

EVALUATION OF WORLD BANK GROUP PROGRAM

Timor-Leste Country Program Evaluation, 2000–2010



Timor-Leste Country Program Evaluation, 2000-2010

Evaluation of the World Bank Group Program



Report No. _____

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evaluation, 2000-2010 :
evaluation of the World Bank
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Abbreviations and Acronyms

AAA	Analytic and Advisory Activities	MAFF	Ministry of Agriculture, Forestry, and Fisheries
ADB	Asian Development Bank	MDG	Millennium Development Goals
ANZ	Australia and New Zealand Banking Group Limited	MDTF	Multi-Donor Trust Fund
AusAID	Australian Agency for International Development	MOH	Ministry of Health
BBI	Better Business Initiative	MoPF	Ministry of Planning and Finance
BDC	Business Development Centers	MSS	Ministry of Social Solidarity
BPA	Banking and Payments Authority	NDP	National Development Plan
CAS	Country Assistance Strategy	NORAD	Norwegian Agency for Development Cooperation
CEM	Country Economic Memorandum	NGO	Non-government Organizations
CHC	Community Health Center	NYP	National Youth Policy
CPE	Country Program Evaluation	PAD	Project Appraisal Document
CSP	Consolidation Support Program	PCF	Post-Conflict Fund
DGF	Development Grant Facility	PDO	Program Development Objective
DPO	Development Policy Operation	PEDF	Pacific Enterprise Development Facility
EAP	East Asia and Pacific	PER	Public Expenditure Review
EC	European Commission	PFM	Public Financial Management
EDTL	Electricidade de Timor-Leste	PFMCB	Public Financial Management Capacity Building
EICB	Economic Institutions Capacity Building Project	PFMCBP	Planning and Financial Management Capacity Building Project
ETI	Extractive Industries Transparency Initiative	PIU	Project Implementation Unit
EMIS	Education Management Information System	PPAR	Project Performance Audit Report
ESW	Economic and Sector Work	PSD	Private Sector Development
EU	European Union	PSPIP	Power Sector Priority Investment Project
FIAS	Foreign Investment Advisory Services	PTAP	Petroleum Technical Assistance projects
FRETILIN	Revolutionary Front for an Independent Timor-Leste	QAG	Quality Assurance Group
GDP	Gross Domestic Product	SME	Small and Medium Enterprises
GNI	Gross National Income	SSYS	State Secretariat for Youth and Sports
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit	TA	Technical Assistance
IBRD	International Bank for Reconstruction and Development	TFET	Trust Fund for East Timor
ICR	Implementation Completion Report	TSO	Timor Sea Office
IDA	International Development Association	TSP	Transitional Support Program
IDF	Institutional Development Fund	TSS	Transitional Support Strategy
IEG	Independent Evaluation Group	TSTD	Timor Sea Tax Division
IFC	International Finance Corporation	UN	United Nations
IFU	Investment Infrastructure Unit	UNDP	United Nations Development Program
IMF	International Monetary Fund	UNTAET	UN Transitional Administration for East Timor
ISN	Interim Strategy Note	USAID	United States Agency for International Development
JAMR	Joint Assessment Mission Report	WBG	World Bank Group

FOREWORD

This Country Program Evaluation assesses the outcomes of the World Bank Group (WBG) program in Timor-Leste during the review period (2000 to 2010). The World Bank Group's strategy during this period was to support the Government of the nascent country in three broad areas: (a) poverty alleviation and the provision of basic social services, including health and education; (b) development of state institutions, including creating good governance and building the capacity of state institutions; and (c) promoting sustainable non-petroleum growth, especially through the development of agriculture and the private sector. During the review period, the Bank was actively involved in the reconstruction and development of the economy, through 39 operations, financed through regular IDA (US\$24.6 million) and IBRD grants (US\$5 million), in addition to numerous grants from the Trust Fund for East Timor and other donor trust funds (US\$316.3 million in total). Over the same period, IFC had four advisory service (AS) activities.

While the WBG made some important contributions to Timor-Leste's development, the CPE rates the overall outcome of its support to the country over the review period as moderately unsatisfactory. The Bank Group strategy was broadly congruent with the country's own aspirations, but its relevance and effectiveness waned through the evaluation period. From its initial focus on immediate reconstruction needs, the restoration of key social services and alleviation of basic deprivation, the strategy became diffuse and all-inclusive, to the detriment of the most critical areas, such as agriculture and capacity-building of state institutions, and failed to respond to critical social challenges arising from youth unemployment and rising poverty. The outcome of the Bank Group's support was mixed. The outcome of assistance to Timor-Leste in securing its petroleum revenues and managing them transparently was highly satisfactory. The outcome of assistance in health and on veterans' issues was moderately satisfactory. The outcome of Bank Group support fell well short of objectives in the remaining areas, particularly so in promoting sustainable non-petroleum growth, notably through the development of agriculture and the private sector.

In spite of Timor-Leste's considerable progress thanks to its efforts, the country still faces considerable challenges in promoting faster and more sustainable growth, and in reducing poverty and unemployment, while furthering its achievements in institution building. To boost the WBG's role as an effective partner in Timor Leste's development, IEG recommends that the World Bank Group: (i) set its key objective as one of supporting vigorous and sustainable non oil growth, creating jobs and improving infrastructure; (ii) in consultation with development partners, sharply prioritize its program, being realistic about time frames; (iii) increase its focus on effective human resource development for institution-building and improved governance; (iv) follow more closely its own guidance on dealing with fragile states; (v) ensure more active management of its assistance program, strengthening its capacity to deliver timely high-quality policy and technical advice; (vi) be realistic with regard to the situation on the ground and what is needed to attain development objectives; (vii) make IFC's interventions of sufficient scale to address the objectives of its program; and (viii) bolster M&E by focusing on a few key results and improving statistical capacity to obtain reliable data of sufficient frequency.

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Preface

This Country Program Evaluation examines the World Bank Group's assistance strategy to Timor-Leste during the period FY00-FY10. It analyzes the objectives and content of the assistance program during this period, the outcomes in terms of economic and social development, and it notes the contributions of the World Bank Group to these outcomes. Appendix 1 describes the methodological framework.

The evaluation team visited Timor-Leste in June and August 2010, and met with past and present senior officials of the Government of Timor-Leste, representatives of the private sector, civil society and external development partners, as well as staff from the World Bank Group. The June mission overlapped with the visit to the country of a team of the Asian Development Bank's Independent Evaluation Department. During that period the two missions shared some meetings with government officials and stakeholders, and met regularly to discuss information and findings. Prior to visiting Timor-Leste, the evaluation team met with most of the World Bank Group staff members that had worked or are working on the Timor-Leste country program. All cooperation and assistance received is appreciated with gratitude.

The CPE report is based on background papers covering the main areas of the World Bank Group's support to Timor-Leste, prepared on the basis of desk reviews and validated in the two evaluation missions as well as through interviews with World Bank Group staff. The background papers relied on reviews of project files, economic and sector reports, implementation completion reports, project performance assessment reports, other IEG evaluations, available Quality Assurance Group assessments including ratings of quality at entry and supervision for Timor-Leste projects and economic and sector reports. A list of persons interviewed during report preparation, including those in Timor-Leste during the 2010 missions, is provided in Appendix 8.

Comments from the Bank's Regional Management were received on March 24, along with the Regional response to the Management Action Record. These comments have, to the extent possible, been addressed in the report. A draft of the evaluation was shared with the Government of Timor-Leste on April 11. The comments received from the Government, dated May 26, 2011, are reproduced verbatim as Attachment 1. A discussion of the report by the CODE Subcommittee was held on May 23, 2011, and a summary of the discussion is included.

The report was prepared by Chandra Pant, under the direction of Jaime Jaramillo-Vallejo (Task Manager), with background papers and other substantive inputs from Nils Fostvedt, David Gairdner, Gita Gopal, Maria Ines Agudelo, Min Joo Kang, and Allan G. Dizioli. Nils Fostvedt prepared the annex on Trust Funds. With support from NORAD and as self-standing papers, Gita Gopal and Allan G. Dizioli prepared the annex on Public Financial

PREFACE

Management Capacity Building Efforts, and Maria Ines Agudelo on Money Path – From Budget Preparation to Budget Execution. Roderick L. de Asis provided administrative support, and Barbara Balaj provided editorial support.

This evaluation benefited from the comments from peer reviewers Jose Braz (external) and Nalini B. Kumar (internal). Prem Garg also provided comments. The report also benefited from comments received within IEG's review process, especially from Daniela Gressani, Cheryl W. Gray, Hans Martin Boehmer, Ali M. Khadr, Mark Sundberg, Stoyan Tenev and Anis A. Dani.

Timor-Leste:

Summary of World Bank Group Program Outcome Ratings

IEG's Country Program Evaluations assess and rate the *outcomes* (the "results") of a given *World Bank Group (WBG) country program relative to its objectives*. This differs from rating the country outcomes of the Government of Timor-Leste or the WBG, as well as the performance of either of these. The central question underlying the table that follows is "to what extent did the WBG program achieve the outcomes that it set out to achieve?" Distinct ratings and sub-ratings are typically assigned to each "pillar" or set of strategic goals set out in the relevant WBG strategy documents. In the case of the pillar on growth and job creation, the evaluation gives greater weight to the areas of private sector development and agriculture, due to their high relevance for generating employment and reducing poverty. Appendix 1 of the evaluation elaborates on IEG's rating methodology.

WBG STRATEGIC AND OPERATIONAL GOALS	ACHIEVEMENT OF RESULTS ASSOCIATED WITH WBG GOALS	MAIN WBG INSTRUMENTS TO HELP RESULTS MATERIALIZE	WBG PROGRAM OUTCOME RATINGS
PROVISION OF BASIC SOCIAL SERVICES, SOCIAL PROTECTION AND ALLEVIATION OF POVERTY AND UNEMPLOYMENT			Moderately Unsatisfactory
WBG's objectives in the health sector were to improve access to and quality of basic health services in the country.	Many health centers built, mobile clinics made operational, hospitals rehabilitated and reconstructed. More immunizations and births supervised by health care professionals led to declining infant mortality rates. However, progress was less than expected. Moreover, strict enforcement of WBG rules delayed procurement of the equipment for four new hospitals for a full year.	The WBG's provided support through four projects that sought to improve access and quality through reconstruction of primary health care centers and hospitals, and adequate provision of essential medical equipment and medicines. Through four development policy operations (DPOs), the WBG provided technical assistance and training for enhancing the capacity of the Ministry of Health and health service providers. Sector AAA was completed in FY07.	Moderately Satisfactory
In the education sector, the primary objectives of the WBG's program were to increase access to education at primary and secondary levels and improve the quality of education.	Primary and secondary enrollment rates improved. However, little progress was made in improving the quality of education which remains poor. Progress on school infrastructure and textbooks was held back by the lack of adequate attention to the complex language situation for effective teaching. A full cohort of the population may be functionally illiterate.	The WBG's program provided support through six projects and four DPOs. The projects aimed at the reconstruction, rehabilitation and refurbishment of schools, and the production and distribution of textbooks and other learning material (which were for the most part in a language foreign to many teachers, pupils and parents). DPOs buttressed institutional capacity building in the Ministry of Education and educational institutions. An education sector study was completed in FY03.	Moderately Unsatisfactory
In the area of poverty and unemployment alleviation , WBG objectives included providing a short-term social safety net through labor-intensive jobs (urban and rural), and having a sustainable and effective social safety net for the most vulnerable.	Short-term jobs and income created with targeted Bank projects in the early years did well but, as expected, were not sustainable. In subsequent years, the WBG did poorly with unemployment and social assistance for the most vulnera-	In its initial interventions the WBG provided grants (three operations related to the second Pillar and five operations related to the third Pillar) to facilitate economic activity in rural and urban areas. Poverty and unemployment issues were also areas	Unsatisfactory

SUMMARY OF WORLD BANK PROGRAM OUTCOME RATINGS

WBG STRATEGIC AND OPERATIONAL GOALS	ACHIEVEMENT OF RESULTS ASSOCIATED WITH WBG GOALS	MAIN WBG INSTRUMENTS TO HELP RESULTS MATERIALIZE	WBG PROGRAM OUTCOME RATINGS
	ble. Poverty and unemployment rose significantly through most of the evaluation period and declined only after 2007, when the government, against Bank advice, increased its spending using petroleum resources including in the form of cash transfers.	in DPOs, but these interventions were at the policy level. The WBG did two poverty assessments (FY03 and FY09).	
To address youth unemployment and disaffection , the WBG goals included temporary employment creation, particularly in rural areas and engagement of alienated youth in productive community-based activities	There is no evidence that youth empowerment has increased or youth disaffection has lessened. Youth issues were a major factor behind the 2006 civil strife.	The Bank came late to a realization that youth unemployment was an issue and contribution to address youth issues has been modest. Two studies (FY08) helped inform the government's policy responses to the youth challenges and a project targeted to the youth, which was approved in FY09 but has barely disbursed.	Unsatisfactory
WBG's objective for veterans was to provide technical assistance and support to enable the Government of Timor-Leste to alleviate the veterans' concerns about recognition, appreciation and assistance.	By the end of 2005, more than 75 thousand veterans or their survivors had been registered. A Veterans Law was adopted by Parliament in March 2006, providing the legal basis for the recognition of veterans and their assistance. A Veterans' pension system was established and the first pension payments to 12 thousand beneficiaries were made in July 2008.	Veterans' issues were addressed in the Transitional Support Program (2003-05) and first steps were initiated. With Timorese government leadership, the 2006 Veterans Law was drafted and a veterans' data base was created to determine and administer benefits. In FY05 TA was provided on veterans' policy and its implementation.	Moderately Satisfactory
GOVERNANCE AND DEVELOPMENT OF STATE INSTITUTIONS			
WBG's objective was the reconstitution of the capacity of the state , including establishing and re-enforcing key economic ministries, procurement and audit agencies, customs, revenue agency, and developing and strengthening the state's capacity for policy, planning and service delivery.	Institutional capacity is uneven across ministries, and remains weak in many of them. Overall, the human skills base is still very low and the government remains dependent on foreign advisers even for routine line functions. Capacity building initiatives have not generally worked because of absence of strategy and of a needs-based assessment, in addition to barriers such as language.	Initial WBG efforts aimed at improving local governance through three projects. Health and education projects also bolstered capacity in the line ministries. A more frontal WBG effort came through an FY01 capacity-building project, which was supported by four DPOs. Later, a major capacity-building project became effective in FY06 and is still in place.	Moderately Unsatisfactory
Improved fiscal and public financial management , including revenues from petroleum, was an important part of the WBG's institution-building agenda.	Fiscal policy in general and expenditure policy in particular are now planned and with increasing focus on public service delivery. Better budget execution was achieved with a significant number of foreign advisors. Procurement system developed with the Bank's help is not delivering on expectations and is now being reformed and in need of a comprehensive refurbishing. The Petroleum Fund is an effective and transparent mechanism, but the	The WBG provided support, as noted above, through four DPOs, AAA, and the capacity building projects for the Ministry of Finance and the Petroleum Fund. Limited assistance was provided by the WBG to parliamentarians, focusing on the Petroleum Fund, but not on budget oversight.	Moderately Unsatisfactory

SUMMARY OF WORLD BANK PROGRAM OUTCOME RATINGS

WBG STRATEGIC AND OPERATIONAL GOALS	ACHIEVEMENT OF RESULTS ASSOCIATED WITH WBG GOALS	MAIN WBG INSTRUMENTS TO HELP RESULTS MATERIALIZE	WBG PROGRAM OUTCOME RATINGS
	savings rule does not factor in Timor-Leste's significant deficit of human and physical capital. While Parliament's oversight is now in place, its role in checks and balances is limited due to capacity constraints. The system of checks and balances is further weakened by the non-inclusion of donor-financed projects, including the Bank, in the overall budget.		
Legislation. Adoption of laws to improve governance and creation of institutions to strengthen governance and accountability were also part of the WBG's governance objectives.	New institutions for governance have been created and many laws have been adopted. However, their functioning remains constrained by shortages of trained and qualified staff, and the new laws' weak congruence with Timor-Leste's legal system and its reality. New institutions (the Ombudsman and the Inspector General) have been mostly ineffective. No significant effort seems to have been made to adapt the new legislation to the civil service capacity that was actually on the ground. Issuing the implementing regulations and working on the consistency of the new laws are tasks where further work is needed.	The WBG provided support, as noted above, through four DPOs and AAA.	Unsatisfactory
SUSTAINABLE AND DIVERSIFIED NON-PETROLEUM SECTOR FOR JOB CREATION AND ECONOMIC GROWTH			Unsatisfactory
The WBG's objective under this pillar was to create a vibrant private sector that would generate sustainable non-petroleum sector economic growth and productive jobs. Aside from the right legal environment, the objective included stimulating local investment through improved access to credit and infrastructure. This objective included increasing the efficiency and coverage of the power supply.	No significant improvement in non-oil foreign or domestic private investment. Infrastructure and finance, key binding constraints on private sector growth, remain to be addressed properly, including by the WBG. Limited progress in improving regulatory framework for PSD, which is too complex and has yet to regulate contract enforcement and use of collaterals in loans.	The WBG had two small enterprise projects until FY02. Subsequent WBG support was largely centered on the adoption of laws and the establishment of institutions to facilitate private sector activity, with support through the three DPOs. IFC focused mostly on advisory services including a hotel e-booking system, public-private dialogue, and business registration and licensing reform.	Unsatisfactory
In the agriculture sector, the WBG's objectives were to increase agricultural production and productivity, improve food security, enhance business-oriented production of agriculture products, and promote sustainable resource management in forestry and fisheries.	No increase in food production or agricultural productivity for most of the evaluation period. Food insecurity remains a serious concern. Very limited business-oriented production of agriculture products; the sector dominated by subsistence farming, and production hampered by poor roads and high transportation costs to markets. Some improvements in developing sector policy, but low WBG involvement. Rehabilitated irrigation only reached ten percent of	The WBG promoted this agenda through three agricultural rehabilitation projects approved during 2000-04, as well as DPOs during 2003-06.	Unsatisfactory

SUMMARY OF WORLD BANK PROGRAM OUTCOME RATINGS

WBG STRATEGIC AND OPERATIONAL GOALS	ACHIEVEMENT OF RESULTS ASSOCIATED WITH WBG GOALS	MAIN WBG INSTRUMENTS TO HELP RESULTS MATERIALIZE	WBG PROGRAM OUTCOME RATINGS
In the Hydrocarbon Sector , the WBG's objective was to bring transparency and probity in managing petroleum revenues, in order to effectively manage oil and gas revenues and savings to benefit present and future generations.	rice-production land.	The WBG had two projects which aimed to provide technical assistance in this sector. PTAP I provided support to the Government of Timor-Leste on negotiations with neighboring countries and oil companies in the petroleum sector. PTAP II contributed to the oversight of the petroleum sector in the areas of investment and project development, sector policy and administration, and revenue collection and management.	Highly Satisfactory
In the Power Sector , the WBG's objectives included improved efficiency of power supply and collection efficiency in national capital to allow greater spending on district power services; and enhanced availability of reliable, affordable power in the districts to support social and economic development.	Lack of access to reliable power supply is still a bottleneck for private sector development and there is limited evidence of a strong policy impetus for this sector.	The Bank's interventions include one completed project addressing Dili's power supply and two ongoing, which have been troubled by cost overruns and delays. The projects aimed to improve the generation capacity and distribution efficiency and to provide technical assistance and training to support project implementation and strengthening of the institutional capacity.	Moderately Unsatisfactory
Overall Assistance			Moderately Unsatisfactory

Evaluation Summary

Timor-Leste Country Program Evaluation, 2000-2010

The Evolving Role of the WBG in Timor-Leste

From a new state under UN protection in 2000, entirely dependent on the international community, Timor-Leste has transformed itself into a state that stands on its own and has progressed considerably in developing its basic institutions and economy. The country is still challenged by potential instability, limited institutional and human capacity, and limited economic opportunity, but now has the benefit of substantial petroleum resources. Timor-Leste's institutional layout appears better able than before to manage political competition and tensions, and the expectations of citizens have matured in recent years. The Timorese leadership brought the country out of civil unrest in 2006-07 and its aftermath, and has become increasingly assertive in defining its development vision and priorities.

The World Bank Group (WBG) strategy in Timor-Leste during 2000-10 was articulated in a series of documents. The Joint Assessment Mission Report (JAMR), produced in December 1999 by the Timorese in collaboration with the Bank and other donors, formed the basis of the Bank's initial interventions. In November 2000, the Bank's Executive Board discussed a Transitional Support Strategy (TSS), which covered the period until Timor-Leste became eligible to apply for membership of IBRD/IDA, expected to occur after full independence (May 2002). A first full CAS was prepared in June 2005, outlining the strategy for the period FY06-08. That strategy was derailed by the outbreak of civil strife in 2006-07, and a new Interim Strategy Note (ISN) that was discussed by the Bank's Board in August 2009 defined the strategy of the WBG for the period FY10-11. Throughout these strategy documents, the WBG planned to support Timor-Leste in three broad areas: (a) poverty alleviation and the provision of basic social services, including health and education; (b) development of state institutions, including creating good governance and building the capacity of state institutions; and (c) promoting sustainable non-petroleum growth, especially through the development of agriculture and the private sector.

The relevance of the WBG strategy waned through the evaluation period, despite being broadly congruent with the country's own aspirations. During the first three years, the WBG strategy was relevant, focusing on immediate reconstruction needs, the restoration of key social services and alleviation of basic deprivation. At that time the Bank was the trustee and co-manager of the Trust Fund for East Timor (TFET), which brought together resources from different donors and funded investments through grants. As years went by, this immediate focus dissipated. The strategy became more diffuse and all-inclusive, covering a very broad front to the detriment of

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the most critical areas such as agriculture and capacity-building of state institutions. WBG support increasingly took the form of development policy operations and extensive analytical and advisory services. The WBG failed to respond to critical social challenges arising from youth unemployment and rising poverty, as the initial emphasis on delivering early tangible benefits to the population lost momentum.

The efficacy of the program varied over time and by sector. The Bank performed relatively well in the early reconstruction period, when conditions were most challenging. As a result, access to basic health and education services improved and dire human deprivation was mitigated. Thereafter, measured against the objectives set by the WBG for itself, the results of its interventions with respect to long-term development challenges became much more uneven. Overall, moderately satisfactory outcomes in health and veterans' issues and highly satisfactory outcomes in the petroleum sector were offset by weak outcomes in other areas covered by the WBG program. Despite the priority accorded throughout the succession of WBG strategy documents to agriculture, private sector development and employment generation, very little was achieved after the initial period of reconstruction and stabilization. Progress in improving governance and building state institutions, another priority area for the WBG, was good in some respects, but in others opportunities for greater impact were missed. Overall, the outcome of the WBG's program was *Moderately Unsatisfactory* when rated against the goals that it set for itself.

Country Context

In 1999, after some 24 years of armed conflict against the Indonesian occupation and a referendum for independence, Timor-Leste was beset by unprecedented violence and destruction. Under the mandate of the UN Security Council, peace and security were restored and the country was governed directly by the UN, until in 2001-02 free elections led to the establishment of a representative government. The country became independent in May 2002.

Since then Timor-Leste has made much progress in building the institutions of the state and restoring basic services to the people. The architecture and institutions of government foreseen in the Constitution have been established and are functioning, albeit at varying levels of effectiveness. The government is managing a significantly bigger budget and providing basic social services to an increasing share of its citizens. Other institutions outside of the executive branch—such as the Parliament and the Judiciary—have also been established, and civil society is also more empowered and engaged.

The violence following the 1999 referendum was devastating for the people and the economy of Timor-Leste. More than a thousand people died, hundreds of thousands were displaced and the country's infrastructure was de-

stroyed. The agriculture sector suffered a major blow with the destruction of livestock and machinery.. The modern sector was most affected by the destruction of vital physical infrastructure, as well as the exodus of the non-Timorese population that had provided much of the public administration and technical expertise. Basic social services were hit hard. There was a total breakdown in the health care system and the education system also ground to a halt. Valuable records and files, including land and property titles and the civil registry were destroyed. There were no government institutions left. The economy was devastated, and real GDP fell by 33 percent from already low levels.

Since the difficult beginning, the economy has gone through several periods of vigorous economic growth, although with significant annual variations. Under the impetus of the reconstruction activities initiated with the support of donors following the restoration of peace and stability, economic activity picked up considerably in 2000-01. The sharp draw-down of international presence following the withdrawal of UN peacekeeping operations after independence in 2002 and the civil unrest of 2006-7 led to a slowdown of economic activity, and poverty and unemployment increased during 2002-07. Once again, international presence restored order, and following fresh presidential and parliamentary elections, a new

coalition government took office in August 2007, which took urgent steps to address the grievances of disaffected soldiers, unemployed and poor, and other sections of society.

The improved security environment, the recovery of the agriculture sector from drought in 2007, and significantly increased levels of public spending (including capital expenditures) resulted in strong economic growth, averaging around 9 percent annually between 2007 and 2010. However, unemployment remains high, especially among the youth. The country continues to face a serious shortage of qualified and trained professionals in most spheres. Institutional capacity is still very weak in many areas of government and outside, contributing to inefficiencies and leakages in government programs.

The international community has had a significant presence since 1999, when the UN moved quickly to restore peace and security and prepare the foundations for independence in 2002. Apart from purely humanitarian aspects, development assistance supported reconstruction of damaged facilities including schools and hospitals, rehabilitation of infrastructure such as roads and ports, restoration of electric power and water supply and sanitation, support for agriculture and the private sector, and, most importantly, developing the capacity of state institutions at all levels.

Support has been provided in the form of financial grants, technical assistance and analytical and policy advice. Since 1999, Timor-Leste has received about US\$ 3.6 billion of foreign assistance from roughly 28 bilateral donors (most prominently Australia, Portugal, the European Union, Japan, and USA) and multilateral organizations (UN agencies, WBG, Asian Development Bank and IMF.) Few other post-conflict countries have received higher levels of financial support on a per capita basis. Yet, poverty increased from 2001 to 2007—the period of the largest aid inflow—and almost half of the population was poor in 2007.

The role and influence of donors, including the WBG, has declined since 2007. Though the country still requires substantial international technical support, increased hydrocarbon revenues make it less dependent on foreign financial assistance. The government shows growing frustration with what it sees as complex, heavy donor mechanisms. It also appears more skeptical about the advice received from the WBG and other donors. The de-

clining influence of the traditional donors including the WBG is taking place in the context of an apparent larger realignment of Timor-Leste's development policy and international alliances, with particular expansion towards countries in Asia and in the Lusophone community.

Program Overview

The First Pillar – Human Development

The stated objectives of the Bank's program in the health sector were to improve access to and quality of basic health services in the country. Bank projects sought to improve access and quality through reconstruction of primary health care centers and hospitals, adequate provision of essential medical equipment and medicines, and technical assistance and training to enhance the capacity of the Ministry of Health and health service providers.

Progress was made in improving the population's access to basic health services. A large number of health centers were built, mobile clinics were made operational, hospitals were rehabilitated and reconstructed and the supply of medical equipment and drugs was improved. Basic health services were restored. These interventions had a positive impact on the delivery of health care, despite delays in the equipment of hospitals caused by strict enforcement of Bank procurement rules. Immunization coverage for children 12-23 months rose; an increasing number of births were supervised by health care professionals; and infant mortality rates fell. However, progress was slower than expected, child malnutrition worsened and the health of the population in many respects (life expectancy at birth, maternal mortality, malnutrition among children) still remains well below the average in the region and is closer to the average for low-income countries.

In the education sector, the primary objectives of the Bank's program were to increase access to education at primary and secondary levels and improve the quality of education. The Bank's program included the reconstruction, rehabilitation and refurbishment of schools, the production and distribution of textbooks and other learning material and institutional capacity building in the Ministry of Education and educational institutions.

These interventions succeeded in bringing children back to school quickly and contributed to an

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overall improvement in enrollment rates at the primary and secondary levels, though progress was much slower than expected after the initial years. As late as 2007, 40 percent of population aged 6 and above had never attended school. Also, very little was achieved in improving the quality of education which remains poor. Moreover, the implications of the complex language situation for effective teaching were not given adequate attention by the Bank, so that learning materials were for the most part unintelligible to many teachers, pupils and parents.

Poverty and unemployment alleviation were also important objectives of the Bank under the first pillar. In its initial interventions the Bank provided grants and loans to facilitate economic activity in rural and urban areas. These interventions succeeded in providing much needed cash among the poor in remote areas and, to some extent, in creating short-term jobs and employment, as was often the key intention. But many of these jobs were not sustainable and many of the new businesses did not survive the significant UN departures in 2002-03.

A major shortcoming of the WBG program was its inability to help develop a significant and sustainable program for alleviating unemployment, especially of **the youth**, which remains a potent threat to social and political stability. The Bank also missed an opportunity to have impact by not providing hands-on assistance in designing and implementing a program of social assistance in the aftermath of the 2006 civil strife. Through most of the evaluation period, poverty and unemployment rose significantly and the youth issues were not addressed.

The Bank played a useful role in supporting the government in developing and implementing a sensible policy to alleviate legitimate concerns of **veterans** for recognition, appreciation and assistance, although earlier results would have abated tensions. The Bank's program of policy advice and technical assistance helped establish the government's policy as well as the institutional framework and the administrative systems to implement the policy.

Overall, the outcome of WBG support for the first pillar is rated *Moderately Unsatisfactory*.

The Second Pillar – Governance

Taken from the starting point of 1999, the state's **capacity** to govern and deliver public goods has increased significantly. The architecture and institutions of government foreseen in the Constitution have been established and are functioning. The Government of Timor-Leste is managing a significantly expanded budget, driven by growth in petroleum revenues. Ministries and agencies of the state are better able to plan and manage their activities and resources. On its side, the legislative branch of government has produced a significant body of legislation and is making efforts to carry out its oversight functions. A cadre of well-trained and knowledgeable Timorese is at the heart of these considerable developments.

Macroeconomic management was prudent throughout most of the period, although the fiscal stance was too tight until the civil unrest. This stance was consistent, however, with the saving rule of the Petroleum Fund, which did not take into account the sizable deficit of human and physical capital faced by Timor-Leste, nor the urgent need to provide social services and relieve deep poverty.

