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ECONOMIC REFORMS IN TIMOR LESTE: BETWEEN ECONOMIC GROWTH, EASE OF DOING BUSINESS AND INEFFECTIVE GOVERNMENT

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Abstract

Despite of its growing Gross National Income (GNI) per capita in the recent years, Timor Leste is still being classified as an economically fragile country for consecutive years by some international organizations. This research was then conducted within the purpose to understand the reasons behind such classification, by focusing on the relation between poverty, unemployment, government ineffectiveness, as well as the ease of doing business in the country. By using the secondary data provided by some notable international organizations, the research found out that all factors mentioned above are interrelated to each other, which consequently influence the economic fragility in Timor Leste, regardless of how growing their GNI per capita is. At the end of the research, certain recommendations are also proposed, in order to solve the problem of economic fragility in Timor Leste.

Keywords

Fragile State, Economic Reforms, Poverty, Unemployment, Ease of Doing Business, Government Effectiveness, Regulatory Quality

1. Introduction

Timor Leste, also known as East Timor, is one small country that located on the southern part in the Southeast Asia. Its capital city is Dili, its official language is called “Tetum” and its governmental system is Semi-Presidentialist Republic with President as the Head of States (Government of Timor Leste, n.d.-b). The country is located in the eastern part of Timor Island, sharing its western part with the West Timor district, Nusa Tenggara Timur Province, Indonesia. The total area of Timor Leste is 14,919 km², which become the home for 1.211 million people with a population density around 81.5 people per km² (United Nations Data, n.d.). According to the World Bank (n.d.-g) and Knoema (n.d.-b), in 2015, 41.8% among that population were falling into the poverty line and 35,97% of them were illiterate.

Historically, Timor Leste initially declared their independence on 27 November 1975. However, two months after, the neighboring country—Indonesia, decided to annex the region and to include it as their 27th province under the name of East Timor. Such annexation then marked the beginning of violent conflict in Timor Leste, which lasted for 24 years. Following such conflicts, other internal conflict, caused by rebellious and separatism group also occurred during 2007 to 2012 (BBC, 2017).

Consequently, the occurred conflicts had a very significant effect toward the country’s instability and fragility. The term “fragile state” itself has several definitions, which are different according to the indicators included during the assessment. The Organization for Economic Cooperation and Development, commonly known as OECD, defines fragile states as countries where there is a lack of political commitment and insufficient capacity to develop and implement pro-poor policies. French Government simply defined the fragile state in their national report as the countries with poor economic performance and ineffective impotence of government. (Carment, Prest, and Samy, 2008).

Following such definition, some organizations have constantly published an annual report on the fragile states with different indicators. Annual report by OECD in 2015 had used violence,

justice, institutions, resilience and economic foundations as indicators to assess state fragility (OECD, 2015). On the other hand, another institution named the Fund for Peace had used twelve indicators on their assessment, including demographic pressures, refugees and IDPs, group grievance, human flight and brain drain, uneven economic development, poverty and economic decline, state legitimacy, public service, human rights and rule of law, security apparatus, factionalized elites, and lastly, external intervention (Fund for Peace, 2016).

Regarding the case of Timor Leste, according to the OECD Report in 2015, Timor Leste has been constantly falling into the category of “Fragile States” for 10 years based on economics, justice and resilience indicators. A year after, the same organization also—once more—included the country as a fragile state based on the same indicators. Furthermore, the Fund for Peace Report in 2016 had put the country in the 35th rank among all countries in the world and classified it under the “Alert” category.

As the economic situation in the country has been considered as one of the three reasons of its fragility issue, it seems reasonable to begin the research by looking over their GNI per capita data first. Based on the World Bank data, their GNI per capita in 2000 was US\$1,820 and it had been fluctuatively changed—both positively and negatively—during 15 years (World Bank, n.d.-e). The recent data shows that, in 2015, their GNI per capita reached the nominal of US\$ 4,550—2.5 times more than it was in 2000. With such amount of GNI per capita, the country has been classified as one of the lower middle income countries by the World Bank (n.d.-h).

In addition to that, taking into consideration that they had experienced violent conflict before, their GNI per capita is quite fine, especially if it is compared to another country with a same experience of violent conflict within the same area. For example, let’s take a look on the GNI per capita of Papua New Guinea—another country in East Asia and Pasific region. In 2014, its GNI per capita was only US\$ 2,240 in 2014 (World Bank, n.d.-d). Papua New Guinea was also classified as a fragile state by the 2015 OECD report. However, regardless to its less number of GNI per capita, this country was not considered economically fragile. In contrast with Timor Leste, the OECD classified Papua New Guinea as a fragile state based on the justice and resilience indicators only.

