



EXECUTIVE SUMMARY

SOCIO-ECONOMIC IMPACT  
ASSESSMENT OF COVID-19 IN TIMOR-  
LESTE, ROUND 2, 2021: Micro, Small  
and Medium Enterprises Survey



## Research Team

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## Acknowledgement

The Micro, Small, and Medium Enterprises (MSMEs) Survey as part of the Socio-Economic Impact Assessment of COVID-19 in Timor-Leste, Round 2 (SEIA-2) was led by UNDP and conducted in collaboration with the General Directorate of Statistics of the Ministry of Finance in Timor-Leste, and the Ministry of Coordination for Economic Affairs (MCAE).

Great appreciation is extended to Mr. Elias dos Santos Ferreira (Director General of Statistics) and Mr. Cristino Gusmao who led the GDS team and provided essential support for the preparation and implementation of the data collection in challenging times under COVID-19 restrictions. We appreciate the hard work of the GDS trainers Antonio Claudio Belo, Octaviana Maria de F. S. Lemos, Nani Rolanda P. C. Costa, Alzira Doutel, Laura de Jesus Moreira, Domingos Antonio da Costa Freitas, Alsindo Martins, Domingos Sebastião Freitas, Rosantina da Costa Cruz Sarmento, Geovania Maria da C Vieira and Joao Soares Gusmao. We also would like to thank Silveiro Martins Pinto, Finance Officer of GDS who provided valuable support at all stages of the survey.

Technical Team of Ministry for the Coordination of Economic Affairs provided valuable inputs to the design of the questionnaire: Cesar Dias Quintas, Emanuel Antero Garcia da Veiga, Florentina Smith, Fernando Carvalho de Araujo, Yoan K. Castells, Leonesa Fortes, Sara López and José Manual de Andrade.

SEIA-2 team expresses its gratitude to the UN Resident Coordinator, Roy Trivedy, and the entire UN Country Team in Timor-Leste for providing overall guidance and support. This study benefited from comments and feedback from all UN agencies in Timor-Leste including Ricardo Santos from UNDP, Frank Eelens and Bart de Bruijn from UNFPA, Rita Fernandes from ILO, Claude Mpirat from UNCDF, Gerson Alves from RCO, Carol Boender and Wai Shan Chan from UN Women, and the UN Volunteers. In addition, UNDP staff Lazima Onta-Bhatta, Angelina Gusmao, Cosme Boavida, and Ahmad Zubair provided invaluable support throughout the SEIA-2.

We thank the dedicated team of supervisors and interviewers from 13 municipalities who interviewed the communities and collected quality data whilst adhering to COVID-19 safety protocols. We would also like to sincerely thank all the businesses in all municipalities across Timor-Leste who participated in the questionnaires and interviews for being open and willing to share their stories and experiences. We would also like to thank the numerous individuals in government offices, institutions and organizations around the country who shared their time, expertise, and insights to understand the impact of COVID-19 on micro, small, and medium enterprises within the country.

## Background

The global economic downturn due to the COVID-19 pandemic is having a disproportionate impact on low-income and emerging economies. Timor-Leste experienced the largest GDP contraction since its independence, significantly worse than the income loss during the 2006 civil unrest, and the 2017 political deadlock (IMF, 2021)<sup>1</sup>. In March 2021, the Government of Timor-Leste (GoTL) introduced lockdowns and other restriction measures to prevent the spread of COVID-19. These restrictions along with the global economic slowdown and oil price uncertainty plunged the local economy into severe contraction with expected real GDP per capita to slip down to the 2009 level. Timor-Leste's non-oil businesses, represented mostly by micro and small enterprises, continue to be squeezed by the fallout of the COVID-19 crisis with looming long-lasting negative outcomes.

Based on the rapid Socio-Economic Impact Assessment of COVID-19 (SEIA-1) conducted by the United Nations (UN) with the technical lead of the United Nations Development Programme (UNDP) Timor-Leste in 2020, the private sector had been heavily impacted by the pandemic with 81.0 percent of micro, small, and medium enterprises (MSMEs) reported a loss of income, 26.0 percent reporting difficulty in paying staff, and 65.0 percent reported a drop in demand. The businesses surveyed in SEIA-1 reported that there had been a more negative impact to women employees of MSMEs compared to men.