Timor-Leste, however, still faces major governance challenges. Institutional capacity is uneven across ministries, and remains weak in many of them. There has been almost no strengthening at the district and local levels. The Judiciary remains a challenge. Overall, the human skills base is still very low and the government remains highly dependent on advisors, many of them foreign, with only limited success in transferring knowledge and skills between the advisors and national staff.

The Bank had state capacity building as a key priority from the start. However, the contribution to capacity development has been limited, as noted in the WBG's Interim Strategy Note (ISN). For most of the evaluation period the Bank did not have a clear needs assessment, a strategic vision, or a realistic and monitorable strategy that could have guided its actions to bolster capacity in Timor-Leste in a more effective way. Moreover, WBG technical assistance has been hindered by problems with the mentoring model, in addition to factors such as language and poor education.

Timor-Leste has also made very significant progress in setting up a **system of fiscal and public financial management**. The stable ma-

macroeconomic environment and the improved budget execution in recent years are evidence of this progress. The basic institutions for fiscal and public financial management have been set up and are functioning. Fiscal policy in general and expenditure policy in particular, are now planned and with increasing focus on public service delivery. These policies are better grounded, using more reliable estimates of the macroeconomic aggregates and the needs of the population. The utilization of petroleum revenues is governed by a prudent and transparent framework widely regarded as best practice. Institutions of the state outside of the executive, such as Parliament, are also in better condition to discharge their functions on the petroleum fund.

Nevertheless, use of the financial management systems needs to be spread evenly across all government agencies and all levels of government, including the local. Parliament, the Judiciary and the other oversight institutions need to be strengthened so that they can fulfill their function as checks and balances. The part of the budget that is financed with donor funds must be brought into the overall budget, and the investment budget must catch up with the current budget in execution rates.

The Bank's efforts in this area were late to bear fruit, and have faced significant adaptation challenges. Had the system of fiscal and financial management been in place when the flow of petroleum revenues started, the government would have been in a better position to tackle the unemployment and the deficiencies that helped brew the civil strife of 2006. Moreover, some of components of the system suggested by the Bank, e.g. procurement, turned out to be ill-adapted to Timor-Leste. The successes with the Petroleum Fund and the recent project on public financial management need to be weighed against these shortcomings.

On the creation of a **legal framework**, Timor-Leste has also made very significant progress. It now has laws that govern taxation and customs, as and the exploitation and use of its petroleum wealth. It also has a public financial management law better adapted to its reality. Procurement legislation has taken several rounds, but also seems to be better adapted now. However, Timor-Leste still needs to harmonize the different pieces of legislation stemming from separate legal traditions, so that they are congruent and adapted to the uses

and mores of the country. An additional challenge is to develop the implementing regulations that are needed to bring these laws to life. Yet another one is to fill in the blanks that were left behind in the haste that seems to have dominated the legislative process until now.

The WBG has supported the development of the legislative framework in a wide set of areas. Perhaps the coverage has been too wide for Timor-Leste's capacity constraints—too many draft laws for a new Parliament and for a few lawyers capable of adjusting the drafts to the Timor-Leste's nascent legal system—which are even greater if the capacity to implement the new laws is factored in. While the urgency was pressing, the need for a structured and strategic vision was all the more relevant in light of the limited resources and capacity. So were the need for a better understanding of the challenges of setting up a new legal system under a civil law tradition, and an acknowledgement of the limitations faced by Timor-Leste.

Overall, the outcome for WBG support for the second pillar is rated as *Moderately Unsatisfactory*.

The Third Pillar – Growth

The WBG's objective under this pillar was to create a vibrant **private sector** that would generate sustainable economic growth and productive jobs. Timor-Leste's non-petroleum economy is dominated by the public sector, which contributed roughly 45 percent of non-petroleum GDP in 2007, the last year for which data on the sectoral composition of GDP is available, and private non-petroleum investment was estimated by the IMF at US\$12 million in 2007, about 3 percent of non-petroleum GDP.

The private sector development agenda supported by the WBG was largely centered on the adoption of laws and the establishment of institutions to facilitate private sector activity. Left aside were the more pressing binding constraints posed by bad infrastructure and the difficulty of accessing credit. Much of its agenda was implemented through the development policy operations of 2003-06.

A number of laws meant to facilitate private investment were adopted during this period, including those on commercial entities, investment, insurance, bankruptcy, cooperatives, and leasing of government property. A land law addressing publicly owned real estate was also passed in 2003.

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However, a clear sense of priorities or legislative strategy has been missing. As was the case with governance, congruence among the various sets of legal advice received by Timor-Leste is uncertain and critical laws, such as on contract enforcement and securitizing land for collateral, are still pending. Moreover, while a lot of attention was paid to developing laws, less attention was paid to the more difficult issues of developing enabling regulations and enforcement, including the judicial system's ability to resolve disputes within the existing legal framework.

At a different level, IFC helped create the Better Business Initiative, a forum to improve the dialogue between the government and the private sector. This forum was largely responsible for the recent creation of the Chamber of Commerce and Industry. IFC also helped develop an e-booking system to help international travelers and the tourism sector, and has made some efforts in easing microcredit using resources from another donor. In total, there were four advisory services since IFC launched its operations in 2006. No IFC investment was approved during this period.

Under a reasonable division of labor agreed at the start with ADB (but one that could have been revisited at some point), the WBG's program did not address two critical constraints to private sector development: poor infrastructure (except for some relatively modest power projects) and lack of access to credit. Progress in both these areas has been quite limited, and they remain the key binding constraints on private sector development. Shortages of electricity and poor roads and other infrastructure are increasing private sector costs, while banks remain reluctant to lend in the absence of debtor discipline and a credible framework for contract enforcement. Overall, as noted in the ISN (p15), "there has been a serious and damaging failure to create conditions conducive to the emergence of a vibrant private sector".

In the **agriculture sector**, the WBG's objectives were to promote sustainable resource management (in forestry and fisheries), increase agricultural production and productivity and improve food security. This agenda was promoted through a series of agricultural rehabilitation projects approved during 2000-04 as well as the development policy programs approved during 2003-06.

As a result of the Bank's interventions, almost 4,000 hectares of land were rehabilitated in 46

community-based irrigation schemes, covering 2.4 percent of arable land. An extensive program of vaccination of livestock was undertaken through early Bank projects, which reduced mortality rates. In addition, a sector policy framework was developed, as well as a forestry and watershed management policy and strategy. A fisheries decree law and supporting legislation were also approved.

However, the overall impact of Bank interventions on production and yields was limited because other complementary inputs such as fertilizers and high yielding seed varieties were not used. Many of the production activities supported by Bank projects in upland and coastal communities did not have a significant impact because they were hampered by poor roads and high transportation costs to markets. The pilot agricultural service centers established by Bank projects to provide services to farmers were not viable as farmers were unwilling (or unable) to pay for the services on offer.

Considering the entire period 2000-10, the outcomes in the sector have been disappointing. After the early recovery that followed the 1999 collapse, there was no generalized increase in production (but significant annual variations) of the three main food crops (maize, cassava and rice) between 2000 and 2008. However, there was a significant increase in the output of all three in 2009. Nevertheless, agricultural productivity has not increased and remains very low, both for food-crops and livestock. The sector is still dominated by subsistence farming, which suffers from poor quality of inputs (seeds, fertilizers, pesticides, irrigation) and lack of knowledge regarding new technologies and best practices.

Food security remains a serious concern, especially in rural areas. Despite large imports of rice, the 2007 Survey of Living Standards found that rural households did not have sufficient rice or maize to eat for about four months each year. As acknowledged in the ISN ("...support for this sector since independence has not been adequate to tackle underlying factors."

The **energy agenda** of the WBG included the hydrocarbon sector and power. Timor-Leste has made considerable progress in dealing with the petroleum wealth stemming from the find in the Timor Sea. There is a negotiated treaty with Australia, a set of rules governing taxes and royalties, and a Petroleum Fund to guide revenue use. Evi-

dence of the progress is the recent declaration of Timor-Leste as EITI compatible, only the third member country to reach this stage. The Bank gave significant support to Timor-Leste in its negotiations with Australia, and in setting up the system of taxes and revenues. In collaboration with the IMF and NORAD, the Bank helped create the Petroleum Fund by helping gather wide support for its approval. The negotiations and the system of taxes and revenues for hydrocarbons are the highlights of the Bank's program in Timor-Leste.

In the power sector Timor-Leste has made only modest overall progress, and lack of access to reliable power is still a bottleneck for private sector development. In the early years, ADB was the lead agency. The Bank also engaged in the sector early on. Progress in the areas supported by the Bank, namely improving the availability and efficiency of the power supply and collections from users, has also been modest.

Overall, the outcome of WBG support for the third pillar is rated as *Unsatisfactory* despite highly satisfactory rating for hydrocarbon.

Findings on the World Bank Group Program

On the positive side, the evaluation finds noteworthy the **Bank's assistance to Timor-Leste in negotiating with Australia its rights in the hydrocarbons find in the Timor Sea, as well as the establishment of a petroleum regime that is internationally competitive in its terms and in line with international best practice**. In many respects, the regime has set new standards for developing countries in regard to transparency and accountability in the management of petroleum revenues, and in limiting their arbitrary use. This example could be followed in other countries, being mindful, however, of their deficits in human and physical capital when setting the savings rule.

The evaluation also finds several weaknesses in the design and implementation of the WBG's program in Timor-Leste that negatively affected outcomes. Grouped by areas, these are:

The **program in Timor-Leste**:

- After the first couple of years, the **WBG's program over-emphasized long-term institutional objectives, placing too little emphasis on short-term interventions**

that would yield immediate benefits to the population. The disconnect between increasing poverty and unemployment during these years and the large volumes of foreign assistance (which focused mostly on long-term policy and institutional development) contributed to a perception in the country that external support did not serve the country's population—the heavy dependence on foreign advisers helped to reinforce this perception. The high emphasis on the long-term translated itself into a push to adopt laws and develop frameworks and strategy documents, particularly in the development policy operations. While laws and frameworks are important, they were probably not the most important binding constraints on development at the time. Instead, the emphasis could usefully have been on concrete actions that had a more direct and immediate link to the objectives of policy. For example, with respect to private sector development, instead of laws that have apparently made little difference, the focus could have been on concrete measures to improve electricity supply, roads, and access to credit.

- Over time, the **WBG's program increasingly lacked a clear focus.** The program also did not appear sufficiently based on the specific characteristics of Timor-Leste. The sense of priorities that characterized the Bank's early operations was missing. In particular, agriculture did not receive the support it deserved, given its importance in the economy and the preponderance of poverty in the rural areas. This lack of focus was evident in the development policy operations, which sought to cover as broad a front as possible without a clear sense of priorities or apparent awareness of institutional capacity constraints. Even within a given area, focus was lacking in some cases and the program was spread thin, as was the case with capacity building. It would have been preferable to focus on a couple of key areas such as strengthening of public financial management (to improve budget execution, which was hampering delivery of basic services) and the key ministries involved with it.

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- **Institution building did not pay sufficient attention to human resource development and training**, creating a major lacuna in the WBG's operations. Several new institutions were created (e.g. Ombudsman, Inspector General), but were unable to fulfill their mandates, partly because the mandates and ownership were not clear and partly because they lacked qualified people. The justice system was similarly hamstrung by a severe shortage of trained prosecutors and judges. Foreign advisers, which were to train the Timorese staff and help the new state function, did much better in the latter than in the former function. They have been very useful in enabling the government to perform its routine functions. However, they have largely been unsuccessful in transferring their knowledge and skills to the Timorese staff, and a better system is required to ensure skills are transferred, so that institution building can be sustainable.

The WBG's **role and instruments**:

- In spite of the emphasis placed by WBG strategy documents on simplicity of project design and the need to align projects with the weak institutional capacity in the country, this principle was breached in many cases, especially after the first few years. Evaluations frequently found projects too complicated in design, sometimes involving multiple implementing agencies. Interventions tended to seek to achieve multiple objectives, rather than focus on a well-defined objective. The implementation schedules were often unrealistically optimistic. In spite of some procedural simplifications that were introduced to expedite project preparation and implementation, there was widespread dissatisfaction with the complexity of Bank rules and procedures, especially for procurement. The WBG's incentive system did not help to bring on board the best possible skills and know-how. The WBG did not follow (closely enough) its principles on how to deal with fragile states. Overall outcome ratings for evaluated projects that closed in FY00-FY10 are below those of other fragile states.
- Within the program itself, the WBG did not adequately integrate lessons of

experience into subsequent projects and programs. Mistakes kept repeating themselves, like complex project design, over-optimistic and unrealistic assessment of the ground realities, focus on the long-term largely ignoring the short-term, and monitoring outputs instead of outcomes. Stronger management oversight would be desirable to ensure that lessons are learnt from earlier operations, and, more importantly, to maintain the focus on what is really needed to strengthen Timor-Leste's state.

- The Bank's early efforts at building a structure of local governance by supporting the creation of democratically-elected village development councils were largely unsuccessful. The Bank did not have an adequate understanding of the political dynamics in the country, nor did it have the mandate or experience for this difficult endeavor. Mainstreaming of gender and youth issues in the Bank's program was not effective. While some measures to this end were included in some Bank projects, there was no serious follow up. These measures slowed project preparation and progress, and there was no evidence that they had any meaningful impact on gender or youth issues.
- Compared to the ambitious agenda that it set for itself, IFC's actual program was very limited in scope. Partly because of the difficult and uncertain business environment, it did not approve any of the intended investments. Nor did it provide any of the planned support for public-private infrastructure partnerships, or piloting of SME loan products and risk sharing facilities to increase the private sector's access to finance. Instead, its activities were largely confined to four TA initiatives funded by PEDF Trust Funds. These activities, the most important of which were the hotel e-booking site and the creation of the Better Business Initiative (which in turn led to the establishment of the Chamber of Commerce and Industry) had some positive impact. Overall, however, IFC's interventions have been too small to address the challenge of creating a private sector, especially domestic, and addressing its real constraints.

- The WBG's program rightly emphasized the importance of monitoring actual results of its interventions on the ground. In practice, while a lot of effort was spent in developing indicators to assess progress measuring inputs and outputs, insufficient attention was devoted to acquiring accurate data to make the indicators a reliable guide for monitoring results. In addition, seldom did indicators measure outcomes or impacts on the ground. Moreover, some of the Bank's programs had an over-load of information and monitoring requirements on inputs and outputs that may have diverted scarce government capacity away from implementation of programs. It would perhaps have been better to focus efforts on a few key outcome indicators underpinned by accurate data.

Recommendations

The above findings lead to the conclusion that the significance of the WBG's role for Timor-Leste's economic development has been declining over time, and thus also its relevance for the Government of Timor-Leste. The WBG will regain its relevance if it is able to show Timor-Leste that it can be a knowledgeable, responsive and creative development partner, focused on helping the poor through sustainable development. To this end, the WBG may want to consider ways to strengthen its engagement, while providing additional resources to the work program. Innovative program or project packages could conceivably help mobilize additional donor resources and could also be combined with the government's own resources. If needed, judicious use of some IBRD lending could be considered as and when the country is found eligible for such lending.

Timor-Leste is in several ways in a unique situation – a new country with new and still developing institutions, a severe lack of capacity both inside and outside of the government, monumental development challenges, and rapidly growing revenues from its hydrocarbon resources. Poverty remains rampant in the rural sector.

At this stage, the challenge for Timor-Leste is to use its petroleum regime to make the most of its hydrocarbon wealth in a sustainable way, and to spend effectively and efficiently these resources, with a clear goal of addressing the critical development constraints of the country in order to fos-

ter sustainable growth and reduce poverty. Key among these constraints are low capacity within the government; poor quality in education; inadequate infrastructure; unemployment, in particular among the youth; and the backwardness of agriculture.

The WBG has the potential capacity to become a key development partner for Timor-Leste in addressing its challenges, in collaboration with other donors. However in order to be an effective and creative partner, the WBG will need to change important aspects of its strategy and ways of operating in the country, thinking more in terms of teaming up with the country and moving beyond the traditional client-WBG paradigm.

On this basis and based on the analysis and findings of the Country Program Evaluation (CPE), IEG makes the following recommendations, which are summarized, together with the findings, in Table 1:

On the WBG program in Timor-Leste:

- The WBG set as its key objective going forward to help the government in its current efforts to promote vigorous and sustainable growth of Timor-Leste's non-petroleum sector, as a means of reducing poverty and unemployment. With widespread poverty and unemployment, especially among the youth, poor physical infrastructure, and the petroleum revenues, a sustainable public works program to create jobs and build critical infrastructure such as roads, water supply and sanitation infrastructure and rural infrastructure could usefully be a priority area for WBG organizational and financial support. This program would be supported by rural development projects that could help Timor-Leste move from subsistence farming into a surplus-producing sector capable of absorbing the underemployed rural poor.
- Whatever the choice of direction Timor-Leste makes, the WBG prioritize clearly, after renewed consultations with other development partners, the key goals of its work program and all its interventions, and be realistic with regard to the time-frames required to achieve the institutional and social development objectives. The situation on the ground needs to be factored in as well, as noted

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below. Such priority setting will likely entail a stronger focus on a smaller number of key poverty-focused interventions that would address top country priorities and permit substantial input of experienced staff resources. It would also need to be based on a revamped and clear understanding with other external development partners on the roles and responsibilities that each one would play.

- Within the program agreed with the government for institutional development, the WBG increase its focus on effective human resource development for institution-building and improved governance, within a clear overall strategy for capacity-building that fosters the transmission of skills and knowledge from foreign advisers to local staff. The WBG's past emphasis on the supply of skills should give way to a much greater focus on transfer of skills. Examples like what NORAD did with the Petroleum Fund or the IMF did with the Banking and Payments Authority (BPA) are good models to follow.

On the **WBG's role and instruments** in Timor-Leste:

- The WBG follow more closely its own principles and guidelines on how to deal with fragile states in its program in Timor-Leste. Projects need to be simple and mindful of the weak institutional capacity of the country. Multiple objectives or implementing agencies ought to be avoided in WBG interventions in Timor-Leste. WBG rules need to be applied with the flexibility called for in fragile states. The WBG incentive system could be brought to bear in order to mobilize the best knowledge and organizational skills to Timor-Leste.
- The WBG strengthen, to this end, its capacity to provide timely, high-quality policy and technical advice together with enhanced use of its organizing skills and know-how. The timeliness, creativity and quality of its advice and organizing skills, based on unparalleled international experience that acknowledges the realities and constraints of Timor-Leste, together with the WBG's financial contribution, will determine the role it will play in Timor-Leste in the future. High

quality of staff will be important to this end, together with more active management of the assistance program, including closer oversight of operations.

- The WBG be realistic with regard to the situation on the ground and what is needed to achieve the institutional and social development objectives in Timor-Leste. To this end, the WBG needs to have a better understanding of the political dynamics in the country and only intervene when the government asks it to do so. The WBG also needs to find an effective way of mainstreaming of gender and youth in its interventions, without slowing them.
- IFC's interventions should be sufficient and proportional to address the objectives of its program and help Timor-Leste face the challenge of creating a viable private sector, especially the domestic one. In doing so, IFC needs to factor in the real constraints to private sector development in Timor-Leste—energy, infrastructure and access to credit, and focus on the rural sector and the small and micro enterprises. These interventions will maximize the impact of the program on employment generation and poverty reduction.
- The WBG shift its monitoring and evaluation of the program toward a few key results and the improvement of the statistical capacity to obtain reliable and accurate data on outcomes. The monitoring and evaluation frameworks need to factor in the limited institutional capacity on the ground, and leave aside the emphasis on following inputs and outputs.

As a final thought, the WBG may want to consider ways of providing additional resources to the work program. Project lending from the very small IDA allocation alone may be insufficient to have the desired impact, even when combined with the current level of donor resources, which is substantial. Innovative program or project packages, perhaps in labor-intensive infrastructure (such as trunk roads, feeder and rural roads), could conceivably help mobilize some additional donor resources and also be combined with the government's own resources. If needed, judicious use of some IBRD lending could be considered as and when the country is found eligible for such lending.

Table 1. Timor-Leste: Summary of Findings and Recommendations

FINDINGS	RECOMMENDATIONS
<i>WBG Program in Timor-Leste</i> After the first couple of years, the WBG's program over-emphasized long-term institutional objectives, placing too little emphasis on short-term interventions that would yield immediate benefits to the population. This translated itself into a push to adopt laws and develop frameworks and strategy documents, which were probably not the most important binding constraints on development.	The WBG set as its key objective going forward to help the Government's efforts to promote vigorous and sustainable growth of Timor-Leste's non-petroleum sector as a means of reducing poverty and unemployment. A sustainable public works program to create jobs and build critical infrastructure could be a priority area for WBG support. This program would include rural development projects to absorb the underemployed rural poor.
Over time, the WBG's program increasingly lacked a clear focus, and did not appear sufficiently based on the specific characteristics of Timor-Leste. The sense of priorities that characterized early operations was missing.	Within the direction taken by the country, the WBG prioritize clearly, after renewed consultations with other development partners, the key goals of its work program and all its interventions, and be realistic with regard to the time-frames required to achieve the institutional and social development objectives.
Institution building did not pay sufficient attention to human resource development and training. Many new institutions were unable to fulfill their mandates, partly because they lacked qualified people. Foreign advisers were largely unsuccessful in transferring their knowledge and skills to local staff.	As agreed with the Government, the WBG increase its focus on effective human resource development for institution-building and improved governance, within a clear overall strategy for capacity-building that fosters the transmission of skills and knowledge from foreign advisers to local staff.
<i>WBG Role and Instruments in Timor-Leste</i> The principles of simplicity of project design and the need to align projects with the weak institutional capacity in the country were left aside, especially after the first few years. Interventions tended to be complicated, with multiple objectives and implementing agencies. Implementation schedules were often unrealistic. Bank rules were complex and applied too rigidly. The WBG incentive system could have brought better resources on board. Within the program itself, the WBG did not adequately integrate lessons of experience into subsequent projects and programs. Mistakes kept repeating themselves. Stronger management oversight could have made a significant difference.	The WBG follow more closely its own principles and guidelines on how to deal with fragile states in its program in Timor-Leste. Projects need to be simple, mindful of the weak institutional capacity, with simple objectives and one implementing agency. WBG rules should be applied with the flexibility needed for fragile states. The WBG incentive system should be brought to bear in order to mobilize the best knowledge and organizational skills. The WBG strengthen its capacity to provide timely, high-quality policy and technical advice, together with enhanced use of its organizing skills and know-how. High quality of staff will be important to this end, together with more active management of the assistance program, including closer oversight of operations.
The Bank's early efforts at building a structure of local governance by supporting the creation of democratically elected village development councils were largely unsuccessful. The Bank did not have an adequate understanding of the political dynamics in the country, nor did it have the experience for this difficult endeavor. Mainstreaming of gender and youth issues was not effective. Compared to the ambitious agenda that it set for itself, IFC's actual program was very limited in scope, especially for the challenge at hand. It did not approve any of the intended investments, nor did it provide any of the planned support for public-private infrastructure partnerships, or piloting of SME loan products and risk sharing facilities to increase the private sector's access to finance. Activities were confined to four TA initiatives funded by PEDF Trust Funds.	The WBG be realistic with regard to the situation on the ground and what is needed to achieve the institutional and social development objectives in Timor-Leste. The WBG needs to have a better understanding of the political dynamics in the country and only intervene when the Government asks it to do so. The WBG also needs to find an effective way of mainstreaming gender and youth without slowing its interventions. IFC's interventions should be sufficient and proportional to address the objectives of its program and help Timor-Leste face the challenge of creating a viable private sector. In doing so, IFC needs to factor in the real constraints to private sector development in Timor-Leste, and focus on the rural sector and the small and micro enterprises. These are the interventions that will maximize the impact of the program on employment generation and poverty reduction.
The WBG's emphasized the importance of monitoring actual results of its interventions, but, insufficient attention was devoted to acquiring accurate data to make the indicators a reliable guide for monitoring results. Often, indicators monitored inputs and not the outcomes or impacts on the ground. Moreover, some programs had an over-load of information and monitoring requirements.	The WBG shift its monitoring and evaluation of the program toward a few key results and the improvement of the statistical capacity to obtain reliable and accurate date on outcomes. The monitoring and evaluation frameworks need to factor in the limited institutional capacity on the ground, and leave aside the emphasis on following inputs and outputs.

Management Action Record

Major Monitorable IEG Recommendation Requiring a Response	Management Response
<ul style="list-style-type: none"> ■ The WBG set as its key objective going forward to help the Government's efforts to promote vigorous and sustainable growth of Timor-Leste's non-petroleum sector as a means of reducing poverty and unemployment. A sustainable public works program to create jobs and build critical infrastructure could be a priority area for WBG support. This program would include rural development projects to absorb the underemployed rural poor. 	<p>Management agrees on the need to continue to support broad based growth in the non-oil economy, to find creative ways to develop the nascent private sector, and to address unemployment – particularly amongst youth. These objectives are central tenets of the current ISN and, in consultation with the government and other stakeholders, expected to underpin the medium-term program outlined in the forthcoming WBG CAS. The identification of infrastructure development as an imperative in the Government's <i>Strategic Development Plan</i> provides an opportunity to explore large-scale public works programs that provide interim employment opportunities for (particularly) unemployed youth in rural areas.</p>
<ul style="list-style-type: none"> ■ Within the direction taken by the country, the WBG prioritize clearly, after renewed consultations with other development partners, the key goals of its work program and all its interventions, and be realistic with regard to the time-frames required to achieve the institutional and social development objectives. 	<p>Management agrees that WBG engagement should reflect the important and credible steps the government has taken to restore stability. A focused and realistic WBG program should seek to blend pragmatic interventions calibrated to Timor-Leste's growing capacity and priorities with less conventional operations and analysis that can help consolidate and secure the country's transition. Such a program can only emerge through wide-ranging consultations with government and other stakeholders.</p>
<ul style="list-style-type: none"> ■ As agreed with the Government, the WBG increase its focus on effective human resource development for institution-building and improved governance, within a clear overall strategy for capacity-building that fosters the transmission of skills and knowledge from foreign advisers to local staff. 	<p>Management reiterates its commitment to bring to bear international expertise to help Timor-Leste to help develop capacity in both the public and private sectors. Capacity building and institutional development are long-term propositions. Notwithstanding the extraordinary progress that Timor-Leste has made since independence, the deficit in capacity emerges as a critical constraint to the country's efforts to pursue its development vision. A successful capacity-building strategy in such a dynamic and unconventional context must provide a framework that can guide multiple interventions over time – both opportunistic and planned – rather than hope to achieve this through more rigid and conventional approaches.</p>
	<p>Management is pleased to note that the role of foreign advisers continues to evolve from a transitional mode of support to a more rational and sustainable approach to addressing critical capacity deficits. A limited role remains for a reduced complement of Technical Advisers where there is demonstrated government support for them, and provided they take full advantage of a growing pool of national specialists who capable of providing these services.</p>

MANAGEMENT ACTION RECORD

<i>Major Monitorable IEG Recommendation Requiring a Response</i>	<i>Management Response</i>
<p>The WBG incentive system should be brought to bear in order to mobilize the best knowledge and organizational skills.</p>	<p>of the support needed by fledgling institutions would have helped increase the impact of the WBG program.</p> <p>Management accepts the need for flexibility in the application of WBG processes. Recent initiatives to: reform IL instruments; the development of the P4R mechanism; thoughtful guidance on the effective use of DPOs in fragile and conflict-affected states; and, consideration of how procurement and financial management requirements can be better calibrated to the needs and capacity of countries such as Timor-Leste, provides staff with tools and approaches that were previously unavailable and which have the potential to enhance the quality of future WBG engagement.</p>
<ul style="list-style-type: none"> ■ The WBG strengthen its capacity to provide timely, high-quality policy and technical advice, together with enhanced use of its organizing skills and know-how. High quality of staff will be important to this end, together with more active management of the assistance program, including closer oversight of operations. 	<p>Management concurs that the value of WBG engagement in Timor-Leste stems from the capacity to provide high-quality, objective advice on policies and issues of national importance, and its ability to convene stakeholders around activities with potential national impact. The WBG will continue to play this role – one acknowledged and valued by both government and development partners – recognizing that continued relevance depends on the ability to attract and retain global expertise and to provide requisite implementation support.</p>
<ul style="list-style-type: none"> ■ The WBG be realistic with regard to the situation on the ground and what is needed to achieve the institutional and social development objectives in Timor-Leste. The WBG needs to have a better understanding of the political dynamics in the country and only intervene when the Government asks it to do so. The WBG also needs to find an effective way of mainstreaming gender and youth without slowing its interventions. 	<p>Management recognizes that a deep appreciation of the political economy is critical to understanding the country context and to informing WBG interventions that respond directly to national priorities. Timor-Leste's development over the last decade has been anything but conventional. Sustained WBG efforts to deepen understanding of the political economy have helped the institution remain relevant and responsive. Greater understanding may not always have been translated into appropriate, flexible, interventions specifically calibrated to the needs and capacity of Timor-Leste.</p>
<ul style="list-style-type: none"> ■ IFC's interventions should be sufficient and proportional to address the objectives of its program and help Timor-Leste face the challenge of creating a viable private sector. In doing so, IFC needs to factor in the real constraints to private sector development in Timor-Leste, and focus on the rural sector and the small and micro enterprises. These are the interventions that will maximize the impact of the program on employment generation and poverty reduction. 	<p>Management recognizes a greater focus on gender and youth concerns is essential to institutional and social development objectives. WBG has made efforts to address the issue of unemployed youth in an operation that represents the forerunner of similar interventions underway or planned in the Pacific. Implementation challenges are intensified in this area and management expects to refine and adjust its approach to youth issues as it garners greater experience in this area. Management – with the support of EAP more broadly – is also actively engaged in identifying systematic opportunities to integrate gender considerations into all its operations.</p>
	<p>Management would appreciate clarification of what would represent a “sufficient and proportional” role for the IFC in the context of a new, fragile, post-conflict country. In a few short years following independence, the country has had to manage the blessings – and curses – that accompany large oil and gas discoveries even as the country reestablishes the basic functions of state. This underscores the need for a measured private sector development program – one whose pace and progress is determined by the country's capacity and not imposed by partners. It is important to note that IFC is now, by virtue of a fundamental reassessment of its role in the Pacific, now far better placed to offer more comprehensive program of advisory and investment services.</p>

MANAGEMENT ACTION RECORD

Major Monitorable IEG Recommendation Requiring a Response	Management Response
<ul style="list-style-type: none"> ▪ The WBG shift its monitoring and evaluation of the program toward a few key results and the improvement of the statistical capacity to obtain reliable and accurate date on outcomes. The monitoring and evaluation frameworks need to factor in the limited institutional capacity on the ground, and leave aside the emphasis on following inputs and outputs. 	<p>Management accepts that the development of statistical capacity is a critical dimension of the broader capacity-building challenge confronting the WBG and development partners in Timor-Leste. This effort will need to be sustained over the medium- to long-term and the challenge should not be underestimated – as illustrated by the IMF's difficulties in developing accurate macroeconomic projects in a country whose development trajectory has been anything but conventional.</p> <p>Management also agrees on the need for selectivity and expects to exercise this discipline in the latest generation of interventions. Management also notes the difficulty of reconciling the CPE's call for selectivity with the exhortations to play a more active role in, for example: agricultural development, employment generation, gender, youth, social safety nets and microenterprises. Similarly agreeing "<i>only [to] intervene when the Government asks it to do so</i>" may prove neither feasible nor desirable. Resolving dilemmas of this kind may determine the extent to which WBG is able to learn and adopt the many important lessons contained in this report.</p>

CHAIRPERSON'S SUMMARY

COMMITTEE ON DEVELOPMENT EFFECTIVENESS

**INFORMAL SUBCOMMITTEE REPORT: TIMOR-LESTE COUNTRY PROGRAM EVALUATION (CPE), 2000-2010:
EVALUATION OF WORLD BANK GROUP PROGRAM
(MEETING OF MAY 23, 2011)**

1. On May 23, 2011, the Informal Subcommittee (SC) of the Committee on Development Effectiveness (CODE) considered an Independent Evaluation Group (IEG) report entitled *Timor-Leste Country Program Evaluation 2000-2010: Evaluation of the World Bank Group Program* (CODE2011-0027).
2. In its opening remarks IEG informed members that the Timor-Leste CPE evaluates the outcome of the World Bank Group (WBG) assistance program against the objectives it set for itself. It noted the country context in 1999 after independence: infrastructure destroyed, nonexistent political institutions, and a rudimentary economy based on self-subsistence agriculture. The main findings were that after an initial success the WBG's program focus and sense of priorities were gradually lost with over-emphasis on long-term institutional objectives and less attention to immediate needs. It added that institution building could have paid more attention to human resource development as projects and programs were complex. Going forward, IEG recommended that the WBG and donors help Timor-Leste use well its petroleum resources, target job creation, address critical infrastructure and re-prioritize assistance strategy.
3. Management remarked that an effort to contextualize Bank engagement in Timor-Leste and appreciation of the uncertainty of fragile and post-conflict situations were needed in order to identify lessons learned and contribute to the debate on engaging in such volatile environments. It noted that the evaluation could have better distinguished the political periods in which the Bank operated under distinct strategies and could have benefited from greater consultation with Timorese civil society, media, project beneficiaries and Bank counterparts. Management questioned the assertion that the Bank should have predicted the social unrest of 2006. It added that since independence, Timor-Leste institutions have begun to show capacity to discharge state functions effectively, while also managing natural resource revenues efficiently. In that sense, it remarked that the total rebuilding of the state from the ground up is a commendable achievement of the Timorese Government.
4. Members appreciated the informative document and thanked both IEG and Management for the answers to the questions raised. Members noted that IEG findings were pertinent not only to Timor-Leste but also to WBG engagement in fragile and post-conflict countries given the recent 2011 World Development Report (WDR) on Conflict, Security and Development. They remarked that advances were notable given the difficult country context and recognized that results were impacted by situations on the ground, which were out of WBG control. In that sense, they asked that the report pick up on lessons learned including on coordination and division of labor among development partners. They commented that monitoring and evaluation are crucial to engagements in fragile scenarios as well as the need for flexibility to provide mid-course corrections. With regard to communication and dissemination a majority of members and speakers asked that the report properly frames the country context.

