

COMBATING POVERTY AS A NATIONAL CAUSE

Promoting Balanced Development
and
Poverty Reduction



Democratic Republic of Timor-Leste
March 2006

COMBATING POVERTY AS A NATIONAL CAUSE

PREFACE

OUR STRUGGLE

When one reads that Timor-Leste is independent but is becoming poorer, it makes my soul ache. Is it really so? Has our effort during the last five years been for nothing? Even though the reports show a negative growth trend during the first years after the Restoration of Independence (due in great part to the departure from the country of several thousand internationals who artificially enlivened our economy following 1999), the economic indicators show that Timor-Leste has been recovering and that it will grow during the next few years. This is the truth that the numbers show. But the reality is also that we remain the poorest country in Asia.

It is clear that poverty, which is the worst of diseases, is a condition that affects many Timorese. A great number of them. But it is for them – in order to improve their living conditions – that we have been working and that we will keep on working. It is undeniable that life in Díli is better than in the other districts of our country. The capital, a lighthouse in the search for stability, attracts many people that come in search of work, leaving the fields where subsistence agriculture still prevails. In order to make sure this is not a permanent scenario the Government began by establishing 2006 as the year of solidarity and human development. Then, in a macroeconomic policy perspective, it determined that combating poverty must be seen as a national cause. Indeed, it is not enough for the State to concentrate its action on the improvement of the living conditions for most citizens. It is vital that all of us, politicians, religions, non governmental organisations, donors and professional and youth organisations come together to start a new struggle.

In 2002 we yearned for the Restoration of Independence, a rightful accolade of a legitimate ambition which is acknowledged by all. Some of us thought that independence and democracy would be a synonym of immediate development. It was not. It never is. First it was necessary to build up the State, as a structure where the Rule of Law prevails. The Public Administration was created, based on the long experience of our struggle and enriched by the many cultures of the international staff that came to help build it, and the respect for the law was institutionalised. This was no small feat. In three years we have managed what other States have taken decades to achieve, and only in a shy way: we have a functional structure of State and we are aware that the respect for the law is a reality. We have a State!

With this background, we can now move on to the overarching goal: helping our people to reduce the gap that separates them from other countries in the region where we live. Therefore, it is time to mobilise the entire nation in an effort to combat poverty. This report, a successor of the “Sector Investment Programs Overview Report”, shows us the

way, the guidelines of the Government strategy to accelerate the fight against poverty, giving us an assessment of the state of the Timorese economy.

Even though the effort in this fight must be collective, with all parties involved, it is up to us, the Government representatives, to play an essential role: to put the State, that machine that we have structured in three years, at the service of the citizens, to become the locomotive of the Timorese economy. By choosing a coherent, sector-crossing and universal public investment policy, we seek to bring development to the most remote “knuas”, so that, step by step, we manage to really improve the living conditions of us all.

To all those who contributed with their assistance in producing this report, namely the Ministry of Planning and Finance, I hereby give my heartfelt appreciation.

Mari Alkatiri
Prime Minister

March 17, 2006

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Executive Summary

Timor-Leste has made impressive gains since the restoration of Independence in its transition from that of a post-conflict country. Most of the institutions provided for in the Constitution have now been established. Capacity building programs for institutional and human development have been expanded, and there has been good progress in providing growing numbers of people with access to education and health services. Moreover, in the past two years the economy has begun to recover from the contraction that followed the departure of large numbers of UN and other personnel beginning in 2002. Non-oil gross domestic product (GDP) is estimated to have grown by about 2% in real terms in 2005. There has been a significant increase in food production since the drought in 2002/03 that has contributed to the decline in domestic inflation and reduced levels of food imports in the past two years. With continued good performance in agriculture, and a large increase in public spending, the non-oil GDP growth rate is expected to rise to about 5% in 2006.

Despite these impressive gains, the fact is that far too many people remain in poverty, or remain vulnerable to poverty and food insecurity. With the prospect of substantially larger financial resources from oil and gas revenues, the Government believes that the Nation must now be mobilized to combat persistent widespread poverty. Among the many challenges that face the Nation, the following stand out.

- High levels of poverty, especially in rural areas, where there is continued heavy dependence on subsistence agriculture and vulnerability to food shortages
- Large numbers of people who still do not have access to basic services of adequate quality, including education, health, safe water and adequate sanitation
- Insufficient productive employment opportunities for the rapidly growing labor force
- Weak private sector and low levels of private investment needed for job creation
- Poor infrastructure services in combination with rapid urbanization
- Inadequate human resources and institutional capacities

The Government has a four-pronged strategy for poverty reduction: (i) promoting opportunities for the poor; (ii) improving access of the poor to basic social services; (iii) enhancing security, including reducing vulnerability to shocks, and improving food security; and (iv) empowering the poor and vulnerable groups.

A stronger economic growth performance is central to the campaign to combat poverty. International experience over the past half century indicates that economic growth is the single most important factor that influences poverty reduction outcomes. In the year ahead, the Government will launch a major step-up in public spending that, in combination with rising levels of private investment, will lift economic growth to 7-8 % a year from 2010. Given that population and the labor force will continue to grow rapidly for another decade or more, the Government believes that a non-oil GDP growth rate of 7% a year or more in real terms will be required to ensure a sustained decline in the incidence of poverty in Timor-Leste.

Domestic and export markets are both expected to play an important role in providing the demand basis for accelerated growth. A major increase in government spending in the next five years will be an important source of domestic demand that, in combination with rising real household incomes, will have important implications for local business activities. Ongoing programs to improve the business climate and encourage private investment will be intensified. Increased levels of private investment in a range of opportunities that produce goods and services for the

international market will also play an increasingly important role. These include further development of commercial agriculture for export markets, development of the near-shore and onshore oil and gas industry that will also have important multiplier effects for the local economy, and steady growth in services such as tourism.

The second feature of the program is a large increase in levels of public and private investment that will be needed to underpin sustained strong economic growth. At the present time, investment levels in the country are equivalent to about 20% of non-oil GDP. Through prudent use of domestic and petroleum revenues, continued support from Development Partners and an aggressive program to promote private investment, the Government aims to raise the investment level to somewhere in the range of 40% of non-oil GDP by 2010. International experience indicates that with continued sound macroeconomic management, these levels of investment will permit sustained strong economic growth, increased productive employment opportunities, and declining levels of poverty.

The third key element of the national campaign to combat poverty is increased emphasis on promoting greater balance in the development of the country. This report sets out the main principles that will guide the Government's approach to achieving a more equitable balance in development. These are as follows:

- The benefits of strong economic growth must be broadly shared among all groups in society regardless of their geographic location.
- There is a need to promote several growth poles within the country to slow the growth in population in and around Dili and create a more balanced pattern of urbanization.
- There must be continued strong emphasis on improved access to basic services throughout the country, in both rural areas and small towns. These include health and education services, improved water supply and sanitation, electricity and increased access to transport and communications services at affordable costs.
- The bulk of the poverty in the country is in rural areas and is heavily concentrated among households that depend primarily on subsistence farming for their livelihood. There would be strong emphasis on programs that provide these families with increased opportunities for participation in the monetized part of the economy.
- There is a need for improved access to financial services, including microfinance programs for the poor that can facilitate production of marketable surpluses and involvement in trading activities. A more extensive banking network will be essential for sustained strong growth of the business community as well.
- The various initiatives that promote growth and employment must be complemented with targeted interventions that will afford additional protection to vulnerable groups, including those affected by seasonable variability. A number of programs are already underway. These are to be expanded.