Such data are somehow interesting to be explored furthermore, as a country that has higher—even doubled amount of GNI per capita—in this case, Timor Leste was considered as economically fragile while another country that has lower GNI per capita—in this case, Papua New Guinea was not. After looking into such preliminary data, it is prematurely assumed that there is something wrong with the economic institution in the Timor Leste, which makes it falls into the category of fragile state based on economic indicator. Thus, an inductive rationale research is conducted in order to find out what is missing from their economic reforms by exploring the current economic institutions—relatively compared to the Papua New Guinea's. Starting with gathering secondary data obtained from the respective institutions in the development field, the research interrelatedly analyzed those data within the purpose to find a legit theoretical explanation about the current situation. The result of such research will further elaborated in this paper within three different parts: first, the relation between poverty and unemployment in Timor Leste; second, the relation between unemployment and the ease of doing business in Timor Leste; and, third, the relation between the ease of doing business, regulatory quality and good governance, which represented the existing political institution of the country. Finally, at the end of the research, certain recommendations will also be given in order to solve the found problem as well.

1.1 Gross National per Capita, Poverty and Unemployment in Timor Leste

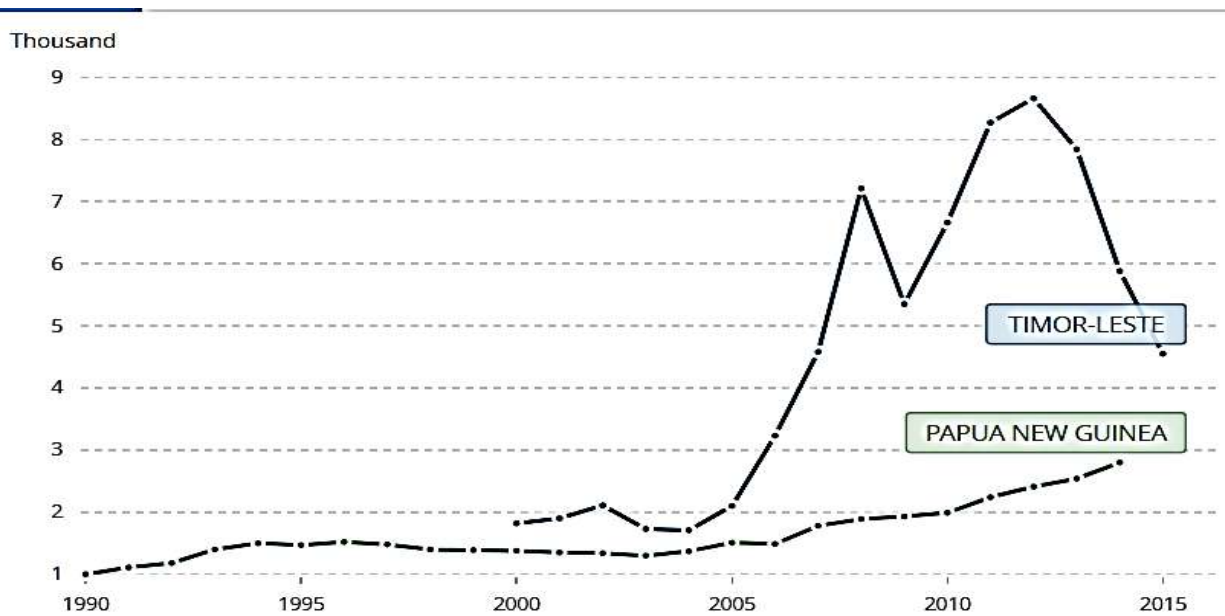
Timor Leste has been tried to reform their economic institution since the end of annexation by Indonesia in 2002. Certain economic programs have been performed to ensure their economy keeps growing. The expansion of business performance through diversification, such as tourism and private sectors, and the modernization of the existing agricultural sector are some of the efforts that the country did to increase their economic situation (Government of Timor Leste, n.d.-a). Such efforts are considerably successful as it propitiously increases the GNI per capita of Timor Leste during the last ten years.

