be a stigma associated with business failure. If the business defaults on its obligations, however, particularly when the creditor is quite powerful (such as a bank or prominent family), the repercussions can be substantial. Stakeholders reported that such a falling out in a small community could make it essentially impossible to start a new business in the future.

4.3 Conclusions

Given weaknesses in the judicial system, lack of complementary legislation for the finance sector, and the current contracting practices of firms in Timor-Leste, there is little need for a modern insolvency regime nor likely to be much uptake in the medium term. In addition, the code will likely encounter substantial implementation challenges as it requires the development of entirely new professions and a long-term campaign of socialization within the business community.

Insolvency reform will no doubt find traction eventually, and as the economy grows more complex and the cultural checks on business behavior decline in strength, more formal insolvency protections and procedures will become necessary. As estimated by a variety of stakeholders, insolvency reform has a ten-year time horizon rather than any realistic short or medium-term feasibility. The only short-term impact of passing a new insolvency code would likely be an increase in the country's Doing Business score on the Resolving Insolvency indicator. Absent other reforms, the existence of an insolvency regime on the books would be unlikely to unlock access to finance. Adding an additional layer of institutional management of business transactions, along with sharp penalties for failure to voluntarily submit to this process, seems completely out of touch with the reality of doing business in Timor-Leste and more likely to do harm than good in the short run.

5. Other BEE Constraints

Overall, the constraints identified in the CA were echoed by most, if not all of private sector interviewees (with the exception of insolvency). Weak land tenure and court systems are routinely cited as key constraints to business. However, other issues in the business enabling environment that were also frequently cited, include issues around language, lack of human capital, weak public administration and lack of access to finance. Below we capture the feedback received on these constraints.

5.1 Language

For a country with a population of only 1.3 million, Timor-Leste has tremendous linguistic diversity. Timor-Leste has two official languages (Portuguese and Tetum), two working languages (English and Indonesian), and a wide range of local languages and dialects spoken in rural areas. The linguistic divide is both geographic and generational: most of the Portuguese speakers are over 60 years old and were born during the colonial period; the younger generation primarily speaks Tetum and, increasingly, English. In a nominally lusophone country, it is striking that only a handful of more than 80 interviews conducted by this team required translation from English. Public schools teach in Tetum or Indonesian,

but many students speak a local dialect at home. According to the 2015 census, only 6.1% of the population identifies Portuguese as their 1st, 2nd, or 3rd language, compared to 87.2% for Tetum.⁵³

Limitations on access to legal rights and formal institutions: Despite low levels of proficiency in Portuguese, all laws are written in Portuguese, and Portuguese is the primary language of the courts and Parliament. Language barriers present a major constraint to access to justice and public awareness of legal rights and responsibilities. In practice, court pleadings are typically submitted in Portuguese, but most court proceedings take place in Tetum or must be translated from any number of local dialects. In addition, a variety of Indonesian laws remain in force that have not been translated, and judges who are uncomfortable with the language are reluctant to apply the law.

Recognizing the strain on court resources and access to justice the current Minister of Justice favors the eventual move to a fully bilingual or Tetum-based legal system (which would require translating all laws to Tetum).⁵⁴ Translating laws into English would be useful to the donor community and for ASEAN, but the government would be unlikely to sanction them as official translations is not in an official national language. Efforts to adopt a bilingual system have been stymied by the fact that, despite being the primary language of 30% of the population, legal Tetum is being developed as the laws are being translated. It lacks certain verb tenses and does not yet have the vocabulary to adequately translate complex legal terminology. Official translations of laws can be awkward, involving literal translations or the insertion of words borrowed from Portuguese or English. Some judges find it more difficult to read the Tetum version than that in Portuguese, which may be their 3rd or even 4th language.

Efforts to make the legal system truly bilingual will require developing legal Tetum. The government recently passed Decree-Law 11/2017 *Regime Utilização das Línguas Oficiais no Sector Justiça*, which establishes the *Conselho Especializado para o Desenvolvimento do Tétum Jurídico*, a special commission for the development and standardization of legal Tetum, with representatives from the Ministry of Justice, courts, prosecutors' office, public defenders, and National Linguistic Institute. At present, a translation unit within the Ministry of Justice works with the original Portuguese drafters of the laws to achieve an official Tetum translation that adequately captures the intent behind the law. The LTC provides students with a Tetum legal glossary of terms that have already been established.

Increased costs to government and business: In the business community, Indonesian and English are much more commonly used. Requirements to use the official languages create additional burdens and cost on business. For example, the new consumer protection law will require all printed materials to be published in one of the two official languages of Timor-Leste, while businesses typically publish in one or both of the working languages to facilitate customer access. Even the websites for government agencies show a preference for English. For example, business surveys published by the statistics department are available in English or Tetum but not Portuguese. Procurement laws on the Ministry of Finance website are available only in English.

Overall, language challenges increase costs to business and the government, inhibit access to justice and formal government institutions, and reduce Timor-Leste's competitiveness in the region. Within ASEAN, Timor-Leste is the sole Portuguese-speaking country, and English is the formal working language. Ministries do provide unofficial translations of Timorese laws to English for foreign investors, ASEAN, and the World Trade Organization, but they lack the resources and the legal authority to provide official

⁵³ See 2015 Timor-Leste Population and Housing Census, available at <http://www.statistics.gov.tl/category/publications/census-publications/2015-census-publications/>.

⁵⁴ The cost of this is unknown but would require knowing the total number of laws and regulations in Timor-Leste, which languages they have been written in, and a determination of which languages are needed. Some are still in Indonesian; many are only in Portuguese.

translations since English is not an official language of the country. Finding a solution that balances Timor-Leste's historical ties to Portugal, the realities of its linguistic pluralism, and the ongoing encroachment of English in the business community will be a challenge for many decades to come.

5.2 Human Capital

Lack of skills: Business owners and managers across a variety of sectors highlight critical skills gaps among Timorese employees as key constraint to doing business. Whereas companies interviewed had varying degrees of constraint around land or commercial dispute resolution, virtually all companies (estimated at >90% of those interviewed) cited issues around human capital. Skill gaps include a lack of critical thinking, writing skills, and most notably numeracy and financial literacy (including basic accounting). In addition, technical skillsets required for construction and manufacturing are also missing. As a result, businesses often need to bring in staff from abroad to fill critical functions, and particularly managerial level positions. Similarly, lack of skills for quality production and capacity within the agriculture sector, means that businesses need to import heavily from overseas. A local flower business reports that they need to import all their flowers from Indonesia, citing poor quality and lack of ability of local farmers to properly treat the products. The lack of skills is not just identified as an issue for business, but also for public officials.

Further, lack of financial literacy and accounting skills create barriers to financing. Aside from the largest Timorese firms and foreign firms, the level of sophistication in business operations in Timor-Leste is rudimentary. Timor-Leste has no formal accounting standards and requires little in the way of financial statements and annual reporting from businesses. Most firms lack basic accounting and bookkeeping skills. Banks interviewed noted that SMEs do not have the ability to provide basic company financials, which would enable the bank to conduct the necessary due diligence to assess lending risk. This also is cited as a barrier to large, foreign firms who want to partner with local companies citing their inability to provide adequate financial information and accounting records to indicate that they are financially healthy companies, without significant debts as a significant challenge to identifying local partners.

To develop the skills of their employees, firms often set up their own training programs, or send employees abroad to places like Singapore or Australia to participate in training or shadowing programs.

The causes of these lack of skills and a common work ethic is attributable to a number of factors. The education system does not adequately prepare individuals for the labor force (even those who have completed tertiary education), and the quality of education is perceived to be very weak. Schools teach via lecture with limited engagement of the students, and curriculum is reported to be theory-based, with limited practical focus. While some vocational schools exist, there are no linkages with business to better target skill development needs. Limited soft skills such as management is also cited as a challenge to business. Communities and families have a strong sense of duty to look out for individual members, including lending money and caring for the sick or elderly.

In an effort to increase employee commitment, several companies operating in Timor-Leste have developed social policies and programs for employees. One is also providing savings and health programs for their staff, and its managers have personally provided own funds to support employees in times of hardship.

However, at the same time, several interviewees noted that, once trained on good work practices and work ethic, Timorese are good workers and are motivated to do well. Further, these individuals strongly believe that there is an entrepreneurial spirit, particularly among Timorese youth that can be supported and built upon. Certainly, the observation that several local businesses are engaged in numerous sectors and types of businesses indicate that those with a business mindset are engaging in out of the box thinking, entrepreneurial thinking. While a number of the SMEs that we interviewed had connections to some of Timor-Leste's wealthy families, there are also a number of entrepreneurs without these connections and without easy access to capital who have relied on personal drive and years of savings to start businesses.

Difficulty obtaining work visas: Given the weak skill base of Timorese workers, firms must resort to bringing labor from abroad to fill critical functions. In particular, foreign workers are needed to fill management positions, positions requiring strong financial literacy, and specific technical skillsets, such as welders. Interviewees indicate that skilled labor from countries including Indonesia, Malaysia, and the Philippines are commonly used. In particular, numerous interviewees noted that Filipinos are most commonly hired for positions of finance and accounting.

The process of getting individuals work visas is cumbersome and can be quite costly to business. From the various stakeholder accounts, it appears that the policies and guidelines around work visas are unclear. Some firms note that while awaiting work visas, employees are not allowed to do other work, which requires them to be unemployed for large amounts of time, a burden which they cannot afford. According to one prominent Timorese business man and developer, getting work visas will take up to a year, and can cost the company fines of \$1,000 dollars if rules are not followed. As a result of the long time it takes for work visas to be processed, many staff are on business visas and sent out of the country for a day every 30 days period, so as not to overstay the business visa, costing \$300-400 for a trip. Of their 500 employees, 10% are expats.