The Government introduced an economic stimulus package through the dedicated COVID-19 fund to support living standards, preserve jobs, and protect businesses to mitigate negative repercussions of public health protection-related restrictions. The government's fiscal response to COVID-19 has been significant and helped offset some of its indirect impacts. These measures provided some relief in mitigating income losses, even if they were delayed by planning and implementation challenges. Overall, \$333.2 million was allocated for the COVID-19 Fund (MoF, 2020), of which \$228.5 million was specifically allocated for '*social support and economic rescue to the population, affected by activities to prevent and fight the disease COVID-19 (MoF, 2020)*'<sup>2</sup>. This was one of the largest relief packages in the world – representing 21.1 percent of the forecasted \$1.582 billion GDP in 2020 (GoTL, 2020)<sup>3</sup> compared to 1.7 percent to 6.6 percent of GDP for developing countries in Asia and the Pacific<sup>4</sup>. On 23 April 2021, the allocation to the COVID-19 Fund was further increased to \$217.5 million.

The resource allocation faced competing choices between health, social and economic priorities. The public health measures were crucial to prevent the spread of COVID-19 in 2020, however they had a considerable downturn impact on economic activity. Most of the fiscal support has been spent on households through measures, such as cash transfers (in May 2020) and emergency food distribution (December 2020 – May 2021). Additionally, stimulus policies were also adopted to support MSMEs, which included \$42 million for employment social security subsidy, \$7 million

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<sup>1</sup> Estimation varies from 6.8 percent (World Bank) to 8 percent (Ministry of Finance and General Department of Statistics)

<sup>2</sup> Relatório Financeiro Anual do Fundo COVID-19, Ano Fiscal de 2020.

<sup>3</sup> 8<sup>th</sup> Constitutional Government, Economic Recovery Plan, August 2020.

<sup>4</sup> UN ESCAP, 2021, Economic and Social Survey of Asia and the Pacific 2021, Towards post-COVID-19 resilient economies.

on wage subsidy providing 60 percent of wages for registered firms, \$5 million on a credit moratorium, and about \$3.87 million on utility subsidies (electricity and water) (MoF, 2021)<sup>5</sup>.

The economic stimulus and response package, consisting of 19 strategic measures, was further enhanced through a short-term economic recovery plan (GoTL, 2020)<sup>6</sup>. The purpose of the plan was to counteract the expected negative effects of COVID-19 on the economy, support households and businesses, and cushion the economic impact of the health emergency. Two cornerstones of the government economic recovery plan, which included saving jobs and supporting MSMEs income, were discharged through the following components:

- Economic resumption support grant (recovery subsidy) - the purpose was to have employers resume economic activity.
- Social security Contributory exemption - the objective was to support the liquidity of businesses.
- Special support for informal sector workers - to support all self-employed and informal sector workers.

Scaling up the rapid SEIA-1 conducted by the UNDP in 2020, the SEIA-2 MSME survey expands both the themes and the coverage of the MSMEs to assess the impact of market conditions on MSMEs and their employees due to the prolonged COVID-19 pandemic and the associated state of emergency (SoE) in Timor-Leste. UNDP, with the Ministry of Finance - General Directorate of Statistics (GDS), and Ministry for Coordination of Economic Affairs (MCAE), conducted SEIA-2.

The aim of the assessment is to inform the economic recovery responses and policy decisions to support the private sector and MSMEs in Timor-Leste. The scope of the MSME survey was:

- To assess the impact of COVID-19 on operations and outlook of formal and informal MSMEs
- To assess the impact of COVID-19 on MSME employees
- To assess the impact of government measures on MSMEs
- To provide in-depth analysis of the impact on MSMEs by different stratification
- To provide policy recommendations to effectively support business continuity of MSMEs through the pandemic and its challenges.

Studying the impact of COVID-19 on MSMEs is crucial in the context of Timor-Leste. MSMEs are critical for employment, where the share of youth Not in Employment, Education, and/or Training (NEET) is 21 percent (ILO, 2016)<sup>7</sup>. The 2020 UNDESA report on MSMEs and the Sustainable Development Goals, estimates that globally four out of five new jobs in the formal sector were generated by MSMEs. In addition, informal MSMEs generally engages and employs poor and marginalised people<sup>8</sup>.

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<sup>5</sup> Ministry of Finance, 24 August 2021, Progress Execution COVID-19 Fund.