However, it seems that the country has been failed to predict any trade-off that may arise after their economic reform programs. Most of the development scholars believe economic reform programs that the country with an experience of violent conflict applies, will always have a trade-off to one another. It is also mentioned that unless, they can accommodate and balance such trade-offs, their economic reforms is not likely to be well-developed. According to the

United States Agency for International Development (2009), there are at least three types of trade-offs that may occur during the economic reforms, which are: (i) trade-off between effectiveness of the economic reforms in the short run and its efficiency in the long run; (ii) trade-off between performing urgent tasks and its effect that may occur to the legitimacy of government; also (iii) trade-off between the desire to use the window opportunity to make dramatic economic reforms immediately and the country's very limited absorptive capacity to manage such drastic change.

The first type of trade-offs between the long-run efficiency and short-run effectiveness of the economic policy is one of the most occurring trade-off in the economic reforms. The concrete example of it is the trade-off between national economic growth and expansion of job opportunities in the society (USAID, 2009), which unfortunately happened to the economic reforms in the Timor Leste. It presumably becomes the main reason why the country was considered as economically fragile when they have a fairly growing GNI per capita.

Regarding such trade-off, it seems that the growing GNI per capita has another trade-off in the different side, which turns out to be growing inequality rate and poverty rate. Income inequality and poverty itself have been identified to be closely associated to each other as the latter shows how unequal the distribution of economic growth within the country (Sen, 1973). While Timor Leste successfully increases their GNI per capita (*graph 1*), showing the stable national economic performance during years, they unfortunately keep failing to address the issue of income inequality and poverty within the country. While they have more than US\$4,000 per capita in the 2014, almost half of them (41.8%) were still under the poverty line. Such fact also conveys that while they are successful in rising their GNI per capita, the economic equality between each person within the country is not addressed properly.



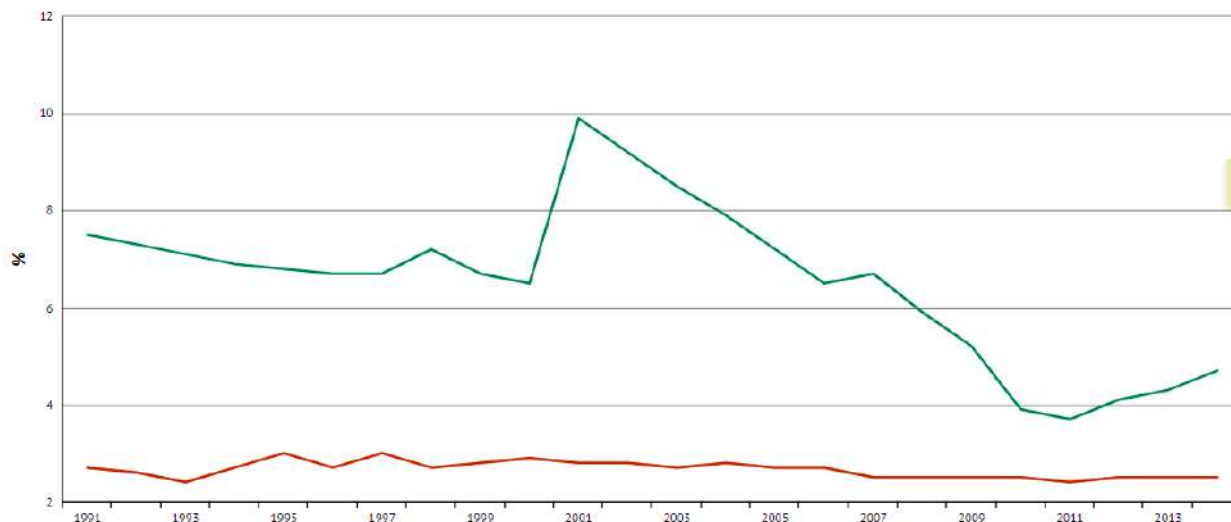
Graph 1: Comparison of GNI per Capita (PPP) of Timor Leste and Papua New Guinea during 2000 to 2015. Adapted from the World Bank.

Moreover, the 2016 GINI index of the World Bank (n.d.-c) also supports the idea that Timor Leste has a fairly unequal distribution of income as its income inequality is amounted around 30% to 35%. It shows that, unless the country is able to distribute their national income equally to all citizens within the country, the increase of GNI per capita in one side will not automatically increase the wealth of all people within the country.