The Constraints Analysis notes the significant challenge around high-skilled labor. The 2014 Living Standards Survey noted lack of available skills to be most critical at the tertiary level of education with returns to income for attaining tertiary education to be extremely high at 45% compared to 15% in a median country. This challenge is reinforced by the 2014 Enterprise and Skills survey, which notes that 40% of managers and 30% of professionals were foreign nationals. Further, the 2016 World Bank Investor Survey noted that 60% of investors would like to see improvement in the process for obtaining work visas. In contrast to these sources, the World Bank's most recent Enterprise Survey does not indicate access to skilled labor among the top 10 business environment obstacles, and only 13.5% of firms surveyed identified inadequately educated workforce as a major constraint. Further analysis should be conducted to understand the degree to which the work visa policies are constraining firms, and whether those firms ultimately hire locals. It would also be helpful to understand the private sector's perception of local tertiary education institutions and the degree to which they are able to supply the demand in the market.

A large property development company with a diverse portfolio including construction, retail operations, hotels & apartments is considering developing a new a tourism-focused hotel.

In addition to constraints around infrastructure (e.g. insufficient air and sea transportation), owners of the business noted a key constraint to developing a tourism industry was the lack of skilled labor specialized in hospitality. He would like to see some government engagement in this area (citing good practice in Singapore), but currently notes the lack of tourism demand as well as lack of hotel and tourism infrastructure which would encourage government engagement.

5.3 Public Administration

In line with the human capacity challenges discussed above, one of the major constraints cited by businesses and donor organizations was a general lack of capacity for public administration within the civil service.

Timor-Leste is a young country with understandably weak institutions, but the low capacity of public administration leaves room for corruption and lowers the level of government service for business. Businesses expressed the following chief areas of concern related to public administration: (1) lack of skill in policymaking and poor understanding of existing law, (2) heavy-handed bureaucracy and lack of customer service mentality, and (3) corruption.

Lack of skill in policymaking and poor understanding of existing law: Stakeholders cited numerous incidents in which public officials were not aware of or failed to properly interpret existing law. In general, businesses felt that civil servants tend to react to any queries or requests outside of their comfort zone with a flat denial. In these cases, companies often find themselves having to educate the government on what is required within the legislation and note that government counterparts are not prepared to deal with decisions and complex processes. The availability of only a few decision makers leads to delays and frustration, including issues around licenses for business as a barrier to investment. One business interviewed reported experiencing difficulty in obtaining a license to open a shrimp farm; it is unclear who the correct authority is to provide this, resulting in delay.

In a broader sense, some policy initiatives seem to lack clear thinking and room for public debate and comment. For example, a recent advertising tax levied against the size and visibility of public signage resulted in an overnight tax bill totaling tens of thousands of dollars to businesses. Predictably, businesses reacted by removing signs from buildings and vehicles, and the tax has since been repealed and then reinstated at a much lower rate. This kind of ad hoc policymaking creates instability for investors.

Heavy-handed bureaucracy and lack of customer service mentality: According to businesses, the process of obtaining licenses, work visas, and other approvals can take months or even years and presents a substantial obstacle to business start-up and operation in Timor-Leste. Licenses for heavily regulated industries such as health can take 1-2 years to obtain. Environmental impact assessments must be approved at the Minister level and frequently delay the issuance of investment certificates. One company waited two years to receive its business registration only to find that the issued document would expire in six months.

By most accounts, the recent institutional reforms to SERVE and TradeInvest have improved the investor experience, but SERVE and TradeInvest⁵⁵ act only as a conduit for businesses – they do not remove the need to obtain approvals from individual ministries, but rather are intended to help business better navigate processes.

Long delays in the issuance of work visas for foreign workers reflect a general perception in the business community that government agencies are hostile to the private sector, and in particular foreign businesses. Businesses felt that lower-level civil servants lack a customer service mentality. Agencies adhere to unnecessary formalism, including reports of applications and court filings being rejected on the basis of file color or font on the cover page. In many institutions, only one individual is authorized to sign off on any given stage in an approval process, and illness or maternity leave can result in long

⁵⁵ Those minimal capital requirements for investments working with TradeInvest is \$50,000 for local firms, \$500,000 for foreign firms, and for joint ventures \$250,000 (foreign and local).

backlogs in processing. For example, one business described a situation in which the port closed without warning when the quarantine agent fell ill.

Corruption: Weak public institutions provide a fertile breeding ground for corruption. On the whole, businesses did not express extreme concerns about the cost of corruption to doing business. They did, however, cite corruption as a competition issue.

5.4 Access to Finance

Lack of bank lending: Access to finance continues to be a core barrier facing private sector development in Timor-Leste. While foreign firms bypass this by seeking financing abroad, local Timorese firms have no such recourse. When lending does occur, it typically is in the form of unsecured lending and therefore typically is likely to be smaller loans with higher interest rates and shorter maturities.

Of the four main banks in Timor (ANZ, BNU, Mandiri and BNCTL), the national bank, BNCTL, is the only one actively providing financing to Timorese businesses. ANZ and BNU banks will only extend credit based on government contract or salary, given the inability to currently lend against secure collateral. This type of lending is generally perceived to be the least risky. BNU bank goes further, requiring that the government contract be paid directly into an account at BNU Bank, so that they always have the recourse to recover the funds. This means that even well respected, large Timorese business owners are unable to get a loan and as a result funds his businesses through Singapore and Australia, as the local banks won't provide him financing, noting that local lending is based on cash flow and turnover and not one's assets.

Although the only Bank actively lending, BNCTL is in a situation where they lack liquidity due to a high loan to deposit ratio (114%). This raises questions about their continued ability to lend. BNCTL lends against both land and movable property. However, since land and movable property don't bring true security (even though BNCTL does accept it as collateral), the bank heavily relies on borrower's reputation and other aspects by which it determines a credit score. BNCTL reports NPLs of 0.70% and that there have been no defaults where land has been used as collateral.

The GoTL will soon implement a credit guarantee scheme in an attempt to encourage bank finance to Timorese businesses, in which the GoTL will cover 60% of the risk of each loan. Even with this assurance, some foreign banks have declined to participate in the scheme.

Nascent credit registry: While a credit registry was established by the Central Bank, stakeholders indicate that it is not being used effectively. There is voluntary membership by banks, and reporting to the registry is neither mandated nor enforced. There is some registration of major loans within the registry, but this is not done systematically. Further, the registry is not being used by the banks to help them better assess applicants' debt positions and risk of lending. The current registry does not allow for the generation of reports or to query existing creditors.

Secured transactions: The secured transactions law is still in draft form. ADB is supporting the development of this law, however they did not have an update or expectation on when it would be passed. This law appears to be one of the many pieces of legislation that is on hold until a new government is in place.

While there is no legal basis governing secured transactions, this does not mean that it is not done in practice (by BNCTL and MFIs), just that it is not enforceable, nor is it possible to trace multiple claims on the same piece of movable property.

Based on interviews with both foreign and domestic banks, it does not appear that the passing of the secured transaction law would have a major impact on unlocking lending. The foreign banks questioned

indicated that it would not make any significant difference to them in reducing risk of lending. They appear to have no appetite to accept movable property. According to one law firm interviewed, the notion of secured transactions, and lending against movable property, is not common in the Portuguese legal system. As such, for this law to have a significant impact, would require socialization and trust in the system. As an example, the interviewee noted that car registration is not good and so there is no accounting of what is bought/sold. A well-functioning collateral registry is needed so that lenders can have security that the movable assets used for collateral belong to the individual borrowing against them. This is especially important as there is currently no back-up of land as collateral. Further, BNCTL as well as MFI Moris Rasik are already lending against movable property and are comfortable with how they are doing business. They did not perceive that the new law would greatly impact their lending.

Limited alternative methods of financial support: While limited, there are some mechanisms that SMEs have access to which provide additional funding and support for their activities. The Institute for Business Development (IADE) provides training, counseling, funding, and business support services to help business develop internal capacity to grow. IADE's Business Plan Competition funds Timorese entrepreneurs with an innovative business idea. Funding is reported to be between \$250 to \$5,000, according to recipients. Funding support is also available through the UNDP Youth Center as well as a small grant from the Ministry of Commerce and Industry, though details about this program are unknown. At the local level, credit unions and intercommunity lending, ranging from \$50/month up to \$1,000 are common funding mechanisms. Generally these types of loans are used for school fees, small businesses and household expenses, and lending is done based on guarantees from family members. Value chain financing is rare. The team did not do a deep dive into whether alternative funding methods are sufficient to meet entrepreneurs' needs.

The Australian Market Development Facility (MDF) is one mechanism available to fill the gap in mid-level financing, providing grant financing to medium to large-size companies in Timor. The MDF has identified the agribusiness, processing and rural distribution and greenfield industries as key sectors for growth and employment.

Given the limited availability of these financing mechanisms, local SMEs generally need to start out with only their savings. This was the case with numerous small businesses consulted, including three IADE winners (all of whom self-financed the initial stages of their business prior to using IADE grants to finance small expansion activities).

5.5 Gender

The Constitution of Timor-Leste grants women equal rights to men under the law. While the data⁵⁶ indicates that at a societal level women face high levels of inequality in terms of physical and social mobility, resource ownership and civil liberties; by all accounts, the young country has quickly surpassed its neighbors on scores of the participation of women in politics and the economy. There is a 30% quota for the number of women in Parliament, and a similar requirement for gender-sensitive budgeting in all policymaking.⁵⁷ At the village level, the Law 3/2009 on Community Leadership and their Election requires at least three women in each suco council (at least one of whom must be a youth).⁵⁸ Women are found in the most senior levels of government, including the current Minister of Justice, head of the

⁵⁶ Data sources include the Gender Development Index (DGI) in which Timor-Leste ranks 130 of 160 countries; the Global Gap Index, in which Timor-Leste ranks 125 of 144 countries; and the Social Institution and Gender Index.