The fourth element of the strategy for poverty reduction is continued prudence in macroeconomic management that will ensure a stable environment for growth and investment. The Government is committed to the prudent management of the increasingly large revenues that will flow from the development of the country's oil and gas resources. On many occasions, the Government has reiterated the importance that it attaches to avoiding the mistakes made by other resource rich countries that have led to macroeconomic instability and worse. Consistent with this commitment to sound economic management of the country's rich resource endowment, the Government has put in place a savings policy that will ensure effective management of petroleum revenues. Central to effective implementation of this policy is the Petroleum Fund, which was established

in August 2005, and which is widely regarded as an application by Timor-Leste of best international practice.

The fifth component of the strategy is a continued strong emphasis on building institutional and human capacities at both the national and local levels. It is clear that the capacities of the country to finance high priority development programs aimed at poverty reduction and improved well-being throughout the Nation now exceed capacities for effective implementation of these programs. The Government is pursuing a three-pronged approach in addressing this problem. First, notwithstanding the improved financing capacities of the country, Timor-Leste's Development Partners continue to have a very important role in helping to build these implementation capacities through direct support and by bringing to bear experience and lessons learned from other developing countries. Second, to overcome implementation constraints in the immediate future, the Government is considering greater use of international contractors who, in partnership with the local business community, can give an immediate boost to domestic capacities for program implementation. Third, the Government is redoubling efforts to build institutional and human capacities within the country, with particular attention being given to these capacities at a sub-national level. Achieving a more balanced and equitable pattern of development will require that local governments and civil society play a larger role in the national fight against poverty.

The report elaborates on these broad policy directions that will be taken by the Government to combat poverty and improve the well-being of all Timorese. The forthcoming Combined Sources Budget for FY2006/07 will begin to translate these programs into tangible action at both the national and local level. The newly created Sector Working Groups, with the support of Development Partners, are expected to play a major role in ramping up the nation-wide fight against poverty.

Part A: Progress and Current Challenges

What are the Goals of the Country?

Since restoration of Independence in 2002, the Government has articulated clearly its vision for the development of the country and, with the help of the donor community, has set about the pursuit of this vision. The National Development Plan (NDP), widely discussed during the course of its preparation, sets out the strategy for the five-year period 2002-2007. The strategy is driven by two key goals for the longer term.

- The reduction of poverty in all sectors and regions of the Nation; and
- The promotion of economic growth that is equitable and sustainable, and that improves the health, education and well-being of the entire country.

Table 1: Top Priorities for Development
(As Articulated in the 2002 National Consultation)

Region and District	Ranking of Priorities		
	First	Second	Third
Region I			
Baucau	Education	Health	Agriculture
Lautem	Education	Health	Employment
Viqueque	Education	Health	Employment
Region II			
Ainaro	Education	Health	Infrastructure
Manatuto	Education	Health	Agriculture
Manufahi	Education	Health	Agriculture
Region III			
Aileu	Education	Health	Agriculture
Dili	Education	Health	Employment
Ermera	Education	Health	Agriculture
Region IV			
Bobonaro	Education	Health	Infrastructure
Covalima	Education	Health	Employment
Liquiça	Education	Health	Employment
Region V			
Oecussi	Education	Agriculture	Health

These development goals for the country drew heavily on a national process of consultation held in early 2002. In this process, directed by Xanana Gusmão, more than 38,000 Timorese in all sucos participated in the consultation process. The process gave a clear indication of the priorities of communities throughout the Nation. The results of the Consultation were published by the Government in *East Timor 2020 – Our Nation, Our Future*. The consultation process identified Education, Health, and Economic Well-being as the three primary concerns of people throughout the country. More than 70% of those consulted put Education among the top three priorities for the Nation, followed by Health (49% of those consulted) and Agriculture (32% of those consulted). As Table 1 indicates, a majority of participants listed Education as the highest priority in all 13 districts of the country.

Subsequent to the preparation of the NDP, the Government recognized the need for a mechanism by which the longer-term goals and aspirations of the Nation could be translated into action. In 2003 it therefore began the preparation of sector investment programs for each of the key sectors of the economy. By mid-2005, a total of 17 individual SIPs had been prepared. Each articulated the goals and objectives for the sector concerned and established a clear sense of the priorities and programs for the medium-term. The 17 SIPs, which have recently been updated, give a clear account of the many challenges that confront the country. The current versions of the SIPs translate the longer term goals and aspirations of the Nation into detailed policies, programs and expenditure requirements for each sector for the period FY2005/06 through FY2009/10.

There has been steady progress in the pursuit of the national goals that were articulated in 2002, but the country continues to face major challenges in its efforts to improve well-being throughout the Nation. Themes that are common to many of the sectors include the following:

- High levels of poverty, especially in rural areas, where there is continued heavy dependence on subsistence agriculture and vulnerability to food shortages
- Large numbers of people who still do not have access to basic services of adequate quality, including education, health, safe water and adequate sanitation

- Insufficient employment opportunities for the rapidly growing labor force
- Weak private sector and low levels of private investment needed for job creation
- Poor infrastructure services in combination with rapid urbanization
- Inadequate human resources and weak institutional capacities

Sustained strong economic growth and balanced distribution of the benefits of growth remain central to the goals and objectives of the country, along with continued high priority for education, health and basic services such as safe water and sanitation.

Table 2: Selected Macro-economic Indicators, 2000-2005

Indicator	2000	2001	2002	2003	2004	2005
Population (mid-year in '000)	821.0	846.0	872.0	898.0	923.2	952.2
Non-oil GDP at 2000 constant prices (US\$ mill)						
Agriculture, forestry, fisheries	81.5	88.6	93.9	93.5	99.1	105.2
Non-farm private	98.2	107.9	107.4	106.2	108.0	110.5
Public sector	53.1	80.4	82.2	84.2	88.6	98.3
United Nations	83.4	91.5	60.3	38.6	28.0	17.0
Total non-oil GDP	316.2	368.4	343.8	322.5	323.7	331.0
Non-oil GDP growth (% p.a.)	13.7	16.5	(6.7)	(6.2)	0.4	2.3
Non-oil GDP at current prices	316.2	367.9	343.4	335.7	338.6	349.9
Inflation						
Non-oil GDP deflator (% p.a.)	3.0	0.1	0.1	4.3	0.5	1.0
Consumer price index (% p.a.)	3.0	3.6	(0.4)	0.1	0.8	1.8
Non-oil GDP per capita (US\$)						
At 2000 constant prices	385	435	394	359	351	348
At current market prices	385	435	394	374	367	367
Fixed investment (US\$ mill at current prices)						
Public	97.5	115.2	91.3	82.0	52.4	66.4
Private	21.3	30.2	27.6	23.0	7.5	7.5
Total fixed capital formation	118.8	145.4	118.9	105.0	59.9	73.9
Total investment as % non-oil GDP	37.6	39.5	34.6	31.3	17.7	21.1
International trade (US\$ mill)						
Merchandise exports	1.0	4.0	6.0	7.3	7.9	8.1
Merchandise imports	(82.4)	(86.5)	(92.6)	(104.0)	(113.3)	(101.6)
Trade balance	(81.4)	(82.5)	(86.6)	(96.7)	(105.4)	(93.5)

Note: National income accounts data for 2004 and 2005 are estimates.