<sup>6</sup> Government Resolution 28/2020, August 19, 2020, on Approving of Short-Term Economic Measures to Mitigate the Impact of Economic Hardship Caused by COVID-19 Under the Economic Recovery Plan.

<sup>7</sup> Timor-Leste Labour Force Survey 2016.

<sup>8</sup> 2020 UNDESA report on MSMEs and the Sustainable Development Goals

## Methodology

The data for the SEIA-2 MSME survey was collected between 3 August and 28 August 2021 from all 13 municipalities. A mixed-method approach was used to collect the data for formal and informal MSMEs:

**Sampling for formal MSMEs.** The survey used two datasets to ensure completeness of the sampling frame. The first dataset included a list of 7,710 firms from the Ministry of Finance (MoF) that were operational and paying taxes before the COVID-19 State of Emergency (SoE). The second dataset of 4,304 firms was obtained from SERVE and included MSMEs that were registered in 2020.

The sampling method had a two-stage sampling. In Stage 1 in municipalities outside of Dili, sucos with more than ten MSMEs were identified to avoid the costly and time-consuming exercise of finding and interviewing businesses whereas in Dili, random sampling from all sucos was conducted. In Stage-2, a systematic sampling of MSMEs was conducted.

**Sampling for informal MSMEs.** Given the nationwide coverage of the SEIA-2 Household survey, the survey dataset was used to create the sample frame for the MSMEs in the informal sector. Through the household survey, own-account workers and unregistered businesses were identified and the sample of informal businesses was drawn from the individuals' database. Out of 4292 households interviewed (with 14,134 individuals aged 15-65 years old) in the household survey, 3,188 individuals from 1,295 households were identified as informal workers who only sell or mainly sell agricultural products or were self-employed with unregistered businesses. They fit our definition of informal MSMEs and formed our sample frame.

The sample of informal businesses consisted of 404 MSMEs in 23 sucos. Enumerators visited identified informal businesses and households (if the business is home-based) after the household survey. To reduce travel cost and time, the suco selection between formal and informal were aligned. Where there were only a limited number of informal MSMEs in the sucos, all were selected into the sample. To the extent possible, we selected sucos where both formal and informal MSMEs overlapped.

Therefore, the results of this survey for both the formal and informal MSMEs are representative of the distribution as found in the survey and not nationally representative.

**Data collection:** Face-to-face interviews were conducted with **1,086 MSMEs** (708 formal, 378 informal) via CAPI (computer-assisted personal interview) method. Three sets of questionnaires were prepared for active, closed and yet to start businesses. A total of 13 key informants and in-depth interviews were conducted with government stakeholders, MSME owners and the private sector. With COVID-19 movement restrictions, the SEIA-2 MSMEs study is the only comprehensive research undertaken for the business sector in the country with the GoTL support. In addition, the assessment of the informal sector under SEIA-2 uses the recommended approach outlined by the Asian Development Bank<sup>9</sup>.

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<sup>9</sup> ADB, 2011, A handbook on using the mixed survey for measuring informal employment and the informal sector.

## Key findings of the SEIA-2 MSME survey

This study highlights how the COVID-19 SoE magnified many of the underlying vulnerabilities within the country, including lack of basic infrastructure, reliance on imports, limited productive activities in the country, limited access to government services and limited technological capabilities. COVID-19-related negative impacts on formal and informal MSMEs in urban and remote areas have been exacerbated by the prolonged SoE. The employees of the MSMEs have also been impacted, however, the impact was more severe on women than on men.

Although some MSMEs were able to take advantage of the market conditions and grow, most MSMEs reported being negatively impacted due to the prolonged COVID-19 related SoE. The MSMEs segment consisted of 65.3 percent formal and 34.7 percent informal enterprises; the proportion of informal business outside of Dili was 51.6 percent. **The private sector in Timor-Leste is concentrated with micro enterprises which accounted for 92.4 percent of the MSMEs in our survey.**

At the time of the fieldwork, 19.7 percent of MSMEs were inactive and 80.3 percent were active. Many of the active MSMEs were struggling with the prevailing market conditions with **38.2 percent reported being very concerned, and overall, 90.1 percent reported being concerned about the sustainability** of their enterprise.

Most formal MSMEs, particularly in Dili, were impacted by the SoE restrictions. Informal MSMEs remained less effected by the restrictions but they were also impacted by the emerging market conditions due to the SoE restrictions. It should be noted businesses that stopped their activities during the SoE only micro businesses while all small and medium businesses are currently active.