⁵⁷ The Secretary of State for Gender Equality and Social Inclusion (SEIGIS) provides training on gender mainstreaming to government agencies to help them better understand the potential disparate impact of policy decisions on women.

⁵⁸ See http://www.nyulawglobal.org/globalex/Timor_Leste.html. Confirmed in conversations with USAID.

recent Fiscal Reform Commission, Director General of the tax authority, and the former director of the Legal Training Center who was recently appointed Director General of the Ministry of Justice.

From stakeholder interviews, including with female business owners,⁵⁹ gender disparity was not explicitly highlighted as an issue in the business environment. Women are well-respected in business, and the assessment team met a large number of women entrepreneurs heading diversified business operations, including restaurateurs, cement businesses, and micro-credit providers. According to the 2015 Enterprise Survey, 64% of firms surveyed had female participation in ownership, and 27% had a female top manager. The Director of SERVE stated that women-owned businesses comprise 45% of registered companies. Even in rural areas, women dominate the high-value horticultural sector as growers, collectors, and small-scale processors while men tend to focus on staples such as maize and rice. Women often lead farmer groups and loan clubs and make up the majority of microfinance borrowers (98% of Moris Rasik borrowers and a high percentage of BNCTL's MSME portfolio). With respect to commercial matters in rural areas, one of the donors active in rural areas asserted that they have not seen evidence of restrictions on women's ability to participate in the economy.

These encouraging statistics contrast sharply with the high levels of reported domestic violence and traditional norms imposed on women in some rural areas. One project working in horticulture has found that financial decisions appear to be made as family, while other projects have reported husbands confiscating income earned by their wives. In some areas, women do the cooking and must wait in the kitchen until the men finish eating.

In Dili, the women business owners consulted do not report experiencing such outright discrimination.⁶⁰ A prominent business association with female leadership stated that the primary constraints faced by women relate to unequal access to assets, the need for better training in business and accounting, and the "invisible wall" that holds some women back. For example, although exact statistics were not available, stakeholders estimated that 50% of law school graduates are women. Nonetheless, the majority of judges are still men. Of the 33 total judges in Timor-Leste, less than a third are women. Cultural norms regarding family obligations and child rearing may explain these dynamics.

Women also face disparity in access to formal bank finance above the microcredit level. Almost all bank finance in Timor-Leste is currently secured through government contracts or civil service salaries. According to a recent labor survey by UN Women, women in Timor-Leste represent only 16% of the public administration and defense industry.⁶¹ In the construction industry, which constitutes the bulk of public procurement, women have only 3% of the market share. Women are also far more likely to be self-employed than wage and salaried workers. Indeed, two of the women entrepreneurs interviewed began their businesses using savings from their husbands' salaried jobs.

While the land law provides equal ownership rights to men and women, in practice, women have less access to land than men. This starts with access to land within their families. Many communities are patriarchal, with land passing along to sons in the family (although there are examples of matrilineal communities whereby the man moves into the wife's home). Limits on access are also a result of women being reliant on husbands' sources of income and having less economic decision making power in the household. Note that the assessment did not go into inheritance rights and their impact on women's access to land.

⁵⁹ Female-owned businesses comprised roughly a quarter of all private sector interviews.

⁶⁰ The AEMTL cited one incident of perceived gender discrimination in a public procurement award process, but further information to substantiate the gender aspect of the incident could not be obtained.

⁶¹ UN Women, Gender Analysis of the 2013 Timor-Leste Labor Force Survey (2017).

How the land titling process unfolds, and the degree of female land title holders, will have implications on women's access to productive assets and loans. Both the SNC cadastral process and the previous Ita Nia Rai project have encouraged joint ownership claims for married families. According to SNC head, about 40% of the current claimants are women. The Asia Foundation Survey on Access to Land identified that in Dili, 33% of claims were individually owned by men, 15% by women and 16% jointly. The majority of the remaining responses regarding ownership indicated that the land was either owned by parents or other family members (22%), by the state (7%), or other (7%).⁶²

6. Conclusions

6.1 Summary Analysis and Conclusions

The deep dive analysis indicated that both land and commercial dispute resolution are binding constraints to investment (both foreign and domestic) and businesses across a variety of sectors. Insolvency was identified as a lesser issue and in the current climate is not a binding constraint. Human capital issues, focused on access to skilled workforce, were also noted by private sector stakeholders as a barrier on-par with land and commercial dispute resolution. As this was not a focus of this analysis, it is suggested to conduct a subsequent deep dive into the issue of human capital and skills.

The table below provides a summarization of the root causes identified under each of the key BEE constraints, as well as the implications that these constraints have on investment and business growth in Timor-Leste. The conclusions and impacts on investment were reinforced by the private sector stakeholder interviews and transaction case studies (full case studies are provided in the *Annex*). To the extent that BEE constraints, differ based on the profile of the firm, these were captured.

While the constraints impact all investors, the challenges may be most acutely felt by Timorese SMEs, which lack access to alternative sources of finance, outside dispute resolution, and the benefits and support of government institutions such as TradeInvest. Though on the whole the large foreign investors expressed a degree of frustration with TradeInvest's support, overall they did not perceive that TradeInvest's involvement in their investment was unhelpful; more than it could be more effective in their support (e.g. better facilitating consultations with relevant ministries and easing burdens and timelines for licenses/approvals). Overall, respondents viewed SERVE as a very positive introduction to the business environment and noted that since its founding, practices around starting a business have become much easier.

BEE Area	Constraint	Root Causes	Impact on Investment
Commercial Dispute Resolution	Lack of a clear legal framework for commercial transactions	<ul style="list-style-type: none"> • Lack of a basic contracts law or commercial code • Critical gaps in other areas of law relating to commercial transactions • Problematic process of commercial law reform • Lack of clear ownership of the reforms 	Lack of a clear legal framework for commercial transactions increases uncertainty for businesses and is one of the top reasons cited for delays in civil cases in the courts. Without clear rules on contracts, secured transactions, competition, and other issues, businesses cannot clearly communicate complex contractual terms, banks cannot lend against various types of

⁶² <https://asiafoundation.org/wp-content/uploads/2017/01/Survey-on-Access-to-Land-Tenure-Security-and-Land-Conflicts-in-Timor-Leste-1.pdf>

BEE Area	Constraint	Root Causes	Impact on Investment
			collateral, and courts cannot fairly adjudicate contractual disputes.
	Ineffective judicial resolution of commercial disputes	<ul style="list-style-type: none"> • Inadequate legal education • Insufficient capacity within the court system • Lack of familiarity with civil law and procedure • Poor case management • Ineffective judicial enforcement of decisions 	Businesses in Timor-Leste cannot realistically expect to use the court system as a forum for the resolution of commercial disputes. Lack of a fair, effective, fast-track option for dispute resolution encourages businesses to restrict their operations and limits expansion outside of their trusted community.
	Lack of alternative dispute resolution mechanisms	<ul style="list-style-type: none"> • Limited capacity of traditional dispute resolution methods • Lack of a legal or institutional framework for ADR 	Without recourse to the courts, businesses need alternative mechanisms for dispute resolution. In practice, those who can afford it (e.g., large foreign companies) must resort to costly international arbitration. Other businesses, including almost all Timorese businesses, only have recourse to local mediation by the <i>chefe de suco</i> , whose expertise extends only to basic contractual issues (such as agreement around money lending) as well as basic land disputes, such as those with regard to borders.
Land	Limited access to land	<ul style="list-style-type: none"> • Land ownership restrictions make foreign investors reliant upon public or private lease • Government inability to provide land to private sector in an effective and timely manner • Lack of an active formal private land market (particularly outside of Dili) • Strong culture of communal land, with public skepticism of land use for commercial purposes 	Investors spend a significant amount of time identifying land for their investment (either privately or through government). According to stakeholders, this can serve as a deterrent to investment, as some reports indicate that government has taken over 2 years to identify an appropriate parcel of land. Moreover, in the case of larger investment where relocation of existing occupants is often necessary, investors are spending their own money to fund relocation, causing unplanned expenses and detracting from spending that could go to the investment.
	Lack of land rights security	<ul style="list-style-type: none"> • Overlapping land titles, from previous land authorities (Indonesian 	The lack of certainty around land owned or acquired creates a considerable risk to businesses that their investments are unsecure. Stakeholders cited instances































BEE Area	Constraint	Root Causes	Impact on Investment
		<ul style="list-style-type: none"> and Portuguese) and land reform efforts No single title has authority under the current land regime Lack of a formal land titling and registration process Incomplete cadastral mapping Weak land dispute resolution practices 	where land on which businesses had been for 10+ years were disputed and ultimately taken away. Such stories as well as widespread lack of confidence in the court system to fairly resolve land disputes in a timely manner creates insecurity and fear around land which permeates the business environment. While on the whole, stakeholder consultations suggest that this does not stop initial investment from occurring, it may limit a firms' appetite for growth or expanded investment on the land.
	Limited capacity for land administration	<ul style="list-style-type: none"> Weak administrative capacity with the DNTPSC to implement the land law Institutional structure and authority to implement registry is unclear Perception of weak leadership around land 	The lack of institutional capacity for land administration has been reported to have deterred other investors (the team was unable to gather quantitate evidence as to the magnitude of this). Further, some current investors who have had lengthy struggles around land are considering pulling out their investment. Domestic firms express that weak land administration has inhibited them from growing their businesses, due to the governments' inability to help them find appropriate parcels of land (and the lack of available private land).
	Inability to effectively use land or movable property as collateral for finance	<ul style="list-style-type: none"> Lack of formal titles to provide assurance on collateral ownership Restrictions on foreign land ownership further disincentivize foreign bank lending Lack of registries make lending against land and moveable property risky Incomplete legislation, including for implementation of the land law and around secured transactions law 	The impact of land on access to finance is primarily a barrier to domestic firms. One of the factors that limits Timorese businesses (both SMEs and larger firms) from obtain financing from Banks is the inability to use land and other assets as collateral. While this impacts all firm sizes, it is most inhibiting to small firms, which do not have other sources of financing that they can leverage. Further, the lack of a secured transaction law currently limits the effective use of movable property for collateral.
Insolvency	Inability to resolve bankruptcy through formal	<ul style="list-style-type: none"> No legal framework for insolvency 	At present, the inexistence of insolvency procedures appears to have little impact on investment. Challenges to businesses are more fundamental – lack of access to land, credit, and effective judicial dispute




BEE Area	Constraint	Root Causes	Impact on Investment
	insolvency procedures	<ul style="list-style-type: none"> Lack of insolvency professionals and institutions Overburdened and ineffective court system (see <i>Section 2: Commercial Dispute Resolution</i>) 	resolution. Without these preconditions, business practices are conducted in a simpler manner, making the need for formal bankruptcy negotiations between multiple creditors irrelevant. This issue should be revisited as the economy develops.