Promoting Economic Recovery and Macroeconomic Stability

Over the past two years, there has been a steady improvement in the macroeconomic framework of the country and encouraging signs of a recovery from the sharp economic contraction in 2002 and 2003 that stemmed from the withdrawal of UN personnel. As Table 2 indicates, non-oil GDP is estimated to have increased by about 2% in real terms last year. The recovery has been helped by a strong performance in food production in the agriculture sector following the drought in FY2002/03, and substantial growth in bank lending to the private sector. Credit to the private sector rose from 2% of non-oil GDP at end 2002 to 25% at end 2005, made possible by a notable increase in demand and time deposits in the banking system. This measure of broad money supply has increased from \$20 million in 2000 to about \$95 million at end 2005, equivalent to about 28% of non-oil GDP.¹ The past year has also seen a significant increase in recurrent spending by the Government that has stimulated domestic economic activity. Macroeconomic stability has been further strengthened by a decline in domestic inflation, with the consumer price

¹ The estimate of broad money supply excludes currency holdings of the public, data for which are not available.

index for Timor-Leste increasing by a total of less than 3% in the past three years. External competitiveness has also improved with the depreciation of the US\$ in real terms. The real effective exchange rate vis-à-vis Timor-Leste's main trading partners, Australia and Indonesia, is now at the same level as it was at end 2002.

However, the pace of recovery has been restrained by a sharp decline in the level of fixed investment in the past four years. From the peak of \$145 million in 2001 (equal to 40% of non-oil GDP), fixed capital formation is estimated to have declined to about \$60 million in 2004 – equivalent to about 18% of non-oil GDP. Last year saw the beginnings of a recovery in capital spending as the Government placed increased emphasis on the role of construction activity as a means of creating employment throughout the economy and a number of new private investment projects got underway.

But the fact is that non-oil GDP per capita is still very low. From the peak of \$435 per capita in 2001, non-oil value added per person declined to about \$365 in 2004-2005. The contraction in economic activity and sharp reductions in capital spending have led to increased under-employment and unemployment. Although there are no up-to-date surveys of the incidence of income poverty in the country, the weak growth performance, together with an annual increase in population of 3%, has almost certainly led to a rise in the incidence of income poverty. Surveys in 2001 indicated that about 40% of the population – almost 335,000 people – was below the income poverty line. Informal estimates suggest that perhaps 41% of the population may now be below the poverty line – an increase of some 50,000 people since 2001.

Progress in Strengthening Public Finance

An important achievement since the restoration of Independence has been the steady improvement in the public finances of the country. Table 3 provides a summary of receipts and expenditures on a combined sources basis for the past six years. A number of important points emerge:

- There has been a steady increase in tax and non-tax revenues of the government to \$42.1 million last fiscal year – equivalent to 12.2 percent of non-oil GDP. This revenue performance is only marginally lower than the average for low income developing countries around the world.
- Petroleum revenues rose sharply last year to \$265 million as a result of rising production from the Bayu Undan field and higher world prices for petroleum.
- Recurrent spending on a combined sources basis has leveled off in the past three years, averaging about \$180 million a year. There has, however, been a steady increase in CFET recurrent expenditures, which accounted for 37% of total recurrent outlays last year. A further sharp rise in the share funded by CFET is expected this fiscal year.
- CFET funding of recurrent expenditures last year was equivalent to about 19% of non-oil GDP – a level that is comparable to the average for all low income developing countries around the world.
- Capital expenditures by CFET (net of transfers to BPA and other entities) have remained at about \$12 million a year for the past three years – equivalent to about 3.6% of non-oil GDP. Donor funded capital expenditures have declined from the high levels of FY2000/01 and FY2001/02. The Government is concerned about the decline in public investment on a combined sources basis and is taking steps to increase these outlays in the coming years to lay the foundations for a stronger growth performance in the economy.
- In the past four years, total public spending on a combined sources basis has leveled off at about \$235 million a year. In the past three years, there has been a 7% decline in real

terms in total spending on a combined sources basis (at FY2004/05 prices). The failure to increase the real level of public expenditures is a matter of major concern for Government. Steps are being taken to reverse this trend.

Table 3: Whole of Government Financial Accounts on Combined Sources Basis
(US\$ millions)

Indicator	FY99/00	FY00/01	FY01/02	FY02/03	FY03/04	FY04/05
Government revenues						
Domestic tax and non-tax revenues	2.0	13.6	19.9	19.1	29.2	34.1
Petroleum royalties and taxes	-	12.9	10.7	29.4	41.3	265.0
Autonomous agency revenues	-	1.4	4.5	5.0	5.6	8.0
Interest income	-	0.5	0.6	0.2	0.1	2.7
Total receipts	2.0	28.4	35.7	53.7	76.2	309.8
Public expenditures						
Recurrent expenditures						
Central government	18.9	24.0	31.6	47.0	51.8	53.3
Autonomous agencies	5.2	10.1	8.9	9.6	10.7	12.5
Donor funded recurrent outlays	66.2	97.8	110.6	122.0	123.9	111.6
Sub-total	90.3	131.9	151.1	178.6	186.4	177.4
Capital expenditures						
Central government	10.9	5.2	11.3	13.3	9.8	11.7
Autonomous agencies	1.0	0.5	0.2	0.3	0.2	0.3
Donor funded capital outlays	13.4	50.2	69.5	48.3	40.6	42.3
Sub-total	25.3	55.9	81.0	61.9	50.6	54.3
Current and capital transfers (net)	-	8.5	6.2	4.2	3.7	58.8
Overall balance	(113.6)	(167.9)	(202.6)	(191.0)	(164.5)	19.3
Financing						
United Nations contributions	33.0	27.7	5.4	-	-	-
Budget support by donors	2.6	3.9	17.3	32.5	34.8	34.2
Direct donor funding	79.6	148.0	180.1	170.3	164.5	153.9
Change in cash balances (increase -)	(1.6)	(11.7)	(0.2)	(11.8)	(34.8)	(207.4)
Total funding	113.6	167.9	202.6	191.0	164.5	(19.3)
Memo items:						
Domestic revenues as % non-oil GDP	0.7	4.4	6.9	7.1	10.3	12.2
CFET recurrent as % total recurrent	26.7	25.9	26.8	31.7	33.5	37.1
CFET recurrent as % non-oil GDP	8.2	10.0	11.4	16.7	18.4	19.1
CFET capital as % non-oil GDP	4.1	1.7	3.2	4.0	2.9	3.5
Total combined sources expenditure	115.6	187.8	232.1	240.5	237.0	231.7
Cash & trust acc't balances (end year)	1.6	16.9	22.0	37.0	75.3	341.6
Non-oil GDP at current prices	293.2	342.1	355.7	339.6	339.1	344.1

The international community has played a major role in the successful transition of Timor-Leste to Independence and the subsequent progress in building services and capacities in the post-conflict transition period. The amount and composition of the external assistance provided has undergone dramatic change in the past six years. As Table 4 indicates, the first few years were dominated by humanitarian assistance, budgetary support and large outlays for the operations of UNPKF and UNPOL. Programs of development and technical assistance were also built up quickly, with inflows of this type of assistance emerging as the dominant type of support by FY2002/03. In the first few years, there were substantial inflows of donor funding that were regarded as being “off-budget.”² In more recent years, the level of “off-budget” funding by donors has declined.