1. CONTEXT

Recent History and Political Developments

1.1 Timor-Leste has a population of slightly more than a million people on an area of just under 15,000 square kilometers. In spite of its small size a large number of languages are spoken on its territory - sources typically mention more than 30, of which only Tetum (or Tetun) can be considered a written language (see Box 1). The complex language situation has implications for education and administration.

Box 1. Languages in Timor-Leste

- The official languages of Timor-Leste are Tetum (or Tetun) and Portuguese while Indonesian and English are designated as working languages.
- A large number of languages are spoken on the territory of Timor-Leste - sources typically mention more than 30, of which only Tetum can be considered a written language, although in a rudimentary way. The dialect of Tetum spoken around Dili, which has incorporated many Portuguese words, is the version now more widely used, and is now taught in schools, but other dialects are widely used in the country.
- Before 1975 Portuguese was the language of education and administration. Under Indonesian rule, the use of Portuguese was banned, and Bahasa Indonesia was the official language and used in the education system. Portuguese was however used by the clandestine resistance, especially in communicating with the outside world, and gained importance as a symbol of resistance.
- Upon independence the government therefore adopted Portuguese as one of the two official languages (with Tetum), and as a link to nations in other parts of the world. Portuguese and Tetum are used as educational languages.
- Given the country's complex linguistic situation and history, and in a world where English has become the lingua franca (including for much development assistance), any choice of languages would clearly have created problems for administration and education. However, the Lusophone world has extended considerable assistance for Portuguese training and educational material.

1.2 Timor-Leste was ruled by Portugal for several hundred years until 1975, when Portugal surrendered its colonies. In that year the Indonesian army occupied the country, which was from then on ruled as part of an Indonesian province. After some 24 years of armed conflict against the occupation, and a vote for independence in a referendum in 1999, Timor-Leste was racked by unprecedented violence and destruction by the departing forces during the Indonesian withdrawal. Under the mandate of the UN Security Council, peace and security were restored and the country was governed directly by the UN. In 2001-02 free elections led to the establishment of a representative government and the country became independent in May 2002.

1.3 Since then much progress has been made in building the institutions of the state and restoring basic services to the people. However, poverty and unemployment increased dur-

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ing 2002-07, and progress has also been interrupted by periodic episodes of civil unrest, most markedly in 2006 when fighting broke out between the army and police following the dismissal of over a third of the army's soldiers. More violence erupted at that time with the involvement of disaffected youth gangs in and around the capital Dili. Once again, international presence restored order. Following fresh presidential and parliamentary elections, a new coalition government took office in August 2007, which took urgent steps to address the grievances of the disaffected soldiers, the unemployed and poor and other sections of society. Though street violence and political instability have abated, the high level of unemployment (especially among the youth) remains a serious threat for social and political stability.

VERY DIFFICULT INITIAL CONDITIONS

1.4 The violence following the 1999 referendum was devastating for the people and the economy of Timor-Leste. More than a thousand people died, hundreds of thousands were displaced and the country's infrastructure destroyed, including buildings, roads, bridges, and telecommunications network. Valuable records and files, including land and property titles, civil registry, education and banking records were destroyed. There were no government institutions left.

1.5 The economy was devastated, and real GDP fell by 33 percent from already low levels. The agriculture sector suffered a major blow with the destruction of livestock and machinery and the looting of food stock, seeds and agricultural inputs. The displacement of people caused serious manpower shortages during cropping. The modern sector was most affected by the destruction of vital physical infrastructure including roads and electricity supply, as well as the exodus of the non-Timorese population that had provided much of the public administration and technical expertise. Basic social services were hit hard. There was a total breakdown in the health care system following extensive destruction of hospitals and medical equipment and loss of medicines. The education system also ground to a halt, with 75-80 percent of primary and secondary schools partially or completely destroyed and virtually all textbooks and school materials stolen or destroyed. The collapse of the health care and education systems caused a serious erosion in health and educational services respectively, from already low levels prevailing at the time.

1.6 Moreover, the exodus of Indonesians from the country following the violence meant that the bulk of those employed by government agencies and providing many services left the country – at the time the country was reported to be left with only two power engineers, 20 percent of its secondary school teachers, 23 medical doctors including one surgeon, and not a single qualified pharmacist.

SIGNIFICANT PROGRESS SINCE 1999

1.7 Table 2 shows that since the difficult beginning, the economy has gone through several periods of vigorous economic growth, although with significant annual variations. Under the impetus of the reconstruction activities initiated with the support of bilateral and multilateral donors following the restoration of peace and stability, economic activity picked up considerably in 2000-01 and real GDP rose by an estimated 18.9 percent. But the sharp draw-down of international presence following the withdrawal of UN peacekeeping opera-

tions after independence in 2002 resulted in economic slowdown: real GDP then grew by 2.4 percent in 2002 and 0.1 percent in 2003.

1.8 Real GDP grew at an average of 5.2 percent per year in 2004 and 2005, driven mostly by a rebound of agriculture from drought in 2004 and some expansion of private activity in construction and services. Economic recovery was halted by the civil unrest that started in April 2006 and continued through the year and early 2007. Real non-oil GDP declined by about 6 percent in 2006. Thereafter, GDP growth averaged around 9 percent annually (2007 to 2010).¹ Several factors contributed to this swing, including the improved security environment, the re-induction of donor spending, and the recovery of the agriculture sector from drought in 2007. The most important one, however, was a hefty increase in total public spending (including capital expenditures), which doubled between FY06-07 and calendar 2008—additional expenditures amounted to three and a half times the increase in donor spending between 2006 and 2008.

Table 2. Timor-Leste Average Growth Rates

Series Name	Timor-Leste			
	2001-03	2004-06	2007-10	2001-10
Growth and inflation				
Real Non-Oil GDP growth (annual %) ¹	6.1	1.4	9.7	6.1
Real GDP growth (annual %, including oil) ²	7.3	1.5	9.9	6.5
Real GDP per capita growth (annual %, including oil)	3.5	-2.6	6.4	2.8
Inflation (CPI, percentage change, period average) ¹	5.1	3.1	5.1	4.5

Source: IMF 2005, 2008, 2009 and 2010 Article IV Consultation. 2009 and 2010 data are estimates from the IMF staff. World Bank estimates of population growth based on 2010 analysis using survey-to-survey imputation method.

1/ International Monetary Fund, Article IV Consultation, March 2011

2/ Fiscal Accounts for years 2004-2008 are from IMF Timor-Leste 2009 Article IV Consultation-Staff Report.

1.9 The choice of the US dollar as currency, coupled with a restrictive fiscal policy, helped keep inflation low until 2006. However, prices increased rapidly from 2006 to mid-2008, with inflation peaking at 8.9 percent a year, pushed in part by higher international commodity and food prices. As international commodity prices subsided, inflation also came down to 0.1 percent in 2009. It rose again to an estimated 4.0 percent in 2010.²

1.10 Timor-Leste has over this period made solid progress in several areas since its very difficult beginnings as an independent country. The security environment is much improved. The political system and institutions are more mature and are better able to address serious social and political unrest without collapsing into anarchy. The architecture and institutions of government foreseen in the Constitution have been established and are functioning, albeit at varying levels of effectiveness. The Government of Timor-Leste is managing a significantly bigger budget and providing basic social services, such as primary health and education to an increasing share of its citizens. Other institutions outside of the execu-

¹ IMF staff estimates for 2009 and 2010.

² IMF staff estimate for 2009.

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tive branch (such as the Parliament and the Judiciary) have also been established and their capacity is being strengthened. Civil society is also more empowered and engaged.

POVERTY INCREASED BETWEEN 2002 AND 2007

1.11 Timor-Leste remains the least developed economy in the region and poverty actually increased between 2002 and 2007. The slow rate of growth of real non-petroleum GDP between 2002 and 2006 (6.9 percent cumulatively over the period from the very depressed level left by the independence quest), combined with the rapid population growth rate (averaging over 4 percent per year, 18.3 percent cumulative over the period) meant that nearly half of the population lived below the poverty line in 2007, up from 36 percent in 2001. The rapid growth of real non-petroleum GDP since 2007 should have reduced poverty in recent years, though there are no updated poverty estimates. Progress in achieving the Millennium Development Goals (MDG) has been limited and Timor-Leste still ranks as low as 158 out of 179 countries in the UN's Human Development Report.

1.12 Unemployment also remains high, especially among the youth. The country continues to face a serious shortage of qualified and trained professionals in most spheres. Institutional capacity is still very weak in many areas of government and outside, contributing to inefficiencies and leakages in government programs. And with increasing government revenues from petroleum wealth, there are growing concerns about corruption.

CURRENT ECONOMIC STRUCTURE³

1.13 National Income (GNI) per capita was estimated at US\$1,623 in 2007, largely on account of the income from hydrocarbons. With the launching of production in 2004-05, the petroleum sector has come to represent the most significant segment of the national economy. In 2008, petroleum revenues were estimated at 484 percent of non-petroleum GDP. Timor-Leste's non-petroleum economy is dominated by the public sector (which contributed roughly 45 percent of non-petroleum GDP in 2007), followed by industry and services (28 percent) and agriculture (27 percent). The formal private sector (outside of agriculture) is very small, employing only 40,000 people. Coffee is the country's main non-petroleum export.⁴ Despite its hydrocarbon wealth, almost 50 percent of the population was poor in 2007, up from 36 percent in 2001.⁵

³ Some macroeconomic data are not official and are based on estimates made either by the government or by the IMF. Box 2 provides information about the reliability of Timor-Leste's macroeconomic data.

⁴ Prior to independence, Timor-Leste was primarily an agricultural economy, with almost 90 percent of its population living in rural areas. Coffee was its only significant export. Its economy was heavily dependent on external transfers, with almost 85 percent of its current and capital expenditures coming from Indonesia. The territory was one of the poorest in south-east Asia.

⁵ The poverty line was defined as US\$0.88 per capita per day.

Box 2. Macroeconomic Data in Timor-Leste

- No official national accounts data have been produced since 2004. The data provided are estimates made by the Government of Timor-Leste and the IMF. The government is now reported to be compiling official national account statistics.
- The inflation data are considered among the strongest data for Timor-Leste. They are recorded by the Ministry of Finance's statistical office.
- The sector decomposition of the GDP is estimated by the IMF.
- The merchandise trades by land are not recorded.
- Official fiscal accounts data have been produced since 2006. From that date onwards, these data are reliable, according to IMF.

1.14 Shortly after independence, Timor-Leste signed the Timor Sea Treaty with Australia, which governs the sharing of revenue from the petroleum fields between the two countries. The country's economic prospects improved significantly when its hydrocarbon resources started to be tapped in 2004-05.⁶ However, Timor-Leste did not have the institutions and capacity in place to make good use of the revenues from these resources. Moreover, lack of established procedures and fear of corruption led to excessive centralized control on government spending, which kept their level low and prevented its programs from reaching the poor. This contributed to the civil unrest of 2006.⁷ The key development challenge is to ensure that petroleum revenues are used efficiently to reduce poverty and lay the foundations for sustainable economic growth.

1.15 The country's population is growing rapidly, with an annual net population growth rate of over 3 percent and female fertility rate exceeding 7—these figures seem to have moderated according to the preliminary results of the 2010 census, which estimate the population growth rate at 2.41 percent.⁸ It has a significant youth bulge, with 34 percent of the population in the 12-29 age group. Moreover, there has been significant migration to urban areas, with urban population growth exceeding five percent per year. Dili's population grew by 39 percent during 2001-05. However, almost 74 percent of the population of the country still lives in rural areas.

⁶At present there is only one oil producing field, Bayu-Undan. Official projections suggest production levels from this field will taper off by 2023. Remaining revenue to Timor-Leste is estimated at US\$11 billion in net present value. Potential oil production from the Greater Sunrise project could add revenues, but significant revenues from this source are not likely to materialize for almost a decade. Annex 2 gives more information about the petroleum sector.

⁷ The low levels of employment and high levels of poverty associated with the stringent fiscal policy worked together with political factors in bringing about the civil unrest of 2006.

⁸ Source: "Population and Housing Census 2010, Preliminary Results", Ministry of Finance, Timor-Leste.

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STRONG INTERNATIONAL DONOR PRESENCE

1.16 The international community has had a significant presence since 1999, when the UN moved quickly to restore peace and security and prepare the foundations for independence in 2002. International development assistance focused on a variety of areas. Apart from purely humanitarian aspects, development assistance supported reconstruction of damaged facilities including schools and hospitals, rehabilitation of infrastructure such as roads and ports, restoration of electric power and water supply and sanitation, support for agriculture and the private sector, and, most importantly, developing the capacity of state institutions at all levels. Support has been provided in the form of financial grants, technical assistance and analytical and policy advice. Since 1999, Timor-Leste has received about US\$ 3.6 billion of foreign assistance⁹ from roughly 28 bilateral donors (most prominently Australia, Portugal, the European Union, Japan, and USA) and multilateral organizations (UN agencies, WBG, Asian Development Bank and IMF).¹⁰ Few other post-conflict countries have received higher levels of financial support on a per capita basis.¹¹

1.17 While the aid has no doubt been useful in many ways, particularly in strengthening the central government, it has failed to improve the lives of the poor. As already mentioned, almost half the population was poor in 2007 and poverty actually increased between 2001 and 2007, which was also the period of the largest aid inflow. This fact is often behind the frequently expressed opinion in the country that most of the aid did not benefit the recipient country but rather the donors themselves.¹²

1.18 The role and influence of donors, including the WBG, has declined since 2007.¹³ Though the country still requires substantial international technical support, increased hydrocarbon revenues make it less dependent on foreign financial assistance. The Government of Timor-Leste shows growing frustration with what is seen as complex, heavy donor mechanisms that at times are perceived as delivering modest tangible benefits relative to investment and effort. It also appears more skeptical about the advice received from the WBG (and other donors). The declining influence of the traditional donors and the WBG is taking place in the context of an apparent larger realignment of Timor-Leste's development policy

⁹ Source: Registry of External Assistance (REA) Report, 6th release, MOF 2008 and NDAE internal database.

¹⁰ The rest is the assessed and voluntary contributions from UN member states for the various UN missions active in the country since 1999 including military peacekeeping and civilian police.

¹¹ On a per capita basis Timor-Leste received US\$188 per year between 1999 and 2009. This compares with annual averages of US\$379 in Solomon Islands, US\$240 in West Bank and Gaza, US\$138 in Afghanistan, US\$125 in Republic of Congo, and US\$85 in Liberia (computed after the cessation of hostilities). The information on Kosovo is US\$237 for 2009, the only year for which OECD data is available.

¹² One estimate suggests that almost 90 percent of foreign aid (including on security) went towards payments of international salaries, foreign soldiers, overseas procurement, imported supplies, consultants, overseas administration, etc. that did not directly benefit the local economy. Source: *La'o Hamutuk (2009): How Much Money Have International Donors Spent In And On Timor-Leste?*

¹³ Not taking into account security presence, and despite having a high per capita aid allocations compared to other post-conflict countries.

and international alliances, with particular expansion towards some countries in Asia and in the Lusophone community.

ROAD MAP OF THE CPE

1.19 This CPE focuses on the WBG's assistance program for FY00-10. It asks the following questions: (i) Did the WBG correctly assess the problems faced by Timor-Leste? (ii) Was the WBG's strategy appropriate for meeting the country's development needs? (iii) How effective was the WBG in implementing its strategy? (iv) What were the outcomes of the assistance relative to plan? (v) To what extent did the WBG contribute to the country outcomes?

1.20 The CPE is structured as follows: the next chapter outlines and evaluates the WBG's overall strategy (and changes therein) as formulated in the key strategy documents, and the assistance activities to implement that strategy. In that context, it discusses, in particular, the series of multi-sectoral budget support operations during FY00-06 that formed the core of the WBG's assistance program during those years. Chapters 3-5 cover thematic aspects: the social sectors (education and health) and programs for alleviation of poverty and unemployment (the first pillar of the WBG's strategy) (Chapter 3); governance and capacity-building of state institutions, (the second pillar) (Chapter 4); and sustainable non-petroleum growth including private sector development and agriculture (the third pillar) (Chapter 5). That chapter gives special attention to the role of IFC in fostering private sector development in Timor-Leste. In each area, the chapters evaluate the achievements and failures of the WBG's program and draw out the lessons from experience thus far.

1.21 In view of the large donor presence in the country, chapter 6 discusses the WBG's role in donor coordination and issues relating to alignment and harmonization. Chapter 7 brings together the assessments of the previous chapters and develops a combined assessment of the WBG's contribution to Timor-Leste's development during FY00-10. It also contains a summary of findings and recommendations.

2. WORLD BANK GROUP STRATEGY AND PROGRAM

World Bank Group Strategy

2.1 The WBG strategy in Timor-Leste during 2000-10 was articulated in a series of documents. The Joint Assessment Mission Report (JAMR), produced in December 1999 by the Timorese in collaboration with the Bank and other donors, formed the basis of the Bank's initial interventions. A formal strategy document called the Transitional Support Strategy (TSS) was approved by the Bank's Board in November 2000. That report set out the rationale and operational program of the Bank until such time as Timor-Leste would become eligible to apply for membership of the IBRD/IDA, which was expected to occur after full independence (Timor-Leste became independent in May 2002). The finalization of a CAS in 2003 was postponed at the request of the government, pending the completion of its own sector investment program. A first full CAS was therefore prepared only in June 2005, outlining the WBG's strategy and work program for the period FY06-08. However, the outbreak of violence and civil strife in 2006-07 invalidated many of the assumptions underlying this strategy and made it difficult to implement the programs. In May 2007, the WBG began processing new operations under Operational Policy 8.00, Rapid Response to Crises and Emergencies. A new Interim Strategy Note (ISN) discussed by the Executive Board in August 2009, defined the strategy of the WBG during FY10-11.

2.2 The WBG's Strategy and its Evolution. In mid-end 1999, when the JAMR was finalized, the country was in ruins. The focus of the JAMR was therefore on identifying immediate reconstruction needs so that basic social needs could be met and a semblance of economic activity restored. Two areas were seen as especially important. These were agriculture and capacity-building of state institutions. Agricultural recovery was rightly seen as critical for sustainable poverty alleviation, in the short and long run, and strengthening of state institutions was vital not just for sustaining short-term reconstruction programs but also for sustainable development in the medium term. The JAMR, which was prepared with the participation of the Timorese and several of the major donors, also helped allocate the support areas to the different donors.

2.3 The TSS identified five key objectives that defined the framework for the Bank's assistance program during FY2000-02. There were two objectives in *the selection of activities*:

- i. The focus of the Bank's program in the short-term would be on the basics: protection of the poor, private sector recovery, health and education; and to
- ii. Provide research and capacity-building in key policy areas to assist the government and civil society prepare for independence.

There were also three objectives in *how the Bank would be working*:

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- iii. Build maximum local ownership for the development program to ensure quality of program design and the durability of post-conflict reconstruction programs and policy decisions;
- iv. Maximize the effectiveness of donor resources by facilitating coordination of aid flows, to avoid duplication and sub-optimal allocation of resources; and
- v. Sequence programs and policy interventions to match existing political realities and institutional context and capacity.

2.4 The CAS for FY06-08 (an IDA-only strategy) was labeled as a comprehensive framework for shifting the focus from post-conflict assistance to sustainable growth and poverty reduction, in the form of a multi-donor strategy among development partners for coordinated support to the government's development priorities. Consistent with the Government of Timor-Leste's Stability Program (SP), the CAS had three strategic pillars listed below, with cross-sectoral issues of youth and gender to be mainstreamed across these pillars:

- Delivering sustainable services, focusing on improving coverage and quality in priority sectors such as education, health, and basic infrastructure;
- Creating productive employment, focusing on targeted efforts in private sector development and agriculture;
- Building state institutions and strengthening governance, including prudent and transparent management of public resources, development of safeguards against corruption; and civil service reform.

2.5 The CAS also defined four 'principles of engagement' which were to be applied in the selection, design and implementation of activities across the pillars. These were:

- Building institutional capacity;
- Deepening the results orientation;
- Strengthening transparency and communication; and
- Consolidating and extending the partnership with other development partners.

2.6 The ISN was prepared jointly by IDA and IFC in the aftermath of the eruption of violence in 2006 (which lasted well into 2007) and a new government taking office in 2008. The ISN defined an interim strategy for the WBG for the fiscal years 2010 and 2011.¹⁴ It was seen as interim for two reasons. First, though peace had been restored, the risk of instability had not been completely eliminated and a shorter time horizon was seen as appropriate. Second, the government was still in the process of developing its own medium-term development program, which would provide a better framework for the Bank's medium-term strategy.

¹⁴ As a consequence of the preparation of the ISN, the progress report for the CAS (CASPR) was not finalized. A draft was reviewed by the Bank's Regional Operations Committee in April 2008. The CPE team did not have access to this draft, despite repeated requests.

2.7 The objective of the interim strategy in the ISN was to support the government's efforts to use its petroleum wealth to both address immediate post-conflict stabilization imperatives and lay a sound basis for sustained growth in the non-petroleum sectors. WBG interventions were aimed at strengthening government effectiveness in three strategic areas:¹⁵

- Development of capacity for the formulation and implementation of a national development strategy;
- Design and implementation of short-term stabilization measures, including programs for tackling youth unemployment and alienation;
- Steps to secure longer-term economic growth and development, including support for enhanced rural productivity and for improving the enabling environment for private sector.

2.8 Despite semantic differences and some variations of nuance, all the strategy documents had similar areas of focus. Essentially there were three broad areas (in this report labeled Pillars 1 through 3) that were supported by the Bank programs to varying degrees throughout the period:

- Pillar 1: Poverty alleviation and the provision of basic social services, including health and education.
- Pillar 2: Developing state institutions, creating good governance and building the capacity of state institutions.
- Pillar 3: The promotion of sustainable non-petroleum growth including the development of agriculture and the private sector.

2.9 In the first period, 2000-02, the main focus of the strategy was on the first pillar, that is, to improve access to basic social services and help address acute poverty and unemployment. In the second period 2003-07, greater emphasis was placed on the second pillar (the development of state institutions, capacity-building and improved governance); and in the third phase 2008-10, the immediate concern reverted to Pillar 1 - the re-establishment of social stability through delivery of social assistance and services (together with the creation of sustainable employment).

2.10 Except for a few interventions in the energy sector, the Bank did not have any program for infrastructure development, including water supply and sanitation. The financial sector was also not touched by the Bank. These two important areas were left to other donors, including ADB. Such a division of labor was appropriate given the need for the Bank to focus its limited resources on a limited number of interventions, but could perhaps have been revisited at some point.

¹⁵ The ISN mentioned four strategic areas. The capacity to *formulate* a national development strategy and the capacity to *implement* this strategy were treated as two distinct areas. In this CPE these two areas have been merged into one.

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2.11 The Bank's strategy addressed many of the core development issues for Timor-Leste. However, it would have benefited from elaboration within a more conscious longer-term vision for Timor-Leste with its central question: what should be the appropriate development path for a small new country rich in some natural resources (petroleum), but with widespread poverty (half its population living below the poverty line), limited institutional capacity and dramatic skills gap, and no obvious areas of comparative advantage? The Bank's strategy documents did not provide such a long-term vision, nor did they assist significantly the government in developing its own vision for the country's development prospects.¹⁶ It was only recently (in mid-2010) that Timor-Leste developed its medium- and long-term vision, with support mostly from *Bappenas* – Indonesia's National Development Planning Agency.

STRENGTHS

2.12 The Bank's strategy, especially in the early years, had several positive features. The Bank made the right call to focus initially on physical rehabilitation and reconstruction together with the restoration of basic social services and economic activity. Schools and hospitals were rebuilt and basic infrastructure was repaired. The Bank was also right to emphasize selectivity and to recognize the prime importance of the agriculture sector and the need to build the capacity of the state. Unfortunately, this focus got lost in later years.

2.13 The Bank's strategy correctly recognized the importance of balancing the need for short-term measures (the so-called low hanging fruits or quick wins) and longer-term institutional and structural reforms. However, over time this balance got tilted too far in favor of long-term institutional development at the expense of immediate needs. Learning from the experience in other post-conflict countries, the strategy correctly underscored the importance of aligning its interventions with the political realities and the institutional and capacity constraints in the country. The 'principles of engagement' were unexceptionable, including focusing on results on the ground, the importance of country ownership of the development program, the need for effective partnership with other donors, and the efficacy of good communication.

2.14 At the level of the relationship with the nascent state, there were several dimensions in which the WBG was perceived by the Timorese interviewees as having gotten it "right." The WBG was perceived as speaking with one voice throughout the evaluation period and interviewees contrasted this with other development partners that were perceived as delivering seemingly inconsistent messages through different channels. Besides clarity, the approach taken by the WBG gave a sense of comfort and direction to many who were relatively new to the world of policy-making and public administration.

2.15 Another positive feature of the relationship in the initial years of the evaluation period was the WBG's willingness to cut through the "red tape" and get things going fast. Efforts were made by WBG staff to find creative solutions and fast track processes, allowing things to move at the quick pace being demanded by the rapid first steps of the nascent state. There were several examples of staff "thinking out of the box" and finding creative ways of dealing with seemingly insurmountable challenges, be it in designing interventions

¹⁶ Strictly understood, the 2006 ISN was supposed to address mostly the short-term issues.

that allowed aid to start flowing, in facilitating the importation of buffaloes to replace destroyed livestock, or in channeling funds to remote corners without any banking system in place.

2.16 More recently, the WBG was also perceived by local counterparts as acting helpfully through the efforts made by the staff in the field to understand better the political environment, and to navigate in the most effective way through it. According to interviewees, WBG staff have been seen, for the most part, as better acquainted than other development partners with the constraints that political issues imposed on development efforts. This helped the WBG play a leadership role within the community of development partners, with full support from both the Timorese and the development partners. However, like other development partners, the WBG failed to read correctly political and social developments at some critical junctures.

SHORTCOMINGS

2.17 Though the broad objectives and areas of focus were appropriate, there were some serious shortcomings in the WBG's strategy.

2.18 First, the strategy was at times based on an inaccurate reading of the ground realities. The Bank (like most other donor partners) did not show a good understanding of the evolving political situation, the divisiveness within society, and the latent discontent and disaffection among sections of the population (including the youth).¹⁷ Until 2005, the Bank saw no signs of disaffection and believed that internal cohesion prevailed and was an asset for the development process. The Transition Support Program (TSP) that is discussed in paragraph 2.35 was heavily focused on long-term institutional development measures, with very little in terms of delivering immediate benefits to the population. It was only in 2005 that the dangers of internal strife were noted, but even then the threat was not taken seriously enough.¹⁸ The CAS and the FY06 Consolidated Support Program (the latter prepared together with other donors) reflected a 'business as usual' approach with an accent on longer-term structural issues to the neglect of short-term poverty and unemployment alleviation programs – at a time when poverty and unemployment, and social discontent were rising.