6.2 Prioritization of Constraints




Interventions must prioritize those constraint areas which can have the biggest impact on unlocking investment, be realistic for short-to-medium term implementation, and have limited risk and momentum for movement. These factors were mapped by the team below using a stop-light approach to ranking. Note that this approach is based on the team's subjective assessment of these areas.

All investments must be realistic and tailored to the human capacity available in Timor-Leste. This challenge may require a phased development of the business enabling environment in keeping with the culture and capacity of public servants who must implement new laws and the desire and ability of the private sector to use these institutions. This has been taken into consideration in the relative ranking of "short-to medium-term implementation".

Constraint	Expected impact on unlocking Investment, if resolved*	Realistic for short to medium-term implementation	Low risk and momentum for movement
Commercial Dispute			
Lack of a clear legal framework for commercial disputes			
Ineffective judicial resolution of commercial disputes			
Lack of alternative dispute resolution mechanisms			
Land			
Limited access to land			
Lack of land rights security			
Limited capacity for land administration			
Inability to effectively use land or movable property as collateral for finance			
Insolvency			

Constraint	Expected impact on unlocking investment, if resolved*	Realistic for short to medium-term implementation	Low risk and momentum for movement
Inability to resolve bankruptcy through formal insolvency procedures			

* Note that for a number of these constraints, “resolution” is dependent upon alleviating other constraints as well. For example, constraints around land access and land rights security will require that appropriate capacity for land administration is built such that these systems can function properly.

Legend	Expected impact on unlocking investment, if resolved	Realistic for Short- to Medium-term intervention	Low Risk/momentum for movement
	Strong direct impact on unlocking investment if resolved	Realistic for implementation of an intervention in short- to medium-term	Low risk, with perceived political will and support from civil society
	Would indirectly impact investment	Expected gains could be made in short- to medium-term, however full implementation might require a longer timeframe	Potential for risk, including questionable political will and potential for civil society resistance
	Limited or no clear impact on unlocking investment	Requiring longer-term intervention	High risk, with lack of political will and/or strong resistance among civil society

Further, the fit with the programs and activities of other donors operating in Timor-Leste is important, such that there is not a duplication of effort, but also so that there are donors who may continue the work after the Compact ends. The table below summarizes donor activities in each of the BEE areas. A more detailed donor mapping can be found in Appendix 2.

Topic	Summary of Donor Engagement		Considerations for the Compact Design
	Prior Engagement	Current Engagement	
Commercial Dispute Resolution	<ul style="list-style-type: none"> ADB supported MECAE in the development of the legal framework for commercial transactions (This was an activity under the ADB’s Business Law Reform Program, which started in 2011 and still ongoing) USAID and Asia Foundation conducted surveys of attitudes towards law and justice (ended in 2012) 	<ul style="list-style-type: none"> Australian DFAT is currently funding a legal advisor to evaluate the status of civil cases in the court system under the NGO Judicial Sector Monitoring Program UNDP is providing capacity building, policy making and coordination 	<ul style="list-style-type: none"> Some engagement by donors in supporting judicial sector Limited engagement in court reform for civil matters, as well as ADR

	<ul style="list-style-type: none"> Oxfam provided continuing legal education for judges and prosecutors around suspended sentencing 	throughout the justice sector	
Land	<ul style="list-style-type: none"> USAID's Ita Nia Rai land titling project titled 50k land parcels in urban areas (ended in 2011) ADB supported drafting of secured transactions law (This was an activity under the ADB's Business Law Reform Program, which started in 2011 and still ongoing) 	<ul style="list-style-type: none"> JICA is supporting Dili urban master planning Oxfam is providing capacity building to civil society institutions around land Asia Foundation is providing leadership around policy dialogue and research on land 	<ul style="list-style-type: none"> Limited donor engagement, with activities primarily focused on dialogue/research Highly sensitive area, with strong civil society engagement Skepticism reported from civil society of 'outsider involvement
Insolvency	<ul style="list-style-type: none"> ADB conducted a legal diagnostic of Timor-Leste's insolvency laws and supported drafting of an updated law (This was an activity under the ADB's Business Law Reform Program, which started in 2011 and still ongoing) 	<ul style="list-style-type: none"> N/A 	<ul style="list-style-type: none"> Gap in donor engagement, but also not viewed as a priority area

Annex: Investment Transaction Case Assessment

To complement the policy-oriented BEE root cause analysis relating to land, commercial dispute resolution and insolvency, the engagement team conducted a series of case studies of 6 recent investments (3 large/3 small) to understand individual firms' experiences in investing in and operating a firm in Timor-Leste.

1. Overview

The case studies selected were identified as representing investments and businesses of various size, scope, and at various stages in the transaction lifecycle.

1.1 Rationale for Inclusion

The case studies were selected to provide a broad overview of the Timor-Leste economy and its business environment, as well as to represent various sectors and ownership characteristics. To highlight the different constraints experienced by large foreign investors compared with local small and medium-sized enterprises (SMEs), three cases for each group were selected.

The reason for including three large-scale transactions as well as three smaller businesses was due to an expectation that significant investment transactions, especially those with foreign investors, may not be bound by the same constraints that impact smaller domestic businesses. As will be discussed in *Annex Section 1.2*, this expectation proved partially correct. It is certainly the case that large scale transactions enjoy a range of benefits that smaller investments and businesses do not, however they also come with their own challenges.

For selection, a long list of potential case studies was developed based on three overarching criteria:

- The investment/business's potential economic benefits for Timor-Leste
- The social, political, and environmental factors that were impacting the investment
- Practical constraints supporting or hindering case development (e.g. willingness to participate)

In addition to the factors detailed in the Methodology, diversity was also a factor both in terms of industry coverage and the relative sophistication of the operation. The three large-scale transactions were selected prior to initiating fieldwork, using publically available information upon which to make a decision. It is worth noting that in the case of the larger transactions, the decision was simplified somewhat by the relative lack of large scale investments in the country, as well as by the fact that a large number of stakeholders interviewed referenced these transactions anyway. For the smaller transactions, where limited public information was available, the team consulted with local stakeholders and held preliminary meetings with the shortlisted businesses, to gather additional information prior to making a final decision.

1.2 Key Themes Emerging from the Case Studies

The firms interviewed all faced barriers either to entry or to business expansion. Some of the barriers faced were consistent across cases – e.g. several faced some sort of land or bureaucratic barrier (typically around registration/licensing), while others are unique to firm size or ownership type. The remainder of this section highlights themes in three key areas – first, it considers trends across firm size and ownership; second, it presents sectoral-specific trends identified across the case studies, and finally it considers a range of business enablers supporting firms. Importantly, while the discussion and the examples below focus primarily on the case studies, it also includes additional insight gain from the broader private sector consultations conducted as part of this work, and as such, these broader themes can be extrapolated to the Timor-Leste business community in general.

1.2.1 Trends across firms size and ownership

The following table captures the key benefits and constraints faced by the various firm groups, as reflected in case studies and supplemented by other private sector interviews. It should be noted that while the team gathered anecdotal stories of experiences of smaller foreign firms (such as those from Malaysia or the Philippines), we did not directly interview any, and therefore information on the challenges these firms face is limited.

	Large	Small
Foreign	Benefits: <ul style="list-style-type: none"> • Tax and other benefits available through an SIA • TradeInvest support in navigating registration and licensing processes (effectiveness is a question) • Availability of financing from abroad • Access and financial capacity to use international arbitration (typically written into contracts) Constraints: <ul style="list-style-type: none"> • Unable to own land • Lack of local networks to identify land, resulting in dependence on government • Require larger labor force, often with specific skill requirements that requires hiring from abroad and leads to work visa challenges • Limited local supplier quality/quantity means the majority of inputs are sourced from abroad, adding to cost 	Benefits: <ul style="list-style-type: none"> • Availability of financing from abroad Constraints: <ul style="list-style-type: none"> • Unable to own land • Lack of local networks to identify land, resulting in dependence on government • Work visas may be a challenge if looking to bring in staff from abroad • Limited support in navigating processes around registration and licensing • Limited financial capacity to participate in commercial dispute resolution either through international arbitration or through the Timorese courts
Local	Benefits: <ul style="list-style-type: none"> • Tax and other benefits available through an SIA • TradeInvest support in navigating registration and licensing processes (effectiveness is a question) • Ability to own land and large networks by which to access land 	Benefits: <ul style="list-style-type: none"> • Typically have land parcels either individually or within the family, upon which business can be established • Strong local networks if land needs to be bought/leased Constraints:

	Large	Small
	<ul style="list-style-type: none"> • Likelihood that can finance investment through existing funds or from abroad • Likely to be able to pay for international arbitration to settle disputes <p>Constraints:</p> <ul style="list-style-type: none"> • Require larger labor force, often with specific skill requirements that requires hiring from abroad and leads to work visa challenges • Limited local supplier quality/quantity means the majority of inputs are sourced from abroad, adding to cost 	<ul style="list-style-type: none"> • Significant challenges around access to finance • Lack of knowledge regarding contract use and limited financial capacity to participate in commercial dispute resolution through the courts • Limited support in navigating processes around registration and licensing

Larger businesses or investments, whether foreign or local, benefit from access and relationships which enable them to mitigate barriers more effectively than smaller firms: Although it cannot be said that large investments or businesses do not face barriers – clearly they do, as evidenced by the case studies – it is nevertheless clear that there are several advantages to being big. Three of the major benefits are described below.