Furthermore, their unemployment issue is adding another problem in their economic reforms. Grosso and Smith (2012) had stated that unemployment inhibits the economic growth of a nation and contributes to the problem of ongoing poverty. Furthermore, unemployment and poverty itself are, in some other way, induced by each other in the vicious cycle. Anderson (1967) pointed out the interrelation between unemployment and poverty as people become poor because they do not have a proper job to fund themselves a household necessity, such as food, water, electricity and even, house. Yet, poverty also becomes the reason of unemployment, as poor people tend to skip education because they have no money to pay the school fee, thus giving them less hope and opportunity to get a proper job in the future. In the case of Timor Leste, regrettably, the unemployment rate there is quite high.

Based on the 2014 Report by the International Labour Organization (Knoema, n.d.-c), it is mentioned that the unemployment rate in the country was 4.7%. The number was increased about 1% since 2011, showing that there were around 10.000 new unemployed people within three years (*graph 2*). On the other hand, taking a look on Papua New Guinea, a neighboring country with similar experience of the violent conflict, it seems that they have a good strategy to deal with those two problems, regardless their limited GNI per capita.

As can be seen in the graph below, the unemployment rate of Papua New Guinea has been quietly stable around 2.3% to 2.8% for almost 23 years. The recent data from 2014 shows that the unemployment rate in Papua New Guinea was 2.5%, showing a constant rate since 2012 (Knoema, n.d.-a). Such data shows that even with limited GNI per capita, they are able to address the unemployment very well. Moreover, based on the World Bank data, the poverty rate in the country was only 39.9% (World Bank, n.d.-f). Even though the latest data available for poverty rate of the country are the 2009 data, however, by looking to its stable and lower unemployment rate, also taking into consideration about interrelation between unemployment and poverty, it may as well be assumed that they probably have lower, or at least, stable poverty rate. It is then believed to be the reason why this country is not considered as an economically fragile country, as they can keep the poverty and unemployment rate lower relatively to Timor Leste's.



Graph 2: *Comparison of Unemployment Rate of Timor Leste and Papua New Guinea.*
Adapted from Knoema

The two issues are somehow under-wrapped and slightly unaddressed by the economic reform policy applied in the Timor Leste. It is later believed to be one of the influential reasons that make Timor Leste still being considered as a fragile state based on economic indicator when they have a good number of GNI per capita during the years.

2. Unemployment and the Ease of Doing Business in Timor Leste

It is somehow interesting that a country with lower GNI per capita like Papua New Guinea can have a relatively smaller rate of unemployment than Timor Leste. In normal situation, Timor Leste, with its higher GNI per capita should be able to offer more job opportunities in the public sector, to support more private company so they can expand their industry—thus, able to offer more job vacancies in the private sector, or at least, to financially support those who are unemployed to build their own business. However, the country does not really do much work on it, especially on providing financial support to establish a new business.

Regarding the latter, Meango (2016) and Kritikos (2014) had mentioned on their research that starting a new business will not only give a better financial opportunity for the owner of the business, but also offer much bigger opportunity and easier route to the job vacancies for other people. Usually because of the limited budget that the government has for paying the monthly income of public officer, it is difficult for some lower middle income countries to offer more job opportunities in the public sectors. Therefore, those countries are most likely to encourage people to start opening their own business by giving out bank loan as well as creating a friendly bureaucracy to support it. By offering the mentioned strategies, a lot of people will be more motivated to start their own business so that, at least, they can save themselves from being unemployed. Yet, this is not what Timor Leste currently does.

Based on the Doing Business data (*table 1*), Timor Leste has been placed on the 175th rank worldwide for its business performance (World Bank, n.d.-b). The country was unfortunately way behind other 24 countries in East Asia and Pasific region, as it was placed in the last rank within the region. Moreover, they are also lacking behind other countries on the some specific matters regarding doing business, such as on the ease of getting credit. Regarding