### *Key findings for active businesses:*

- **Severity of impact by sector:** The key factors influencing the severity of COVID-19 impact on formal and active businesses are the closure of business operations, supply disruptions, and decrease in income. Using a structural equation model, the study identified tourism, accommodation, and arts and crafts as being severely impacted. Cafés and restaurants, retail trade of imported goods, transport, and private construction were identified as moderately impacted. Other sectors were mildly or not impacted.
- **Disruption to supply chain:** 50.5 percent of MSMEs reported it was taking them longer to receive supplies and for most of these enterprises, the delay ranged from a few weeks up to three months. In addition, 3.3 percent of MSMEs were unable to receive their supplies during the SoE. Due to supply disruptions, formal businesses in construction, infrastructure, and other services lost more revenue than other formal businesses and 31.1 percent of all formal businesses experienced supply disruptions since March 2020.
- **Access to market/customers:** During SEIA-1 in 2020, 77 percent of the businesses had reported access to market was a major difficulty with limited transport. Although access to the market had improved since, 33.9 percent of the MSMEs still could not reach customers at the time of the survey. Only 4.0 percent of the businesses surveyed had

adjusted their operating model and selling from fixed locations to reach customers and adapt to the market conditions.

- **Inflationary pressure:** Like many island nations, Timor-Leste imports most of its products from other countries and is impacted by inflation in those countries. The price of supplies had increased for 37.3 percent of the MSMEs, mainly for daily consumables and consumer goods. Additionally, 25.2 percent of the businesses also reported an increase in their operating expense. Some of the increase in cost had been transferred to consumers with 34.1 percent of MSMEs increasing their sales price.
- **Demand and sales:** The restrictions on the movement made it difficult for businesses to reach their customers, and lockdown also reduced demand from institutional or business customers. International border closure crippled tourism and other businesses that primarily relied on tourists. MSMEs have had to increase their sales price to cover the increase in their operations and supply cost. Against this backdrop, it is no surprise that 72.0 percent of the MSMEs reported reduced demand for their products and services. Domestic sales to private customers had decreased for 77.1 percent of the MSMEs, domestic sales to business customers had decreased for 24.3 percent and exports had dropped for 3.6 percent of MSMEs.
- **Impact to income:** The income of 66.4 percent of the MSMEs had decreased in 2020, compared to 2019. Decrease in income was proportionally higher for the informal sector with 70.1 percent, compared to 63.9 percent in the formal sector. Few MSMEs, 8.7 percent of total surveyed, reported an increase in income made up of 12.7 percent of formal MSMEs and 2.3 percent of informal MSMEs.
  - Most formal businesses (70.4 percent), especially micro-businesses responded that their income decreased.
  - Despite more MSMEs reporting a loss in income, the dollar value of the increase reported was higher than the loss in income reported, however, the amount of increase was concentrated to few businesses in the infrastructure construction sector. Female-owned businesses income dropped by 21 percent, while male-owned and joint-owned businesses income increased by 97 percent and 105 percent respectively.
- **The expected income** for 2021 had 41.9 percent of formal and 40.0 percent informal businesses projecting a decrease in income in compared to baseline year of 2019. This sentiment is the same in all groups (regardless of sector, size, gender of owner, location, formality, and involvement in international trade).
- **Use of technology:** Use of technology remained low in Timor-Leste with 44.3 percent of the MSMEs reporting that they did not use any technology for their business. With the formal sector, information technologies (IT) capabilities existed with 74.4 percent, but only 27.2 percent of informal businesses reported they had IT capabilities. Most of the IT capabilities used by businesses were limited to telephone order taking, the use of internet, social media, and smartphone. The underlying infrastructure to support e-commerce and online transactions were almost non-existent. Few banks had introduced electronic fund

transfer point of sale machines which were used at retail stores. Two telecommunication companies had introduced mobile wallet and fund transfer services, and recently banks and telecommunication companies had introduced bank-to-wallet and wallet-to-bank features, but acceptance of these technologies remained low.