First, larger businesses or investments typically have greater capacity and financial backing to mitigate or avoid the barriers faced. This can be seen in two of the cases, which have incurred costs in the millions of dollars over several years, owing to a range of unexpected delays. For a smaller investor, bearing such a burden would be difficult, if not impossible. Similarly, it is worth noting that each of the major transactions considered here (and anecdotally, most, if not all, of the major investments in Timor-Leste) have used external funding (either using profits from existing operations abroad to fund the new investment, having access to international funding partners, or through acquiring a loan abroad). Smaller firms without access to external funding are either not able to obtain funding (due to an inability to use land as collateral and a requirement to have a bank balance worth 50% of the loan value) or have no option but to pay excessive interest rates on domestic finance.

The second benefit typically experienced by large investors is that they are more likely to receive the support of government and other entities in working through the various bureaucratic and legal processes. This is not to say that large investors do not experience issues with delays and bureaucracy; it is simply that the larger transactions tend to have more options available to them seeking support and navigating barriers, especially as related to accessing land. Although there are a range of views as to the efficacy of TradeInvest, the ability to leverage TradeInvest to work with the various Ministries, and to have a government advocate where necessary, is undoubtedly a benefit of being big.

Large firms also tend to have larger networks and connections that enable them to work around BEE constraints. An example of this is that such networks are often used to identify private land for purchase or lease, whether smaller firms might otherwise struggle due to the current lack of active land market.

Finally, major investments have access to a Special Investors Agreement (SIA). According to the new Private Investment Law, the minimal capital requirements to qualify for SIA benefits is \$50,000 for local firms, \$500,000 for foreign firms, and for joint ventures \$250,000 (foreign and local). Under and SIA, investors may be granted the following special benefits:⁶³

⁶³ New Private Investment Law In Timor-Leste – Law No. 15/2017, Of 23 August 2017.

- Guaranteed delivery of five work visas to foreign workers hired as supervisors, directors or technical functions adequate to the investment project;
- Right of rental of real estate owned by the State for an initial period that may be set up to 50 years, and renovated for 25 years up to a total of 100 years;
- Fiscal and customs benefits in projects related to (i) agriculture, livestock, forest, fishing and aquaculture, (ii) transforming industries, (iii) housing, and (iv) tourism activities.

Many have some form of international arbitration (generally either in Singapore or Australia) built into them, in recognition of the futility of pursuing commercial cases through the Timorese judiciary. In essence, two of the most pressing barriers to business – land issues and the lack of effective, reliable commercial dispute resolution – are ‘contracted out’ of the SIA. Even so, experience of the investors indicate that the SIA is not a sufficient mechanism to de-risk the environment for investment, and weaknesses in TradeInvest and other institutions to carry out the promised benefits of the SIA remain a challenge and constraint to business.

Although large businesses enjoy a range of benefits, they also face a range of barriers which smaller businesses generally do not face. One such barrier is the greater need for reliance on formal contracts, as their business relationships typically are much broader and go outside of their local communities, particularly where they lack local connections. Further, larger firms tend to experience more challenges around skilled workforce, both requiring larger number of workers, but also requiring higher-skilled workers, including managers and those with financial/accounting skillsets. As a result, these types of firms typically must bring in workforce from abroad, adding additional cost and barriers around work visas. Finally, larger investments tend to attract more attention, resulting in some challenges (like squatters occupying assigned land) that a small firm may not have.

Though foreign firms face some barriers to entry not experienced by local firms, once in country, they face many of the same constraints: The largest barrier specific to foreign firms is around land acquisition. Since foreign firms cannot own land, they effectively have three options, 1) to lease land from the government; 2) to lease land from a private individual or 3) to find a local Timorese partner who will own the land. Typically, foreign firms seek land through the government as the easiest option, particularly in instances where they do not have local networks. Given the lack supporting actors in the land market (e.g. real estate brokers), finding private land can be a challenge.

Foreign investors often struggle to find the requisite information to help with investment decisions, including data that could help decision making, as well as to understand the processes to obtain an investment certificate, set up and operate their business (a point which highlighted by three large investors). TradeInvest advised that in 2017, five prospective investments had an application for an Investment Certificate rejected. However the specific criteria used to judge these transactions, and the reasons for their rejections, were ambiguous and not publically available.

Further, smaller foreign firms that do not benefit from support provided by TradeInvest would also experience challenges as result of their lack of local connections and networks. These foreign investors would face difficulties in navigating the range of regulations and the lack of transparency in business processes associated with setting up businesses or obtaining license or work visas. Further, the lack of formalized contractual relations (owing to the ineffectiveness of the judiciary), would likely discourage such foreign entrants from considering Timor-Leste, as smaller firms may not have the capacity or ability to seek external arbitration abroad.

Once a foreign firm has overcome the various barriers to entry, they do have several benefits in line with the large firms described above, including access to foreign capital, and connections that would likely

provide them with something of an advantage over local firms when it comes to day to day operations (e.g. with foreign suppliers).

1.2.2 Sectoral Insights

Although by and large the issues identified during the transaction analysis were sector agnostic, some high-level themes relevant to key sectors are below:

- For **agriculture** the main barrier relates to productivity – low farm yields, etc., caused by a lack of sophistication in farming practices. In addition, infrastructure (poor roads) is a challenge for transporting crops from rural areas to urban areas.
- For **tourism and hospitality**, human capital presents a considerable challenge to operations – poor staff training, caused by a lack of educational options in the country, specifically a lack of a hospitality training options. Infrastructure also appears to be a challenge, with current limited capacity for tourism (e.g. lack of a passenger port, and limited airline flights).
- For **health care**, the main issue is legal and procedural; health care is something of a ‘new frontier’ for policymakers and in many instances the legal framework is not sophisticated enough to handle the requirements of private healthcare operations.

1.2.3 General Enablers that Help Overcome Key Business Challenges

Given that the focus of this report is on barriers to business, it is perhaps easy to forget the enablers. With almost every barrier a range of ‘work arounds’ have been developed – such as providing on the job training to employees to get around lack of skills, or maintaining a strong network of local connections to get around a lack of transparency and understanding of business processes. This section focuses on a few of the more pertinent enablers identified through case interviews. While the examples provided are specific to case studies, it should be noted that these enablers also apply to the broader business community.

Education and ‘on the job’ training is a critical enabler for businesses: The challenges associated with human capital emanate not just at a business level, but also from a broader, economy level. According to the United Nations’ 2018 Human Development Report, Timor-Leste has the 15th youngest population in the world, with 40% of the population under the age of 15,⁶⁴ which also translates to a young, and unskilled work force. Challenges associated with obtaining skilled staff (both locally and staff from abroad) were noted by nearly all stakeholders as impediments to doing business in Timor-Leste. The United Nations’ 2018 Human Development Report for Timor-Leste notes that for the government to reach its goal of universal secondary school completion by 2030, it would have to more than double its investment in education.⁶⁵

Though improving education is a long-term solution, in the short-term, firms are turning to on the job training and in some cases sending employees abroad for training in an effort to improve the skillsets of their Timorese employees (in addition to bringing managerial-level workforce from abroad). Nearly all of the firms interviewed for the case studies – and indeed most businesses consulted – noted that they invest considerable amounts of time, energy and financial resources into training their staff. Two of the cases include quite a sizeable local capacity building element as part of the investment plans. Others face challenges relating to the low productivity of the farmers from whom they purchase inputs, and invest in training programs for their suppliers.

⁶⁴ http://www.tl.undp.org/content/dam/timorleste/docs/reports/HDR/2018NHDR/978-92-1-126436-4_web.pdf

⁶⁵ *ibid*

Local connections and strong advisory support can help overcome a lack of transparency: Despite improvements in recent years – Timor-Leste’s overall ‘corruption perception index’ score from Transparency International has risen by 10 points in the last four years⁶⁶ – a lack of transparency with regard to key business processes remains a key challenge to Timorese businesses, both large and small. There is often a lack of clarity around specific regulations, and in speaking to a number of businesses (not just the case studies) it was apparent that the application of laws and regulations is inconsistent across businesses. It is also worth noting that many of the businesses consulted did not have a clear understanding of the relevant legal and regulatory framework that applied to their business. Many of the laws or regulations that bind businesses are either not publically available, or written in Portuguese, which much of the population (including judges) do not fluently speak. Thus, many businesses are simply unaware of the true process.

A number of firms noted that the business registration process has improved markedly in recent years with the introduction of the Service for Verification and Registration of Entrepreneurs (SERVE). However, the process to obtain the requisite licenses once the business is registered is still somewhat ambiguous. Not only is it often unclear what exactly is required in order to obtain the requisite licenses, and who to speak to for ‘official’ advice, but it is also often unclear what licenses are even required.