the latter, based on the same data set, it is stated that the Timor Leste was placed in the 24th rank (out of twenty-five East Asia and Pacific countries) regarding the ease of getting credit. In Timor Leste, it is unfortunate that bank loan or credit is kindly difficult to get, unless you have a promising collateral to be offered to the bank. However, as mentioned in the previous section, around 41.8% of the populations of Timor Leste are below the poverty. By considering that unemployment and poverty itself are interrelated to each other, it may be predicted that those unemployed people come from the poor populations, as they possibly have no sufficient money to fund their educational life. Obviously, these groups of people will not have any collateral to offer to the bank, which makes them ineligible to obtain any credit or loan from it. Consequently, they may not be able to start a new business, as well as not be able to open job opportunity mainly for themselves, and additionally, for other unemployed. Such situation later fueled up by weak enforcement of business related-contract, complicated procedures of registering property and getting business permits, which worsening the unsupportive business environment there. Thus, it is not a surprise to find Timor Leste only in the 18th rank on the ease of starting a new business within the East Asia and Pacific region and the 145th rank worldwide. While the ease of doing business has been considered necessary to bring significant effect on economic growth and poverty reduction (Ani, 2015), the existing data clearly show how unsupportive the business environment in Timor Leste for new entrepreneurs, thus hindering the progress of poverty reduction.

Table 1: *Ease of Doing Business Ranking of some countries in Asia Pacific on 2015*
 Adapted from World Bank

Country	Worldwide Rank	Asia Pacific Rank	Starting a Business	Construction Permits	Getting Electricity
Timor-Leste	175	25	18	23	18
Myanmar	170	24	19	12	23
Kiribati	152	23	17	19	25
Micronesia	151	22	23	22	17
Marshall Islands	143	21	7	13	19
Lao PDR	139	20	22	10	24
Palau	136	19	12	16	22
Cambodia	131	18	25	25	20
Papua New Guinea	119	17	16	20	16

Country	Registering Property	Getting Credit	Enforcing Contracts	Resolving Insolvency
Timor-Leste	23	24	25	23
Myanmar	19	25	24	20
Kiribati	20	23	15	24
Micronesia	25	14	23	14
Marshall Islands	24	16	14	22
Lao PDR	11	15	11	25
Palau	5	17	16	21
Cambodia	17	1	22	9
Papua New Guinea	16	6	21	18

In contrast, Papua New Guinea has been placed in the 17th rank within the East Asia and Pasific region, and the 119th rank world-widely for its performance on doing business. They even made it into the 6th rank within the region for its flexibility on giving out a bank loan for people who want to start their business (World Bank, n.d.-a). In Papua New Guinea, the government tries hard to encourage people to open their own business, instead of being unemployed or working in the seasonal agricultural field with temporary income (Business Advantage PNG, 2017). They are not only applying simple bureaucracy on giving out a bank loan, but also ensuring the process of getting construction permits and electricity, as well as registering their property is not complicated, which make the business environment way friendlier to welcome newcomers. It is in some way or another contributing on the decrease number of unemployment in the country. Regrettably, this is what economic institution of Timor Leste fails to offer to the society.

Timor Leste may have a higher GNI per capita more than Papua New Guinea, however, the slightly unfriendly and unsupportive business environment for newcomers may as well be believed as a critical problem in their economic institution, which led the country to be considered economically fragile by the OECD. In contrast, the way Papua New Guinea handles the business environment in the country, especially in its relation to the ease of doing business has been assumed as their secret to maintain unemployment and poverty rates in low number, thus, avoid themselves being classified as a fragile state based on economic indicator—regardless of their lower number of GNI per capita.

3. Ease of Doing Business, Regulatory Quality and Governance Effectiveness in Timor Leste

Theoretically, most of the development scholars believe that there is a strong relation between political institution and economic institution. Acemoglu and Robinson (2008) argued that the better political institution would result on the better economic institution. They further believed that the level of democracy has as strong relation to the economic growth, in which the more democratic one country is, the higher economic growth they will have. Inversely, it is also believed that the less democratic one country is, the lesser economic growth they will have in the future.

Such proposition seems to be proved in the case of Timor Leste. As previously mentioned, one of the indicators that made Timor Leste as fragile state is the economic indicator. The country's failure to address the issue of unemployment and poverty along with unsupportive environment on doing business are believed to become the reasons on such categorization. In addition to that, it is further presumed that the poor regulatory quality and ineffective government are the causes of their unsupportive business environment, which indirectly stagnate the unemployment and poverty rate.

