

# Strategic Analysis Paper

11 February 2021

## Political and Governance Challenges Confronting Timor-Leste

**Jarryd de Haan**

*Research Analyst*

*Indo-Pacific Research Programme*

### Key Points

- While its domestic economy was hard hit, Timor-Leste fared relatively well during the COVID-19 pandemic, largely due to its sovereign Petroleum Fund.
- The longevity of the Petroleum Fund is now in question as the feasibility of a key infrastructure project that would give access to new oil fields is being re-evaluated.
- Political instability within the government has had significant economic consequences in recent years.
- A restructuring of the government spurred on by COVID-19 has brought some respite to that instability, but will likely only offer temporary relief.
- Australia has a strong interest in a prosperous and stable Timor-Leste, which is underpinned by security concerns.

### Summary

The Australian Government significantly increased its aid to Timor-Leste in 2020, despite an overall drop in the official development assistance budget and significant cuts in the amounts of aid given to other countries. The increase in aid, identified as a post-COVID-19 recovery fund, can be seen as an extension of the “Pacific Step-up” foreign policy. While Timor-Leste does not fall under the Pacific Islands grouping, its significance to Australia is similar to that of the broader Pacific, if not greater. With that significance in mind, this paper will look at the primary challenges that Timor-Leste faces on both the economic and political fronts.

## Analysis

### **COVID-19 Challenges**

In response to COVID-19, the Timor-Leste Government declared a state of emergency and put lockdown measures in place which saw public transport suspended and meetings of more than five people banned, and the shutting down of religious services, festivals, sporting events, cultural activities, schools and universities. According to a [2021 Pre-Budget Statement](#) released by the Timor-Leste Government, those shutdowns significantly affected the economy: ‘Domestic revenues in April saw a substantial impact, with overall revenues increasing by only \$10.8 million in 2020; nearly half the total in 2019 of \$20.9 million.’ In addition to lockdowns, the departure of expatriates and the fall in remittances from Timorese losing their jobs overseas had a significant impact on local businesses. Non-oil gross domestic product (GDP) is also expected to contract by six per cent, due to the lockdowns in combination with a delayed budget and political uncertainty.

Comparatively, however, Timor-Leste, like many of the Pacific Island countries, has fared rather well amid the COVID-19 pandemic, contracting very few cases and requiring less stringent lockdowns. In comparison to many other developing countries, Timor-Leste is also in a much better position to handle the short-term economic costs that have come with COVID-19. In its response to the pandemic, Timor-Leste [spent far more](#) than its Pacific neighbours and twice as much as the average developed country, with additional expenditure reaching 8.6 per cent of GDP. The reason why the government can afford such spending is the country’s Petroleum Fund, a sovereign wealth fund which can be freely accessed by the government and which currently totals US\$18.7 billion, almost seven times the size of Timor-Leste’s annual GDP.

### **Broader Economic Concerns**

While Timor-Leste has avoided the worst of COVID-19, the pandemic has highlighted a worrying vulnerability in its economy. Instability in the global economy and a drop in demand for oil in the wake of the COVID-19 pandemic sparked a price war at the beginning of 2020 which saw Tapis crude oil prices plummet by more than 65 per cent between January and March. That resulted in a significant drop in the petroleum fund’s valuation, with losses estimated to be US\$844 million in the first quarter of 2020. Most of the assets in the petroleum fund were protected by the drop in oil price, however, given that 98 per cent of the fund is tied up in financial assets.

Even so, the drop in oil price has negatively affected oil revenues at a crucial time for Timor-Leste. The Bayu-Undan field, which has been the source of oil revenue for the country, is expected to be exhausted by 2022. That is a concern given the tendency of the Timor-Leste Government to withdraw more from the fund than it earns. Without a long-term source of revenue, the balance of the fund will eventually be reduced to zero, returning the country to being entirely dependent on its underdeveloped domestic economy.

Being forced to prematurely rely on the domestic economy could have severe implications for the population. While the government has made [significant progress](#) in improving

sanitation, access to electricity, access to clean water and reducing poverty levels, there is still a long way to go to bring those indicators up to satisfactory levels. To continue that effort, the Timor-Leste Government needs to invest significant funds into infrastructure. Without the petroleum fund to finance that investment, reducing those poverty indicators will be much more difficult.