As a response to this, firms rely on those networks available to them and local connections to better understand necessary processes. For large firms, these connections can include the designated points of contact at TradeInvest. Others who do not have this resource rely on their local connections, or other firms that have gone through the process previously and for the most part mentioned that the business registration process had been challenging. .

Related to this is the importance of having a good advisor (e.g. lawyer, accountant, etc.) from the very outset of business planning. Given the lack of transparency described above, a key enabler for business owners is to engage professional advisors who have a good understanding not just of the process as it relates to the business at hand, but also the process as it relates to similar businesses in the same industry. That way, the advisor(s) can cross reference advice provided to any one business with their broader knowledge of the processes and requirements faced by comparable businesses. Ultimately, this will help to even the playing field and minimize the regulatory burden across all industries.

For foreign investors, local presence is critical: Timor-Leste is not a place where business can be done remotely. Even aside from all of the explicit barriers to foreign investment (e.g. land laws prohibiting foreign ownership), for businesses that wish to establish a presence in Timor-Leste, it is necessary to establish that presence *before* seeking the requisite approvals (noting that that presence may simply be a trusted local advisor or a local partner). Though approval processes may be lengthy (in one case the Investment Certificate took nearly three years), once things are ready, they often require immediate action – forms often need to be hand delivered within a certain timeframe. The team was advised of one instance, for example, where an investment required hand delivery of manila folders in a certain shade of blue, otherwise it would be rejected.

To be successful businesses need to be patient, and plan for delays: Nearly all of the case studies mentioned that they had experienced some form of delay. One investment has been in process for nearly a decade; another has been held up by delays both in operations and in the issuance of visas; and a third has had its plans for expansion delayed since 2015 while it waits for a new law to be drafted, and it took some three years to be granted an Investment Certificate. In Timor-Leste, everything takes time. For a business to succeed, it has to plan for delays.

⁶⁶ https://www.transparency.org/news/feature/corruption_perceptions_index_2017#table

1.3 Linkages with the MCC Constraints Analysis

As noted above, the barriers to business (be it barriers to entry or business expansion) in Timor-Leste are multiple and diverse. As can be seen in the figure following, the constraints of land and commercial dispute resolution were pressing for the majority of case studies. Insolvency was not found to be a major constraint. There are two probable reasons for this.

- First, although analysis indicates that a lack of formal winding up procedures presents itself through a lack of access to finance, the main constraints to finance is not insolvency. The weak commercial court system and a lack of land use for collateral is the more pressing issue. Without a formalized system of land titles (and an ability of foreign-owned banks to take temporary possession of land in case of default), banks' acceptance of land as collateral is limited.
- Second, insolvency is simply not on the radar of the average business in Timor-Leste. There is a general attitude that, if something were to happen, the business would simply cease operating. It is also noteworthy that the majority of businesses do not have insurance, indicating either a lack of understanding of the benefits of insurance, lack of confidence in the ability to enforce such an arrangements through the courts should the insurance provider not hold up their end of the deal, a higher-risk tolerance among Timorese businesses, or some combination of these. The lack of insolvency proceedings presents a risk to doing business, as lenders have no recourse to reclaim money in the event that a customer cannot repay credit. Whereas a lack of formal insolvency procedures might prevent businesses from being established other parts of the world, in Timor-Leste it is simply accepted as a risk of doing business.

Although not a focus of this deep dive analysis, human capital issues were noted by virtually every business consulted – large and small, foreign and domestic. Bureaucratic and regulatory concerns were also frequently mentioned by businesses of all sizes and origins.

1.4 Linkages with BizCLIR/Doing Business

The BizCLIR methodology (largely aligned with the key Doing Business areas) provides a means of assessing business holistically; from inception through to closing a business. Thus, by considering the findings emerging from the transactions analysis against the ten topics contained within the BizCLIR methodology, it is possible to hypothetically 'map out' a typical business lifecycle in Timor-Leste, and through it attempt to identify key 'pinch points', which can ultimately help to target and prioritize necessary interventions. As highlighted below, the case study assessment has identified barriers or 'pinch points' at virtually every stage of the investment lifecycle.

Starting a Business: The process of registering a business has reportedly become much easier in recent years after the introduction of SERVE. The main barrier to starting a business is associated more with the practical and logistical challenges associated with Timor-Leste – access to finance, a lack of transparency in navigating the business environment.

Dealing with Licenses: Obtaining the requisite business licenses was noted by several businesses as an impediment. Firms report that they received different and sometimes conflicting guidance with regards to licensing needs and processes, depending on which individual or Ministry they spoke to. One example where a company was potentially being misadvised on the requirements for a health license provide a case in point. The lack of transparency as well as the time it time it is reported to take to get some licenses adds considerable time and cost burden on business.

Access to Credit: Access to credit is a clear barrier for small, local firms, since the absence of land titles means banks are unwilling to accept land as collateral (and foreign ownership restrictions prevent foreign banks from lending even if a land registry were in place). Further, loans require an existing

balance equivalent to at least 50% of the value of the loan, a significant challenge for most SMEs. Though a variety of micro-finance schemes have emerged (such as Morris Rasik in Dili and an MFI in Baucau), in general larger (and foreign-owned) firms have a considerably easier time with financing. While movable property is accepted as collateral by the national bank, there is little appetite for this type of lending from the large foreign banks, even if a Secured Transactions Law were to be passed.

Trading Across Borders: Apart from oil and gas, Timor-Leste's economy does not have a particularly large nor overly sophisticated 'tradeables' sector. The main barriers to trade are bottlenecks and bureaucratic delays at ports are reportedly common (One case noted that inefficient customs practices regularly delay their shipments), as well as poor infrastructure (road, ports, airports). Further, in agriculture, lack of a local certification authority around organics limits ability to export high-value produce.

Registering Property: The lack of a comprehensive registry for land titles is noted as amongst the most pressing barriers to business, as identified both in the constraints analysis, and confirmed by the current analysis (including by the transaction case assessments).

Protecting Investors: A lack of formalized insolvency or winding up procedures means investor protection is considerably lacking in Timor-Leste. Further, the unreliability and inefficiency of the judiciary in enforcing accountability to contracts presents considerable challenges. In brief, while Timor-Leste provides considerable opportunities for investors (see for example the investment Guide prepared by EY Portugal)⁶⁷, a weak institutional framework means a lack of formal investor protection.

Employing Workers: Human capital constraints – specifically, the challenges associated with finding skilled workers – were noted by virtually all stakeholders as among the most pressing constraints to business in Timor-Leste. In addition, several stakeholders commented that the process for obtaining work visas required to bring skilled workers from abroad is unbearably long – in some cases taking as long as a year – and costly, further enhancing the difficulties.

Paying Taxes: Taxation was not mentioned as a specific barrier. According to the Investment Guide, 'Timor-Leste's has a very competitive tax regime, with corporate tax, customs duties and indirect tax rates that are lower than in comparable countries in the Asia-Pacific region.'

Enforcing Contracts: The Timor-Leste judiciary lacks sufficient capacity around commercial law, significantly limiting its ability to enforce contracts. There is no separate commercial court, meaning judges from the criminal court system, who are not trained in commercial law, are left to handle both criminal and civil cases. Companies report lengthy, costly, and ultimately inefficient court processes, where even if the court rules in favor of the company, there is no mechanism to enforce the ruling (leaving the company with nothing after having spent considerable time and money going to court). As such, many relationships, especially those with suppliers are informal arrangements with no recourse if things go wrong. Although this does not appear to affect day to day operations, it clearly presents a considerable barrier to expansion of businesses outside of their local networks, and highlights the importance of having connections.

Closing a Business: The majority of businesses in Timor-Leste operate on a 'here one day, gone the next' mentality. There is very little insurance coverage in the country, and as noted above there are no formalized winding up procedures. Interestingly, this does not appear to affect day to day operations – it is simply accepted as a risk of doing business. That said, as noted above it also means a lack of investor protection, which is clearly a barrier to investment.

⁶⁷ http://investtimor-leste.com/files/EY_TimorLeste_Inv_Guide.pdf

Appendix 2: Donor Mapping

The below table provides a mapping of the ongoing and recently completed programmatic activities of key donor organizations operating in Timor-Leste. These were gained through public research on the different donor websites. All projects/interventions available on their websites with regard to active or relevant recently closed projects (within the last 5 years) was included. Though the USAID land project was completed 6 years ago, this was included due to its importance in the space. It should be noted that, as a result of the current political instability, many donor programs, including the World Bank and IFC, are on hold until a new government is in place and joint priorities can be agreed upon.

Program Description	Focus	Timeframe	Value
The World Bank* ⁶⁸ *Note that the lack of a Country Partnership Strategy means that programming going forward has not been defined and agreed upon.			
<i>Sustainable Agriculture Productivity Improvement Project:</i> Support increased productivity and marketed production of smallholder agriculture in selected geographical locations in Timor-Leste.	Agriculture	2016-2022	\$21M
<i>Community Driven Nutrition Improvement:</i> Supports improved nutrition practices targeted to children under the age of two and pregnant and lactating women in targeted least developed communities, focusing on community sensitization and mobilization, including <i>development</i> of Participatory Rural Appraisal and selection of Community Nutrition Educators; increasing knowledge and behavior related to nutrition specific messaging with nutrition-sensitive solutions; and training for and implementation of nutrition-sensitive initiatives at both demonstration plots and household plots.	Nutrition	2014-2018	\$2.84M
<i>Health Sector Strategic Plan Support:</i> Fostering social capital development to improve lives through education, health and nutrition and strengthening institution for quality of spending and inclusive service delivery.	Public Health	Active, approved 2013	\$17.7M
<i>Infrastructure Projects:</i> Road Climate Resilience Project Disaster Resilience Along the Dili-Ainaro and Linked Road Corridors	Infrastructure	In second phase – 2011-2021 2014-2018	\$95.2 M \$2.7M
IFC* ⁶⁹ *Note that the lack of a Country Partnership Strategy means that programming going forward has not been defined and agreed upon.			