Alemu (2013) had highlighted that government effectiveness and regulatory quality are crucially important to increase the ease of doing business, thus providing a more supportive business environment. In addition to that, Besley (2015) also pointed out the importance of a well-functioning legal and regulatory system in creating an effecting market economy and supportive business environment, as it may directly effects to employment, output, investment, productivity and living standards. Furthermore, Aikins (2009) argued that in order to ensure the good quality of the regulation, the government—in this case, regulators, shall maintain their credibility while constituting the regulation, thus encouraging enactment of useful and effective regulation. In other words, an efficient government is needed in order to create a good regulation as its efficiency tends to positively influence both the policy making process and the implementation stage. In contrast, an inefficient government tends to induce a similarly inefficient regulation and poor implementation.

To be more elaborated, during the policy-making procedures, if a government is ineffective and inefficient, they tend to produce a poor regulation—mostly because of the lazy

official or complicated, corrupted bureaucracy. Consequently, when this poor regulation is implemented by the same ineffective government, it leads to the way worse implementation, which likely unfavoured the subject of regulation itself. That is what believed to be happened in Timor Leste. Based on the Worldwide Governance Indicators (Knoema, n.d.-h), Timor Leste regrettably has a weak regulatory quality—only -1.10 point (*graph 3*), and quite ineffective government—by -0.97 point per 2015 (*graph 4*). By considering such data, it is most likely that the unsupportive business environment there is the result of poor business-related regulation, made by an ineffective government.

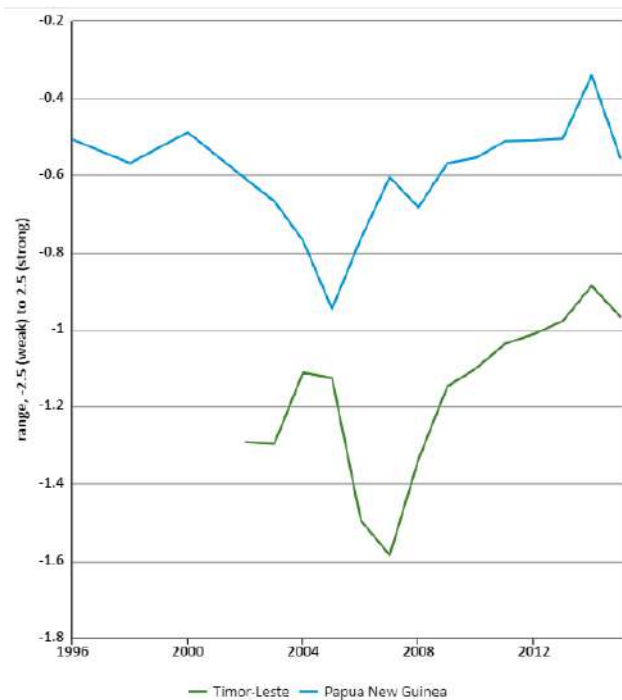


Figure 3: Comparison on the Regulatory Quality between Timor Leste and Papua New Guinea – Worldwide Governance Indicators – World Bank. Adapted from Knoema.

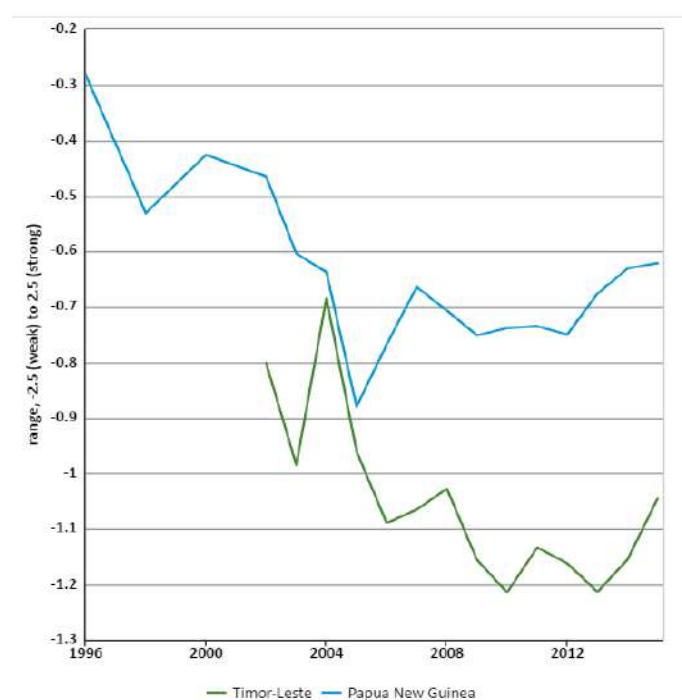


Figure 4: Comparison on the Government Effectiveness between Timor Leste and Papua New Guinea – Worldwide Governance Indicators – World Bank. Adapted from Knoema.