2.19 Second, the WBG's assistance strategy gradually came to encompass a wide range of areas of emphasis. As a result, the strategy lost focus, identified critical areas such as agriculture did not get enough attention, and by choosing to 'cover the waterfront' the strategy seemed to become generic and less flavored by specific Timor-Leste circumstances. The three pillars were so broad that they could be used to describe the WBG's standard approach across many countries - promoting private sector development, improving the effi-

¹⁷ This was despite early signs of conflict, starting from December 2002 when riots broke out in Dili over the killing of two demonstrating students. Stability was tested once again during a three week demonstration organized by church leaders in April/May 2005.

¹⁸ Paragraph 84 of the CAS mentions as one of the risks that "the population may become increasingly dissatisfied with the government resulting in civil unrest and a relapse to conflict." The same paragraph mentions as mitigating measures a greater focus on job creation and improving productivity and market orientation in rural areas. In the event, the interventions associated with mitigation were not undertaken before the civil unrest started.

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cience of the state and the public sector, and providing a viable and effective social safety net for the poor. Consequently, the strategy did not do full justice to the unique circumstances and challenges faced by Timor-Leste.

2.20 One example is the heavy reliance in the strategy on the development of the (virtually non-existent outside of agriculture) private sector for generating growth and creating jobs.¹⁹ This neglected somewhat the rural sector which was, and continues to be, an important source of employment and income. Also, for Timor-Leste much of the impetus for growth will need to come from public sector spending and investments. Although developing a strong urban private sector may well be feasible over the longer run, the strategy should therefore have given relatively more emphasis to the importance of (and requirements for) increased efficient public spending to create a basic infrastructure for services and private commerce also outside of Dili, thus spurring growth and employment. Stronger early attention could then also have been given to developing a strong and reliable public financial management system, including budget execution and the quality of public spending. The importance of public spending to generate employment was only recognized much later.²⁰ Moreover, the lack of focus and the ‘waterfront’ approach also placed a heavy burden on the already weak capacity of government agencies.

2.21 Third, the WBG’s strategy was not adapted to the underdeveloped situation of Timor-Leste and was not sufficiently responsive when the availability of substantial oil and gas revenues, starting in 2004-05, allowed for a more expansive public spending policy. Moreover, in the face of a dramatic and favorable change in the initial conditions, there does not seem to have been any significant re-thinking of Bank strategy or priorities.

2.22 Fourth, the WBG’s strategy was based on an unrealistic and overly optimistic assessment about Timor-Leste’s capacity to comply fully with the fiduciary requirements of the Bank. Enforcing full compliance with the Bank’s fiduciary requirements caused serious delays in the implementation of Bank projects, including projects that were meant to provide immediate short-term benefits to the poor and where speedy implementation was essential.²¹ These delays also negated the other efforts of the Bank to respond to crisis situations by accelerating project preparation and approvals. Complaints to the CPE mission regarding the Bank’s implementation of its procurement policies and procedures were a constant refrain from within the government but also from other donors and WBG staff.

2.23 Fifth, there appears to be a disconnect between the WBG’s ambitious objectives and the meager financial resources it had at its disposal – as illustrated by the heavy reliance on

¹⁹ For example, private initiative was considered the main source of future employment, which was seen as a welcome turnaround from the Indonesian occupation when the public sector constituted the main source of employment. (See CAS, p 15).

²⁰ The interim strategy for FY10-11 had as its centerpiece a National Workfare Program in support of public works program for creating sustainable jobs and infrastructure. Unfortunately, at the request of the government, this project was subsequently dropped from the program.

²¹ In one case, four hospitals built with trust fund resources from the European Union ended up idle for about one year while procurement of the needed equipment was cleared by the Bank’s procurement specialist.

co-financings through multi-donor trust funds, and reliance on Bank-executed trust funds to fund some of the project staff in the Dili office. The implicit assumption that it could deliver its objectives by using other donors' resources may have been optimistic, and in recent years the WBG's role has also been somewhat marginalized as its dwindling resources have been increasingly dwarfed by the significantly increased resources of the government.²²

2.24 While the strategy was thus flawed in some respects, the bigger failure of the WBG was in the implementation of the strategy. This is discussed below.

World Bank Program

OPERATIONS

2.25 The Bank has been actively involved in the reconstruction and development of the economy since late 1999, by providing regular IDA grants in addition to numerous grants financed from the Trust Fund for East Timor (TFET), which is discussed in paragraph 2.26 below. The Bank has also managed co-financing by multi-donor trust funds for a number of its projects, and has undertaken various other activities with trust fund financing. In addition to projects, the Bank has provided analytical and advisory services and also played a key catalytic role in mobilizing and helping to coordinate international assistance to Timor-Leste. Thus far, there has been no lending to Timor-Leste, reflecting the authorities' policy of avoiding external borrowing, including concessional loans.²³ Appendix 6 lists the projects undertaken by the Bank during FY00-10.

2.26 In the period 2000-03, the Bank's involvement centered around its role as trustee and co-manager (along with ADB) of the Trust Fund for East Timor (TFET), which was established in December 1999 as a vehicle to provide grant assistance for investment operations for reconstruction activities and economic development in Timor-Leste.²⁴ The Bank contributed \$10 million from its surplus to the Fund. Altogether, TFET has financed eighteen Bank-administered projects (for community development, economic capacity-building, education, agriculture, energy, health, the petroleum sector, and small enterprise development) and six ADB-administered projects (for water, roads, port development and micro-finance) totaling just over \$170 million disbursed between FY00-10, with most projects approved be-

²²Timor-Leste's IDA allocation is necessarily modest given the small size of the country. However, as a post-conflict country it has received an extra allocation that has been phased out for some years - FY11 is the last year of any such extra allocation.

²³ The country's Budget and Financial Management Law was revised only towards the end of 2009. Until that time the country could not borrow - not even for IDA credits. As a result, Timor-Leste was treated as a special case and this was reflected in footnotes in both the IDA14 and IDA15 replenishment documents. The IDA allocation was converted to grants at about 60 percent of what they would have received if IDA credits - so if in a year illustratively the country received US\$6 million in the way of IDA grants they could have received US\$10 million in the form of credits. Under either scenario the Bank would have been a small player in terms of financial flows, dependent on trust funds, but it could probably be argued that if the country had received credits the Bank's footprint could have been somewhat larger.

²⁴ The TFET also funded two TA projects in the petroleum sector.

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fore end FY02. TFET financed projects also attracted significant co-financing from bilateral donors. A fuller discussion of TFET and other multi-donor Trust Funds in Timor-Leste is contained in Appendix 3.

2.27 Following the TFET-funded projects, the Bank played a major role in mobilizing donor funding for budgetary assistance for the post-independence period (FY03-06) through annual multi-donor budget support operations. The Transition Support Program (TSP) from FY03 to FY05 (para 2.35) brought about US\$90 million in budget support funding with about US\$9 million financed by IDA (and another US\$5 million by DGF), and the balance financed by eight bilateral partners through multi-donor trust funds administered by the Bank, and parallel cofinancing by other bilateral and multilateral donors (including Portugal, Japan and ADB). The subsequent Consolidation Support Program (CSP) during FY06-07 brought US\$12 million in budget support funding, with about US\$0.5 million provided by IDA. These operations, discussed in greater detail below, addressed all three pillars of the WBG's strategy and were together the main vehicle for comprehensive policy dialogue between the Government of Timor-Leste and its development partners during that period.

2.28 Limited IDA grant funds were also leveraged to attract substantial co-financing from other donors for sector investment programs (particularly in health, education, and financial management and planning capacity-building). IDA also implemented projects in education and health sectors that were wholly funded either by bilateral donors (the European Commission (EC) in the case of health) or by other multi-donor trust funds (the Catalytic Fund of the Fast Track Initiative in education). In addition, and especially during FY00-05, the Bank implemented several TA projects funded through IDF and other grants in areas like public expenditure management, poverty monitoring and analysis, procurement, veterans' policy implementation, and institution building for the office of the Inspector General and Ombudsman. A large array of analytical studies, ranging from short policy notes on issues of immediate interest to sector studies and CEM were also completed during the period. These, which are listed in Appendix 7, included a PER in FY04 and a Poverty Assessment in FY09. The annex also shows that only half of the tasks programmed in the CAS were delivered, and that the vast majority of the delivered tasks were not programmed in the CAS.

FINANCIAL SUPPORT

2.29 The WBG's financing role (TFET and IDA grants) has been shrinking over the years. During FY00-02, sixteen Bank-administered projects were approved, with commitments amounting to US\$130.8 million. During FY03-05, the number had fallen to 12 and during FY08-10 only 4 new projects were approved for US\$32.3 million (Table 3). This decline in the Bank's role partly reflects a changing role for donors after the immediate reconstruction period. The increased resources available to the government in recent years from petroleum revenues have also reduced its dependence on foreign aid. In addition, there seems to have been an increasing impatience with traditional donors (including the WBG) and what is seen as the limited impact on poverty from their support. The Bank's ability to ramp up its financial assistance was precluded by the Government of Timor-Leste's policy against incurring foreign debt (as mentioned earlier).

2.30 The direct financial contribution from resources under the Bank's operational control to Bank-administered projects also declined. The share of TFET and IDA (including IDF and

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DGF grants) in funding Bank administered projects declined from almost 81 percent in FY00-02 to 25 percent by FY08-10. This decline was offset by increased co-financing from bilateral donors often through multi-donor trust funds. Their share increased from about 17 percent of total project cost in FY00-02 to 60 percent by FY08-10.²⁵

Table 3. Shrinking Role of Bank: Percentage Distribution of No. of Projects, Project Cost and IDA and TFET Funding During FY00-10

Fiscal Year	No. of Projects	Total Project Cost	TFET	IDA+	TFET+ IDA+	Share of (TFET+IDA+) funding in project costs (%)
FY00-02	41	36	93.7	1.7	69.5	80.9
FY03-05	31	30	5.5	38.1	14.1	19.8
FY06-07	18	25	0.8	40.0	11.1	18.9
FY08-10	10	9	0.0	20.2	5.3	25.1
TOTAL PERIOD	100	100	100	100	100	42.3

* IDA+ included IDF and DGF grants

2.31 In terms of priorities, there was only a modest allocation of Bank resources to the agriculture sector (Table 4). Throughout the period, only three agricultural projects were approved and implemented by the Bank, the last in FY04, accounting for 8.1 percent of total cost of Bank-administered projects. Funding for agriculture absorbed 11.7 percent of total IDA and TFET project financing.²⁶ This is less than the funding for education and for health from IDA and TFET.²⁷ While agriculture projects were a small part of the Bank's project portfolio in Timor-Leste, it had a somewhat larger presence in the portfolio of some other donors.²⁸ Overall, however, agriculture has not been addressed sufficiently by the WBG or by the donor community as a whole.

Table 4. Relative Importance of Agriculture Projects

	Percent of Total Number of projects	Percent of total project cost	Percent of IDA+ funding for all projects	Percent of TFET+IDA+ funding on all projects
Agriculture	7.7	8.1	0.0	11.7
Education	15.4	18.9	27.5	29.8
Health	10.3	19.4	2.5	17.3

*IDA+ includes IDA, DGF and IDF funds

²⁵ The balance is the share of financing by government and other trust funds such as the Fast Track Initiative's Catalytic Fund.

²⁶ No IDA funding at all went to agriculture. The Bank's financial contribution to the sector came through its share in TFET resources.

²⁷ Education sector projects accounted for almost 19 percent of all projects (in terms of costs), 30 percent of all IDA and TFET funding, and 28 percent of IDA funding during the period. Health sector projects made up almost 20 percent of all projects, received about 17 percent of IDA and TFET funding and absorbed about 2.5 percent of IDA funds.

²⁸ Agriculture projects accounted for 15.5 percent of total donor project funding during 2000-07.

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2.32 The focus of Bank strategy on delivering basic social services and poverty alleviation was implemented as planned. Projects under the first pillar (delivery of essential social services and poverty and unemployment alleviation) accounted for 54 percent of the resources allocated in all Bank projects during FY00-10 (Table 5).²⁹ They also absorbed 64 percent of IDA (plus IDF and DGF) and TFET funding, mainly on account of projects in education and health. This dominance of the first pillar was especially marked following the various crisis years, viz. FY00-02 and FY08-10.

Table 5. Importance of the Three Pillars in New Lending Approvals, 2000-10

<i>By Approval year</i>	<i>FY00-02</i>	<i>FY03-05</i>	<i>FY06-07</i>	<i>FY08-10</i>	<i>FY00-10</i>
% of project costs					
Human Development	77	29	36	100	54
Governance	1	28	54	0	22
Growth	22	43	10	0	23
% of TFET plus IDA+funds					
Human Development	73	24	37	100	64
Governance	1	25	42	0	9
Growth	26	51	21	0	27
% of IDA+ funds					
Human Development	0	34	39	100	49
Governance	100	35	45	0	33
Growth	0	31	16	0	18

*IDA+ includes IDA, DGF and IDF funds

2.33 The two other pillars roughly absorbed the same amount each of a little over a fifth of the total. Most of the governance projects were approved during FY03-07. These projects accounted for about 9 percent of IDA and TFET funds and were largely funded from bilateral co-financing. However, the actual importance of this pillar in the WBG's portfolio is much larger than these figures suggest because several projects that belonged to Pillar 1 and Pillar 3 had institutional and capacity-building components.³⁰ The third pillar, promotion of sustainable non-petroleum growth, reached a peak in FY03-05. IDA and TFET funds accounted for about 27 percent of the cost of these projects. About 45 percent of these funds were absorbed by projects in agriculture.

2.34 The evolution of the WBG's program also mirrors changing government priorities. In the early years, the focus was clearly on alleviating poverty and restoration of basic social services. This is reflected in the WBG's funding for projects under the first pillar. As the

²⁹ In assessing the importance of the three pillars in Table 3, the cost and funding of the four budget support operations that addressed all the three pillars have been divided equally among the three pillars.

³⁰ For example, health sector projects often had funds earmarked for building capacity in the ministry of health or in health sector institutions (such as laboratories or clinics). The same was true in education sector projects which included capacity building in the ministry.

economy revived in FY00-02 and an independent government took office, its priorities shifted towards strengthening the institutions of the state. This is also reflected in the rising share of Bank funding for governance and institution building between FY03-07. The outbreak of violence in 2006-07 put the emphasis back on maintenance of social stability and this is seen in the higher share of Bank funding for the social sectors during FY08-10.

THE TRANSITION SUPPORT PROGRAM (TSP) (2003-05)

2.35 The TSP (and the follow-up Consolidation Support Program (CSP) of 2006) was the main instrument used by the donors and the Government of Timor-Leste to engage on a broad policy front in the critical years following independence. The TSP comprised a series of three annual budget support operations during 2003-05 in support of the country's economic program based on the Government of Timor-Leste's National Development Plan (NDP). The main objective of these operations was to provide fast-disbursing funds to the government to finance its budget and external account until sufficient revenues from oil and gas came on-stream. These additional funds were meant to enable the government to implement critical programs and sustain levels of imports and public expenditures that would not otherwise be possible.

Table 6. Budget Support Operations FY03-06

Name of Project	Year approved	Disbursed Project Amount (US\$ mill)	IDA funding* (US\$ mill)	IEG Outcome Rating**
Transitional Support Program (TSP1)	FY03	56.8	5.0	MU
TSP2	FY04	4.2	4.2	MU
TSP3	FY05	29.2	5.0	MU
Consolidation Support Program (CSP)	FY06	12.0	0.5	MU

* IDA includes IDF and DGF grants as well;

** MU=Moderately Unsatisfactory.

2.36 TSP1 (2003) was funded by a post-conflict grant from the Development Grant Facility (DGF) of about US\$5 million. TSP2 (2004) and TSP3 (2005) were funded by IDA grants which averaged around US\$4.6 million. IDA/DGF funding was part of an overall grant financing package for the TSP program as a whole of about US\$90 million by bilateral donors and IDA. Co-financing by eight bilateral donors (Australia, Canada, Finland, Ireland, New Zealand, Norway, UK, and USA) was channeled through Bank-administered trust funds, and additional bilateral and multilateral funding was provided directly (Portugal, Japan, and ADB).

2.37 The DGF and IDA grants were disbursed in single tranches at effectiveness, following the completion of specific prior actions agreed with the government. A separate Action Matrix of policy measures and actions was also agreed with the government for each operation. The implementation of these policies was periodically monitored by the government and the donors though it did not condition disbursements.

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2.38 The economic policy objectives of the three operations were in essence identical. They were to facilitate the transition of a post-conflict country towards sustainable growth and poverty reduction. The broad design of the operations was also similar,³¹ and they had three thematic components:

- Service Delivery for Poverty Reduction, including increased access to and improved quality of basic health and education;
- Good Governance, including improvements in public sector management, public expenditure management, oversight institutions, local government, poverty reduction planning;
- Job Creation, mainly through private sector development (understood in most documents and in this CPE to be exclusive of agriculture) and agriculture.

2.39 Specific measures in each of these areas, and a timetable for implementation, was agreed with the government and included in Action Matrices for each operation. The program was intensively supervised by the Bank and other donors.

2.40 The record of implementation under the respective thematic areas (which coincide with the three pillars of the WBG's strategy) is discussed in greater detail in chapters 3-5. This section reviews the overall program and its achievements and shortcomings. It draws heavily on the IEG's PPAR for TSP (June 2008) with which the CPE team largely concurs.

2.41 The PPAR saw the main achievement of the TSP to be the funding it made available to the government to augment its budget during the critical years soon after independence. Without this funding, economic growth during this period would have been even lower than it turned out to be, and poverty and unemployment higher, posing a threat to social stability.³² The Bank played a vital role in mobilizing donor support for this program and helped the government manage the process.

2.42 While this argument has validity, it is not equally relevant for the TSP period in its entirety. First, throughout this TSP period, but particularly after 2003, the main constraint on government expenditures was not so much the resources available but its inability to spend, especially in rural areas and on capital projects. Budget execution on a cash basis averaged only 75 percent during FY03-05, and it was significantly lower for capital expenditures (9 percent in 2004 and 17 percent in 2005).³³ Second, the onset of revenues from petroleum production in 2004 resulted in the emergence of a large fiscal surplus, and accumulation of international reserves equivalent to about 15 months of imports by the end of 2004.³⁴ Under these circumstances the rationale for budget support funding after 2004 is

³¹ There were some differences. TSP1 included the power sector. This was dropped in subsequent operations which included agriculture instead.

³² The PPAR estimated that grant financing for the TSP was close to half the annual level of consolidated expenditures of the budget during 2003-05.

³³ Source: PAD of Planning and Financial Management Capacity Building Project (Feb 2006); p 3.

³⁴ Source: IMF Country Report, July 2005; p 4.

questionable. Had more efforts been made to improve budget execution (as was done in 2007) and improve the quality of spending, the need for additional budget support funding would not have arisen.

2.43 A second positive achievement according to the PPAR was the TSP process itself, which provided the Government of Timor-Leste a framework for planning, implementing and monitoring a whole range of development activities and budgetary outlays. The Action Matrices summarized these activities in a convenient way. The TSP framework also provided a vehicle for coordination among donors and facilitated interaction between the government and the donors.

2.44 While the Action Matrices provided a broad and comprehensive framework for monitoring government initiatives, it is debatable whether the ‘cover the waterfront’ approach underlying the long and unwieldy matrices was appropriate under the circumstances.³⁵ By trying to be comprehensive, the TSP lost focus and included too many issues that were not of immediate importance and had weak ownership (such as establishing the Office of Ombudsman or passing a bankruptcy law). Consequently, project design became too complex and overwhelmed the capacity of the government. It would have been preferable to maintain a comprehensive matrix for general planning and monitoring within the government but to have a selective and tightly focused matrix of key policies guiding the implementation of the TSP.³⁶

2.45 The TSP (and the follow-up CSP) also illustrates the difficulty the Bank can have in adjusting its interventions to evolving realities. Experience with TSP1 already suggested that the program was too ambitious and that a number of measures were either not met or were met with considerable delay due to capacity constraints. Yet, subsequent operations did not narrow the scope of the program. In fact, the programs grew in size: from 50 actions listed in the Action Matrix of TSP1, the list had expanded to more than 120 actions in TSP3.

2.46 In terms of substance, most of the actions included in the matrices were primarily formal/procedural and related to planning, budgeting, regulations, laws, licensing, reporting and monitoring, with only a few concrete results related to service provision in the health and education sectors. The emphasis was on developing the institutional, policy, and regulatory environment on a broad front, rather than on delivering quick wins and some tangible benefits for the people that was the need of the hour.

2.47 With respect to the implementation of policies and programs listed in the Action Matrices, the record was very mixed. There were some areas where reasonable progress was made (Petroleum Fund, Health sector, Veterans’ policy), but by and large the record was modest, and particularly disappointing with respect to the goal of job creation through private sector development and agriculture. Overall, the impact of the TSP series on creating

³⁵ For example, the Action Matrix for TSP 1 listed 50 actions.

³⁶ There were internal debates within the Bank regarding the pros and cons of a broad versus a narrowly focused program. There was also pressure from the government and some other donors in favor of a broad approach. Whatever the reasons, the Bank ultimately supported a wide-ranging and diffuse program.

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conditions for sustainable growth and poverty reduction, the main objective of the Government of Timor-Leste's NDP and the TSP, was insignificant. IEG rated outcomes under the three projects as *Moderately Unsatisfactory*.

2.48 The Consolidation Support Program (CSP 2006) was a follow-up of the TSP. It was originally seen as the first in a series of three operations spread over FY06-08. However, only the first project was implemented; the others were shelved because of changing circumstances, including higher-than-expected petroleum revenues and lapses in the implementation of key actions under CSP1. As in the TSP, the main objective of the program was to provide fast-disbursing funds to the government to augment its budget resources. The main policy objectives and the thematic areas were also identical with the TSP, except for the inclusion of infrastructure under the service delivery component. The CSP was funded by an IDA grant of US\$0.5 million and additional cofinancing amounting to US\$11.5 million from other donors. The IDA grant was disbursed in a single tranche upon effectiveness in March 2006, barely a month before the country was engulfed in violence and social unrest.

2.49 In terms of outcomes, while progress under the CSP was made in some areas (health, veterans' policy, some aspects of governance), overall the results were disappointing. The most disappointing performance was in job creation, which was the single most important issue at the time. IEG rated outcomes as *Moderately Unsatisfactory*.

2.50 In spite of previous experience, the Bank continued under the CSP with its overly optimistic assessment of the local conditions. Its starting premise was that the transition phase was successfully completed under TSP with a new phase of consolidation being ushered in by the CSP, focusing on long-term issues. Yet, within a few months of effectiveness the country erupted in violence, underscoring the continued fragility of the political and economic situation. Clearly, the Bank misread and did not draw the appropriate conclusions from the ground realities at the time. The need of the hour was a program to deliver some quick results on the ground (in terms of jobs and income) and not one that focused largely on longer term institutional development. The CSP also continued with the TSP model of many actions spread over a wide front, without a clear sense of priorities. The Action Matrix was 20 pages long and covered a wide range of policy, institutional, regulatory and legislative areas. Simplicity and focus were ignored once again.

WAYS OF DOING BUSINESS AND PRINCIPLES OF ENGAGEMENT

2.51 Standard Approach to Unique Circumstances. In spite of the unique and very difficult environment in Timor-Leste, the WBG adopted with a few exceptions a 'standard' approach.³⁷ Even when the strategy recognized the special circumstances prevailing in the

³⁷ Certainly some simplification was made in the Bank's standard procedures to accelerate project preparation and approval in the case of emergency operations. Under the TFET, project preparation and appraisal were combined, and projects were approved at the vice presidential level rather than by the Board. As a result, the average time between appraisal and approval of projects was about 3 months, considerably less than the Bank-wide average of 9 months. However, accelerations in project preparation could be nullified by long delays in implementing these projects. For example, the Emergency Youth Development Project (FY09) which was the Bank's response to youth disaffection that contributed to the civil unrest, was approved within one month of appraisal but then took almost 8

country and the need to develop new approaches and guidelines, standard Bank-wide rules and procedures came into play during implementation. Procurement procedures were a specific case in point, and one of the most frequently cited reasons for delays in project implementation.

2.52 Mainstreaming of Gender and Youth. Though it was only in the CAS (among the key planning documents) that mainstreaming of gender and youth was highlighted, gender issues were reflected in Bank projects from the start, in varying degrees. The most common form in which this occurred was that some of the project outcome targets included specific targets relating to women (for example share of jobs going to women; percent of trainees who were women; enrollment rates for girls; etc.). In only one case were funds directed specifically to women or programs designed largely for women. The early Community Empowerment Projects were more ambitious with regard to gender. They sought to empower women by explicitly mandating *equal* representation in the newly elected village councils, and proposed specific measures to increase the capacity of women representatives on the village councils. In the case of youth, very little was done. A few projects listed youth-related targets (such as percent of employment created for youth) but without much impact. The mainstreaming of youth issues called for by the CAS only served to neglect the issue altogether, as pointed out by the ISN.

2.53 By and large, projects reported success in meeting their gender targets. But no assessment has been made as to whether these quantitative targets signified any real progress for women. What was the quality of training imparted and did it make any difference to the women who received training? Were the jobs created sustainable? In the case of the village councils, the Implementation Completion Report (ICR) reported that though more women were elected as mandated by the UN Traditional Administration for East Timor (UNTAET), in some cases they merely acted as proxies for their spouses. Moreover, it was not clear how many of these women continued to participate in the village councils after the project closed: the ICR of the first Community Empowerment Project reported that participation of women had fallen sharply and that existing power structures continued to dominate. In their meetings with the CPE team, some senior government officials believed that the Bank's efforts were merely symbolic and had no lasting impact on women's role and or status in society. The Bank's efforts may be better spent in raising public awareness and convincing the government about the importance of gender issues for social and economic development.

2.54 Complexity in Project Design. The Bank's strategy documents correctly emphasized the need to keep projects simple and ensure that project design was well-aligned with the institutional and human resource capacities in the country.³⁸ Unfortunately, this guideline was not followed in a majority of projects, especially in later years when projects became

months to become effective. Only a small share of funding has actually been disbursed so far, four years after the onset of the crisis.

³⁸ For example, the TSS says the Bank will seek to "avoid launching complex projects with policy implications until institutions are in place" (p.15). The ISN also reflected the same sentiment when it stated that 'the ISN emphasizes selectivity and will reflect the lessons learned under the previous CAS by ensuring simplicity of project design and ...'. (p.18)

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more ambitious and broad-ranging in scope. Action matrices were large and unfocussed and did not take account of the institutional capacity constraints of the government. For those closed projects where such assessments were made, 62 percent were found to have been too complex and/or had unrealistic timetables based on over-optimistic assessments of institutional capacities on the ground (Table 7). Complex design has plagued many still-active projects as well.³⁹

Table 7. Simplicity in Projects, 2000-10.

Percent of All Closed Projects Noted for Simplicity or Complexity of Design by IEG Assessments

Year of Approval	% of Projects noted for complexity of design	% of Projects noted for simplicity of design
FY00-02	62	38
FY03-05	57	43
FY06-07	100	0
FY08-10	NA	NA
TOTAL PERIOD	62	38

Source: *Based on IEG's ICR reviews and PPARs. This table only includes those projects where IEG's project reviews commented on complexity or simplicity of design, and the total numbers are therefore modest.

2.55 This finding was confirmed by interviews with Bank staff and stakeholders. The 2008 QAG review of Pacific Islands (that also included Timor-Leste) also highlighted the same concern.⁴⁰ Complexity of design and unrealistic and overoptimistic assessment of capacity constraints contributed to delays in implementation and cost over-runs. On average, projects closed more than a year behind schedule (see Table 8 below). The average delay in project closings from original estimates has been about 20 months when single tranche budget support operations and small TA projects are excluded. In some sectors (e.g., health) the delays were significantly longer.⁴¹

2.56 Results Framework. Throughout, but certainly after 2002, the WBG emphasized the importance of a 'results orientation' to make sure that program implementation would be monitored and guided by actual results on the ground. This was appropriate as it would discipline the government and the WBG to focus on actual results and final outcomes at the sector level (for example improvement in infant mortality) rather than only on actions un-

³⁹ For example the flagship (Public Financial Management Capacity Building (PFM) (2006) project didn't get off the ground until late 2007 partly because it was not focused and selective. It was subsequently restructured. The Youth Development project is also stuck, partly because of its complex design involving multiple implementing agencies.

⁴⁰ To quote the QAG report: "The principal lesson from years of evaluation by IEG, QAG and others is the necessity of matching capacity and complexity. ...And yet, routinely the Bank funds overly-complicated projects due to a combination of incentives (size matters) and opportunity (you only get one chance, so put in everything)". In Timor-Leste, the pressure to make things complex may also have come from other donors who were significant co-financiers.

⁴¹ According to an internal Bank Database, this average is longer than the Bank average of 1 year and 25 days. Projects in fragile states closed about 13 months behind schedule for the same period.

dertaken and policies implemented (such as number of new schools established or textbooks distributed; improvement in health facilities). Consequently almost every Bank-administered project had a 'results matrix' which listed input and output indicators for each component of the project.

**Table 8. Timor-Leste: Speed of Project Preparation and Implementation:
Time Interval (in months)**

	<i>Between Appraisal and Approval</i>	<i>Between Approval and Effectiveness</i>	<i>Gap between planned closing date and actual</i>
FY00-02	2.8	3.1	21.4
FY03-05	3.1	3.3	7.1
FY06-07	2.8	3.3	5.3
FY08-10	3	5.7	Na
FY00-10	3.1	3.4	13.4
Edu. Projects	2.3	3.4	17.7
Health Projects	2.3	3.2	36.7
Agr. Projects	2.6	2.3	11

Source: ICRs and ICR Reviews

2.57 However, often not enough attention was devoted to collect accurate data to track progress in key areas (see discussion on health and education in chapter 3). As a result of data deficiencies, progress reports have not always been consistent and measurement of progress in key areas remains problematic (for example, the quality of education). A focus on a limited number of important indicators and a greater attention to developing a strong data base would have been more useful. This would also have reduced the burden on the government and allowed its limited capacity to focus on implementing the program rather than on monitoring and reporting on a large number of often quite useless indicators.