⁶⁸ http://projects.worldbank.org/search?lang=en&searchTerm=&countrycode_exact=TP

⁶⁹ https://disclosures.ifc.org/#/enterpriseSearchResultsHome/*&f_region_description=EAPREG

Program Description	Focus	Timeframe	Value
<i>Business Registration and Licensing:</i> Supported the establishment and capacity building of SERVE, the one stop shop business registry. Planning on engaging in streamlining and simplifying procedures around business licenses and sector-specific licenses.	Business Licensing	2008-2013 ⁷⁰ New licensing activities in planning	
<i>Customs Reforms:</i> Provided advisory services to reform the Custom Code, general quarantine regulations and related regulations and support process <i>reengineering</i> for customs and quarantine	Customs	2014-2016	\$1.7M
<i>Access to finance:</i> Partnered with three financial institutions, including MFIs Kaebauk Investimentu no Financas and Tuba Rai Metin, providing capacity building and financing ⁷¹	Micro Finance	Active, approve 2015	\$1M Investment \$1.5M Advisory
<i>PPP implementation support:</i> Support to GoTL to structure and implement PPPs including: <ul style="list-style-type: none"> Tibar Bay Port PPP Dili Airport PPP Project (outcome unknown) 	PPP Advisory	Active, both approved 2012	\$2.9M \$1.5M
<i>Infrastructure Investment:</i> \$20 million green-field Project constitutes the construction and management of the first block ("Block A") of Phase I of Dili Financial Business Center	Infrastructure	On hold	\$20M
Asian Development Bank⁷²			
<i>Business Law Reform Program (through the Pacific Private Sector Development Initiative⁷³):</i> Supported a number of activities including: <ul style="list-style-type: none"> Drafting of the Secured Transactions Law, in conjunction with Miranda Law Firm (legislative drafting is complete, though this has not been passed). Supported MECAE in the development of <i>the</i> legal framework for commercial transactions (see other boxes). Conducted a legal diagnostic of Timor-Leste's insolvency laws to support drafting of an updated insolvency law (ultimately did not endorse final law drafted). Supporting ongoing commercial and economic legislative reforms, including the Companies 	Judicial	Ongoing, since 2011	\$3.3 million to Timor-Leste PSDI as of mid-2016

⁷⁰ <http://www.serve.gov.tl/en/content/serve-one-stop-shop-open-business>. New licensing activities discussed during stakeholder interviews.

⁷¹ IFC was also provided technical assistance (TA) to establish the feasibility and roadmap for developing a credit registry in Timor-Leste (this TA ended in 2007) and it does not appear that further activities/projects have supported this.

⁷² <https://www.adb.org/projects/country/tim/status/approved-1359/status/active-1367>

⁷³ <https://drive.google.com/file/d/0B45vfxm-gRsybENLeTRwOU94Qzg/view>

Program Description	Focus	Timeframe	Value
Law (Law 10/2017). Support included a legal and registry diagnostic, and policy and legal drafting recommendations to simplify and modernize the law.			
<p><i>Pacific Private Sector Development Initiative:</i>⁷⁴ <i>Support activities including:</i></p> <ul style="list-style-type: none"> • Support to GoTL to establish a PPP Unit and project development process and conducted capacity building of ministers and senior public officials on the role of PPPs in infrastructure • Conducted a diagnostic and supported drafting of Competition Policy • Assisted the Central Bank in undertaking a review of its offsite banking supervision system and developing the regulatory framework for digital financial services. Provided support to strengthen anti-money laundering/combating the financing of terrorism framework. 	PPP Advisory	Ongoing, since 2011	\$3.3 million to Timor-Leste PSDI as of mid-2016
<i>District Capitals Water Supply Project:</i> Support Ermera, Oecussi, and another district manage their water resources better to reduce water-related diseases and raise household incomes.	Water	2012-2019	\$11M
<i>Mid-Level Skills Training Project:</i> Introduce and implement mid-level skills training in construction and automotive trades by strengthening selected public and private training providers.	Skill Development	2012-2018	\$12M
<i>Support for Preparation of a National Coffee Sector Development Plan:</i> Preparation of a National Coffee Sector Development Plan and support for the Timor-Leste Coffee Association is helping it to become a credible representative and advocate in the sector.	Economic Development	2016-2018	\$250K
<i>Dili to Baucau Highway Project:</i> Upgrade and climate-proof the road between Dili and Baucau.	Infrastructure	2017-2022	\$49.7
<i>Road Network Upgrading Project:</i> Build a shorter and safer route between Dili and Tibar Bay.	Infrastructure	2017-2019	23.37
<i>Electricity System Strengthening and Sustainability Program:</i> Investment in Electricidade de Timor-Leste, Timor-Leste's state-run electric utility) to improve electricity service reliability, expand access and improve performance.	Infrastructure	2016-2018	\$1M
<i>Fiscal Policy for Improved Service Delivery:</i> Building capacity for analysis of the welfare implications of fiscal policy and for more general economic analysis.	Policy	2016-2018	\$750K

⁷⁴ <https://drive.google.com/file/d/0B45vfxm-gRsybENLeTRwOU94Qzg/view>

Program Description	Focus	Timeframe	Value
<i>Capacity for Regional Economic Integration:</i> Supporting improvements in Timor-Leste's ability to meet ASEAN requirements	Economic Development	2012-2018	\$1M
<i>Policy and Planning for Skills Development in Secondary Education:</i> Strengthening the skills base of human resources by improving access to quality and equity of technical education.	Skill Development	2016-2018	\$1M
<i>Urban Services Improvement Sector Project:</i> Conduct assessments of existing water supply and solid waste management systems, including surveys and stakeholder consultations and develop water supply and solid waste investment strategies for Dili.	Governance	2014-2018	\$1.3M
<i>Expansion of Financial Services:</i> Support the commercial transformation of BNCTL through (i) support to the implementation of BNCTL's strategic and business plan, (ii) design and delivery of products; (iii) introduction of technologies that improve efficiency; and (iv) building staff capacity.	Finance	2014-2018	\$750K
<i>Strengthening Water Sector Management and Service Delivery:</i> Rehabilitate the urban water supply systems of Pante Macassar and Manatuto, and introduce the use of PPPs for service provision.	Water	2012-2018	\$1.3M
USAID⁷⁵			
<i>Strengthening Property Rights in Timor-Leste:</i> Aimed to strengthen and clarify property rights, including aiding government to develop implementing regulations for the land law (i.e., registration, taxation, valuation, expropriation, foreign ownership).	Land	2007-2012	\$9.9M
<i>Access to Justice and Legislative Reform Program:</i> Included support for surveys of attitudes towards law and justice in partnership with the Asia Foundation.	Judicial	Ended 2012	
<i>Ba Distrito Program:</i> ⁷⁶ Enhanced decentralized governance in Timorese communities, strengthened legal aid systems, and increased the effectiveness of the judicial system.	Judicial	2013-2017	
<i>Tourism Development Project:</i> ⁷⁷ Supporting public and private cooperation to market Timor-Leste as an "off-the-beaten-path" destination for adventure travelers and eco-tourists.	Tourism	2018-2020	

⁷⁵ <https://www.usaid.gov/timor-leste>

⁷⁶ http://www.tetratedhdpk.com/images/stories/East_Timor/east_timor_2pager.pdf

⁷⁷ <https://www.usaid.gov/timor-leste/press-releases/jan-28-2018-usaidtimor-leste-signs-agreement-help-timor-leste>

Program Description	Focus	Timeframe	Value
<i>Avanza Project:</i> Support activities aimed at improving incomes by increasing farm productivity and establishing links to new markets, better access to quality agriculture inputs and access to finance.	Agriculture	\$19.2M	2015-2020
<i>Democracy, Human Rights and Governance:</i> Partners with the GoTL to strengthen democratic institutions, consolidate good governance practices and work with the judiciary and legal service providers to facilitate increased access to justice for rural populations. This includes 2 programs: Strengthening Decentralization of the Office of the Ombudsman for Human Rights and Justice and General Election Support and Electoral Security Program.	Democracy and Governance	Ombudsman support – \$523,000 Election Support: \$4M	2015-2018 2016-2019
<i>Reinforce Basic Health Services:</i> Working to improve the clinical skills of Ministry of Health staff to deliver high quality and high-impact basic health care services in reproductive, maternal and newborn health.	Global Health	2015-2020	\$8.4M
<i>Revenue Enhancement for Good Governance Activity:</i> ⁷⁸ Reform and streamline customs operations to promote economic development, greater business transparency and security and adoption of world trade standards	Customs	2017-2019	\$5-million
Australian DFAT⁷⁹			
<i>Governance for Development:</i> Currently funding a legal advisor who was formerly part of the Law Reform Commission and now works with the NGO Judicial Sector Monitoring Program (JSMP) to evaluate the status of civil cases in the court system.	Governance	2014-2021	\$46.4M
<i>Market Development Facility:</i> Provides grant funding to support businesses with innovative ideas to increase business performance and stimulate economic growth.	Economic Development	2013-2021	\$18.1M
<i>Partnership for Human Development:</i> Provides technical assistance in health, education, water, sanitation, nutrition, gender equality, disability and social protection under one consolidated, multi-sectoral approach.	Global Health Nutrition Education	2016-2021	\$120M
<i>TOMAK Farming Program:</i> Focuses on improved productivity and nutritious foods, to reduce malnutrition and improve commercial farming opportunities for rural households.	Nutrition	2016-2021	\$25M

⁷⁸ <https://www.usaid.gov/timor-leste/press-releases/jun-11-2017-usaidtimor-leste-signs-agreement-assist-reforms-timor>