As noted in a previous [Strategic Analysis Paper](#), a possible lifeline for the economy could be the Greater Sunrise Field, to which Timor-Leste was granted access following maritime boundary negotiations with Australia. That field, worth approximately \$30- to \$50-billion, would add an extra fifteen years to the life of the petroleum fund, thereby giving more time to develop the domestic economy. To exploit Greater Sunrise, the Timor-Leste Government has sunk significant resources into the Tasi Mane project, which aims to establish local, onshore petroleum development through the construction of a supply base in Suai, refineries and petrochemical plants in Betano and liquefied natural gas plants in Beaço. For the past few years, that project has accounted for approximately 15 to 20 per cent of all infrastructure costs.

Recent developments, however, may have suspended that lifeline. In 2020, then newly-appointed Petroleum Minister Victor Conceição Soares, [told media](#) that the feasibility studies for the Tasi Mane project had been manipulated to match the government's ambitions at the time. Those comments were backed up by the new head of Timor GAP, who stated that, 'There was never a proper feasibility study in the years leading up to the Tasi Mane project' and adding that the government and former head of Timor GAP were politically motivated to justify the project by using 'flawed economic data and predictions.' Consequently, the feasibility of the Tasi Mane project is now being re-evaluated, which will likely further delay the exploitation of the Greater Sunrise fields and put further pressure on the Petroleum Fund.

### ***Political Instability***

The [World Bank](#) has described political uncertainty as the main internal risk affecting the Timor-Leste economy:

Timor-Leste is a young democratic nation that has devoted considerable energy to re-build its institutions. Nevertheless, the country has had eight different Governments since independence was formalised 18 years ago. A civil crisis contributed to three changes in Government between 2006 and 2007. In 2015, tensions between CNRT and FRETILIN were resolved with a national unity government – which was formed without an election. However, this was the start of an intermittent period of political uncertainty. There have been four Governments in the past six years, while the recent reconfiguration of the ruling coalition could also be considered as a new Government.

The effect of political instability on the Timor-Leste economy has been especially marked in the past few years. Following parliamentary elections in mid-2017, the country experienced a political deadlock which was blamed for economic recession for 2017 and 2018. On top of that, the parliament failed to approve a federal budget for most of 2018. Without an

approved budget, the Timor-Leste Government has had to operate under a duodecimal budget system, with each government agency spending one-twelfth of the previous budget's allocation each month. Such a system is less than ideal as it severely constrains public expenditure due to limited access to the petroleum fund. As covered in the [Strategic Weekly Analysis](#), the Timor-Leste Government again failed to pass a state budget in 2020, exacerbating the already difficult economic circumstances resulting from COVID-19 with the return to a duodecimal system. The failure to pass the budget also caused a [breakdown](#) in the governing coalition and the resignation of the Prime Minister. In April, however, the Prime Minister rescinded his resignation and the government underwent a drastic restructure in an effort to bring stability in the midst of the COVID-19 pandemic. While the recent restructure of the collapsed coalition will bring some respite, political instability is likely to be an ongoing issue.

### ***Australia's Interest in Timor-Leste's Success***

Australia has strong interests in the success and stability of Timor-Leste. So far, its foreign policy approach to the country has been geared at ensuring stability through developmental aid which serves several strategic objectives, including:

- warding off potential refugee crises;
- giving the Timor-Leste Government the capacity to meet its own security needs;
- securing Australian shipping lanes that pass through Timor-Leste waters;
- helping to defend Australia's northern approaches; and
- protecting Australia's Exclusive Economic Zone.

More broadly, there is concern in Canberra about the potential for foreign influence in the country, which has been highlighted in past [White Papers](#). If the Timor-Leste Government fails to overcome its economic challenges and succumbs to political instability, the country will become significantly more vulnerable to foreign ambitions which could be at odds with Australian interests. Beijing is an obvious source of such concerns and, given the recent trajectory of the Australia-China relationship, a Timor-Leste that is free of unwelcome foreign influence would ease the minds of Canberra policymakers. While there is no strong indication that Beijing already has any significant foothold in Timor-Leste, it is necessary for Australia's strategic outlook to be alert to the implications of such a possibility in the future.

Timor-Leste has been spared the worst of COVID-19, thus far. While the pandemic has still had a substantial impact on the domestic economy, the Government has been able to use the Petroleum Fund to protect the economy in the short term by providing support for households and businesses. Looking towards the longer term, the government needs to ensure that it can maintain stability in its restructured coalition, especially as the future of the Petroleum Fund is far from assured.

\*\*\*\*\*

*Any opinions or views expressed in this paper are those of the individual author, unless stated to be those of Future Directions International.*

Published by Future Directions International Pty Ltd.  
Suite 5, 202 Hampden Road, Nedlands WA 6009, Australia.  
Tel: +61 8 6389 0211  
Web: [www.futuredirections.org.au](http://www.futuredirections.org.au)