- **Economic support measures:** The awareness of GoTL economic recovery measures varied by location and the registration status of the MSMEs. More than half (57.0 percent) of the MSMEs reported they were aware of the support measures; outside of Dili, the awareness dropped to 39.4 percent of the MSMEs compared to 65.9 percent of MSMEs in Dili. The awareness was also lower with informal businesses with 44.9 percent reporting they were aware of the support measure.
  - Proportionally, more female-owned informal businesses (51.3 percent) were aware of government support measures, compared to male-owned informal businesses (37.4 percent). Female-owned formal businesses had less participation (42.7 percent) than male-owned (48.0 percent) and jointly owned (64.9 percent).
  - For informal businesses, a lesser proportion of male-owned informal businesses participated (32.9 percent) in the programmes compared to female-owned (39 percent) and jointly owned informal businesses (62.5 percent)
  - The support measures available for formal and informal MSMEs were attached to eligibility requirements. Therefore, the participation in support measures was even less than MSMEs' awareness. Other than electricity subsidy, which was a universal support measure, 10.2 percent or fewer MSMEs participated in any individual support measures. The effectiveness of economic support measures for MSMEs remained low despite GoTL effort who allocated the biggest fiscal policy for COVID-19 prevention and economic recovery in the region.
  - Looking at key policies and support measures aimed at MSMEs to mitigate the negative impact, MSMEs were most aware of and participated in the electricity subsidy, the employees payment subsidy, and the employer social security contribution postponement. Although the participation rates were not statistically different between impact severity groups, severely affected MSMEs participated more in government measures such as electricity subsidy and employees payment subsidy.
- **Female-owned businesses:** In terms of an increase in sales price, 30.0 percent of female-owned businesses reported an increase in their sales price, compared to 34.9 percent for male-owned businesses, and 40.3 percent for jointly owned businesses. At the same time, a higher proportion of women-owned businesses reduced their sales prices for their products and services, at 17.2 percent, as compared to only 11.3 percent of male-owned businesses, and 14.7 percent of jointly owned businesses. In terms of the cost of supplies, 39.3 percent of women-owned businesses reported an increase in the cost of supply, compared to 36.3 percent of male-owned businesses. Women -owned businesses faced higher costs than men-owned businesses, yet they remained more conservative with their pricing strategy than men-owned businesses with fewer women increasing prices and more



women reducing prices to adjust to the market conditions. More women-owned businesses were sensitive to the market conditions and adjusted their price accordingly rather than increasing sales price in a market that was already stressed with low demand.

The pricing strategy adapted by women-owned businesses led to proportionally better outcome for income of the women-owned businesses. Overall, higher proportion, 9.4 percent, of female-owned businesses reported an increase in income as compared to 8.6 percent of male-owned businesses; and lower proportion, 63.3 percent, of female-owned businesses reported a decrease in income, compared to 67.9 percent of male-owned businesses. Despite proportionally reporting better outcomes with income, 44.2 percent of female-owned businesses reported being very concerned, compared to 33.6 percent of male businesses in terms of business continuity.

### **Key findings for inactive businesses:**

- **Closed businesses:** Smaller sized businesses were impacted more than bigger-sized MSMEs. The closed businesses consisted of 90.9 percent micro-businesses and 9.1 percent small businesses; there were not any medium-sized businesses that had closed in the survey. Almost half, 49.7 percent of the closed enterprises were MSMEs in the infrastructure construction sector which was heavily impacted; 72.4 percent of MSMEs in the sector were inactive.
- **Registered inactive enterprises:** Approximately 3.6 percent of the enterprises in the survey had registered their businesses but were yet to start their business. Of these, 58.0 percent reported they would start after the COVID-19 pandemic, 18.0 percent said they would start in the next 12 months, and the rest did not know when and if they would start.

### **Key findings for employment in the MSMEs:**

- Employment in MSMEs dropped in 2020 with a 15.9 percent decrease in full-time employment and a 23.3 percent decrease in part-time employment. The shrinkage in employment was mainly driven by closed businesses, 41.1 percent of which had employees who lost their jobs. Active MSMEs had 5.1 percent growth in full-time employment and 1.8 percent growth in part-time employment. Despite the growth in employment with active MSMEs, employment for women in active MSMEs also fell, and the average income for all employees decreased.
- **Employment with MSMEs has rebounded drastically in 2021** and the calculated increase in full-time employment was 74.5 percent and the part-time job was 33.8 percent. This finding is consistent with the SEIA-2 household survey results. However, this does not mean the income for these employees has increased or the employment quality has improved.