² “On-budget” funding by donors are those activities financed by donors that create budgetary obligations for the Government. The obligation may coincide with the implementation of the donor program; for example, the provision of counterpart funds or staff as part of program execution by the donor. Or the

The level of development and technical assistance actually peaked in FY2001/02 at about \$180 million. There has been a steady decline in these inflows since then as the number of donors active in the early period brought their programs to a close. Table 4 indicates that the amount of development and technical assistance per capita peaked in the same year at \$225. There has been a steady decline in per capita assistance since that time. As the subsequent discussion of prospects for donor assistance indicates, the Government expects that this trend will continue.

Table 4: Trends in External Assistance
(US\$ millions)

Type of expenditure	FY99/00	FY00/01	FY01/02	FY02/03	FY03/04	FY04/05
Development & technical assistance						
On-budget	72.3	118.1	147.0	139.3	134.6	135.8
Off-budget	7.3	29.9	33.0	31.0	29.9	18.1
Sub-total	79.6	148.0	180.1	170.3	164.5	153.9
Humanitarian assistance	82.0	29.6	11.9	3.5	3.1	1.1
Budget & commodity support	35.6	31.6	22.7	32.5	34.8	34.2
UN PKF	65.6	231.1	145.0	104.4	74.7	12.9
UN POL	33.1	51.9	45.4	26.7	15.7	5.1
Donor administrative expenses	1.1	7.0	4.9	4.6	7.5	5.2
Total assistance	297.0	499.2	410.1	341.9	300.2	212.3
Memo item:						
Development assistance per capita (\$)	99	185	225	213	206	192

Rapid Population Growth and Urbanization

The 2004 Census has confirmed that Timor-Leste is experiencing rapid population growth, currently estimated at a little more than 3% a year. The high population growth rate stems from a total fertility rate that is one of the highest in the world. The Census put the total population of the country at 923.2 thousand in mid-2004, 49% of whom are female. As part of the SIP process, a series of demographic scenarios have been developed for Timor-Leste.³ The results for the Base Case projection of population are set out in Table 5 below.

Table 5: Population of Timor-Leste
(thousands)

Indicator	2004	2007	2010	2015
Population (mid-year)				
Male	469.9	515.9	569.6	662.0
Female	453.3	498.0	550.6	639.8
Total	923.2	1,013.9	1,120.2	1,301.8
Memo items:				
Total fertility rate	7.0	6.8	6.5	6.1
Crude birth rate	45.4	43.9	42.2	39.9
Crude death rate	13.5	12.4	11.2	9.6
Population growth rate (% p.a.)	3.2	3.2	3.1	3.0
Females as % total	49.1	49.1	49.2	49.1

Note: The crude birth and death rates refer to the number of births and deaths per '000 population.

Under the Base Case scenario, the total fertility rate declines slowly in the decade ahead; but the ambitious programs of the Government for improved health services and education, safe water and adequate sanitation are expected to result in a sharp decline in the crude death rate from 13.5 per thousand population in 2004 to 9.6 per thousand in 2015. As a result, there is only a marginal decline

obligation may be a contingent liability; for example, a donor finances the full cost of constructing a road or a school, but not the subsequent maintenance of the asset. The new asset creates a future claim on the government budget, in this case for maintenance of the asset and its eventual replacement or rehabilitation. "Off-budget" expenditures do not create a claim on government resources.

³ The Statistics Directorate of the Ministry of Planning and Finance has developed a detailed demographic model that takes full advantage of those developed by United Nations agencies for use in other countries. These demographic projections are provisional and will be revised later this year in the light of the final results from the 2004 Census.

in the population growth rate in this period, with total population rising to 1.3 million by 2015. By 2025 the country is projected to have a population of 1.7 million under the Base Case scenario.

These demographic trends have profound implications for improved access to and quality of education, health, water supply and housing services. These are discussed at some length in the relevant SIPs. Another important consequence is rapid growth in the labor force for at least the next two decades. As the analysis in the next section indicates, creation of productive employment opportunities for the growing numbers of new entrants into the labor force will require a significant increase in private investment in agriculture and in the non-farm private sector, even if a substantial number of Timorese workers are sent abroad as part of the overseas worker program.

Table 6: Alternative Scenarios for Population Growth

Scenario	Population (mid-year '000)			Crude birth rate		Crude death rate	
	2004	2015	Growth rate (% p.a.)	2004	2015	2004	2015
A. Base case	923.2	1,301.8	3.0	45.4	39.9	13.5	9.6
B. High growth case	923.2	1,324.6	3.5	45.4	45.0	13.5	9.6
C. Lower growth case	923.2	1,260.6	2.5	45.4	35.0	13.5	9.6

The Government attaches a high priority to effective execution of programs aimed at reducing poverty and food insecurity, and improving health and education services. It is very likely that the current high crude death rate of 13.5 per thousand will decline as a result of these programs. What are the implications for population growth under alternative assumptions about the extent to which the crude birth rate declines? The answer depends on whether improved living conditions lead to a decline in total fertility. Table 6 summarizes the results of two alternative scenarios for the decade ahead and compares these with the Base Case.

- The High Population Growth Scenario assumes that there is no reduction in fertility rates so the crude birth rate remains at 45 per thousand for the entire period. In this case, the population is larger than in the Base Case by about 25,000 people in 2015.
- The Low Population Growth Scenario assumes that the fertility rate declines more rapidly than in the Base Case. By 2015, the crude birth rate declines to 35 per thousand compared with 40 per thousand in the Base Case. In this case, population is smaller than in the Base Case by about 40,000 in 2015.

These alternative population scenarios give some indication of the effects of population growth on expenditures for public services; for example, the High Case would add about \$2 million a year (at today's prices) to the recurrent cost of primary education.

Table 7: Urban and Rural Populations and Households

Indicator	2004	2007	2010	2015
Population ('000)				
Urban	240.9	279.4	323.4	412.8
Rural	682.3	734.5	796.8	889.0
Total	923.2	1,013.9	1,120.2	1,301.8
Households ('000)				
Urban	43.9	50.8	58.8	75.1
Rural	151.1	162.4	176.2	196.6
Total	195.0	213.2	235.0	271.7
Memo items:				
Urban pop growth (% p.a.)	5.0	5.0	5.0	5.0
Urbanization ratio (%)	26.1	27.6	28.9	31.7
Household size	4.7	4.8	4.8	4.8

The 2004 Census has also drawn attention to the problem of rapid growth in the urban population, primarily in Dili. The Census suggests that the urban population of Timor-Leste rose very rapidly over the past five years. Migration from rural areas and other towns in Timor-Leste was primarily into Dili, which increased from an estimated 120.5 thousand in 2001 to 153.3 thousand

by 2004 – equivalent to an average increase of 6.2% a year.