2.58 Building Institutional Capacity. The need to build institutional capacity was recognized early on by the Bank, and it was one of the two most important priorities identified by the Joint Assessment Mission.⁴² Since then capacity-building has rightly formed an integral part of Bank operations, both in the context of projects and budget support operations. Institutions such as ministries have been established and their capacity and quality of operations have improved (with significant variations between institutions), but often because of foreign advisors doing much of the policy and administrative work. However, with a few notable exceptions (such as the Petroleum Fund), there has been much slower progress in building sustained domestic capacity.

2.59 As discussed in more detail in Appendix 4, there are a number of inter-related reasons for this slow progress. These regularly include a lack of clear prioritization, inadequate practical recognition of the severe constraints imposed by often very low levels of existing competence, language barriers, and reliance on standardized approaches not tailored sufficiently to the conditions of Timor-Leste. Perhaps more importantly, much capacity building was supposed to be carried out by foreign advisors who were unable to provide effective

⁴² As explained earlier, this was the early Bank-led mission to assess reconstruction and development requirements.

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training and transfer of knowledge to local counterparts because performance of day-to-day line functions absorbed the larger part of their time, and also because of language constraints and lack of skill sets necessary to provide effective training.

2.60 Consolidating and Extending Partnerships. The Bank gave considerable attention from the beginning to developing strong partnerships with other donors and with country stakeholders. The Joint Assessment Mission comprised equal numbers of Timorese leaders and representatives from five bilateral donor countries, the EC, UN agencies, the ADB and the Bank.⁴³ Since that time, Bank administered projects have attracted a large amount of funding from other donor partners provided through multi-donor trust funds. Donor coordination has been generally satisfactory and partnerships have remained strong.⁴⁴

2.61 With respect to partnership with country stakeholders, the WBG worked closely with the Government of Timor-Leste in defining its strategy and in aligning its objectives with those of the government. The Results Matrix developed under the TSP was much appreciated by the government for reflecting its priorities and providing a unified framework for monitoring the government's program in different areas. However, until 2007, the Government of Timor-Leste's capacity to engage substantively with the WBG was limited. It is only recently that the Government of Timor-Leste has shown an ability and willingness to articulate an independent policy, in some aspects at odds with the WBG's views. The Bank has also engaged with Parliament, especially its Committee on Economy and Finance and Anti-Corruption, but less actively than what the parliamentarians reportedly would like to see. Regular consultations have also been arranged with non-governmental organizations (NGOs) and civil society.

PROGRAM QUALITY

Portfolio Performance

2.62 Over the period FY00-10, 30 projects were closed. Of these, the IEG has evaluated 20 projects through its project reviews.⁴⁵ Satisfactory outcomes were reported in only 15 percent of cases, 25 percent of projects had moderately satisfactory outcomes, 45 percent had moderately unsatisfactory outcomes and 15 percent of projects had unsatisfactory outcomes (Table 9). These outcome ratings compare unfavorably with ratings Bank-wide and region-wide. They are also inferior to the performance in other fragile states (Table 10). IEG evaluations often found projects to be too complex, and not sufficiently mindful of the serious institutional capacity constraints in the country.

⁴³ The IMF fielded a mission that partially overlapped with the JAM. Both missions worked as one team.

⁴⁴ There have been serious problems as well. In the context of the Community Empowerment Projects the Bank and the UN administration had serious disagreements that were resolved only after interventions at the highest level in both institutions. In recent times, there has been some serious donor dissatisfaction with the Bank's performance and vice-versa in the context of sector operations.

⁴⁵ This includes TSP1, which was covered under the PPAR for the entire TSP program.

Table 9. Project Outcome Ratings for Closed Projects, as a Percentage of Closed Projects whose Outcomes were Rated by IEG

Year of Approval	Satisfactory	Moderately Satisfactory	Moderately Unsatisfactory	Unsatisfactory	Total Number of Closed Projects rated by IEG
FY00-02	8	33	33	25	16
FY03-05	29	14	57	0	12
FY06-07	0	0	100	0	7
FY08-10	Na	Na	Na	Na	0
TOTAL PERIOD	15	25	45	15	35

Source: ICR reviews and PPARs

2.63 As of January 2011, 9 projects are active in the portfolio. Despite a difficult operating environment and repeated implementation delays, relatively few projects have undergone formal restructuring thus far. The first project to be restructured was the 2006 Public Financial Management Capacity Building (PFMCB) Project. After months of little progress, the project was simplified and restructured in 2010 at the initiative of the government and in line with earlier QAG recommendations. A comprehensive portfolio analysis was completed in July 2010. Two projects (Youth Development and Energy Services Delivery) were downgraded to problem projects.⁴⁶ The Health Sector Strategic Plan Support project remains in problem status.

Table 10. Comparison of Project Outcome Ratings in Timor-Leste and Other Regions as a Percentage of Closed Projects that Received Satisfactory or Moderately Satisfactory Ratings from IEG

Region	Percent of Closed Projects with Outcomes Rated Satisfactory or Moderately Satisfactory
Timor-Leste	40
Other Fragile States	69
EAP Region	76
Bank-Wide Average	79

Source: World Bank internal database

QAG's QUALITY ENHANCEMENT REVIEW

2.64 QAG completed in June 2008 a quality enhancement review for the Pacific Islands, including Timor-Leste. It found that assistance strategies had been conventional when circumstances were not, and that many of the Bank's business practices and procedures were not well adapted to the hyper-fragility of the countries in the region, including Timor-Leste. The Bank's analytical work in Timor-Leste had had very limited impact on policies and programs, and there was an absence of a clear economic development strategy understood and shared by the government and the donors. The review also found that in many cases in Timor-Leste there had been a lack of realism in the assessment of challenges faced, and that the targets set for individual projects did not take country context adequately into account. Projects were also often too complex and ambitious. All these points are consistent with the IEG findings reported in this chapter. The QAG report recommended focusing strategy on a

⁴⁶ One was downgraded after a supervision mission in April 2010, and the other one after the portfolio analysis.

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few key areas (in their view this would have to include youth unemployment and capacity-building) and keeping projects simple and aligned with the implementation capacity on the ground. The Review supported the Bank's role in aid coordination and helping convene donors around a common agenda.

3. PILLAR I. PROVISION OF BASIC SOCIAL SERVICES, SOCIAL PROTECTION AND ALLEVIATION OF POVERTY AND UNEMPLOYMENT

The Health Sector

THE SETTING

3.1 Even before the violence and destruction of 1999, the health situation in East Timor was poor. Life expectancy was 55-58 years, infant mortality rate was 85/1000 and the under-five mortality rate was 124/1000. Malaria and tuberculosis were widespread and were the main causes of morbidity and mortality. This situation got worse after the quest for independence in 1999, which resulted in a total breakdown of the health care system.

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Bank Strategy and Objectives in the Health Sector

3.2 In the broadest terms, the stated objectives in the sector were to improve access to, and quality of, basic health care services in the country. The immediate objective after peace was restored in 1999 was to prevent a health catastrophe. International humanitarian interventions focused on providing food and non-food assistance to returning refugees and at-risk populations. Hospitals were reopened and mobile health clinics were operated. Piped and well water systems were repaired. As the emphasis shifted from relief to reconstruction and development, starting in 2000 the objectives of the WBG (and the donor community in general) became wider, combining addressing immediate basic health care needs with long-term improvements in health indicators (MDGs) and institutional development.

3.3 Operationally as articulated in the 1999 JAMR, and subsequently in various strategy and project documents, the objectives were:

- Restoration and improvement of primary health care services at sub-district levels, including physical rehabilitation, restocking of medicines and equipment, and provision for transport for outreach, referral and mobile medical services;
- Reestablishment and enhancement of inpatient care, including the rehabilitation of hospitals in Dili and in the districts; and
- Establishment of a central laboratory and supply system for essential medicines.

3.4 The objectives also emphasized institution building, including:

- Re-establishment of a public health management capacity;

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- Developing in-house capacity for developing health policy and financing options; and
- Training and capacity-building program for health workers.

3.5 These broad objectives remained consistent throughout the period, though the emphasis shifted from physical reconstruction in the early projects to institutional capacity-building in later interventions. The general thrust of the WBG's strategy was appropriate and relevant, though the programs were too complex and ambitious for the conditions prevailing at the time (see below).

Bank-Administered Projects

3.6 There were four Bank-administered projects in the health sector during FY00-10 in support of the above objectives. Health sector policies and institution building were also promoted through the TSP and CSP. Health sector projects absorbed about 17 percent of all TFET and IDA funding for Bank-administered projects in Timor-Leste during 2000-10 (Table 11). Broadly, projects in the health sector sought to:

- Improve the population's access to and quality of basic health care;
- Improve the capacity of health service providers to provide better quality care; and
- Improve the government's capacity to formulate, implement and monitor all aspects of health policy.

3.7 Projects financed reconstruction of primary health centers and hospitals, the adequate provision of essential medical equipment and drugs, establishment of a central medical store (SAMES) and technical assistance and training for various functions (policy formulation, budget execution, procurement, financial management, training of health care providers and health system managers, monitoring and evaluation, etc.) at different levels of government.

Table 11. Health Sector Projects FY00-10

Name of Project	Year Approved	Project Amount** (US\$ millions)	TFET+IDA Funding (US\$ millions)	IEG Outcome Rating*
Health Rehab 1	FY00	13.0	12.7	S
Health Rehab 2	FY01	34.1	12.6	MS
EC Health Sector Support Program	FY06	4.4	0.0	NA
Health Sector Strategic Plan Support	FY08	20.3	1.0	Active

*S=Satisfactory; MS=Moderately satisfactory

** Disbursed amounts for completed projects. Approved amounts for active projects

PILLAR I. PROVISION OF BASIC SOCIAL SERVICES, SOCIAL PROTECTION AND ALLEVIATION OF POVERTY AND UNEMPLOYMENT

3.8 The TSP (2003-05) continued the initiatives undertaken under Rehab 1 and Rehab 2 projects. Improving access and quality of primary health care services was also one of the objectives of the CSP (2006). Specific performance improvement indicators (such as the extent of vaccination coverage) consistent with those outlined in the Rehab projects were monitored under the budget support operations.

3.9 Progress was made in improving the population's access to basic health services. A large number of health centers were built and health posts rehabilitated. Mobile clinics were operationalized to service remote areas of the country. At least four district hospitals and the central referral hospital in Dili were rehabilitated and reconstructed. However, the strict application of the Bank's procurement rules delayed the equipping of those hospitals for over a year after their construction was over. The supply of medical equipment and drugs was enhanced. These interventions had a positive impact on the delivery of health care. An increasing number of people visited health centers and hospitals as reflected in the near doubling of number of outpatient visits per person between 2001 and 2007. An increasing proportion of births (37.3 percent by end 2007) took place under the care of skilled medical attenders. Vaccination coverage for children for immunization against diphtheria pertussis tetanus (DPT3) and measles increased during this period. While these were important achievements, they were significantly smaller (and took longer to materialize) than had been envisaged under the projects.⁴⁷

3.10 Progress was also made in strengthening health sector institutions. The Ministry of Health (MOH) has made progress in establishing systems for planning, monitoring, and evaluation. It has enhanced its capacity to develop medium term strategic plans for the sector. While health facilities collect and report information, quality remains uneven and data is not sufficiently used for planning and monitoring service delivery. The health sector has been among the best-performing ministries in terms of outputs and budget execution. With the rehabilitation and reconstruction of hospitals and health care facilities, they are in much better shape now than they were at independence. The rehabilitation of the Central Laboratory is expected to strengthen laboratory services, while the establishment of an autonomous medical supply entity expected over time to improve the system of procurement, storage and distribution of essential pharmaceuticals.

3.11 However, while Bank projects financed significant capacity-building and some training activities, they did not pay sufficient attention to mitigating the shortage of qualified medical personnel that was a constraint, especially in the rural areas.⁴⁸

⁴⁷ For example, the proportion of births with skilled attenders was to have increased to 35 percent as early as June 2003. This target was actually achieved only in 2007. Similarly the number of outpatient visits per person was to have increased from less than 1 in 2001 to 2.5 by June 2003. Instead it increased to 1.9 by end 2007. Though vaccination coverage increased over the period, the quality of data does not permit to assess by how much (see more on data below).

⁴⁸ The influx of over 300 Cuban doctors at the initiative of the government helped reduce shortages of medical personnel, and vastly improved the availability of medical personnel compared to the situation at independence. Under the same program, over 600 Timorese have been sent to Cuba for medical training. The Bank, with support from Austria and the EU, helped 300 students graduate in support areas, including midwifery, radiology technicians and pharmacists.

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3.12 The very limited implementing capacity in the country was not adequately taken into account in the design of projects and the timetables of project implementation. Both the health rehabilitation projects closed more than four years behind schedule.⁴⁹ These delays were largely attributable to unrealistic and over-optimistic timetables, especially in terms of construction activities. Delays in procurement were also an important factor as was the complexity of project design in some cases.⁵⁰ Partly as a result of these delays, project costs escalated (by almost 29 percent in the case of Rehab 1 and by 60 percent in Rehab 2).

3.13 Not enough attention was paid to getting accurate and reliable data to monitor progress in critical areas. Targets were specified for vaccination coverage, etc., without an adequate appreciation of the lack of accurate and meaningful data. (This was true in other areas as well.)⁵¹ This became quite evident in the ICR of Rehab 1 (June 27, 2005, five years after health sector projects were starting to operate) which noted that "...it is difficult, given the current state of the data, to draw strong conclusions regarding the performance of any health service delivery program at this time". The data situation was no better in 2007 and is probably only marginally improved now. The point is not that quantification and results orientation is not desirable, but that greater effort would have been desirable to identify and collect a *minimal* set of key *reliable* data necessary to track progress. IEG project evaluations rated outcomes under the first Rehab project as *Satisfactory*, and those under the second Rehab project as *Moderately Satisfactory*.

Analytical Work

3.14 A background paper was prepared for the health and education sectors for the Joint Assessment Mission. This paper laid the basis for health sector interventions under the initial projects. The 2002 CEM also addressed issues in the health sector. Subsequently a health sector review was completed in FY07. While findings from this report informed the finalization of the government's health sector strategy and the health sector support sector-wide approach (SWAp) operation (see above), a QAG panel was critical of the analytical quality of the report and the excessive time taken to complete it (it took four years to complete, instead of one as planned). A health sector financing policy note is currently under preparation.

⁴⁹ The first project was expected to close by February 2002 and the second by March 2004, two years before the violence of 2006. As the projects dragged on, they were of course affected by the 2006 unrest which further delayed completion. A third project closed one year behind schedule. The average delay in health projects was three years, more than in other sectors.

⁵⁰ This was noted in the ICR review of the second Rehab project.

⁵¹ There are many examples where the data have not been reliable. For example, the ICR Review of the first Rehab project quotes the number of outpatient visits as reaching 2.1 in 2004. But by 2007 the number was down to 1.9 even though the project claimed success in restoring the public's faith in the health care system. According to the second Rehab project, the *target* for immunization coverage for DPT3 and measles for June 2003 was 50 percent. However, *baseline* data for 2003 quoted in the PAD of the sector strategic plan support (Table on Arrangements for Results monitoring, pp 35) showed these to be 56 percent and 47 percent respectively (DHS data). There is little confidence in vaccination coverage data: the latest country brief of April 2010 still continues to quote an estimate of the immunization rate from 2003!

OUTCOMES IN THE HEALTH SECTOR

3.15 Since 1999, Timor-Leste has made progress both in increasing access to, and improving the quality of basic health care services. As a result, the overall health of the population has improved in many dimensions. Immunization coverage for children 12-23 months has increased significantly between 2003 and 2009-10 from 35 percent to 53.2 percent. More and more births are supervised by health care professionals; the proportion of babies delivered by a health care professional increased from 18 percent in 2003 to about 30 percent in 2009-10. Infant mortality rates have fallen from 68 percent in the 5-9 year period preceding the recent survey to 44 percent during the most recent 5 year period 2004/05 - 2008/09. Fertility rates have declined though they are still high.⁵² Though the numbers should be interpreted with some caution, and the quality of some of the numbers may be open to question, the trend towards improved health outcomes in many respects is unambiguous.

3.16 While progress has clearly been made in some areas, there was deterioration in child nutrition standards in 2003-07, consistent with increasing poverty during this period. Moreover, the health of the population remains poor in some respects, especially in comparison to other countries in the region, and health standards are still closer to the averages for low-income countries. Life expectancy at birth increased from 56 to 61 years between 2000 and 2008, but is still much lower than the average 72 years for the East Asia and Pacific (EAP) region. The gap is more marked in female life expectancy. While the infant and child mortality rates have come down, the average infant mortality rate in the EAP region is less than half of what has been achieved in Timor-Leste. Maternal mortality is also relatively high. Malnutrition among children is widely prevalent: nearly half of children under 5 years of age were underweight and almost 39 percent of children (0-5 years) are anemic.⁵³ This situation is not necessarily because of ineffective health sector policies. It is also the result of a difficult starting position, the modest overall economic performance over much of the period, and the failure of policies in other sectors such as the provision of safe drinking water and sanitation.⁵⁴

3.17 The Bank's program in Timor-Leste gave very considerable attention to the health sector, through both projects and analytical work. This support was important in particular for the rehabilitation and improvement of the physical infrastructure and for the strengthening of health sector institutions, and it contributed to the improvement in access and quality of health services throughout the country. On this basis, IEG rates the overall outcome in the Health Sector as *Moderately Satisfactory*.

⁵² Source: Timor-Leste Demographic and Health Survey 2009-10, Preliminary Report by National Statistics Directorate, Ministry of Finance, Timor-Leste.

⁵³ Source: same as above.

⁵⁴ Only 63 percent of the population had access to safe drinking water in 2007 and the situation was much worse in rural areas where most of the population lives.

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The Education Sector

THE SETTING

3.18 Under Indonesian rule, almost 85 percent of education was supplied by state institutions. Even though primary schooling was extensive, net enrolment was only about 70 percent. Literacy was very low (41 percent in 1998), with lower rates for women than for men. Both educational infrastructure and personnel were hard hit by the 1999 quest for independence. As a result of widespread destruction, the school system collapsed, exacerbating the already low educational outcomes.

THE BANK'S PROGRAM

Bank Strategy and Objectives in the Education sector

3.19 The immediate objective for the Bank and the donor community was to get children back into schools and to keep them there. Over the medium term the primary objective was to continue to improve access to primary and secondary education by improving school facilities and learning and teaching materials, and to improve the *quality* of learning through improved teacher training, curriculum development and social mobilization and communications. Another important medium term objective was to enhance institutional capacity at various levels of government to deliver improved educational services and to develop, implement and monitor sector policies and programs. These objectives remained broadly unchanged throughout the period, and were fully supported by the UNTAET in the transition period and later by the elected governments. The strategy was appropriate though in practice the focus on improving quality of education got lost.

Bank-Administered Projects

3.20 The Bank has financed and/or administered six projects in the education sector between 2000 and 2010. Education sector projects absorbed almost 30 percent of all TFET and IDA funding (including DGF and IDF grants) during this period (Table 12). This makes the sector one of the largest recipients of Bank-administered projects in the country. The initial projects focused on repairing and reconstructing existing school buildings and classrooms and providing basic furniture and learning materials so that children could return to school as quickly as possible. Later projects sought to improve the quality of schools through better facilities. At the same time, there was an effort to improve institutional capacity in the sector at all levels to enable the education system to improve the quality of education services. Bank projects provided funding for TA and training for the Ministry of Education (MoE) and its agencies to improve its capacity to develop sector strategy, plan and implement its budget and reform curriculum.

3.21 In addition to sector projects, education sector policies and capacity-building were included in the TSP and the CSP. In TSP, programmed actions and outputs focused on the development of an education policy framework, improvements in quality of education through curriculum development, strengthening of financial management functions and piloting of mechanisms to transfer resources directly to schools. To achieve the objectives of improved access to basic education and better quality of education, the focus in the CSP was on developing a strategy for universal primary education, strengthening the capacity of the

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MoE, and improving budget execution in the sector by at least 15 percent over the previous year.

Table 12. Bank-Administered Projects in the Education Sector, 2000-10

Name of Project	Year Approved	Project Amount** (US\$ millions)	TFET +IDA Funding (US\$ millions)	IEG Outcome Rating*
Emerg. School Readiness Project	FY00	13.9	13.9	MS
Fundamental School Quality Project	FY02	20.6	20.4	MU
Primary Edu Support Project+	FY06	8.5	0.0	NA
Edu Sector Support Project	FY07	14.9	6.0	Active
FTI Program 2009+	FY09	4.9	0.0	Active
Edu Sector Support Adn'l Financing	FY10	5.0	5.0	Active

*MS=Moderately satisfactory; MU=Moderately unsatisfactory; +=fully funded by FTI Catalytic Fund.

**Disbursed amount for closed projects; approved amounts for active projects

3.22 The focus of Bank-administered projects in the education sector was appropriate. The immediate priorities were obvious: to repair and rehabilitate the school buildings and class-rooms and provide students and teachers with reading and teaching materials so that children could return to schools. It was also recognized that the physical reconstruction of schools should be accompanied by institutional strengthening and capacity-building at all levels so that the quality of educational services would be improved, consistent with the educational policies of the government.

3.23 Bank projects made a positive contribution, especially in the early years. Responding to the emergency needs, a large number of existing schools and classrooms were rehabilitated and refurbished with new furniture, and were provided basic teaching and learning materials.⁵⁵ Subsequently, new and better schools were built. Schools were provided with better furniture for students and teachers and improved amenities including water supply and toilets. Bank-administered projects also financed a large number of Portuguese language texts and teachers' guides. Unfortunately, while the complex language situation was known to Bank staff, its implications for effective teaching were not given adequate attention by, for example, introducing textbooks in Tetum concurrently, as the United States Agency for International Development (USAID) did.⁵⁶

⁵⁵ Under the Bank's first education project, almost 2780 classrooms in 535 schools were rehabilitated within 14 months of effectiveness of the project. Under the second project, the fundamental school quality project, an additional 102 schools were built.

⁵⁶ USAID funded a children's publication in Tetum called "Lafaek" ("Crocodile," a national symbol), which was widely used by teachers and students. After USAID redirected its funds, the Bank provided some funding. Despite this effort, a full cohort of the youth population is functionally illiterate.

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3.24 Bank-administered projects also contributed to institutional strengthening and capacity-building in the education system. Partly as a result of these initiatives, the MoE's capacity for strategic planning was strengthened as shown in the preparation of a comprehensive draft strategic plan for the education sector. The Ministry's budget planning and execution capacities have also been enhanced, and budget execution rates are now close to 74 percent, which makes the MoE one of the better performing ministries in the government in this regard. Improvements in financial planning and procurement are other areas where Bank-administered projects have made a positive contribution.

3.25 Support from Bank-administered projects was also instrumental in developing the School Grants Program that was introduced by the Government of Timor-Leste in 2006 as part of its commitment to abolishing school fees, improving the management and administration of schools and improving the quality of education. Bank-implemented projects supported the creation of the Investment Infrastructure Unit (IFU) in 2003, which has established a good record in identifying, designing and managing the school construction program of the MoE. Finally, Bank projects helped set up an Education Management Information System (EMIS) in 2003 to gather relevant data to monitor results and help in the design of policy interventions in the sector. However, it is only recently that the system has been able to provide reliable information in a timely manner.

3.26 But the Bank's program singularly failed in one crucial dimension: improving the quality of learning. Improving the quality of education was an explicit objective of Bank interventions in the sector under the FY02 Fundamental School Quality Project. Yet very little was attempted by way of actually measuring quality, let alone doing something about it - a major omission.⁵⁷

3.27 It was known as early as 1999 that Portuguese would be the language of instruction in schools if the major political formation *Conselho Nacional de Reconstrução do Timor*, CNRT, came to power (which it did in 2002). It was also well known at the time that a very small proportion of the population actually spoke or understood the language. Yet, not much analysis was done about the implications for learning, at least in the short-term, of the shift from Bahasa to Portuguese as a language of instruction in schools. Nor does it appear that given the implications it would most likely have for the learning outcomes in the short-term, there was a serious discussion within the Bank how the introduction of Portuguese ought to affect the composition of the Bank's interventions in the education sector,⁵⁸ such as whether it made sense for the Bank to finance the distribution of textbooks in Portuguese to teachers and children who didn't understand the language.

⁵⁷ As mentioned earlier, it was only in 2009 that an analysis of early grade reading acquisition (EGRA) was completed by the MoE, where the reading skills of over 900 children in grades 1, 2 and 3 from 40 randomly selected primary schools was measured. The results were very discouraging.

⁵⁸ The appraisal report of the FY02 Fundamental School Quality Project had very little discussion of the language question and the risks it might pose to the quality of learning, which was an explicit objective of the project. The PAD seemed more concerned about avoiding unnecessary political controversy if research revealed that teachers had difficulty teaching Portuguese to children, or that children's learning difficulties were traceable to the new language of instruction.

3.28 Education sector projects also (as for health) tended towards an overly optimistic assessment of local capacity, particularly with respect to procurement and construction activities. Unrealistic timetables combined with ambitious project goals usually resulted in long delays in project completion and expensive cost over-runs.⁵⁹ Such long delays in projects that were planned as immediate responses to emergency situations were not productive.

3.29 Delays in project implementation were also caused by complicated Bank procedures and ways of doing business, which precluded a quick and efficient response to the emergency conditions prevailing at the time.⁶⁰ While projects were prepared and approved relatively quickly and made effective without too much delay,⁶¹ unrealistic timetables and lack of familiarity with Bank processes, especially procurement caused serious delays in implementation.

3.30 Also in the education sector not enough effort was devoted to ensuring that the primary data (from which come the indicators of progress) is reliable and of good quality. This is especially important with respect to the main development objectives in the sector, which were to improve access to education and to enhance the quality of learning. Until recently no attempt seems to have been made to develop indicators on quality of learning. And as

⁵⁹ On an average, education sector projects closed one and a half years later than planned. For the Emergency School Readiness project FY00, the ICR noted that the rehabilitation of classrooms was completed after a delay of one year, and the pilot schools after a delay of one and a half years. It also noted that these delays were due more to the unrealistic schedule prepared at appraisal than to inefficiency in implementation. The Fundamental School Quality Project closed three years later than expected at time of appraisal. The ICR for this project noted that "... the project design was based on an unrealistic two year implementation cycle. This period seems far too short particularly as project component A (the main cost of the project) features a large amount of site acquisition, facilities design, site preparation, construction, rehabilitation and procurement for schools in rural areas. This belief is supported by the fact that the project actually took some 57 months to complete". The ICR Review for the same project notes "the Bank appraised a project to meet ambitious quality objectives and to deliver many and difficult inputs in just a two year period which not surprisingly had to be stretched to five years". The CPE team concurs with these assessments.

⁶⁰ As the ICR of the Emergency School Readiness Project noted, "the project was given the difficult mandate that all children should be in rehabilitated classrooms by the beginning of the new school year (October 2000) - barely four months from Bank management approval of the project. Unfortunately, the implementation arrangements prescribed for the project were more or less those for financing a regular (i.e., non-emergency) investment project, usually requiring detailed procurement assessments and planning, document preparation and Bank reviews and approval, timely advertising, clearances of detailed evaluation reports, formal contracting, documented payments processing, and technical and financial reporting. Going through those conventional processes, it was unrealistic to expect that classrooms would be rehabilitated within the tight deadlines of the mandate and in uncertain post-conflict conditions (in fact, project completion was delayed by one year) ..." The ICR went on to suggest that the Bank could have provided for special procurement and disbursement procedures for accelerating the implementation of this emergency project in a post-conflict situation.

⁶¹ In the education sector, on average, it took two months after appraisal to get the project approved by the Board and another 3 months to make it effective. This is better than the average time lag for all projects in Timor-Leste.

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mentioned earlier, the data on enrollment rates for primary and secondary levels have undergone many changes and are not entirely convincing. It would have been preferable to focus on these two indicators of access and quality of education, rather than spend effort in collecting and reporting a whole slew of data of dubious quality and usefulness.⁶²

3.31 IEG project evaluations rated outcomes under the Emergency School Readiness project as moderately satisfactory, and moderately unsatisfactory under the Fundamental School Quality project.

Analytical Work

3.32 A background paper on the education sector was prepared in the context of the Joint Assessment Mission in 1999. This paper laid down the immediate priorities for donor interventions as well as sketched out the medium term needs of the sector and was an important component in the design of Bank and donor assistance in the sector. The 2002 CEM also addressed issues in the education sector. A comprehensive education sector study was completed in FY03, though it is not clear what impact it had on policy development or project design.

OUTCOMES IN THE EDUCATION SECTOR

3.33 Compared to the situation in 1999-2000, access to primary education had improved considerably by 2003-04. This is not saying much though: in 1999 the education system had collapsed and enrolment was close to zero. The most recent data from the Ministry of Education suggests that there has been a further improvement in school enrollment in recent years: the gross enrollment rate for primary education rose from 93 percent to 114 percent between 2004-05 and 2008-09, and the net enrollment rate rose from 76 percent to 81-83 percent in the same period.⁶³

3.34 With respect to the *quality* of learning, the presumption must be that the quality of learning has improved since the near devastation in 1999. However, there is very little hard evidence. No attempt was made until very recently to measure learning skills in a structured way. In 2009 the MoE assessed the reading skills of over 900 children in grades 1, 2 and 3 from 40 randomly selected primary schools.⁶⁴ This assessment – which was conducted in Portuguese and Tetum – showed very poor outcomes. More than 70 percent of students at the end of grade 1 could not read a single word of the simple text passage they were asked to read. Forty percent of children were not able to read a single word at the end of

⁶² The FY07 Education Sector Support Project listed a large number of indicators for results monitoring, for most of which even the base year numbers were still to be determined.

⁶³ The new data set was significantly different from previous data (difference in net enrollment rates exceeded 10 percentage points in some years) and showed a completely different trend from previously reported data, including data from the 2007 Survey of Living Standards. Up until May 2008, the Bank was quoting data that showed that national net enrollment rates had been declining steadily since 2003. The ICR for the CSP, prepared in June 2008, reported that no progress had been made in primary education enrollment (pp. 10). The new data set showed that enrollment had actually been rising steadily even during the civil strife of 2006-07, which may perhaps be somewhat questionable.