## Supporting MSMEs and recommendations

Considerations shared during the SEIA-1 in 2020 remain valid and some of the same considerations were shared during SEIA-2 in 2021. This included **financial assistance programmes** such as small loans, credit guarantees, cash transfer or other agricultural inputs (to purchase and prepare the goods they need to restart their business), **tax relief** to relieve the loss of income, **clear communication** about rules and guidelines for government support programmes, **demand generation** for local MSMEs through government driven promotion(s), and **keeping the market open safely**.

The top three feedback received from active businesses during the MSMEs survey for policy recovery measures and economic support included the quick reopening of the market (89.6 percent), support for self-employed (21.9 percent), and financial credit support programmes (14.8 percent). Considering the feedback received, and the findings of the survey, some key recommendations for policymakers to consider strengthening the private sector and to improve the reach of government economic support measures are outlined below.

### *Improving the reach of government programmes:*

- Better communication of support measures, particularly targeting MSMEs outside of Dili and informal MSMEs, using local government agencies and civil society partners.
- Simplify requirements and make it easier to apply to improve participation.
- Maximise distribution of the existing loan guarantee scheme and finance MSMEs in the targeted productive sector of the economy.
- Consider better alignment of the government handouts and grants to ensure the positive multiplier effect. So far, public spending in Timor-Leste overlooks the supply-side constraints and as a result, has failed to stimulate the private sector. Public spending is yet to have a lasting positive impact on the economy.
- Promote investment incentives and tax breaks for private sector investment in agriculture, tourism, and other productive sectors.
- Prioritise recommendations from development partners (ADB, World Bank), to provide a legal framework for businesses to enforce contracts and to protect the investment of minority shareholders. Lack of an enforceable legal framework is a deterrent to investment and investors.

### *Financing private sector and Injecting capital:*

- Relax regulatory restrictions for lending, particularly given the low loan to deposit ratios in Timor-Leste.
- Consider introducing partial guarantee schemes to support other productive and innovative sectors of the economy.
- Consider targeted support to informal MSMEs in the post-pandemic package, if any.
- Support banks and lending institutes develop loan products based on moveable collateral such as equipment, inventory, or accounts receivables. Provide training on how these products work if needed.

- Consider loans to support all participants in a value chain, from producers to retailers to consumers, e.g., when supporting the agriculture farmers, also support transportation businesses and the retailers that sell the produce and restaurants that use the product.
- Consider using social security funds to support the private sector develop needed infrastructure and help generate returns for the fund through investment in the local economy.
- Promote private and public investment opportunities for the Timorese diaspora overseas to invest in Timor-Leste and increase remittances.

### **Enable digital capabilities:**

- Invest in technology infrastructure for digitalization and develop the digital workforce.
- Improve IT capabilities of existing entrepreneurs through targeted training programmes. The entrepreneurs should feel comfortable using available e-payments and fund transfers which simplifies/enables transactions.
- Facilitate the transfer of technologies that are already available in ASEAN countries.

This summary highlights key information provided by the respondents and reveals underlying vulnerabilities faced by the MSMEs in Timor-Leste. The SEIA-2 MSME Survey could be used by decision-makers to inform short and medium-term economic recovery and private sector development policies and budgetary allocations of line ministries and municipalities to support MSMEs. It is important to recognize that the disruptions of COVID-19 provided an opportunity to assess the current conditions and think for the way forward for the private sector and MSMEs' development in Timor-Leste. The reliance on imports and how supply chain disruptions could, therefore, impact the basic staple for food security such as rice, became evident during the SoE. Part of the COVID-19 fund was used to procure rice for food security. Reliance on external economies is also putting inflationary pressure on the market conditions in Timor-Leste. While the credit portfolio in the market has grown since 2019, it is mainly driven by consumer loans rather than productive loans. Forward-thinking is needed to develop a comprehensive programme that reduces reliance on imports of basic needs, protects people during disaster and pandemic scenarios, generates local employment, and lifts the population out of the poverty traps.

The pandemic accentuated the inequalities, and the recovery path to building back better and greener needs to engage the youth and marginalized population of Timor-Leste. It is important to improve formal and non-formal education systems to increase skillsets that meet the demand of the market, as well as foster entrepreneurship skills. Formal and informal MSMEs, through their entrepreneurial spirit, have been playing a critical role in generating employment in Timor-Leste and were the fastest-growing employment in the 2015 census. The path towards recovery and development needs to include a focused approach to engage an increasing number of youths, and marginalized people in entrepreneurship addressing the social needs of the community while creating jobs.