Rapid population growth and continuing inequalities in public services among urban and rural areas are likely to give rise to continued rapid urbanization. The Government anticipates that the urban population will grow at about 5% a year in the decade ahead. This growth rate is broadly in line with the experience of other developing countries with high overall population growth. For a panel of 14 countries whose population growth rate averaged 3% a year for a decade or more during the past two decades, the urban population grew at an average of 5.4% a year during 1980-2000.⁴ Under the 5% growth scenario, the urban population of Timor-Leste rises to more 410,000 by 2015, implying an urbanization rate of 32% at that time.

Almost 70,000 people are projected to migrate to urban areas in the decade ahead. A key policy issue for the future, therefore, is the extent to which urban population growth will continue to center largely on Dili. It is clear that there is considerable imbalance in the prevailing pattern of development. Informal estimates of gross regional non-oil GDP suggest that the Dili District may account for about half of the total value added of the country. Part B of this report discusses at greater length the issue of regional balance in development. Suffice to say at this point, the Government is committed to promoting a more dispersed pattern of urban development with the emergence of other growth centers in the country, thereby ensuring that a large number of the above-mentioned 70,000 move to urban centers other than Dili. This will require closer attention to provision of basic services in other potential growth centers, along with improved infrastructure. The proposed aggressive program of private investment promotion that is discussed in Part C of this report will also build on promotion of business opportunities in these other growth centers. The most recent versions of the Local Development SIP and the Housing and Urban Development SIP represent a first step in formulating a coherent set of policies and programs aimed at promoting more balanced development in the country; but the Government recognizes that much remains to be done on this front.

Rapid Labor Force Growth and Employment Creation

The 2004 Census has provided more up-to-date information about the labor force and employment in Timor-Leste. As Table 7 indicates, at the time of the Census, there were 289.3 thousand people in the labor force. The Census provided information on three important aspects of policies for the further development of the labor force. First, the labor force participation rate was found to be about 60%, which is low in comparison to most other developing countries.⁵ As the subsequent analysis indicates, with steady progress towards nine years of education for all children by 2015, larger numbers of young people in the 15-24 year age group can be expected to enter the labor force in search of employment. An increase in the current participation rate is therefore very likely.

Second, about 77% of the labor force – or approximately 212,000 workers – were found to reside in rural areas, two-thirds of whom were engaged primarily in subsistence farming. The total number employed primarily in subsistence farming was estimated at about 140,000 people. This suggests that there are about 95,000 households in rural areas whose main livelihood is

⁴ The 14 countries included in the sample are Angola, Benin, Cambodia, Congo D.R., Congo, Côte d'Ivoire, The Gambia, Honduras, Kenya, Namibia, Niger, Tanzania, Uganda and Zimbabwe. See World Bank, *World Development Indicators*, 2002. Washington DC

⁵ The *World Development Indicators 2002* reports the average participation rate in low income developing countries in 2000 was 95% for males and 59% for females, with an average participation rate of 80% for all low income countries. Labor force participation rates for East Timor from Indonesian labor force surveys were 62.5% in 1995, 61.5% in 1996, 61.1% in 1997 and 71.9% in 1998.

subsistence farming. Many of these people are below the income poverty line of the country. Moreover, they are especially vulnerable to the problems of food insecurity. Many of these families live in remote areas. Providing them with access to basic services such as safe water and adequate sanitation, education and health services, will be a major challenge for the Government.

Third, the extent of unemployment varied widely among districts, ranging from 18% in Manatuto to 2.4% in Liquiça and 1.4% in Oecussi. It should be emphasized that these rates for open unemployment are low by the standards of many developing countries. Moreover, they do not reflect the reality of widespread and substantial underemployment in both rural and urban areas in Timor-Leste.

Table 8: Estimates of the Timor-Leste Labor Force

Indicator	2004	2007	2010	2015	Growth (% p.a.)
Population 15-64 years ('000)					
Male	247.6	271.2	298.1	345.4	3.1
Female	244.8	267.2	292.5	337.5	3.0
Total	492.4	538.4	590.6	682.9	3.0
Labor force ('000)					
Male	171.6	192.0	215.5	258.4	3.8
Female	117.7	133.4	151.2	184.6	4.2
Total	289.3	325.4	366.7	443.0	4.0
Participation rate (%)					
Male	69.3	70.8	72.3	74.8	0.7
Female	48.1	49.9	51.7	54.7	1.2
Total	58.8	60.4	62.1	64.9	0.9

A major challenge for the country is creation of productive employment opportunities for the increasing numbers of young people entering the labor force, while at the same time, raising the productivity of those already in the labor force. Only in this way will the current widespread poverty be reduced. The Ministry of Planning and Finance has developed various scenarios for future labor force growth. The Ministry believes that the most likely scenario is for a labor force

growth rate of about 4% a year for at least another decade. The high growth stems from the past rapid population growth and rising future labor force participation rates. As Table 8 indicates, the expectation is for more than 150,000 new entrants into the labor force in the decade ahead. On a net basis, the annual number of new entrants will rise from 11,200 at the present time, to about 15,500 a year by 2015.

As the subsequent analysis indicates, given the relatively small size of the non-farm commercial sector, creating enough productive employment for new entrants into the labor force represents a major challenge. An essential part of the transition from the current heavy dependence on subsistence agriculture is the creation of income generating opportunities in rural areas, thereby retaining people who might otherwise seek employment in urban areas. Building the capacity of the farm sector to absorb labor in productive activities is therefore an essential part of the transition to sustained strong growth and poverty reduction.

Improving Access to Basic Services

As Table 1 indicates, the overwhelming majority of the population in 2002 said that the highest priorities were improved education and health services. In response, the Government has accorded a high priority to the use of budget resources in support education, training and health services.

Development of the education system. Progress in building the primary and secondary education system of the country is summarized in Table 9. Total numbers of students in school stood at about 245,000 at end FY04/05 – an increase of some 23,000 in the past four years and a level of access to formal education that exceeded that which prevailed during the Indonesian occupation. One of the most impressive achievements has been the large increase in net enrolment ratios for primary, and junior and senior secondary school age children. In the case of primary, for

example, 86% of children in the 6-11 age group were in school in FY04/05, compared to only 68% in FY00/01. This represents very significant improvement in access to primary education throughout the country. Similar impressive gains have been recorded for junior and senior secondary education. The improvement in access has been made possible by the opening of an additional 200 schools in the past four years, and the hiring of an additional 2,600 teachers, primarily for primary and junior secondary programs.

This progress notwithstanding, there are still 21,000 children in the 6-11 age group who do not have access to primary education and a substantial number of 12-14 year olds who do not have access to junior secondary schooling. One of the goals of the Government is to provide basic education to all 6-14 year olds by 2015. Another matter of continuing concern is the large number of over-age students in school. Although the numbers are declining, there were almost 70,000 over-age children in primary and secondary schools last year. A third important concern is the quality of the education. Much remains to be done to improve teacher skills and classroom facilities and teaching materials.