⁶⁴ An Analysis of Early Grade Reading Acquisition, World Bank (2009).

grade 2. Only about a third of the students in grade 3 could read 60 words per minute and respond correctly to simple comprehension question. This is a dismal record after 10 years of efforts at improving the quality of learning. Moreover, a full cohort of the population may be functionally illiterate.

3.35 In the early years, 1999 to 2003-04, the Bank was instrumental in fostering a considerable rehabilitation of the education infrastructure, and access to primary education improved considerably. A further improvement in enrolment has taken place in recent years. There has also been an improvement in institutional strengthening and capacity-building in the education system with the Bank's support. However, there has been insufficient attention to the quality of education, and the available measures of such quality are depressingly low. Little attention was given to Timor-Leste's complex language situation, and the Bank failed in giving attention to the quality of learning. On this basis IEG rates the overall outcome in the sector as *moderately unsatisfactory*.

Poverty and Unemployment Alleviation

THE SETTING

3.36 Even prior to the independence quest in 1999, the territory of East Timor was one of the poorest areas in south East Asia. In 1996, 30 percent of households – or double the average for Indonesia – lived below the poverty line. The violence and destruction of 1999 hit the economy very badly and both the public sector and the private sector suffered almost total collapse, while poverty is estimated to have increased significantly – even by 2001, after strong growth in 2000, it was close to 40 percent.

THE BANK'S PROGRAM

Bank Strategy and Objectives for Poverty and Unemployment Alleviation

3.37 Given these conditions, poverty alleviation was from inception a central theme for the WBG and the donor community. In the immediate aftermath of the violence the focus was on providing humanitarian assistance to restore basic human necessities of food, water, health and shelter. Thereafter, the objective of poverty and unemployment alleviation was sought to be addressed through restoration of basic social services (such as education, health, water supply and sanitation) and by creating job opportunities in rural and urban areas. Over the medium term the strategy was to stimulate diversified non-petroleum growth, including in the private sector and in agriculture, by creating a business friendly environment and by improving infrastructure. The strategy was broadly appropriate, though it may have underestimated the importance of public spending, and overstated the importance of the private sector, in driving growth and employment in the short to medium term.

Bank-Administered Projects

3.38 The Bank undertook a number of initiatives (in partnership with other donors) to alleviate poverty and unemployment and to improve living standards, especially of the poor. The restoration and improvement of basic health and educational standards was an

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important dimension of the Bank's work in the country. A second strand of its anti-poverty activities was the development of the private sector and the agriculture sector, which were expected to be the sources of growth and employment in the medium term. These interventions are discussed in chapter 5. However, some of these interventions (such as the two small enterprise projects, and the three agriculture Rehab projects) were specifically designed to create jobs and incomes and alleviate poverty and these are discussed below. Also included are the three community development projects (Community Empowerment and Local Governance Projects, CEPs), discussed in greater detail under the governance pillar in chapter 4, to the extent these sought to have an impact on rural incomes and poverty.

3.39 Taken together these initiatives covered both rural and urban areas, and included agricultural as well as non-agricultural activities. Economic activity was facilitated either through outright grants to deserving activities, as in the case of the community development projects, or through commercial loans to entrepreneurs for small businesses (as in the small enterprise projects). In the agriculture sector, economic activity was stimulated by providing assets such as livestock or agricultural tools to beneficiary farmers, or by financing vaccines for livestock to reduce mortality and reduce the farmer's economic vulnerability. Other interventions in agriculture sought to improve productivity of certain crops and hence farmer incomes. The community development projects had a special window for vulnerable groups, including the elderly and widows.

3.40 These projects, which were mostly initiated during FY00-02, were partially successful in creating jobs and incomes, though the viability of the activities and the sustainability of the jobs that were created are doubtful. The ICR for the small enterprise project reported that about 1200 new jobs were created through the project, though it estimated that only half of the new jobs were sustainable. The first agriculture Rehab project alone helped create 120,000 person-days of labor, providing a much needed infusion of cash into rural communities. The vaccination program for livestock under the Rehab projects reduced livestock mortality and contributed to improving food security. The community development projects created temporary jobs and also considerable community infrastructure. Given the precarious situation existing at the time, these achievements were small, but important, palliatives, even if they were not sustainable over the medium term.

3.41 The first and most important weakness in the Bank's program was the apparent neglect of social protection and safety net issues in the Bank's work on Timor-Leste. Despite the high incidence of poverty revealed in the Bank's 2001 Poverty Assessment, and the Bank's stated emphasis on poverty alleviation and social safety nets, it was inactive, until very recently, in the area of social protection and design of safety nets for the vulnerable. While the Bank was not opposed in principle to targeted social assistance programs, it did not see these as priorities. Supply side constraints (mainly unavailability of suitable staff) also played a part in the Bank's inaction in this area.⁶⁵

⁶⁵ Recently, as the Bank has given more weight to the need to support social assistance, it has assigned staff specialists in social protection to engage in a small operation and non-lending technical assistance to the Ministry of Social Solidarity.

3.42 As a result, not much preparatory work was done in defining or costing a program of targeted assistance to the most vulnerable sections of the population. Such preparatory work would have been helpful when, faced with widespread disaffection, the Government of Timor-Leste launched a large program of social transfers in 2008.⁶⁶ Instead, the Bank's insistence on further analysis at a time when quick results on the ground were needed effectively sidelined the Bank on this issue. In the event, the Government of Timor-Leste went ahead on its own, the transfers were implemented (albeit imperfectly) and they proved to be critical in restoring social stability and peace. In hindsight, it was clearly an error of judgment on the part of the Bank and a missed opportunity not to have helped the government to address critical emergency needs of the population.⁶⁷ It is only in recent months that the Bank has initiated useful work in this area, and is providing TA for improving the implementation of the transfer programs.

3.43 A second weakness of Bank projects to alleviate poverty and unemployment was that these interventions may have had a positive short-term impact, they were not sustainable. Many of the activities and the jobs that were created through these projects were not viable over the medium term, especially those activities that catered to the demands of the large international presence in Timor-Leste at the time. Even within one and a half years of the businesses being created under the small enterprises project, the ICR reported that only about half the jobs that were created were sustainable.⁶⁸

3.44 Third, in some cases the design of the projects benefited the relatively better off sections of the population compared to the poor. For example, as reported in the PPAR of the CEPs and Agriculture Rehab projects, cattle owners who had lost their livestock during the violence were among the richest in the villages and it was these individuals that received livestock in the Rehab project. Similarly it could be argued that the agricultural projects should have targeted the food security of the poorer sections by focusing more on improving the productivity and production of the main staple crops maize and cassava (rather than rice) that are largely grown in the poorer hinterland of the country. One potentially pro-

⁶⁶ Some of the program components were intended to be short-term and are already being phased out, but the majority are intended as long-term safety net for specific population categories. Based on budgetary classifications, total transfer spending is projected to be 13 percent of non-oil GDP in 2010. Such spending levels place Timor-Leste in an almost unique position among low-income countries in terms of the share of public expenditure devoted to social protection cash transfers. Source: World Bank Social Protection Concept Note, April 2010.

⁶⁷ This error of judgment was acknowledged by senior Bank management in interviews with the CPE team.

⁶⁸ It is not clear what is meant by viability and whether there was any serious analysis made at the time when loans were sanctioned to assess viability. The ICR claims that at the close of the project, 83 percent of the activities were still operating. Does this signal viability, even when most businesses had defaulted on their loan payments?

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poor feature of the community empowerment projects, the financing window for most vulnerable groups, never took off.⁶⁹

3.45 Finally, in common with findings in other sectors, projects were often too ambitious given the weak capacity of the government and its agencies.⁷⁰ To partly overcome this problem, projects had to rely very much on foreign advisors even for routine functions. A large part of project financing (sometimes as much as 40 percent) went for hiring foreign expertise.

Analytical and Advisory Work

3.46 The Bank completed two poverty assessments, one in 2003 and the other in 2009. These studies provided estimates of poverty in 2001 and 2007 which are widely quoted by the government and others in their work. An economic and sector work (ESW) on Social Protection (2005) focused on issues relating to the labor market and the minimum wage. Its recommendation helped delay the introduction of an overly high minimum wage and postpone the introduction of civil service pensions. The Bank also provided TA to the government to enhance its capacity for poverty analysis, monitoring and strategy formulation. However, until recently, little analytical work or TA was undertaken on developing a sustainable social safety net for the poor. This is now being corrected with the TA activity now underway.

OUTCOMES IN POVERTY AND UNEMPLOYMENT ALLEVIATION

3.47 Between 2001 and 2007, for which comparable poverty data is available, there was an increase in poverty from about 36 percent to about 50 percent.⁷¹ This increase in poverty is a reflection of weak economic growth through most of the period 2002-07, and a high rate of population growth exceeding 4 percent per year. The strong economic growth in 2008 and 2009 is likely to have improved the situation since then, as recent estimates of poverty suggest.⁷²

3.48 Unemployment has also been rising in recent years and remains high, especially among the youth. In 2009 unemployment was estimated at 8.5 percent nation-wide and 23 percent in urban areas. Youth unemployment was as high as 43 percent. The IMF has estimated that given the demographics of the country (high population growth rate and a

⁶⁹ The TSS explicitly mentioned support to vulnerable groups in the community empowerment projects as an example of the emphasis of early Bank interventions on poverty alleviation. It also mentioned support for private sector recovery in those sectors that benefit the poorest.

⁷⁰ For example, the PPAR noted that the first agriculture Rehab project was “overly ambitious and put a substantial burden on the ministry staff to undertake and oversee a large range of activities”.

⁷¹ The poverty line is defined as US\$0.88 per day.

⁷² A recent interpolation exercise done by the Bank estimates that the poverty rate may have declined from 49.9 percent in 2007 to 41 percent in 2009 (Source: World Bank “A 2009 Update of Poverty Incidence in Timor-Leste using the Survey-to-Survey Imputation Method”, 2010). With an annual net population growth rate exceeding 4 percent (and urban population growing by almost 5 percent per year), IMF estimates that non-oil GDP will have to grow by at least 7-8 percent per year to prevent poverty from deepening further.

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young population, with 46 percent below the age of 15), about 15,000 to 16,000 young people enter the labor market each year. As against this, despite the increase in public spending and economic growth that occurred in 2008 and 2009, only about 9500 jobs are estimated to have been created in these two years.

3.49 The Bank's analytical work made useful contributions to the government's policy formulations, and early Bank projects played a small but important role in helping to create short term employment and incomes. However, the WBG's interventions and policy advice has not had much of an impact for longer-term sustainable job creation, and it missed the boat completely regarding the important social protection and safety net issues. On this basis, IEG rates the outcome of the WBG program for poverty and unemployment alleviation as *Unsatisfactory*.

Youth Unemployment and Disaffection

THE SETTING AND THE BANK'S STRATEGY

3.50 The Bank was slow to understand the discontent among the youth and was ineffective in helping the Government of Timor-Leste address these issues. Issues of youth represent an important subset of the general employment issues. It was only in the 2005 CAS that concerns were raised about political instability stemming from popular discontent at the slow pace of development. Rapidly expanding youth cohorts with high unemployment and little education were seen as a rising threat to peace and stability. But having recognized this threat in 2005, the Bank's strategy did not do much about it. Except for a planned ESW on Youth, the CAS included no projects to address specific concerns of the youth or to address the flaws in education (especially language) that had weakened this cohort and remained a challenge. Instead, youth and gender issues were expected to be mainstreamed in all the WBG's other activities planned over the period. As noted in the ISN, this meant, in effect, that nothing was really done.

3.51 Within a year of the adoption of the CAS, the country erupted in violence and civil strife. The involvement of the youth in the 2006 crisis forced the new coalition government to address their concerns. Within three months of the government's formation, a National Youth Policy (NYP) was adopted which sought to address a wide range of social, economic and political issues affecting youth. A National Youth Fund (NYF) was created by the government to finance initiatives of youth groups and associations, and the State Secretariat for Youth and Sports (SSYS) was given the responsibility for implementing the government's policies and programs in this area. Despite the slow funding of NYF, there has been no further outbreak of violence and some observers are optimistic about the prospects for continued social peace. However, the continuing high rates of unemployment, especially among the youth, remain a threat to social stability and peace.

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THE BANK'S PROGRAM FOR YOUTH ISSUES

3.52 The Bank's immediate response to the youth crisis came late within the evaluation period and was limited to a series of studies.⁷³ The findings of these studies served to adjust the Government of Timor-Leste's National Youth Policy and influenced the government's response to the challenges.

3.53 The Bank's first (and so far, only) youth centered project was the Youth Development Project approved by the Board in July 2008, a full three years after the Bank first articulated its concerns about youth disaffection in the CAS. The objective of this US\$2.1 million IDA grant is to promote youth empowerment and inclusion in development by expanding the capacities of and opportunities for youth groups to initiate and participate in community and local development initiatives. The project has two components:

- Operationalizing the National Youth Policy, specially the NYF by focusing its support for youth initiatives and youth capacity-building mostly in urban areas; and
- Youth for Local Development, which will help facilitate the participation of rural youth in community development activities and local development processes.

3.54 Under the first component funds are to be allocated to strengthen institutional capacity of the SSYS to implement its mandate, including establishing a unit to run the NYF. Under the second component, funds are to be allocated to the Ministry of State Administration and Territorial Management (MSATM) to establish a mechanism to distribute small grants to youth in rural areas. Part of the funds are to be used to provide earmarked funds for rural youth to identify, prioritize, and implement sub-projects – such as livelihood activities, rehabilitating youth centers, social events, construction of small infrastructure etc. – within their village. The other part of the second component is to be used for training youth to enable them to implement the component's activities at the village level.

3.55 Unfortunately, two years into implementation, there is very little to show.⁷⁴ Although a lot of preparatory work has been done, and more than 170 sub-projects are reportedly ready for implementation, there has been very little disbursement thus far, and no appreciable impact. The net result is a sorry story: four years following the emergency, the Bank has still not been able to provide much funding to support youth empowerment.⁷⁵

3.56 Part of the problem was a complex project design involving multiple government agencies. Despite past experience, and reservations expressed by some staff at the project preparation stage (and reflected in the risks section of the PAD) the project chose complexity over simplicity. This risk was expected to be mitigated by providing guidelines on the rela-

⁷³ The first was a situational analysis to understand the challenges faced by youth and the factors that led to their involvement in the crisis. This was followed by another study on the challenges youth confront in the labor market. Both were completed in late 2007.

⁷⁴ The project became effective almost 8 months after approval, in March 2009.

⁷⁵ This project was treated as an emergency operation for accelerated processing and implementation under OP/BP 8.0. The closing date is December 31, 2011. Yet it took more than two years after the crisis to become effective and another two years have gone by without substantial disbursements.

tionship between the two agencies, and by aligning project design with their respective implementing capacities. Clearly this was optimistic thinking. Lack of cooperation between the agencies combined with their lack of familiarity with Bank procedures (including financial planning and procurement) continues to delay project implementation.

OUTCOMES ON ALLEVIATION OF YOUTH UNEMPLOYMENT AND DISAFFECTION

3.57 There is no evidence that youth empowerment has increased or youth disaffection has lessened. The strong economic growth in the last two years, led by high public spending, may have lessened poverty and created some jobs, but the impact on youth unemployment is unlikely to have been significant given the capital-intensive nature of a majority of the large infrastructure projects funded through the budget.

3.58 The Bank came late to a realization that youth unemployment was an issue in Timor-Leste. Moreover, little was done before the outbreak of civil strife in 2006. Since then, the Bank's contribution to addressing youth issues has been modest – basically some studies (after the outbreak of youth violence) that helped inform the government's policy responses to the youth challenges. The Bank approved one project to foster youth empowerment and inclusion, which was slow in coming and has so far – after very considerable time – still had no appreciable impact. On this basis, IEG rates the outcome of the WBG program on youth unemployment as *Unsatisfactory*.

Veterans' Programs

THE SETTING

3.59 Disaffection among veterans of the armed and civilian resistance to Indonesian occupation has been an important source of political instability through the initial years of Timor-Leste. Tension was high with various groups claiming veterans' status and demanding recognition and assistance from the government. The slow pace of demobilization and integration under the UNTAET had exacerbated these frustrations.

THE BANK'S PROGRAM

Bank Objectives and Strategy

3.60 The main objective of the Government of Timor-Leste was to alleviate the veterans' legitimate concerns about recognition, appreciation and assistance. It was clear that unless these concerns were addressed, veterans' dissatisfaction would endanger the country's political stability. The Bank's objective was to provide technical assistance and support to enable the government to achieve its objectives and address legitimate grievances of the Veterans.

The Bank's Program for Veterans' Issues

3.61 Veterans' issues were first addressed by the Bank through two Post Conflict Fund grants to three of the commissions established by the Government of Timor-Leste to register veterans. Subsequently, in the TSP (2003-05) the first steps were initiated supporting the government's efforts drafting the 2006 Veterans Law and that led to the creation of a veter-

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ans data base. The fragile political situation, and the potentially destabilizing effect of disillusionment among veterans was mentioned in the CAS, which also defined a program of analytic and advisory activities (AAA) and technical assistance to support the registration of veterans and the development of a policy towards them.⁷⁶ The 2005 IDF-funded TA project contributed to establishing the government's Veterans' policy and institutional frameworks and the administrative systems. The Bank's activities in this area were clearly just complementary to the government's own initiatives and activities.

OUTCOMES ON VETERANS' POLICY

3.62 Starting in 2002, under Timorese leadership and with some donor support including from the Bank, a number of commissions were established to register veterans and suggest policy. By the end of 2005, more than 75,000 veterans or their survivors had been registered.⁷⁷ A Veterans Law, to which the Bank only gave some guidance on, was adopted by Parliament in March 2006, providing the legal basis for the recognition of veterans and their assistance. Following a long process of registration, a veterans' pension system was established. The first pension payments to 12,538 beneficiaries were made in July 2008, six years after the beginning of the process and nine after the cessation of hostilities with Indonesia, and the list of beneficiaries was expected to grow as claims were investigated and confirmed. This policy process was successful in channeling veterans' grievances into an institutional mechanism, and helped in managing the threat of political instability from disaffected veterans.

3.63 The Bank played a useful role in supporting the government in developing a sensible policy towards Veterans and in its implementation, but earlier progress would have been desirable to help diffuse tensions. Overall, the outcomes of the WBG program in this area were *Moderately Satisfactory*.

⁷⁶ The Bank's AAA/TA work in this area included a May 2005 IDF-financed TA for Institution Building for Veterans Policy Implementation, an April 2006 Clandestino Survey, and a February 2008 ESW report "Defining a Policy for Veterans of the Resistance".

⁷⁷ Other donors included USAID, AusAID, Irish Aid, and UNDP.

4. Pillar II. GOVERNANCE AND DEVELOPMENT OF STATE INSTITUTIONS

4.1 Immediately prior to Independence, Timor-Leste was part of an Indonesian province, under the authority of Jakarta and administered within the Indonesian system. This was a violent period and the Indonesian system had many efficiency flaws, but it provided a measure of predictable authority and security, transferred wealth into rural areas and ensured a basic level of service delivery.

4.2 The collapse of Indonesian rule in 1999, following a referendum and many years of a violent quest for independence, left a governance vacuum. While Timorese political authorities began to emerge through the independence quest, they lacked experience in government, and were not supported by state institutions. To fill the vacuum, UNTAET was established by a Security Council resolution (UNSC Res 1272/1999) to administer East Timor until the election of a constitutional Timorese Government. In consultation with the Timorese leadership, UNTAET had the mandate to administer the territory of East Timor, exercise legislative and executive authority during the transition period and support capacity-building for self-government. The mandate included all essential governance functions during the transition to independence, and building the very basic structures and capacity of the state to assume sovereign authority.

4.3 Starting from this vacuum, the tasks at hand included efforts along three directions. The first one was to develop the capacity in the civil service to exercise the functions of government, especially regarding the new country's resources. The second one was to devise a set of systems of fiscal and public financial management that would allow those civil servants to carry out their functions in an effective and transparent way. The third one was to set up a legal framework that would define and give structure to the system, and that would guide civil servants in their acts. Each one of these aspects is analyzed below.

Capacity of the State

THE SETTING

4.4 Building on the initial legislative framework set by UNTAET, the most immediate priority was to provide the new leaders of the independent state with critical institutional support. The support included a wide range of activities, going from performing the very basic state functions assigned to the leaders, all the way up to giving guidance on the policy options open to the new authorities. An intermediate but essential element of the support was the development of a cadre of Timorese staff that could grow in numbers, strength and capacity as the country transited this difficult initial stage. The challenges faced by the new authorities included ordinary functions, such as the establishment of a working budget, as

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PILLAR II. GOVERNANCE AND DEVELOPMENT OF STATE INSTITUTIONS

well as arcane and challenging ones, such as the negotiation of Timor-Leste's rights in the petroleum finds of the Timor Sea.

THE BANK'S PROGRAM

Objectives and Bank Strategy for State Capacity-Building

4.5 As early as the Joint Assessment Mission in October 1999, the international community in conjunction with notable Timorese from within and from the diaspora identified the development of the capacity of the state, along with agriculture, as the two urgent priorities in Timor-Leste. This general orientation was picked up and maintained by the Bank in the TSS (FY00-02, effective until FY05), for the period up to formal independence and the initial years of the nascent nation. Rapid progress in capacity-building of public administration was seen as urgent on taxation, budget execution, service delivery, local governance and dispute resolution mechanisms. It was also a key prerequisite to the sustainability of development initiatives in the longer term.

4.6 Immediate priorities supported by the Bank's program included establishing and reinforcing key economic institutions (ministries of finance and planning, procurement and audit agencies, revenue agency, statistical agency and customs office), and developing and strengthening the state's capacity for policy and planning in areas such as health and education, financial supervisory services, tax policy and collection systems, budgeting, procurement and accounting systems and techniques. Other key initiatives recommended included establishing:

- A public administration system, and the creation of a "lean but capable" civil service;
- A functioning system of law and order, including re-constituting the judiciary and public security services (police, prisons, customs services and other security institutions);
- In the early years, the Bank also sought to build a structure of local governance by supporting the creation of democratically elected village development councils, in the hopes of having a reformed system of governance and a more efficient public administration at the village and local level.

4.7 The CAS for FY06-08 included as one of its three pillars building state institutions and strengthening governance, including prudent and transparent management of public resources, development of safeguards against corruption; and civil service reform. Although progress in developing an effective governance system had been very slow until then, the CAS broadened the areas supported by IDA, noting the urgent need to strengthen checks and balances envisioned in the Constitution and to tackle emerging corruption. The CAS targeted eight key governance outcomes. These were:

- Safeguards against corruption and abuse of power in place, with increased awareness of citizens' rights.
- Improved access to justice, with enhanced quality and efficiency.

- Transparency and probity in managing petroleum revenues.
- Enhanced motivation and responsibility among civil servants, resulting in higher standards of probity and service delivery.
- Sound policy and legislative process across government.
- Strengthened capacity to manage for and monitor results on the ground, with particular attention to women and youth.
- Improved implementation of the budget in a transparent manner, in line with savings policy and sustainable growth and poverty reduction.
- Enhanced revenue performance through streamlined procedures and mechanisms.

4.8 Following the civil strife of 2006, the stated unifying theme of the ISN (FY10-11) was to help the Government of Timor-Leste convert its petroleum wealth into policies and programs that preserve immediate post-independence stability, while laying the basis for higher rates of growth in the non-petroleum sectors. The WBG's aim was to help strengthen the legitimacy of the Timorese governance process by strengthening government effectiveness in three strategic areas: (i) formulation of a national development strategy and development of capacity to implement the strategy; (ii) design and implementation of short-term stabilization activities; and (iii) measures to secure long-term economic development. Much of the strategy was built around the continued implementation of on-going activities, particularly on capacity building. No new initiatives were planned.

Bank-Administered Operations

4.9 Governance capacity-building issues were addressed in some form or other in most Bank-administered projects. Projects in the health and education sectors sought to improve capacities of line ministries (health and education respectively) and supporting institutions (such as hospitals, schools, training of doctors and teachers etc.). These have been discussed in chapter 3. Insofar as political institution building through capacity development at the local level was an important objective of the Community Empowerment and Local Governance projects (listed in Table 12), this aspect is discussed below. Their poverty alleviation component is discussed in Chapter 5. The capacity building components of the budget support operations (listed in Table 4) are also addressed here. In addition to these operations, there were other projects (including TA projects) that sought to strengthen capacity and develop state institutions and governance in specific areas. These projects, also listed in Table 12, are discussed below.

The Community Empowerment and Local Governance Program (CEP1, CEP2, CEP3)

4.10 The stated development objectives of the CEP were to strengthen local level social capital and to build institutions to reduce poverty and support inclusive patterns of growth. The projects, therefore, combined economic recovery, service delivery, social protection to vulnerable groups and governance objectives. This section reviews the governance objectives of the projects.

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PILLAR II. GOVERNANCE AND DEVELOPMENT OF STATE INSTITUTIONS

Table 13. Bank-Administered Programs and Projects for State Capacity Building, 2000-2010

Name of Program/Project	Year approved	Project Amount (US\$ millions)***	TFET and IDA funding* (US\$ millions)	IEG Outcome Rating**
Community Empowerment and Local Governance Project (CEP1)	FY00	8.55	7.0	U
CEP2	FY01	8.5	8.5	U
CEP3	FY02	1.5	1.5	U
Econ Institutions Capacity-building Project	FY01	0.92	0.92	MS
Strengthening Public Expenditure Management (IDF)	FY02	0.35	0.35	[MU]
Transition Support Program Series (TSP1, TSP2, TSP3)	FY03-04-05	99.4	90.3	MU,MU,MU
Public Expenditure Management and Procurement (IDF)	FY03	0.31	0.31	[MU]
Institutional Development of Ombudsman (Provedor) (IDF)	FY04	0.22	0.22	[S]
Institutional Development of Inspector General's Office (IDF)	FY04	0.13	0.13	[MU]
Institution Building for Veterans' Policy Implementation (IDF)	FY05	0.15	0.15	[S]
Consolidation Support Program (CSP)	FY05	10.0	9.5	MU
Public Financial Management Capacity-building Project (PFMBC)	FY06	44.5	7.0	Active

* IDA includes IDF and DGF grants as well;

** U=Unsatisfactory, MU=Moderately Unsatisfactory, MS=Moderately Satisfactory; []=Internal Reviewing Document Rating; *** disbursements for closed projects; commitments for active projects.

4.11 The defining characteristic of the CEP was its efforts to create democratic local governance structures to fill the governance vacuum at the village level perceived by outsiders. Under CEP1, participating communities elected sub-district and village development councils according to prescribed criteria and, through them, carried out local infrastructure reconstruction, promoted productive local economic activity, and supported cultural heritage and social reconciliation. The Bank's assessment was that the traditional and resistance authority that emerged through the independence quest was "undemocratic" and was not an acceptable basis for local governance.⁷⁸ The elected development councils were to be more representative, and therefore supposedly more likely to serve the interests of the local people. The councils were to promote democratic values and gender equality, and were expected to be sustained after the CEP to become permanent governance structures at the local level.

4.12 This effort failed. The village councils that were established under the first project were often seen as foreign implants for delivery of foreign aid, and not as real local governance bodies. They did not survive after formal independence. As noted in the PPAR, traditional governance simply continued, with *de facto* authority in the traditional chiefs, while the councils were either co-opted under the chief's authority or marginalized.

4.13 This failure had many reasons. Most importantly, the assumption that the collapse of Indonesian governance institutions created a political vacuum at the local level was wrong. Traditional and resistance authorities became visible immediately after the Indonesians to play a role in the villages. They had a high degree of legitimacy with local populations, even

⁷⁸ For example, traditional village chiefs were excluded from participation in the new councils. To promote gender parity, fifty percent of seats were reserved for women.

if they were viewed as undemocratic by some in the international community. Instead of working with the existing structures and seeking to reform them over time, the CEP established a new governance structure that was effectively parallel to, and at times in opposition to, what already existed in communities.

4.14 In addition, this effort at creating democratic local governance structures was opposed by the UNTAET, the de-facto government at the time, which viewed this attempt by the Bank as infringing on its mandate to govern during the transition. While it ultimately went along with the program, it did not make any serious institutional commitment to it. Finally, the Bank's efforts at influencing the political landscape at the local level were opposed by *Frente Revolucionária de Timor-Leste Independente*, FRETILIN, a key political grouping with a strong local presence that won the 2002 elections. This lack of support from the dominant political party during transition undermined sustainability.

4.15 Thus, through its approach, the Bank either failed to integrate or marginalized key stakeholders at the country level (community leaders, UNTAET, FRETILIN). Without the support of key stakeholders such as these, it is not surprising that the Bank's initiative could not be sustained. The program appeared to leave no lasting 'democratic' structures or values.

4.16 IEG's PPAR (2007) assessed the CEP's governance agenda as "premature", being implemented before the election of a constitutional Timorese Government, the adoption of enabling legislation or a decentralization strategy. These were political decisions that belonged with the government, including establishing policy and the enabling legislation and institutional architecture. The PPAR also concluded that the over-arching program objective of 'strengthening local social capital to build institutions that reduce poverty and support inclusive patterns of growth' was not achieved.

Economic Institutions Capacity-Building Project (EICB)

4.17 The EICB, which became effective in FY01, sought to strengthen domestic capacity to enable the government to assume core financial management and planning responsibilities after formal independence. In the Bank's assessment, the country faced a severe shortage of qualified professionals with the requisite skills for evaluating economic options and for designing and implementing economic policies. The project attempted to address this shortage by supporting a program of training for local staff in basic and advanced tools of applied economic analysis, including for budget planning and implementation, and for the analysis of main macroeconomic aggregates. The project also envisaged on the job training in central agencies. It was expected that this training would result in greater local participation in budget preparation and execution, starting with the FY01-02 budget.

4.18 While the project correctly identified a need for training of local staff, it failed in meeting its objective of strengthening capacity and preparedness for independence. By the time of independence, only about 30 percent of project funds had been disbursed. The bulk of the training took place after independence, and the project closed four years later than scheduled, in June 2006. This delay was partly because the Bank seriously over-estimated the level of knowledge and skill among Timorese officials, and designed a training program that was too advanced and not suited to the local staff. The program had to be adjusted, re-

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sulting in lost time and opportunity prior to independence. The project also suffered because it operated in a fluid environment where the structures of government were still being formed. No one had a clear idea of where functional responsibilities would lie. In the absence of a clear institutional architecture, it was difficult to develop an overall framework for training and capacity-building. An additional problem was the high turnover on the government side, which resulted in a failure to establish counterparts and stronger ownership, as all such personnel were expatriates.