In comparison—as can be seen from both graphs above, Papua New Guinea has a slightly better assessment on the regulatory quality—by -0.55, and on the government effectiveness—by -0.62 per 2015. Taking into consideration to the causal relationship mentioned before, it is more likely that their slightly better quality of regulation, and relatively more effective government to Timor Leste is what led Papua New Guinea to have simpler procedures for getting a loan, starting a new business, registering a property and obtaining a business permit. In other words,

that's what make them have way more supportive business environment, which help the unemployment and poverty rate keeps in lower numbers.

4. Conclusion, Recommendation and Future Research

4.1 Conclusion

According to the above-mentioned explanations, it is argued that regardless of the growing economic performance that the Timor Leste has, the country still has certain problems in their economic institution that make them to be classified as a fragile state based on economic indicator. Such problems come from the unemployment and poverty issue that is not well addressed—regardless of their growing GNI per capita. Even when the country has successfully increased their GNI per capita in double amount within 10 years through diverse economic reform programs, their poverty and unemployment rate is still higher—relatively to Papua New Guinea, a neighboring country with similar conflict experience but lower GNI per capita. It then shows that unless the income is equally distributed to all citizens, the growing number of GNI per capita cannot represent a well economic institution of certain country.

Moreover, the unsupportive business environment for newcomers on the economic market is adding up another problem in this country. While unemployment and poverty are seen as interrelated to each other and starting a new business is considered to be the best solution to solve such problems, unfortunately, the business environment in Timor Leste is not really supportive to the latter idea. Even compared to Papua New Guinea, starting a new business in Timor Leste is relatively difficult—proved by their lowest ranking in the Ease of Doing Business by the World Bank. One of its indicators is the difficulty of getting a loan to start their own business. As it is most likely that the unemployed people come from poor economic backgrounds, it is more likely for them to have no collateral to offer to the bank, in a change of the bank loan. Consequently, they will not be able to get a loan to start their own business, leaving them remain unemployed and poor. The accumulation of this case is later indirectly stagnate the unemployment and poverty rate.

In addition, it is also found that the political institution in Timor Leste has a main influence on these economic institutional problems. The unsupportive business environment there is believed to be the result of its governance ineffectiveness. Regrettably, an ineffective

government tends to produce a poor regulation—mostly caused by lazy official or corrupted bureaucracy. If this regulation is implemented by the same ineffective government, it surely will lead to the way worse implementation, which likely unfavoured the subject of regulation itself. This is what's believed to be occurred in Timor Leste. Such idea is then supported by the Worldwide Governance Indicators on governance effectiveness and regulatory quality as data of Timor Leste is relatively way behind Papua New Guinea.

Finally, to sum up, it may be concluded that the classification of Timor Leste as a fragile state based on economic indicator is due to the unsupportive business environment, which indirectly stagnates the unemployment and poverty rate. Furthermore, such unsupportive business environment itself is caused by the poor regulatory quality and ineffective government of the country

4.2 Recommendation

The above-mentioned problems shall not be left unchanged. In order to ensure that Timor Leste has an equally growing economic performance, there are certain things that shall be done urgently by the government.

First, the government of Timor Leste needs to ensure that they have a more flexible and easier procedure on getting a bank loan. It can be done by changing the national banking policy and regulation related to the bank loan.

Second, the government also needs to ensure that they have a supportive business environment that can encourage more new entrepreneur to start their own business, thus, opening a new job opportunity for themselves, or even other people. This can be done by amending certain business-related regulations, such as company registry law, investment law and property law, to make it friendlier on welcoming newcomer in the business market.

4.3 Potential Future Research

This research contains several limitations because of its nature of used methodology, which is secondary data research with inductive rationale. By understanding the limitation of using secondary data, including the possibility of the data not fully representing the current situation there, another research or study may be potentially conducted in the future, including, but not limited into:

- Research on the same scope of study with a different methodology, for instance, by collecting primary data through questionnaires or interviews with local citizen and respective scholars in Timor Leste;
- Deep research on the banking loan policy and the number of its recipient among the unemployed, in order to deeply shows the actual restrain and problem on starting a new business in Timor Leste;
- Comprehensive research on the business-related regulations, especially on its relation with banking loan, business registration permit and property registration, including how such regulations be actually implemented.

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