Table 9: Selected Indicators for Primary and Secondary Education
(Thousands)

Indicator	FY00/01	FY01/02	FY02/03	FY03/04	FY04/05
Number of students					
Primary	164.7	175.0	185.6	174.6	179.9
Junior secondary	37.3	38.8	38.4	40.4	41.5
Senior secondary	20.8	20.9	19.7	21.0	24.5
Total	222.8	234.7	243.7	236.0	245.9
Net enrolment ratio (%)					
Primary	67.7	73.8	76.9	83.5	86.2
Junior secondary	19.0	21.5	24.1	31.9	30.4
Senior secondary	15.9	16.8	17.3	20.4	33.6
Number of schools					
Primary	719	734	769	835	862
Junior secondary	109	115	113	120	129
Senior secondary	41	48	43	55	76
Total	869	897	925	1,010	1,067
Number of teachers					
Primary	3,470	3,860	4,248	4,862	5,415
Junior secondary	1,111	1,360	1,013	1,135	1,652
Senior secondary	618	855	1,093	670	725
Total	5,199	6,075	6,354	6,667	7,792
Children not in school					
6-11 year olds	43.8	36.7	33.6	24.7	21.1
Over-age children in school					
Primary/junior secondary	97.9	96.1	96.4	68.0	67.9

In the past year, the Ministry of Education and Culture has taken a number of initiatives to strengthen further development of the education system. These include the formulation of a coherent capacity building program, the integration of in-service teacher training programs, and the formulation of a school finance policy that includes the elimination of volunteer contributions. The Strategic Plan for Universal Primary Education by 2015 has been finalized. There has also been progress in strengthening planning capacities and in budget execution.

As the discussion in Part C of this report indicates, the

Government intends to pursue a set of economic policies that will lead to sustained strong growth in the economy. One of the important implications is that there will be a sharp increase in the demand for semi-skilled and skilled workers in the construction industry that, in the medium-term, will be driven by sharply increased levels of public investment. In the longer term, the onshore impact of the oil and gas industry will also create increased demands for a wide range of skilled labor. A high priority must therefore be accorded to the development of skills in the labor force that can respond to these increased demands. As a first step, the Government intends to evaluate present capacities for such skills development programs so that the country can avoid a prolonged heavy dependence on imported skilled and semi-skilled labor from Asia and elsewhere.

Progress in improving the health status of the population. Health indicators for Timor-Leste are among the lowest in East Asia. Among the more serious problems are high infant mortality rates and under-5 mortality rates caused by infectious diseases, with low utilization of skilled assistance for antenatal care, and poor reproductive health identified as the main causes. Maternal and child malnutrition have long been common in the country and there is a high prevalence of malnutrition, iodine and vitamin A deficiency. There is also a high incidence of preventable communicable diseases such as malaria, tuberculosis, childhood respiratory infections, diarrhoeal diseases and a rising incidence of non-communicable diseases. The most common childhood illnesses are acute respiratory infections and diarrhoeal diseases, followed by malaria and parasitic infections. The widespread incidence of diarrhoeal diseases is linked to lack of access to safe water. At least 60% of rural households do not have access to safe water, for example, and as many as 60% of urban households access shallow groundwater that is susceptible to contamination by sewerage and other waste. Malaria is endemic in all districts with the highest morbidity and mortality rates reported in children. Due to the breakdown of surveillance, vector control activities and treatment facilities, malaria had shown a three-fold increase in Timor-Leste following the crisis in 1999. Road and workplace accidents, household, biological and industrial waste, poor building design all contribute to the poor levels of health and wellbeing of the country.⁶

Table 10: Health Indicators for Timor-Leste

Indicator	2003
Infant mortality rate (per '000 live births)	60
Under 5 mortality rate (per '000 live births)	83
Maternal mortality rate (per 100,000 live births)	420-800
Underweight children under 5 (%)	46
Children 12-23 months fully immunized (%)	18
One year olds immunized against measles (%)	47
Life expectancy (years)	57
Births attended by skilled health personnel (%)	24
Population per medical doctor ¹	3,401
Population per nurse/midwife ¹	876
Population per hospital bed ¹	2,380
Population per health center & health post ¹	4,000

Sources: Timor-Leste 2003 Demographic and Health Survey and

Ministry of Health

Note 1. Data for FY2005/06.

operational strategies. The framework emphasises the important role of factors such as water and sanitation, transportation and food supply on the health status of the population. It also stresses the importance of primary health care services in improving the health of the population. A Basic Package of Services has been developed to guide interventions at the primary level with a Hospital Service Package under development to determine the extent, and limits, of comprehensive services in hospitals. Systems for managing the human and financial resources needed to deliver the planned level of services to communities are being refined and rehabilitation of facilities, and development of some new facilities, is proceeding in accordance with the service delivery system set out in the Health Policy Framework.

Access to safe water and adequate sanitation. At the time of the restoration of Independence, access to safe water and adequate sanitation was very low. As a result, substantial numbers of

The Government has accorded a high priority to addressing the health needs of the nation. Rapid progress has been made in rehabilitating the health facilities following the disruption experienced in the lead-up to the restoration of independence in May 2002, and in planning and implementing the development of a sustainable health system. Recurrent health expenditures on a combined sources basis stood at \$26 per capita in FY2004/05, compared to about \$20 per capita in FY2000/01. A Health Policy Framework has been developed and is used as a founding document for the development of

⁶ For a more detailed description of the health status of the population, see Government of Timor-Leste, *Timor-Leste 2003 Demographic and Health Survey*, Ministry of Health, 2004.

people in Timor-Leste become ill from causes related inadequate sanitation or unsafe water supply, in combination with poor hygiene. Improving access to safe water and sanitation facilities is essential to overcome poverty. Better access can raise household living standards by greatly improving health levels and by raising human dignities. Improved and more reliable water and sanitation services promotes economic growth, not just by improving worker productivity, but also by encouraging water dependant private sector investments such as tourism, thus creating more jobs. Insufficient or inadequate sanitation disposal systems lower the health and biological diversity of watercourses and coastal ecosystems, and discourage leisure and tourism activities.

With the support of the donor community, the Government has launched a multi-year program aimed at a major improvement in access to water and sanitation. Table 11 indicates progress to date. As of last year, about 37% of the population had access to safe water compared to only 31% in FY2002/03. There have also been important gains in providing improved sanitation and improved access to these services in rural areas, although the latter continue to lag behind urban areas. Nonetheless, the current situation remains unsatisfactory.

- 65% of rural households do not have access to safe water supplies and 76% do not have access to adequate excreta disposal facilities;
- 82% of urban households in Dili do not have household access to 24-hour safe water supplies and 24% do not have access to household toilet facilities;
- 96% of urban households outside of the capital do not have household access to 24-hour safe water supplies and 40% do not have access to household toilet facilities.

Table 11: Access to Safe Water and Adequate Sanitation

Indicator	FY02/03	FY03/04	FY04/05
HH with access to safe water ('000)			
Urban	14.1	18.0	20.3
Rural	45.5	45.3	54.1
Total	59.6	63.3	74.4
HH with access to sanitation ('000)			
Urban	18.2	21.9	24.2
Rural	24.6	28.7	37.1
Total	42.8	50.6	61.3
% of population with safe water			
Urban	33.8	41.0	44.0
Rural	30.6	30.0	35.0
Average	31.3	32.5	37.1
% population with sanitation			
Urban	43.6	50.0	52.5
Rural	16.6	19.0	24.0
Average	22.5	26.0	30.5
Memo items:			
Households without access ('000)			
Safe water	130.7	131.6	126.2
Adequate sanitation	147.5	144.3	139.3

With rapid population growth there has been little reduction in the total number of households that still not have access to these basic services. At end FY2004/05, 126,000 households lacked access to safe water and 140,000 households were without adequate sanitation.