4.19 IEG's project evaluation rated EICB outcomes as Moderately Satisfactory, acknowledging for the most part the efforts to establish a system of government accounts and compile macroeconomic data. Yet, as regards to capacity building, the quality at entry was low and there was little evidence of outcomes on the ground. Challenging conditions notwithstanding, problems related to *quality at entry* included the inaccurate assessment of existing capacity and needs that resulted in a training package targeted above what the participants could manage and what the country needed. Delivery was also late, reducing its relevance, and at a level not commensurate with the capacity of the targeted audience. While some training did indeed take place, much of it four years later than planned, the CPE team could not find evidence on how this training had actually been used or had improved outcomes (in terms of quality of budget submissions, etc.).

The Transition Support Program (TSP)

4.20 The governance agenda in the TSP series was wide and expanded through time. TSP1 included establishing an independent, competent judiciary; implementing an annual legislative program; creating an efficient and transparent civil service; decentralizing government; and implementing an improved public expenditure policy and management. Under TSP2 the good governance agenda included strengthening oversight institutions; local government; public sector management; public expenditure management; and the judiciary. The TSP3 agenda was similar, and supported strengthening oversight institutions; improving public sector management, including developing a legal and regulatory framework for the civil service; establishing institutional arrangements for a transparent policy and legislative process and a regulatory framework to address risks of corruption and nepotism; strengthening the capacity of the justice system by developing oversight framework for the judiciary; and improving planning and public expenditure management.

4.21 In its review of the TSP series, IEG's PPAR reported partial progress in achieving the governance objectives, with state capacity building being one of the areas of least progress. The highlights noted in the PPAR were the Petroleum Fund and the Veterans Law, both of which had little to do with capacity development and both of which became truly effective after the TSP series closed. The only aspect of the Petroleum Law that had to do with capacity building was a briefing to Parliament on how the Petroleum Fund would work. That briefing did not cover the broader topic of how to go about parliamentary oversight of the government in general, and the budget in particular.

4.22 In state capacity building progress was very limited. Efforts made in establishing two institutions, the Ombudsman and the Inspector General, were basically fruitless and are discussed below in more detail.

4.23 The program placed much emphasis on improving financial planning and management in general and budget execution in particular at the central level, leaving aside local governments. Yet, until 2008-09, very little improvement in budget execution actually occurred. This was attributable to severe capacity constraints, poor procurement processes, the reluctance of the Ministry of Finance and Planning to delegate spending authority to line ministries in order to avoid corruption, and the call by some donors for fiscal restraint.⁷⁹

4.24 As pointed out by the PPAR, if capacity was indeed a binding constraint, more attention should have been devoted to enhancing implementation capacities. Efforts under the TSP to improve domestic capacity in the government to implement the procurement system and processes have had a negligible impact, except possibly in the Ministry of Finance. Procurement capacity remains weak in the line ministries where a large part of procurement is expected to occur after the recent decentralization of procurement authority. The procurement training provided by the Bank focused primarily on Bank procurement guidelines and PIU staff, and is not very relevant for government staff for implementing government procurement procedures.⁸⁰

4.25 Very little progress was achieved in the development of capacity in the justice sector. As pointed out by the PPAR, "... progress in the development of the judicial sector has been very limited and disappointing, with the number of competent magistrates still very limited, the backlog of adjudicated cases rising, and the suspicion that this sector itself is handicapped by corruption."

Consolidation Support Program (CSP)

4.26 The governance agenda under CSP1 was a continuation of the work program initiated under TSP and included many actions that were rolled over from TSP3. It included strengthening the administrative structures of the state (i.e. oversight institutions, core government functions, public sector management, and public finance management), as well as the justice system (including the national police). In the particular area of capacity building, the CSP supported the areas of service delivery, procurement, governance and job creation, leaving public financial management to a subsequent operation (PFMCBP, reviewed below). The CSP was complemented with grants to support capacity building, which are also reviewed in detail below.

4.27 Overall, progress was disappointing in capacity building. Aside from the efforts through the accompanying grants, there is no record of any particular activities that could have resulted in capacity building under CSP.

⁷⁹ Budget execution improved dramatically since 2008, when the new Government of Timor-Leste decided to spend in order to bring growth and abate poverty, putting aside the advice from the Bank and other donors on fiscal restraint. In 2007 actual expenditures were 45 percent lower than the original budget; in 2009 the percentage was down to 11. The Government of Timor-Leste achieved this increase by decentralizing spending authority and increasing the use of advisors to assist in accelerating budget spending.

⁸⁰ For more details, see Annex 4 from which this discussion on procurement is extracted.

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Planning and Financial Management Capacity-Building Project (PFMCPB)⁸¹

4.28 Initial discussions on a proposed project began in 2004 in response to growing concerns at the continuing low budget execution rates and the inability of the government to deliver results to the population despite increasing budget revenues. The original intention was to implement the PFMCPB in tandem with the CSP and to coincide with an increase in state budget anticipated for 2005. Stakeholders saw a need to expand the government's financial management capacity, building on TSP results and tied to CSP implementation.

4.29 The PFMCPB was designed as a US\$7 million IDA investment grant supported by a multi-donor trust fund. The project became effective in May 2006 with project closing planned for 2011. The development objective of the project was *to sustainably strengthen planning, budgeting, public expenditure management and revenue administration for growth and poverty reduction, with emphasis on efficiency, effectiveness, accountability, integrity, service culture and transparency*. The project was originally divided into six components: Public Expenditure Management; Revenue Administration and Macroeconomic Management; Program-wide Activities; Support to Improved Governance and Management and Program Implementation. The PAD also noted the Government of Timor-Leste's expressed objective of moving beyond "the traditional substitution of international for local expertise" and focus on building national capacity.

4.30 PFMCPB effectiveness coincided with the 2006 civil strife, resulting in a virtual stand-still in implementation in the initial years. The program started-up again after the elections in 2007, with a new and more assertive Timorese Government with a strong determination to accelerate budget spending to restore and maintain social stability. The PFMCPB project was used by the government to bring in a large number of advisors to assist in budget execution, many of them international, a move that has led to significant improvements in budget execution since 2007. At the request of the Government of Timor-Leste, and at the suggestion of a 2008 QAG review, the project was restructured in early 2010 to bring it more in line with the new government's priorities. These changes included:

- Remapping of the program's components, to align it with the Ministry of Finance's (MoF) new organizational structure.
- Reduction of the scope and complexity of the program to focus on the MoF and priority public finance management (PFM) functions.
- Revision of the results matrix and the program development objectives (PDO), to ensure they would be realistic and consistent with recent developments.
- Refocusing of capacity-building efforts to implement civil service reform measures in the MoF and enhance Timorese capacity.

4.31 The project has delivered substantial benefits in recent years. The 2009 budget was developed using PFMCPB TA, with significant improvements in the performance of line ministries. There was also a satisfactory improvement in recurrent and capital budget execu-

⁸¹ The broader lessons regarding PFM capacity-building are discussed in Annex 4.

tion, albeit with some variation across ministries. The MoF's approach of using the project's advisors to develop local capacity seems to be bearing fruit. Timorese advisors, fluent in Tetum and English and with solid technical training, have created a middle layer to bridge gap between the English-speaking foreign advisors and the local staff. Despite this progress, however, the project is being less successful in achieving the broader government objective of building national capacity for public financial management (see Box 3 below and Appendix 4 for an evaluation of the Bank's interventions to strengthen human resources to manage PFM systems).

4.32 It should also be noted that the accomplishments after 2008 were achieved three years after effectiveness and five years after the initial 2004 discussions with donors. Possible synergies with the TSP and the CSP were missed, as was the opportunity to develop a fiscal and public financial management system that would have served the country well when the petroleum resources started flowing. Different sources point at the lack of support to the project within the Bank as the main reason for its slow progress and the opportunities missed.

4.33 The original design of the PFMCBP was clearly overly complex, and is now more appropriate after the project restructuring. Also, the Bank's own analytical conclusions about deteriorating conditions did not seem to affect the design or pace of work. However, the Bank showed flexibility in responding to the 2008 QAG recommendations and the changing requirements of the government.

Box 3. Bank's Approach to Capacity Building for PFM

The Bank sought to build domestic capacity through:

- Use of project implementation units (PIUs)
- Appointment of international advisors
- Training of individuals

However, there was neither a strategic vision nor a needs assessment nor an action plan for strengthening PFM systems and capacity for the first six years of the evaluation, when the efforts at capacity building remained fragmented, *ad-hoc* at the project level, and supply driven. Moreover, none of these approaches, as implemented, was effective in building local capacity:

- The PIUs were helpful in ring-fencing projects, but did not strengthen government capacity to manage public resources. Most PIUs hired international staff; when local staff was hired, typically they sought higher paying jobs outside the government once the project was completed.
- International advisors were for the most part unsuccessful in transferring skills to local staff. Typically, these advisors were required to perform routine line functions which did not give them sufficient time to train local staff. Language barriers between international advisors (who often were English speaking) and local staff (who were more fluent in Portuguese, Bahasa or Tetum) were another factor. Twinning of international staff with local counterparts was also difficult because of the paucity of reasonably skilled local staff. Transfer of skills to local staff was also not part of the performance monitoring and evaluation system for foreign advisors in most cases.
- Training of individuals did not generate sustainable results because it was fragmented, project specific and not followed up. Training components were sometimes unrealistic in relation to existing capacity of local staff. Language barriers were a further impediment to the absorption of training.

Source: Appendix 4

CHAPTER 4

PILLAR II. GOVERNANCE AND DEVELOPMENT OF STATE INSTITUTIONS

Technical Assistance Projects

4.34 The Bank provided several small grants to strengthen the government's capacity to undertake specific tasks and functions (Table 12). These included:

- A Public Expenditure Management and Procurement IDF grant to assist the government in strengthening budget execution in the line ministries and improving the outcomes from public expenditure;
- An IDF grant to back up with operational support the Bank's assistance for the creation of the Ombudsman's Office, in charge of protection of human rights, oversight of rule of law and anti-corruption;
- An IDF grant to provide operational support to the Bank's assistance in strengthening the Office of the Inspector General for carrying out financial inspections and audits of government agencies; and
- An IDF grant for strengthening government's capacity for implementing Veterans' policies including developing a national policy on veterans and a strategy for its implementation.

4.35 The results of these grants were mixed. Despite a delay from 2005 to 2008 in implementing the project, the grant for veterans' policy implementation made an important contribution to establishing the government's veterans' policy and institutional frameworks and to establishing administration systems. Together with the Bank-administered TSP, AAA and downstream support from the PFMCBP, the project responded to a high priority area of the Government of Timor-Leste, even if the software recommended by the Bank was not used by the government. Establishing the veterans' pension system has since been an important part of the government's efforts to stabilize the country since the civil strife of the late 2000s. An internal document rated development outcome as satisfactory.

4.36 The other grants were not as successful. An internal reviewing document objective rating for the public expenditure management and procurement project was moderately unsatisfactory. The grant was not fully implemented, with its core objectives being integrated into other projects, among them the PFMCBP. As noted above, the Office of the *Provedor* (Ombudsman Office) was established in 2006, three years after the grant for establishing the Office became effective. However, its accomplishments have been modest thus far and its anti-corruption mandate has been transferred to a newly established Anti-Corruption Commission. The internal reviewing document outcome rating of satisfactory appears to be generous, and the priority accorded to this office is also questionable. The grant for strengthening the Inspector General's Office was also not successful. The internal reviewing document assessed overall efficiency and effectiveness as poor and outcome moderately unsatisfactory. The Office showed only modest progress towards consolidating its capacity to carry out financial inspections and audits of government agencies. Important factors affecting performance have been a chronic shortage of skilled personnel, under-funding and an unclear definition of how it fits within the general Portuguese-based legal system. The Inspector General's Office also appears to lack the political support needed for clarity of mandate and consolidation.

OUTCOMES FOR STATE CAPACITY-BUILDING

4.37 Compared to the vacuum of 1999, there has been gradual and important progress in building Timor-Leste's capacity as a state. The executive branch of the government is now able to plan and manage its resources and deliver public services across the country, albeit with some shortcomings. On its side, the legislative branch of government has produced a significant body of legislation and is making efforts to carry out its oversight functions. A cadre of well-trained and knowledgeable Timorese is at the heart of these considerable developments.

4.38 Despite the significant leap forward, Timor-Leste still faces major governance challenges. Institutional capacity is uneven across ministries, and remains weak in many of them. There has been almost no strengthening at the district and local levels. The human skills base is still very low and the government remains highly dependent on advisors, many of them foreign, with only limited success in transferring knowledge and skills between the advisors and national staff.

4.39 The heavy dependence is a cause of concern. Critical capacities, such as for project planning, appraisal and evaluation, procurement, financial planning and auditing are in very short supply. The shortage of local capacity is also a bottleneck for the non-executive branches of government. The judiciary is hamstrung by the scarcity of qualified lawyers, prosecutors and judges. Parliament still feels that their oversight role could be bolstered and made more effective if capacity of parliamentarians could be strengthened. For these reasons, the quality of governance may be pivotal for Timor-Leste's future development prospects, and the challenge of developing a cadre of well-trained Timorese to run all functions of the state with excellence is still a momentous one.

4.40 The Bank had state capacity building as a key priority from the start. However, for the most part of the evaluation period the Bank did not have a clear needs assessment, a strategic vision, or a realistic and monitorable strategy that could have guided its actions to bolster capacity in Timor-Leste in a more effective way.⁸² Bank-administered operations covered too broad a front, included less pressing areas, were not proportional to the needs, and failed to create the critical capacity that was needed for Timor-Leste to use its petroleum revenues effectively for growth and poverty reduction. The three early Community Empowerment and Local Governance projects over-reached by trying to establish more representative and gender-balanced local governance structures that went against traditional and resistance authorities. Other operations supported the building of structures and capacity at the central level – successfully in the case of petroleum, whereas in other areas of governance the progress has been very limited. The judiciary and Parliament were left aside. The most important effort has been the still ongoing Planning and Financial Management Capacity-Building Project (PFMCBP), which has delivered substantial benefits in recent years through the financing of a substantial number of foreign advisors in support of budget planning and execution. However, the operation took a very long time to become fully operational and needed simplification of its original, complex structure, and the building of domestic capacity has progressed very slowly. More importantly, it was the strong hand of the new Government of Timor-Leste that introduced a staged system to use those advisors

⁸² For a detailed discussion of this assessment, see Annex 4.

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PILLAR II. GOVERNANCE AND DEVELOPMENT OF STATE INSTITUTIONS

effectively, and transfer capacity from foreign advisors to the local staff without the command of English. Overall, there was modest progress in creating the capacity to run the state, and the overall outcome of in this area is rated *Moderately Unsatisfactory*.

Fiscal and Public Financial Management Systems

THE SETTING

4.41 UNTAET's mandate on developing Timor-Leste's system of fiscal and public financial management faced a natural limit in the United Nations' own system of financial management. Aside from the resources provided by the donor community through the TFET and co-administered by ADB and the Bank, there were no "revenues" accruing to Timor-Leste that could be managed and budgeted by UNTAET. The operations expenses of UNTAET, on the other hand, were covered by the special budget allocated by the United Nations, and were spent using the UN's own public financial management system.

4.42 The expectation at the time of the withdrawal of the Indonesian army was that Timor-Leste would benefit from the petroleum find in the Timor Sea, that those resources were likely to be ample, especially on a per-capita basis, and that the inflow could be expected to start around 2005. With the starting and the petroleum milestone points defined, all actors, including the Bank, knew that there was great urgency in setting up a system of fiscal and public financial management that would allow Timor-Leste to use its petroleum wealth wisely, transparently and efficiently for the benefit of its people, especially the poor.⁸³

THE BANK'S PROGRAM

Objectives and Bank Strategy for Fiscal and Public Financial Management Systems

4.43 The call by the Joint Assessment Mission (October 1999) for developing the state was fleshed out more properly by the Bank in the TSS (FY00-02, effective until FY05). Aiming to match existing political realities and institutional context and capacity, the TSS understood the urgency of developing a system of fiscal and public financial management able to deal with Timor-Leste's potential petroleum wealth. The system itself was to be structured within a legislative framework, and brought to life by trained civil servants. High in the agenda were the establishment of tax collection, budgeting, procurement and accounting systems and techniques. The initial priority of Bank support was to establish the key economic institutions where the system would work, including the ministries of finance and planning, procurement and audit agencies, revenue agency (taxes and custom), statistical agency and financial supervisory services, as well as the systems to run these institutions. The expectation was that these efforts would be buttressed by progress in conflict resolution (judiciary) and law enforcement.

4.44 The CAS for FY06-08 stressed once again IDA's commitment to support the building of state institutions, including prudent and transparent management of public resources,

⁸³ While the International Monetary Fund was and is the lead agency in macroeconomic policies, the Bank is the lead agency on fiscal management.

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and the development of safeguards against corruption. As regards to fiscal and public financial management systems, the CAS highlighted as targeted outcomes the development of safeguards against corruption, a transparent system for managing petroleum revenues, a more motivated and responsible civil service, a sound policy processes, a monitoring and evaluation framework focused on results, and a set of streamlined procedures and mechanisms to enhance revenue performance.

4.45 The ISN (FY10-11), focused on continuing the capacity building activities, without bringing in additional objectives or planning new activities.

Bank-Administered Operations

4.46 The development of public financial management institutions and systems was addressed in many Bank-administered projects, especially in health and education – these have been discussed in detail in Chapter 3. There were a number of programs and projects that had a central focus on the development of fiscal and public financial management. These are listed in Table 13 and discussed below.

Table 14. Bank-Administered Projects for Fiscal and Public Financial Management, 2000-2010

Name of Program/Project	Year approved	Project Amount (US\$ millions)***	TFET and IDA funding* (US\$ millions)	IEG Outcome Rating**
Econ Institutions Capacity-building Project	FY01	0.92	0.92	MS
Strengthening Capacity for Poverty Analysis (IDF)	FY02	0.23	0.20	[S]
Transition Support Program Series (TSP1, TSP2, TSP3)	FY03-04-05	99.4	90.3	MU,MU,MU
Consolidation Support Program (CSP)	FY05	10.0	9.5	MU
Enhanced Poverty Monitoring and Analysis (IDF)	FY06	0.30	0.30	[HS]
Public Financial Management Capacity-building Project (PFMCB)	FY06	44.5	7.0	Active

* IDA includes IDF and DGF grants as well;

** U=Unsatisfactory, MU=Moderately Unsatisfactory, MS=Moderately Satisfactory; []=Internal Reviewing Document Rating; *** disbursements for closed projects; commitments for active projects.

Economic Institutions Capacity-Building Project (EICB)

4.47 The EICB, which became effective in FY01, included among its components one that sought to develop the government accounting system and another one that supported the compilation of the main macroeconomic aggregates for 1999 and 2000. Defining the accounting system was the first building block for having a workable budget. Data on where macroeconomic aggregates stood at independence was necessary to guide future macroeconomic projections and policies.

4.48 As noted before, this project faced a number of delays, some associated with the capacity building components, and other with the two relevant components for this section. The difficulties in formulating and implementing the government accounting system stemmed for the most part from the inherent challenge of defining accounts for a government structure that is fluid and in the process of being defined. In addition, expanding the

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scope and quality of the macroeconomic aggregates led to delays in the compilation of the aggregates and in project execution.

4.49 IEG's project evaluation rated EICB outcomes as Moderately Satisfactory, acknowledging for the most part the efforts on strengthening fiscal and public financial management. Albeit with delays, the charter of accounts was developed and the compilation of the macroeconomic aggregates took place. The charter provided a necessary stepping stone and started to be used in 2001 in some government offices – extended use took longer than expected. Meanwhile, the compilation of macroeconomic data was only completed in 2005, and required additional resources.

The Transition Support Program (TSP)

4.50 As noted above, the TSP series placed much emphasis on improving financial planning and management in general and budget execution in particular. Key elements were the establishment of a petroleum fund, a civil service reform, including an effective human resource management system, and local governance, including communities and villages. The public expenditure management aspects covered the formulation of the budget, improved delivery at the line ministry level, and the development of a strategy for financial management functions.

4.51 IEG's PPAR reviewing the series highlights the Petroleum Fund as the most noticeable outcome of the series, even though the adoption and implementation of the law took place under the follow-up program, the CSP. The Petroleum Fund was shaped with advice from the IMF, NORAD and the Bank, following the Norwegian model, and in line with the Extractive Industries Transparency Initiative (EITI). The Bank's role covered two areas. One was to provide advice regarding the savings rule of the fund.⁸⁴ The other was to support a wide consultative process to help get the law approved with as ample political support as possible, which indeed happened.

4.52 Beyond the Petroleum Fund and until 2008-09, very little improvement in budget execution actually occurred and progress in other fronts was not very successful. The procurement system turned out to hamper instead of fostering timely and appropriate expenditures. Among flaws, tender documents were too complex, and most bidding documents were in English, making it difficult for government staff or contractors to understand or use them. The procurement processes are also regarded by many as not transparent. These difficulties have led to a second revision of the procurement law, originally put in place with support from the Bank in 2001.

Consolidation Support Program (CSP)

4.53 The CSP supported strengthening the framework of the administrative structures of the state (i.e. oversight institutions, core government functions, public sector management,

⁸⁴ As noted elsewhere, the savings rule recommended by the Bank follows the Norwegian rule, without factoring in Timor-Leste's significant deficit of human and physical capital. A life-cycle savings approach would have been better adapted to those circumstances.

and public finance management), as well as the development of capacity in service delivery, procurement, and governance (excluding public financial management).

4.54 Progress was weak in these areas. The *Provedor* (Ombudsman) became “operational,” though it is not clear what that meant in terms of actual results on the ground in fighting corruption. The Inspector General’s Office met its commitment under the project by publishing some investigative reports, and appointments were made to the Consultative Council, but the relevance of these actions for addressing civil service corruption is questionable. Limited progress was made in defining a revised pay and grading structure for the civil service as part of a human resource management system. What effect this had on civil service motivation and performance is not evident. Overall budget execution remained low (62 percent in FY06 and 49 percent in FY07, on a cash basis), and did not achieve the intermediate target of 70 percent that had been set for 2006.⁸⁵ On the other hand there was continuing progress in the functioning of the Petroleum Fund, where an Investment Advisory Board was appointed to enhance transparency in use of petroleum revenues

4.55 In the area of conflict resolution and law enforcement, progress in staffing the judiciary was also poor, despite continuing efforts at international recruitment and training of nationals for the position of judges, prosecutors and defenders. Indeed, the backlog of court cases was not significantly reduced and access to justice remained severely constrained especially in rural areas. The language challenge may have been a major factor in slowing progress.⁸⁶ The ICR did not report on commitments and outcomes with respect to strengthening the national police.

Planning and Financial Management Capacity-Building Project (PFMCPB)⁸⁷

4.56 Aside from the capacity building components mentioned above, the PFMCPB included support to improve systems and processes in fiscal and public financial management. The support sought to improve the workflows and interactions between the different dependencies of the MoF, as well as between the MoF and the line ministries. In addition, there was a component that supported improvements in the information technology of the MoF, to make it more transparent, relevant, streamlined and efficient.

4.57 The civil strife of 2006 and the change in government had a major impact on the PFMCPB. For one thing, the newly elected Government of Timor-Leste had a very different approach to public spending, wanting to foster economic activity after years of an overly tight fiscal policy – generating employment and helping the poor were seen as key to restoring social stability and dealing with the issues that had led to the civil strife. For another, the government felt that the accompanying CSP was not that central, and that a major effort

⁸⁵ Performance in the execution of capital spending was even worse. In FY06 capital budget execution was only 35 percent and in FY07 it was 16 percent. Source: ICR, p. 7. This poor performance was despite the expectation that financial planning and budget execution would improve with the TA provided to the Ministry of Finance and line ministries through the PFMCPB project.

⁸⁶ With all laws drafted and approved in Portuguese, only those candidates to the judiciary that are fluent in that language stand a chance of performing up to the desired standard.

⁸⁷ The broader lessons regarding PFM capacity-building are discussed in Annex 4.

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was needed to create an effective fiscal and public financial management system, starting with the MoF. The government took a much more active stance and control over the resources of the project, and implemented it to satisfy its new priorities. While PFMCPB may have evolved in a way different from how it was originally designed, the presence of its different components in the MoF was instrumental in speeding up budget execution rates and getting the money flowing into the economy.

4.58 The restructuring of the project in early 2010 brought the PFMCPB more in line with the government's priorities and addressed some of the issues raised by a 2008 QAG review, a key one being its high complexity. These changes included a better alignment with the new structures of the MoF, a simplification of the program, and a revision of the development objectives to make them more realistic.

4.59 The project has delivered substantial benefits in recent years. The 2009 budget was developed using PFMCPB TA, with significant improvements in the performance of line ministries. There was also a satisfactory improvement in recurrent and capital budget execution, albeit with some variation across ministries. Advisors hired through the project formed a critical mass of capacity within MoF management and line functions.⁸⁸ They provided much of the technical capacity behind expansion and improved execution of the budget. This was particularly important as the government undertook a major public works program in 2008-09 to stimulate the economy. The tenfold increase in the size of the government's budget since 2005 would not have been implementable without the support of the PFMCPB. In this regard and despite the Bank's advice against the fiscal expansion, the project also played a role in helping government stabilize the country after the 2006-08 crisis. A critical factor has been strong government ownership of the program since 2007, which was a marked change from the uneven ownership prior to 2006.

4.60 While PFMCPB can be credited with these positive outcomes, it is also the case that slow Bank action resulted in missed opportunities to align the PFMCPB with the TSP and CSP in 2005, and to strengthen capacity and budget execution when it was really needed.⁸⁹ A key factor undermining timeliness was a lack of attention and support provided to the project within the Bank. At some points there were reportedly discussions within several donor systems about withdrawing from the program over performance concerns. The Bank's reporting also cited insufficient support and supervision as a factor behind the slow start-up in 2007, more than a year after effectiveness.

⁸⁸ Advisors hired within the program fall into one of two groups. One group is composed of foreign advisors, who are responsible for designing new policies and structures. The other group is Timorese, with good command of English and Tetum and with solid technical training. This group is responsible for interacting with the foreign advisors and subsequently transferring that knowledge to the Timorese staff that is fluent only in Tetum or other local languages.

⁸⁹ If public financial management and budget execution had been up to par when the petroleum revenues started to flow in 2005, the country would have been in a different position to have a looser fiscal stance and, to some extent, avert or palliate the 2006 civil strife.

Technical Assistance Projects

4.61 Aside from the grants mentioned above related mostly to capacity building, the Bank provided two small grants to strengthen the government's poverty monitoring and analysis. These were:

- An IDF grant labelled Strengthening Capacity for Poverty Analysis, Monitoring and Strategy Formulation to help the government with the initial steps with basic training in data management and analysis, including the dissemination of the outcome of the poverty assessment done a year before;
- An IDF grant called Enhanced Poverty Monitoring and Analysis to back the Directorate of National Statistics in their planning and implementation of the second national survey of living standards

4.62 Measured against their original objectives, the results of these grants were limited. The first grant was approved in 2002 and was closed in 2005 without being fully disbursed. The label of the grant was more ambitious than the activities themselves, and aside from scant capacity building on surveys, the bulk of the grant was used in disseminating the results of the 2001 survey. The second grant also had unrealistic aims. In the event, the grant, which was approved in the second half of 2005, was instrumental in helping the Government carry out the second survey. That survey was concluded in early 2008, using resources from the PFMCBP because those from the grant could only cover the work leading up to the launch of the survey. These two surveys, one done by donors in 2001 and one supported by the Bank in 2008 are the only two sets of comprehensive information on poverty in Timor-Leste.⁹⁰

OUTCOMES FOR FISCAL AND PUBLIC FINANCIAL MANAGEMENT SYSTEMS

4.63 Compared to 1999, Timor-Leste has made very significant progress in setting up a system of fiscal and public financial management. The stable macroeconomic environment and the growth in the budget in recent years speak loudly about this progress. The basic institutions for fiscal and public financial management have been set up and are functioning. Fiscal policy in general and expenditure policy in particular, are now planned and with increasing focus on public service delivery. These policies are better grounded, using more reliable estimates of the macroeconomic aggregates and the needs of the population. The utilization of petroleum revenues is governed by a prudent and transparent framework widely regarded as best practice.⁹¹ The improvement in budget execution has taken place in the MoF, as well as in some line ministries. Institutions of the state outside of the executive, such as Parliament, are also in better condition to discharge their functions.

⁹⁰ Additional partial information on poverty can be found in the census carried out by the government recently. IEG understands that additional efforts to measure poverty were undertaken by the Bank in FY11.

⁹¹ A 2007 Peterson Institute survey of 32 sovereign wealth funds ranked Timor-Leste's Petroleum Fund as third best in terms of governance arrangements and management performance; a 2008 follow-up ranked it the fifth of 34 funds. Source: ISN, p5, footnote 16.

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4.64 Notwithstanding these improvements, Timor-Leste still has much to do to fully develop its fiscal and public financial management. Use of the systems needs to be spread evenly across all government agencies and all levels of government, including the local. The new procurement system needs to be tested, to see if the two amendments have made it better adapted to the needs and circumstances of Timor-Leste. Parliament, the judiciary and the other oversight institutions need to be strengthened so that they can fulfill their function as checks and balances appropriately. More importantly, the part of the budget that is financed with donor funds must be brought into the overall budget and be discussed and aired as is the rest of the budget—for the time being, donor funded projects remain non-transparent. Furthermore, the investment budget still lags the current budget in execution rates, suggesting that there still is much room for improvement of the budget system.

4.65 The Bank's efforts to help Timor-Leste develop the needed fiscal and public financial management systems were late to bear fruit, and have faced significant adaptation challenges. Had the system been in place when the flow of petroleum revenues started, the Government of Timor-Leste would have been in a better position to tackle the unemployment and the deficiencies that triggered the discontent that preceded the civil strife of 2006. Moreover, some of the systems suggested by the Bank turned out to be ill-adapted to Timor-Leste, as was the case with the procurement system of 2000 and as amended in 2005. Bank support, together with the IMF and NORAD, helped establish the Petroleum Fund, and the consultation process led to wide acceptance from all sectors. The PFMCPB was implemented with a flexibility that allowed the government to move swiftly when it needed, playing a critical role in the improvements in budget execution and the expansion of public spending. These successes are weighed against the poor outcomes of the Bank's program until 2008, including the setting up of systems, like the one for procurement, that were not appropriate for the country's needs. On this basis the overall outcome of the Bank's assistance for fiscal and public financial management is rated *Moderately Unsatisfactory*.