⁷⁹ <http://dfat.gov.au/geo/timor-leste/development-assistance/Pages/improving-livelihoods-in-timor-leste.aspx>

Program Description	Focus	Timeframe	Value
<i>Roads for Development Program:</i> Funding rehabilitation and maintenance of rural road infrastructure.	Infrastructure	Phase 1: 2012-2016 Phase II: 2017-2020	Phase 1: \$36M Phase 2: 26M
<i>Workforce Development Program:</i> Supports scholarship opportunities for tertiary study in Australia, access to vocational training to help young Timorese find employment and supports Timor-Leste increase participation in Australia's seasonal worker program.	Tertiary Education	2014-2019	\$13M
<i>Hamutuk – Nutrition Collective Impact Pilot:</i> Collaboration of more than 20 government and non-government organizations from multiple sectors working together to reduce the prevalence of stunting in children under two-years of age.	Nutrition	2015-2019	\$3M
<i>Ending Violence Against Women in Timor-Leste:</i> Works across government and civil-society organizations to prevent violence as well as provide services and access to justice for survivors of violence.	Gender	2014-2022	\$32M
<i>National Village Development Program:</i> Provides annual grants of around US\$50,000 to communities across Timor-Leste for small scale infrastructure projects. These projects include building or refurbishing water systems, irrigation channels, bridges, motorbike paths or market places, as well as refurbishment of schools or health posts.	Rural Development	2012-2018	\$48.4M
UNDP⁸⁰			
<i>Justice System Program:</i> Capacity building, policy making and coordination throughout the sector. Capacity building support to the formal justice system, providing district courts with appropriate working conditions for operating (in a fixed and mobile modality), along with promoting legal aid service delivery to the population; Capacity building through the Legal Training Center; and legal aid pilot to protect vulnerable groups' rights.	Judicial	2003-2018	\$12.8M
<i>Capacity Building Support to Policia Nacional da Timor Leste:</i> Building up the capacity of the PNTL to run and manage operations independently. While the second (current) phase is from 2016 to 2018 and is entitled "PNTL – Strengthening Governance and Service Delivery"	Judicial	2013-2018	\$5.8M

⁸⁰ http://www.tl.undp.org/content/timor_lesste/en/home/all-projects.html

Program Description	Focus	Timeframe	Value
<i>Youth Action for SDGs Program:</i> Through the creation of the Youth Entrepreneurship and Innovation Hub, creating an enabling environment for youth innovation and entrepreneurship development as well as youth voices and engagement to contribute to increase employment rate and economic diversification.	Economic Development	Ongoing since 2013	
<i>Timor-Leste National Human Development Report 2018:</i> Collaborative project between the Government of Timor-Leste, UNDP and Flinders University, Australia. The report examines well-being and identifies options for seizing the demographic dividend, an issue that profoundly influences human potential and sustainable development.	Human Development	2016-2018	\$126K
<i>Global Environment Facility Small Grants Program:</i> Channeling funds to local NGOs and CBOs to assist the initiatives of rural communities in addressing communities' environmental issues and strengthening their livelihoods.	Rural Development		
<i>Building shoreline resilience of Timor Leste to protect local communities and their livelihoods:</i> Mangroves and coastal wetlands ecosystem protection and restoration interventions will be implemented while strengthening alternative livelihoods options and integrated approaches to coastal adaptation to protect the coastal communities and productive lands	Rural Development	2016-2020	\$1.7M
<i>Strengthening Community Resilience to Climate-Induced Disasters in the Dili to Ainaro Road Development Corridor:</i> Protect critical economic infrastructure from climate induced natural hazards through improved policies, strengthened local DRM institutions and investments in risk reduction measures within the corridor, with the objective of sustaining human development.	Infrastructure	2014-2019	\$3.4M
<i>Enhancing public sector accountability:</i> Strengthening anti-corruption efforts, supporting effective service delivery and decentralized public administration, and strengthening democratic participation.	Governance	2018-2019	\$2K

Program Description	Focus	Timeframe	Value
<i>Support for the Institutional Development of the Authority of the Oé-Cusse Special Administrative Region and Special Economic Zones for Social Market Economy (ZEESM):</i> Working with authorities in Oé-Cusse to operationalize the Special Administrative Region (SAR) and the Special Zones for Social Market Economy (ZEESM) and to strengthen institutional capacity to deliver services to the people of Oé-Cusse	Economic Development	2015-2018	\$2.9M
European Union** **The last Country Strategy Paper ended in 2013.			
<i>Support for the implementation and coordination of the Portuguese-speaking African countries and Timor-Leste cooperation:</i> Promote ties between the 6 PALOP-TL countries, to reinforce cooperation among themselves and on common interests and to promote transfer of knowledge, promote political cooperation and communication. ⁸¹	Economic Development	2015-2018	€1.3M
JICA⁸²			
<i>Dili Urban Master Plan and Integrated Planning Advisor Project:</i> Supporting the Ministry of Planning and Strategic Development in a study for the Dili Urban Master Plan (has been drafted). Also supporting national territorial planning by dispatching an Integrated Planning Advisor since 2016.	Land	2014-2016	
<i>Human Capital Development for Policy:</i> Support the human capital development among civil servants for <i>planning</i> and policy making through funding for education in Japan.	Human Capital	2018-2019	
<i>Infrastructure Financing:</i> Financing infrastructure projects including: Rehabilitation and improvement of Buluto Irrigation; Building for the Faculty of Engineering, Science and Technology of the National University of Timor-Leste; Relocation of Ferry Terminal in Dili Port; and Protection of Mola Bridge.	Infrastructure	2016-2021	
<i>Project for Increasing Farmers Households' Income through Strengthening Domestic Rice Production</i>	Rural Development Agriculture	2016-2021	

⁸¹ https://ec.europa.eu/europeaid/projects/support-implementation-and-coordination-portuguese-speaking-african-countries-palop-and_en

⁸² <https://www.jica.go.jp/project/english/index.html> and https://www.jica.go.jp/easttimor/english/office/others/c8h0vm0000966y5o-att/brochure_en.pdf

Program Description	Focus	Timeframe	Value
<i>Industrial Development Advisor:</i> This advisor assists the Ministry of Commerce and Industry (MCI) in developing concrete action plans to make success models for industrial development and taking necessary initiatives for execution of the action plans.	Economic Development	2016-2018	
<i>Project for Community-Based Sustainable Natural Resource Management Phase II:</i> Promotes community based natural resource management (mainly forestry and watershed management) through participatory land use planning. In addition, based on the future land use plan, various micro programs (e.g. conservation agriculture, food processing etc.) are implemented.	Rural Development	2016-2019	
<i>Capacity Development for Community Policing:</i> Training in Japan followed by one in Indonesia, as well as dispatch of short term Japanese experts to Timor-Leste. The support for community policing will be continued through trainings and their follow ups	Judicial	2013-2016	
Oxfam⁸³			
<i>Land Inclusive Development:</i> Advocate for development processes that provide services and opportunities in a way that lowers inequality, and <i>respect</i> the rights of the poor, marginalized, and vulnerable people of Timor-Leste.	Land	Ongoing since 2015	
<i>Active Citizenship:</i> Work with 20+ partners to improve the well-being of rural women and men by promoting active citizenship through strengthening of civil society. Support to ensure national policies and practices help poor populations.	Governance		
<i>Sustainable Livelihoods:</i> Work with women and men in rural communities across Timor-Leste to adapt their farming techniques to improve their yields of crops, and be better prepared for agriculture in <i>times</i> of disasters brought about by climate change. Savings for Change groups helps women and men to save money, access finance and plan for their futures.	Rural Development		
<i>Disaster Risk Reduction:</i> Work with partners to respond to disasters such as flooding, drought or landslides. Provide timely, appropriate and quality humanitarian assistance in times of disaster.	Humanitarian Aid		

⁸³ <https://www.oxfam.org/en/countries/timor-leste-east-timor>

Program Description	Focus	Timeframe	Value
Asia Foundation⁸⁴			
<i>Support for Good Public Policy:</i> Guided public policy around land issues through evidence-based research and work with a broad range of civil society partners, including the Rede Ba Rai land network.	Policy reform		
Provided Continuing Legal Education for judges and prosecutors around suspended sentencing and developed <i>annotated</i> guidelines on sentencing. Co-funded a nationwide, representative survey on Attitudes Toward Justice under the USAID Access to Justice Project ⁸⁵	Judicial		Ended 2012
<i>Peace and Security:</i> Partnering with the Policia Nacional de Timor-Leste to implement principles of community policing, providing training to council members on setting safety and security agendas. Supports legislation and structural changes to improve coordination and cooperation between Suco councils and the police at the local level.	Judicial		
<i>Women's Economic Empowerment:</i> In collaboration with two local partners and with funding from the U.S. Embassy, is supporting women Tais (a traditional woven cloth) weavers throughout the country to enhance their livelihood opportunities.	Economic Development		
<i>Strengthening Accountable Governance:</i> Supports local NGOs to provide independent qualitative monitoring for the nationwide community driven development initiative, Programa Nasional Dezenvolvimentu Suco.	Governance		
<i>Supporting Good Public Policy:</i> Supporting the development of capacities and mechanisms for good public policy generation and implementation that more accurately reflect public needs. Helping to build a network of influential policy reformers in order to leverage the importance of key individuals in shaping public policy.	Policy Reform		

Note that the team was unable to get timeframe or value information for Oxfam and Asia Foundation engagements.

⁸⁴ https://asiafoundation.org/wp-content/uploads/2016/12/Timor-Leste_Overview_Dec2016.pdf

⁸⁵ <https://asiafoundation.org/resources/pdfs/TimorLesteAccessToJustice.pdf>