The overarching challenge is to increase the prevailing low levels of access to safe water and adequate sanitation to achieve a revised and more ambitious set of national targets. These new targets call for 80% of urban and rural populations to have access to safe water and adequate sanitation by 2015. These new goals will require substantial and sustained programs in both rural and urban areas.

The sustained availability of safe and affordable water supplies depends on the continued existence of sufficient water

resources of reasonable quality. The Government recognizes that the absence of a national policy that incorporates the key principles of Integrated Water Resource Management, coupled with a lack of water resources management capacity, may result in the emergence of conflicting sub-sector strategies for the utilization and management of these resources.

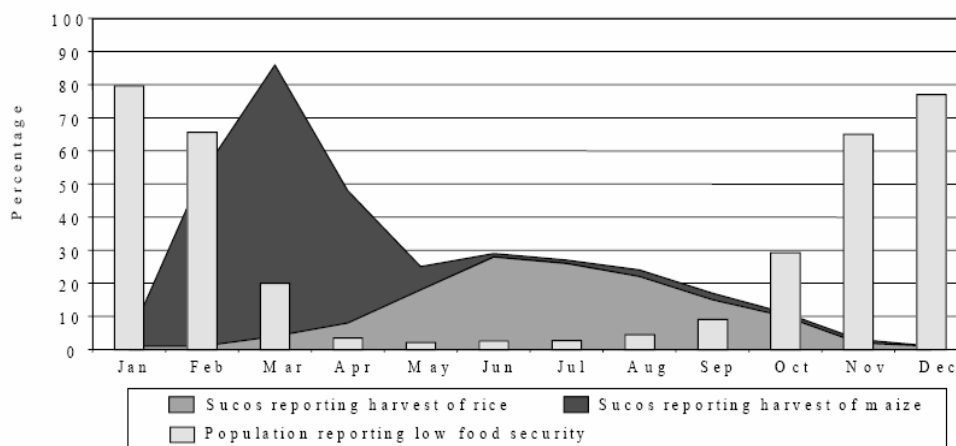
The Problem of Food Security

The nutritional status of the Nation is a major concern of the Government. The findings of the 2003 Demographic and Health Survey point to the inadequate nutritional status of large numbers of men, women and children; for example, 46% of children under the age of five, were found to be underweight.

Surveys in recent years have pointed to households in upland and dryland farming areas as being especially vulnerable to food insecurity. Food insecurity stems from El Niño and the effect of droughts on agriculture. In the dry season, drought conditions generally exist in large parts of East Timor. However, a series of successive droughts in parts of the country due to the effects of El Niño, can severely reduce subsistence food production, adding to annual seasonal food insecurity. In 1997-1998, El Niño drought conditions severely reduced maize and rice harvests. The situation was exacerbated by the civil emergency the following year. In 2003, FAO reported that production of maize, the main staple in Timor-Leste and the main source of carbohydrate, would decline by about 34% from 2002 levels due to delayed onset of rains, below normal rainfall and reduced maize area due to shortages of seeds. As a result, 150,000 people were assessed as needing 14,000 tonnes of food aid from October 2003 to March 2004.

Agricultural and livestock losses due to disease can increase with the impact of natural disasters and produce increased food insecurity for the population. Current farming methods and difficulties in accessing improved technology do little to diminish the threat of agricultural hazards. Crops remain at risk from pest and disease attacks, especially on maize and rice. The overwhelming majority of Timorese farmers are unable to afford industrial pesticides or rodent traps, and have unsecured post-harvest storage facilities. According to FAO, post-harvest loss of rice in Timor-Leste can be up to 30% in some areas, while loss of maize is 30% on average. Poor husbandry, coupled with lack of veterinary facilities, leaves poultry and other livestock at risk of outbreaks of exotic animal diseases, such as Newcastle disease.

Seasonal Food Insecurity in Timor-Leste, 2001



Source: 2001 TLSS.

A National Disaster Risk Management Plan is being prepared under NDMO leadership, a key element of which is an early warning system for weather-related risks to food security. Given the vulnerability of large segments of the rural population to food insecurity, the Government has

refocused the strategy for agriculture and put increased emphasis on food security. There has been good progress in formulating the national Food Security Policy, with programs now underway to generate reliable statistics and data on food production and food security indicators. The first national agricultural survey will be undertaken later this year; among other things, it will provide important information on aspects of food security. The distribution of new seed materials for sweet potato and maize is well advanced with extensive field testing in more than 200 sites. The expectation is that these initiatives will reduce the vulnerability of food production to the effects of adverse weather.

Part B: Policies and Programs for Combating Poverty

Forging a National Consensus for Growth and Poverty Reduction

With the fight for the restoration of independence over, and with the transition from a post-conflict society largely completed, the next major challenge for the country is to fulfill the aspirations of the Timorese people that were so well articulated in the national dialogue of 2002 and the resulting Vision 2020 statement. The energies of the country must now be mobilized in a nation-wide fight to combat poverty

The facts about poverty are relatively well known and understood in Timor-Leste, thanks to a series of surveys undertaken with donor support since 2001 and the 2004 population census. Poverty tends to increase with household size, as larger households usually comprise more non-earning dependents, such as children and the elderly. Poverty is also linked to the age of the household head. In male-headed households, in which 90% of Timorese people live, poverty tends to be highest where the head of household is between the ages of 30 and 49. At this age, the household head's children are likely to still be living at home, and older relatives may be too old to support themselves. As in many other countries, poverty in Timor-Leste tends to decrease as the education level of the household head increases. Nearly half of people are poor in households where the household head has not finished primary school, but this proportion declines to one in seven where the household head has at least a senior secondary education. Finally, poverty is highest where household heads of working age (15-64 years) work only on the household farm. This category includes close to 70% of all Timorese, half of whom are poor. Poverty levels are substantially lower for those who earn income from a household business or from wage employment. Survey data also point to the fact that there is a close link between the amount of family assets, such as land and livestock, and the incidence of poverty. As asset holdings increase, the incidence of poverty declines.

The 2003 Joint Agency Report on poverty estimated that there were about 330,000 people in poverty in 2001.⁷ Moreover, there was a large cluster of people close to the poverty line, which implied that the number of people in poverty can be influenced strongly by economic growth. There are no up-to-date surveys of the current incidence of income poverty in the country, but the sharp economic contraction and subsequent slow growth since 2001 have probably led to an increase in the incidence of poverty. The number now in poverty is conservatively estimated at about 380,000 people. The number of people who live on less than US\$1 a day has likely increased as well. The number in extreme poverty is conservatively estimated at about 200,000 people, compared to about 170,000 in 2001. A high proportion of the people in poverty are concentrated in households that depend primarily on subsistence farming for their livelihood.

The Government has a four-pronged strategy for poverty reduction. It includes: (i) promoting opportunities for the poor; (ii) improving access of the poor to basic social services; (iii) enhancing security, including reducing vulnerability to shocks, and improving food security; and (iv) empowering the poor and vulnerable groups.

At the same time, the Government attaches importance to promoting greater balance in the development of the country. The issue of balance has a number of important dimensions, including, for example:

⁷ Government of Timor-Leste et al, *Timor-Leste, Poverty in a New Nation: Analysis for Action*. May 2003.