Basic Legislative Framework

THE SETTING

4.66 The new state institutions needed a legal framework to define them and to guide their functions and operations. While the Timorese leadership had a clear idea that they wanted to move towards a modern legal system developed on the basis of Portuguese Law, they also wanted to break from the Indonesian Law that had ruled them through the occupation period. The change in the legal system implied bringing back to Timor-Leste legal institutions and courts that had been absent during decades, as well as starting from scratch in terms of conflict resolution and contract enforcement. Indeed, there were very few Timorese that had been trained within the Portuguese legal system. Nor were there many with legal training that were fluent in Portuguese. In terms of priorities, their talents and time would serve the new nation best by helping bring together a legal system that was consistent and coherent, as well as adapted to the customs and mores of Timor-Leste.

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THE BANK'S PROGRAM

Objectives and Bank Strategy for Creating a Legislative Framework

4.67 The FY00-02 TSS, which remained in place until 2005, explicitly set as one of the key areas of Bank support the development of the institutional, legal and regulatory systems of state, including the fiscal and public financial management systems. This support was the natural complement to the efforts that were being considered of creating the systems and developing the capacity for the new institutions and systems to work. Attention was paid at the time of the strategy to both the general legal framework, and the implementing regulations needed to help the legal changes to work on the ground. These implementing regulations, which are not essential in some legal systems, are critical in a civil law system like the Portuguese.

4.68 At the time of the CAS, which covered FY06-08, the governance pillar called for supporting the legislative framework, increasing the scope of the support quite significantly. The challenge of putting to work the system of checks and balances of the Constitution was faced head on in the legislative agenda. In addition, the eight targeted areas of the CAS included some where developing a legislative framework was of the essence, and which were not part of the agenda until then—the Ombudsman and the Inspector General are examples of this. Interestingly, Timor-Leste had already adopted a legal system based on the Portuguese at the time of the CAS.

4.69 As noted above, the ISN (FY10-11), focused on continuing the capacity building activities, to firm up the progress in governance, particularly regarding fiscal and public financial management. No additional legislative objectives were included in the ISN.

Bank-Administered Operations

4.70 The main vehicle of Bank support to the development of a legislative framework came through the development policy operations. These operations reflected the priorities of the strategy documents, giving life to many of the broad initiatives included in them. In addition, the PFMCBP ended up paying a role in supporting the legislative framework, even if at its inception that was not one of its development objectives. The programs used by the Bank to support Timor-Leste are listed in Table 15, and discussed below.

Table 15. Main Bank-Administered Projects for Legislative Framework, 2000-2010

Name of Program/Project	Year approved	Project Amount (US\$ millions)***	TFET and IDA funding* (US\$ millions)	IEG Outcome Rating**
Transition Support Program Series (TSP1, TSP2, TSP3)	FY03-04-05	99.4	90.3	MU,MU,MU
Consolidation Support Program (CSP)	FY05	10.0	9.5	MU
Public Financial Management Capacity-building Project (PFMCP)	FY06	44.5	7.0	Active

* IDA includes IDF and DGF grants as well;

** U=Unsatisfactory, MU=Moderately Unsatisfactory, MS=Moderately Satisfactory; []=Internal Reviewing Document Rating; *** disbursements for closed projects; commitments for active projects.

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The Transition Support Program (TSP)

4.71 The support for the legislative agenda in the TSP series covered many areas. Beginning with design of an annual legislative program, the TSP included legislation on the establishment of the Ombudsman (*Provedor*), the Inspector General, the Petroleum Fund, legislation on local governments, a legislative and regulatory framework for civil service reform, a Budget and Financial Management Law, a Public Procurement Decree (revising the existing system), a Superior Council of the Judiciary Law, a Public Registrations Law, a Public Prosecutors Organic Law, a Public Defenders Office Organic Law, a law on domestic violence and a law on veterans.⁹² These were in addition to other laws on education, private sector development and other areas that were part of the matrix.

4.72 The outcome of all these efforts was mixed. The Bank's support was central in creating the consensus and bringing about the Petroleum Fund Law, which was adopted as a prior action to the follow-up program CSP. The Bank also provided some guidance on the Veterans Law, which was also approved after the TSP series closed.

4.73 On two other cases (Ombudsman and Inspector General) the laws were approved, but the institutional development that was expected from them did not turn out as expected, despite the Bank's grants to support the implementation at an operational level. These two institutions were alien to the legal system that was developing based on Portuguese Law, and did not seem to respond to widely acknowledged issues that needed redress. These institutions come across as free wheels within the overall legal system of Timor-Leste.

4.74 In the majority of cases, draft laws were presented and even approved, but their institutional development outcome is unknown or unclear. The overload that this ambitious agenda had on the government and the Parliament was quite significant. More challenging was the impact on the team that was working in keeping the new legislation congruent with the rest of Timor-Leste Portuguese-based legal system, and in line with the uses and mores of the country. As noted before, there were just a few lawyers with legal training on the Portuguese legal system. Issues with the congruence and adaptation of the new legislation to the conditions and circumstances of Timor-Leste may have been a major force behind the delays in approval and the lack of implementation of the proposed legislation. Moreover, it seemed in practice often overlooked that most of these legislative pieces required of a set of implementing regulations to be able to come to life, a further challenge to the already overburdened government officials and the group of Portuguese Law trained lawyers.

4.75 The revision of the procurement law is a special case that illustrates the issues of transplanting legislation without adapting it. The reform, expected to be approved in 2005, was meant to reform the system that the Bank had helped put in place in 2000.⁹³ The 2005

⁹² The staff acknowledges that the Bank only provided informal guidance to those in the government drafting the legislation on veterans. Under these circumstances, it is unclear why the veterans law was included in the TSP series

⁹³ Timor-Leste's initial regulation on procurement was the *Regulation 2000/10 on Public Procurement for Civil Administration in East Timor*, issued by the UNTAET, which remained in force after independence. This regulation was based to a large extent on a draft prepared with technical assistance funded by the World Bank and reflects in a compact manner many basic principles and procedures

reform has been reformed once more in 2010. Both the government and major stakeholders had pointed out the flaws that made the 2005 so difficult to implement.⁹⁴ The 2005 version was perceived as too complex, generic, and ill adapted to the conditions and legal system of Timor-Leste, as was the initial one adopted by UNTAET. It became a challenge both for the Ministry of Finance and the line ministries. In particular, the law severely constrained the government's ability to spend, and led to patches that were perceived as non-transparent by some.

Consolidation Support Program (CSP)

4.76 The CSP aimed at consolidating efforts in the legislative framework, which had been initiated within the TSP series and were still either in the legislative process or in the implementation process. These included the directive on the policy and legislative process, the Budget and Financial Management Law, the Public Procurement Decree Law, the Petroleum Fund Law, the disciplinary regulations for the civil service, and the Medium-Term Expenditure Framework Budget.

4.77 Eventually, some of these efforts did translate into legislative action, in spite of the difficulties with the CSP. The Petroleum Fund Law and the Public Procurement Decree Law were adopted in 2005, and the Budget and Financial Management draft, significantly watered down to reflect mostly institutional changes, became law in 2009. The directive on the legislative process and the civil service disciplinary regulations were left pending.

Planning and Financial Management Capacity-Building Project (PFMCP)⁹⁵

4.78 The PFMCP was conceived as a complement to the TSP series and the CSP, and hence left the legislative agenda to them. However, as the TSP and the CSP evolved and faded, the PFMCP gained stage to help with two important pieces of legislation related to fiscal and public financial management – the new revision of the Procurement Law and the Budget and Financial Management Law. With advice from the EU and other donors, as well as support from the Bank, the government revised once more the Procurement Law in early 2010.

4.79 In 2009 the Government of Timor-Leste adopted the Budget and Financial Management Law, which had started the rounds with the TSP series. The Law, as adopted, included adaptations to the institutional changes that had taken place since the UNTAET times, and a new provision for borrowing. This new law replaced the one that was in place since 2001, UNTAET Regulation 2001/13. The old system was sound, but had many flaws that should have been addressed much earlier, especially before 2005. A key one was that, in the view of the authorities, it was not appropriate to deal with a budget of the size and the complexity of the one that came with the flows from the Petroleum Fund. A second one was that it had expenditure management systems that were rudimentary and biased to-

set forth in the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Procurement.

⁹⁴ The European Union raised several issues with IEG, and played a role in the most recent reform.

⁹⁵ The broader lessons regarding PFM capacity-building are discussed in Annex 4.

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wards very strict controls that effectively slowed budget execution and, thus, spending. A third one was that it had no clear arrangements for external audits of the budget by Parliament.

OUTCOMES FOR LEGISLATIVE FRAMEWORK

4.80 Timor-Leste has made much progress in developing the legislative framework needed for its governance. It now has laws that govern taxation and customs, as well as the exploitation and use of its petroleum wealth. It also has a public financial management law that is better adapted to its reality, and that has allowed the increase in spending, something central for restoring social stability. Procurement legislation has taken several rounds. Although it seems to be making progress towards better adaptation, challenges still remain. Rudimentary systems of checks and balances are now in place.

4.81 Timor-Leste, however, still has a long road ahead in the development of the legislative framework. A central challenge is to harmonize the different pieces of legislation that come from separate legal traditions, so that they are congruent and adapted to the uses and mores of the country. An additional one is to develop the implementing regulations that are needed to bring these laws to life. Yet another one is to fill in the blanks that have been left behind in the haste that seems to have dominated the legislative process until now. How all the pieces of legislation come together to create a wholesome and comprehensive legal system is a pressing question that needs to be addressed.

4.82 The WBG has supported the development of the legislative framework in a wide set of areas (Table 16). Perhaps the coverage has been too wide for Timor-Leste's capacity – too many draft laws for a new Parliament and for a few lawyers capable of adjusting the drafts to the Timor-Leste's nascent legal system. The capacity challenge is even greater if the capacity to implement the new laws is factored in – no significant effort seems to have been made to adapt the new legislation to the civil service capacity that was actually on the ground. While the urgency is pressing, the need for a structured and strategic vision was all the more relevant in light of the limited resources and capacity. Just as with the efforts in capacity building, there was and still is an urgent need for a needs assessment, for a strategic vision, and for a workable plan of that strategy that can be monitored. In these regards, the WBG fell short by not bringing in a strategy, a thorough understanding of the challenges of setting up a new legal system under a civil law tradition, and an acknowledgement of the limitations faced by Timor-Leste. Taking these facts into consideration, the outcome of assistance in this area is rated *Unsatisfactory*.

Table 16 Timor-Leste - Legislation Adopted with World Bank Group Support

2000
Procurement Law - UTAET Reg. 2000/10 - Revised in 2005
2002
Organic Law for the Ministry of Health
Statutes of the Judicial Magistrates, 2002/8, 2004/11
2003
Aviation Law 2003/1
Establishing the Communications Regulatory Authority and Approving the Statutes
Part I of the Land Law

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Petroleum Development of Timor Sea (Tax Stability)

Taxation of Bayu-Undan Contractors

Telecommunications Regulation Law and Public Broadcast Corporation Regulation

2004

Civil Identification Law 2004/2

Decree law on Community Authorities 2004/2

Commercial Companies Law

Customs Code

Education Law- Organic Law for MoEC 2006/21

Legal System of Notaries 2004/3, amended in 2009

On General Bases of the Legal Regime for Fisheries and Aquaculture Management and Regulation 2004/6

National Defense Law 2004/7

Organic Law for Office of the Inspector General (OIG) 2003/7

Organic Law of Ombudsman 2004/7

Health Act 2004/10

Pharmaceutical Activities 2004/12

2005

Domestic Investment Law - 2005/4 Under Revision

Foreign Investment Law - 2005/5 Under Revision

Institute of Entrepreneurship Development Support (IADE) - Under Revision

Leasing between private parties

Petroleum Fund Law

Procurement Law - 2005/10 Amended in 2010

Regime for the Licensing, oversight and regulation of Insurance companies and insurance intermediaries

Trade Invest Timor-Leste - Under Revision

Law on Petroleum Activities

Water Service 2005/14

2006

Organic Laws for Public Prosecutors and Public Defenders 2005/14

Business Registry Code - 2006/1 Revised and Under Revision

Organic Law of the Superior Council for Defense and Security 2006/16

Education Law- Organic Law for MoEC 2006/21

Tariff Regulation for Power Supply 2006/22

Veteran's Legislation 2006/3

2008

Law on the Council of State 2008/7

Tax law 2008/8

Veteran's Legislation - additional. 2009/9

Education Law 2008/14

2009

Legal System on Supply to the Autonomous Department for Drugs and Health Equipment

Budget and Financial Management Law 2009/13

2010

Procurement Law 2010/2

Law on Domestic Violence 2010/7

5. Pillar III. SUSTAINABLE AND DIVERSIFIED NON-PETROLEUM SECTOR FOR JOB CREATION AND ECONOMIC GROWTH

The Setting

5.1 Timor-Leste was primarily an agricultural economy, and remains as such if petroleum income is excluded. Prior to 1999, about three quarters of its people derived their primary means of livelihood from land. About a third of GDP derived from agriculture. Activities in the modern industrial sectors including manufacturing, utilities, banking and finance accounted for less than 8 percent of GDP. Economic activity, including private sector activity was governed by the legal and regulatory framework of Indonesia.

5.2 The 1999 violence virtually destroyed the economy, including the private sector. Critical infrastructure (such as electric power, roads, telecommunication, the banking system) were laid waste. The small modern sector, including manufacturing and services, was hardest hit by the exodus of the non-Timorese. The links to the legal and regulatory framework (and institutions) of Indonesia that governed and regulated economic activity were severed and no new laws or local institutions existed to take their place.

5.3 As laid out in the JAMR and the TSS, the immediate priority of the WBG (and the international donor community) in the aftermath of the 1999 destruction was to restore law and order, establish macro-economic stability, provide basic social services and help re-start business activity so as to create incomes and reduce unemployment.

5.4 The expectation at that point was that the off-shore oil and gas fields shared with Australia would start to bring revenues in the middle of the decade, and that several steps were needed to help Timor-Leste move into a sustainable development path. For one thing, the country needed assistance in negotiating with Australia and in putting into place a mechanism to deal with the impact of petroleum revenues. For another, balanced and sustainable growth with high employment levels called for the development of a vibrant non-petroleum sector in the economy. That non-petroleum sector would have to be rooted in the agricultural sector, and would have to rely heavily on small business development. Although petroleum production may over time result in some down-stream industries and opportunities for growth in the service sector, such activities are unlikely to be a significant source of employment as these industries are largely capital-intensive. The main challenge was therefore to use the petroleum wealth prudently to stimulate sustainable non-oil growth and reduce poverty.

5.5 The WBC's initial diagnostic about the need to develop a strong private sector based on agricultural development and small businesses remains valid to this date. IEG's consulta-

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tions with different stakeholders, including domestic and private investors, point at these two elements as central to any strategy to develop a non-petroleum sector. Those same consultations rank as the most urgent constraints to private development the absence of an adequate infrastructure that allows goods to flow from rural areas to the domestic and export markets, the lack of a reliable supply of energy, the low levels of agricultural productivity, and, lastly, the governance aspects, including the regulatory environment and the judicial system.

Private Sector Development⁹⁶

WBG'S STRATEGY AND OBJECTIVES FOR PRIVATE SECTOR DEVELOPMENT

5.6 Starting in 2002 the WBG's program to generate a vibrant non-petroleum sector focused on creating an enabling environment for private sector development (PSD), including the legal and regulatory framework, and the development of key physical infrastructure such as electric power.⁹⁷ The basic thrust of the WBG's strategy did not change after the production of oil and gas added significantly to the government's revenues.

5.7 The CAS saw private sector development (along with agriculture) as central to sustainable growth and job creation. In support of PSD, the CAS envisaged measures to create an enabling environment which included:

- Development of the legal framework to make it business friendly, through the enactment of new laws (such as on investment, leasing, credit and collateral, and land and property rights) as well as the simplification of business regulations (such as registration and licensing) inherited from Indonesia;
- Training for civil servants to improve their interactions with business;
- Awareness and capacity-building programs for prospective entrepreneurs;
- Creation of an Investment and Export Promotion Agency to promote foreign direct investment in sectors such as eco-tourism, niche markets for traditional products and agribusiness;
- The development of a credit and collateral registry;

⁹⁶ This section focuses on non-agricultural private sector development; the agriculture sector is discussed separately. However, in the initial strategy documents the Bank understood the importance of the agriculture sector as a key element in the development of a local private sector, and placed a high emphasis on fostering it as a means to private sector development (JAMR and TSS). The initial strategy included a Rural Recovery Program based on a dozen different projects designed to move the agricultural sector from barter to trade (JAMR).

⁹⁷ Good governance, and in particular policies and programs to prevent corruption and strengthen the judiciary, were also an important part of the Bank's strategy and these programs were expected to improve the business environment as well.

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- Training and support programs for microfinance institutions; and
- Supporting the expansion of the three existing commercial banks to rural areas.

5.8 The CAS supported planned initiatives to create a structured dialogue between the private sector and the government so that key problems areas could be identified and addressed effectively. On financial sector matters, the WBG followed the lead of the IMF.

5.9 The CAS envisaged the IFC establishing and implementing a five year technical assistance program through the Pacific Enterprise Development Facility (PEDF). This program's objective was to build upon the work undertaken by the Bank through TFET to improve the business environment for small and medium enterprises, focusing on access to finance, tourism, agribusiness, and entrepreneurship development. All programs were to be designed to:

- Facilitate investment in the priority sectors;
- Complement and work in partnership with other donors;
- Tackle obstacles in the business environment;
- Integrate considerations of sustainability, including environment, gender, and governance; and
- Identify clear metrics for effective monitoring and evaluation.

5.10 The Foreign Investment Advisory Service (FIAS) was expected to complement work undertaken in these areas.

5.11 In the immediate aftermath of the 2006 unrest, the ISN (prepared jointly with IFC) was largely focused on short-term measures to restore social stability, while at the same time laying the foundations for higher rates of growth in the non-oil sector. The ISN envisaged continued IFC support to the government and the private sector to improve the investment climate and help enable business development through business registration and licensing reform, improved access to financial services, and targeted legislative support and assistance to the tourism sector. IFC was expected to continue to serve as the Secretariat to the Better Business Initiative (BBI), which sought to provide a platform for effective and result oriented dialogue between the business community and the government on specific investment climate reform priorities. Other possible initiatives that the WBG could support for private sector development included:

- Creation of a credit bureau;
- Support to public private infrastructure partnerships;
- Piloting of SME loan products and risk sharing facilities to connect local entrepreneurs to markets and increase the private sector's access to finance.

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5.12 IFC was also expected to consider catalytic investments intended to accelerate medium term growth in areas such as tourism, agribusiness, natural resources, infrastructure and micro-finance.

5.13 While the WBG recognized that in the short-term the public sector had a larger role to play in generating growth and creating jobs, it saw the private sector as the engine for growth and employment in the longer term.⁹⁸ This assumption, which is reasonable for many economies, should have called for going beyond the standard Doing Business approach and identifying and addressing what was really needed to have a flourishing private sector in a country like Timor-Leste. Given the absence of entrepreneurial tradition and skills, the lack of any obvious areas of comparative advantage, the small agriculture-based subsistence economy, and the total destruction of all non-agricultural production facilities in 1999, a lot more than a “right” legal environment was needed to have the meager private sector become the engine of growth. Moreover, it was not clear from the WBG’s documents wherfrom private sector growth was going to come or how fast it could come; nor how important non-petroleum private sector activity could realistically ever be relative to the public sector that over some time would benefit from huge revenues from the petroleum sector. The strategy might have been more realistic and more credible if it had addressed such questions up-front and focused on identifying and removing binding constraints in specific areas where the private sector could have a future (such as agri-business and tourism).

5.14 Nevertheless, the strategy correctly recognized what was generally needed to stimulate the private sector (a stable macroeconomic environment, better infrastructure, particularly roads, ports, electric power and telecommunications, improved access to credit, and a stable and business friendly regulatory regime. In three of these areas (macroeconomic policy, infrastructure and the financial system) the WBG had a secondary program, as these areas were led by other donors, most notably the ADB and the IMF.

THE BANK’S PROGRAM

5.15 The Bank administered two investment projects during 2000-02 in support of private sector development. These projects are listed below in Table 17. PSD was also an important component of the TSP and CSP, the development policy operations, during 2003-06 (listed in Table 4). IFC operations (after 2006) are discussed separately.

Table 17. Bank-Administered Projects in Support of PSD, 2000-10

Name of Project	Year Approved	Project Amount (US\$ millions)	TFET+IDA Funding (US\$ millions)	IEG Outcome Rating*
Small Enterprise Project 1	FY00	4.85	4.85	MU
Small Enterprise Project 2	FY02	7.42	7.42	MU

*MU=Moderately Unsatisfactory.

⁹⁸ For example, the Program Document for TSP2 states “Job creation, especially for the youth and ex-combatants, is critical to stability. The government recognizes that private investment will have to take the lead and the importance of an appropriate regulatory and enabling legal framework. At the same time, the government intends to use public spending and external financing as a tool for job creation”. p 14.

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5.16 The main objective of the small enterprise projects was to help re-start viable business activities in the private sector and generate sustainable income and employment. To achieve this end, the focus of the first project was to provide credit on commercial terms to viable small and medium enterprises through an intermediating financial institution. The project also supported capacity-building, including:

- The restoration of essential elements of a land and property administration system;
- Rehabilitation of buildings for establishing four Business Development Centers (BDC) that would provide technical services to clients; and
- Implementation of business skills training programs.

5.17 The second project was a follow-up of the first project and also focused on providing lines of credit on commercial terms to small and medium enterprises. It also sought to rehabilitate marketplace infrastructure. However, one and a half years into implementation, the credit component of the project was cancelled because of lack of demand as well as high levels of payment defaults under the first project. The funds were reallocated for capacity-building in the private sector including:

- Business development services (BDS);
- Training for civil servants in “PSD theory and practice”;
- Development of an enabling business regulatory environment;
- Promotion of Government-Business dialogue;
- Provision of services to private microfinance providers and borrowers under other credit projects; and
- Establishing an investment and export promotion agency (TradeInvest-TITL).

5.18 The first project was partially successful in helping re-start viable business activities. According to the ICR, about 341 small businesses were established in 13 districts, and about 1200 new jobs were created. Most of the sub-loans financed transportation (trucks, buses, and taxis), shops, restaurants and personal services. 83 percent of these businesses were still operating when the project closed, though it is not apparent how many survived the economic downturn following the withdrawal of the UN in 2002-03. This downturn was also partly responsible for the poor repayment performance of the loans. According to the ICR, three-quarters of the loans were in default by early 2003, a major factor behind the cancellation of the credit component of the follow-up project.

5.19 The capacity-building and training activities were largely unsuccessful. Reports on the land and property system added little value to policy-makers, and the training programs came too late in the project cycle to be of much use to the intended beneficiaries. The BDCs

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got their buildings but they were yet to provide the full range of services at the time the ICR review was undertaken, more than three years after the project became effective. IEG rated the outcome of the project as *Moderately Unsatisfactory*.

5.20 The second project was even more problematic. With the cancellation of the credit component, the project did not directly create new businesses or new jobs. Nor was there any impact on SME competitiveness. Perhaps the main achievement was the improvement in marketplace infrastructure brought about by the rehabilitation of 69 markets accounting for about 50 percent of the total number of markets rehabilitated and built at the time in Timor-Leste. While the ICR claimed that significant progress had been made in improving the business regulatory environment and registration and other processes had been simplified to make it easier to start a business, this was clearly insufficient as the WBG continues to find to this day that the process is too complex and remains a constraint to private activity.

5.21 Business development services were provided through the project but their impact is uncertain. The Government-Business dialogue process was initiated through several meetings, and while the government may have become better acquainted with the issues and concerns of the private sector, it is not clear if any concrete actions were undertaken as a result. An autonomous Investment and Export Promotion Agency (TITL) was established under the project, though the weak growth in non-petroleum foreign investment does attest to its failure in promoting and facilitating foreign direct investment. The project closed three and a half years behind schedule and IEG rated its outcomes as *Moderately Unsatisfactory*.

The Development Policy Operations

5.22 Private sector development was included in the strategic pillars of two development policy programs, TSP (2003-05) and CSP (2006). The private sector development agenda in these operations was largely centered on the framing and adoption of laws to regulate private sector activity. Two other areas that were seen as inhibiting private sector activity, corruption in government and a weak legal system, were targeted through the governance components. The adoption and implementation of a legal framework for ensuring that petroleum revenues are used prudently and transparently so as not to endanger macro-economic stability (and hence private sector development) was also a key element. Very little was attempted through these projects to improve critical physical infrastructure, or the private sector's access to finance.

5.23 A number of laws meant to facilitate private investment were adopted during this period. These included laws on commercial entities, investment, insurance, bankruptcy, co-operatives, and leasing of government property. A land law addressing publicly owned real estate was also passed in 2003. However, a clear sense of priorities or legislative strategy was missing. Some laws that were not so important at the time (such as the bankruptcy law) were adopted, while other laws that were perhaps more critical are still pending (such as the law allowing the use of land and property as collateral). In other cases, the adopted law did not address the core issue. For example, the land law which was adopted by Parliament in 2003 clearly did not solve the problem of insecure land ownership rights, because it ignored the centuries-old system of communal property in Timor-Leste. Seven years after, efforts are still under way to find an appropriate solution to land-ownership rights.

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5.24 The other problem was that the focus was too much on adopting various laws, doing little on bringing about compliance with those laws, their enforcement, and their eventual use in the resolution of conflicts. Moreover, the congruence of legal advice based on legal principles different from those of Portuguese law that constitute the backbone of Timor-Leste's legal system remains an issue. Consequently, many important implementing regulations were not addressed, while other rules and regulations turned out to be too complex or even foreign for Timor-Leste, making it more difficult and costly to start and operate new businesses. The regulations for registration and licensing of businesses are particularly problematic, and recent Bank efforts, including of IFC, have been geared towards their adaptation and simplification.⁹⁹

5.25 The introduction of laws to facilitate private sector development was also not matched by a strengthened judicial system to enforce the laws. In the justice sector, more progress appears to have been made in establishing a legislative and regulatory framework for the judiciary and oversight institutions, and much less in building the capacity of the system to dispense justice quickly and efficiently. In addition, the issuance of laws in Portuguese brought a challenge for a judiciary that was not fluent in the new national language. Despite some training activities for judges, public prosecutors and public defenders, and international recruitment of judges supported by the programs, there remains a severe shortage of trained lawyers and judges; this has contributed to the increasing backlog of court cases, and undermined the confidence of the private sector in the court system.¹⁰⁰ Clearly, in hindsight more should have been done to address the human resources deficit.

5.26 The efforts to promote good governance and avoid corruption in government were also flawed. There was too much emphasis on creating the hardware of laws and institutions, without adequate attention to the quality, skills and training of people that were to run these institutions. Some of the institutions that were created (such as the Offices of the Ombudsman and the Inspector General) could be seen as transplants from other countries and contexts that were less applicable for the realities of Timor-Leste at the time and lacked ownership. Without sufficient trained manpower to implement their mandates, with a weak judicial system, and without being able to find their place in the overall governance framework, these institutions have proved to be of marginal significance in promoting good governance.¹⁰¹

Analytical and Advisory Services

5.27 The Bank produced a comprehensive CEM in 2002 which identified the problems facing the sector and the path ahead. This work provided the basis for some of the legal and

⁹⁹ After supporting the formulation and adoption of laws to regulate PSD through 2000-05, the Bank apparently first raised in the context of the FY06 CSP the need for simplification of regulations, especially for registration of businesses. Four years later IFC is still identifying the elements for reform of business registration and licensing.

¹⁰⁰ As noted in the ICR for TSP3 (p.6), by the end of the three-year TSP period, Timor-Leste still did not have one qualified national judge.

¹⁰¹ Indeed, as pointed out in the ICR review of TSP3, the "Governance Matters" rating for control of corruption declined in 2005 and 2006.

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regulatory reforms undertaken under the budget support operations. Periodic Doing Business Surveys were also undertaken starting in 2006. These have been extensively quoted in assessing progress in the business environment, and used to identify key changes in the regulatory regime. The Bank also prepared a private and financial sector assessment report.

5.28 Two TA activities to help establish a credit registry were also completed by the Bank but these were not followed through to their logical conclusion. There were differences with IFC on the nature of the credit registry (public as desired by the government or private as desired by IFC), and its location (within country as desired by the Government or within the Pacific Islands Region as desired by IFC). Eventually the Government of Timor-Leste disengaged from the WBG on this topic and is developing a simple credit registry at the Banking and Payments Authority (BPA), with cooperation from the existing three commercial banks.

IFC IN TIMOR-LESTE

5.29 IFC launched its operations in Timor-Leste in August 2006, a few months after the eruption of violence. Compared to the ambitious agenda laid out in the CAS and the subsequent ISN, IFC's actual program was very limited in scope and it has been unable to implement most of the ideas expressed in the CAS and later in the ISN. Thus IFC has not approved any investments, nor provided any support for public private infrastructure partnerships, or piloted any SME loan products or risk sharing facilities. The main focus of IFC activities was on technical assistance and advisory services, which are discussed below.

Advisory Services

Table 18. IFC Advisory Services in Timor-Leste, FY06-10

Approval FY	Project Name	Status as of July 2010	Total Funding, US\$
2006	Access to Finance Workshop in Timor-Leste	Closed	15,079
2008	Timor-Leste e-booking implementation	Active	50,000
2008	Timor-Leste Public-Private Dialogue	Active	858,000
2009	Timor-Leste Business Registration and Licensing Reform Project	Active	750,000

Source: IFC database

5.30 The Workshop on Access to Finance was a one-day workshop to identify barriers to finance in Timor-Leste. However, there was no follow-up action. The 2008 E-booking project supported the setting up (apparently successfully) of a dedicated web-site and on-line booking engine for facilitating domestic lodging and hotel bookings from international travelers. The Public and Private Dialogue project created the Better Business Initiative, a forum for enabling effective and result-oriented dialogue between the government and the private sector. Finally, the Business Registration and Licensing Reform project was initiated at the request of the government, which has identified business registration reform as a priority. An