- There is a need for sustained strong economic growth, while ensuring that the benefits are broadly shared among all groups in society regardless of their geographic location.
- Promotion of several growth poles within the country to slow the growth in population in and around Dili and create a more balanced pattern of urbanization.
- Ensuring improved access to basic services throughout the country, in both rural areas and small towns. These include health and education services, improved water supply and sanitation, electricity and increased access to transport and communications services at affordable costs.
- The need for programs that will ensure increased participation of the large number of people who essentially live outside the monetized part of the economy.
- Ensuring improved access to financial services, including microfinance programs for the poor that can facilitate production of marketable surpluses and involvement in trading activities.
- Development of targeted interventions that will afford additional protection to vulnerable groups, including those affected by seasonable variability.

Promoting Balance in Regional Development

Survey data point to substantial variation in the incidence of poverty among regions and districts. Data from the *Multiple Indicator Cluster Survey (2002)* give a clear picture of the geographic dimensions of poverty in Timor-Leste. At the time of the survey, almost 80% of the 76,000 households who constituted the poorest 40% of the population were located in the Eastern and Central regions (Table 12). The Eastern region (now Region I) had the highest incidence of poverty, with 60% of the population in the bottom 40% income group.

Table 12: Geographic Location of the Poorest 40% of Households, 2002

Location	Number ('000)	Distribution (%)	Incidence (%)
Eastern region	30.3	39.7	60.2
Central region	29.1	38.1	32.3
Western region	16.9	22.1	39.6
Total	76.4	100.0	41.7
Highland	30.3	39.7	52.5
Lowland	46.1	60.3	36.7
Total	76.4	100.0	41.7
Urban	5.6	7.3	12.9
Major urban	0.6	0.8	2.5
Rural	70.9	92.7	50.6
Total	76.4	100.0	41.7

Source: Estimates based on data reported in MICS (2002)

is no coincidence that the subsequent 2004 Census found that 48% of rural families were primarily dependent on subsistence farming for their livelihood. There is a close link between income poverty and dependence on subsistence farming as the main source of livelihood.

Although there were more families living in the Lowlands who were in the bottom 40%, the incidence of poverty was significantly higher in the Highlands. More than 50% of Highlands households were below or only marginally above the poverty line. The problem of poverty in the Highlands cannot be separated from the large numbers of people there who depend almost exclusively on subsistence farming for a livelihood. The 2002 survey also reconfirmed the widely understood fact that the problem of poverty in Timor-Leste is predominantly rural. More than 90% of households in the bottom 40% income group are found in rural areas. Half of all rural households are in the bottom 40%. It

Almost half the labor force of the country is dependent on subsistence farming for a livelihood, although the share of the population dependent on subsistence farming varies widely among the districts (Table 13). The implication is that about 95,000 of the households in the country are largely outside the monetized economy. The highest dependence on subsistence farming is found in the three districts of Region II, and in Aileu and Oecussi, where about 60% of the population depends primarily on subsistence farming. Lower concentrations are found in Regions I and IV

where roughly half of the population is primarily dependent on subsistence farming. The remaining 100,000 rural households participate in the monetized economy. Approximately 70,000 of these produce marketable surpluses, primarily rice and coffee, although they depend to varying degrees on subsistence farming for food and shelter.

Table 13: Labor Force and Employment, 2004

Region and District	Total Labor Force		No. Employed		Unemployed	
	Number	Participation Rate (%)	Subsistence farming	Other occupations	Number	Rate (%)
Region I						
Baucau	34,343	67.3	18,580	12,329	3,434	10.0
Lautem	15,566	56.7	7,674	5,713	2,179	14.0
Viqueque	20,397	61.9	11,545	7,118	1,734	8.5
Sub-total	70,306	63.1	37,799	25,160	7,347	10.5
Region II						
Ainaro	19,934	74.9	13,057	5,721	1,156	5.8
Manatuto	12,586	65.3	7,325	2,996	2,265	18.0
Manufahi	16,752	71.3	10,034	6,215	503	3.0
Sub-total	49,272	71.1	30,416	14,932	3,924	8.0
Region III						
Aileu	13,574	69.5	8,280	4,615	679	5.0
Dili	43,472	40.4	7,042	32,996	3,434	7.9
Ermera	28,218	54.3	13,714	11,287	3,217	11.4
Sub-total	85,264	47.6	29,036	48,898	7,330	8.6
Region IV						
Bobonaro	25,808	58.3	11,614	12,723	1,471	5.7
Covalima	17,157	62.0	7,961	8,596	600	3.5
Liquiça	17,880	62.6	8,994	8,457	429	2.4
Sub-total	60,845	60.6	28,569	29,775	2,501	4.1
Region V						
Oecussi	23,638	73.6	13,899	9,408	331	1.4
Total	289,325	58.8	139,719	128,173	21,433	7.4

It is obvious that a sustained reduction in income poverty in these communities will require concerted efforts to bring the current 95,000 subsistence families into the monetized part of the economy through sale of farm surpluses and off-farm employment. A range of measures will be needed to facilitate this process, including for example:

- Progress in increasing the reliability of subsistence farm production through the introduction of improved planting materials – one of the cornerstones of the current strategy for reduction in food insecurity that is being pursued by the Ministry of Agriculture, Forestry and Fisheries.
- Improved access to local and regional markets for the sale of marketable surpluses and lower cost transport services that improve competitiveness.
- Improved access to financial services in rural areas to support trading and the supply of manufactured goods, and access to training programs that can develop basic business skills.
- Improved access to education and health services that will equip younger people in subsistence households for productive off-farm employment.

About 30,000 households are currently found in urban areas. A majority of these households depend on wage income generated by family members or on income from informal or formal business activities. The demographic projections that underpin the SIP framework point to migration of some 70,000 people from rural to urban areas in the decade ahead. An essential part

of the Government's strategy is to improve the range and quality of services available in towns throughout the country in an effort to promote more broadly based business development and job creation. This more balanced pattern of development aims to avoid an even larger concentration of the urban work force and population in and around Dili. The regional patterns of growth will depend heavily on the availability of health and education services in urban centers outside Dili, the quality of infrastructure and private investment. The availability of cheap and reliable power, for example, will have a big bearing on the patterns of development that emerge. There are good prospects for early development of much cheaper sources of electricity from thermal and hydro-electric power stations in several locations in the country. At the same time, work is well advanced on preparation of a master plan for the electrification of the country. Adoption of the master plan, and an early start on the development of the transmission and distribution system, will have major implications for regional patterns of growth and employment.

Implications for Income Poverty Reduction

Central to the Government's strategy for a reduction in income poverty is increased levels of public and private investment and an improved enabling environment for business activity that will lead to an increase in the economic growth rate to 7% a year by 2010, thereafter rising to 7.5% a year. The broad outlines of the policies and programs required to achieve this result are described in Part C of this report. A balanced pattern of growth of 7% a year or more will be essential for progress towards the MDG goal of halving the incidence of extreme poverty by 2015.

Table 14: Progress in Reducing Poverty

Indicator	2001	2004	2007	2010	2015
Value added per worker (US\$)					
Subsistence agriculture		537	560	573	620
Rest of private sector		1,193	1,126	1,117	1,242
People below national poverty line					
No. of poor ('000)	334.2	383.1	405.6	392.1	260.4
% of population	39.5	41.5	40.0	35.0	20.0
People living below \$1 a day					
No of people ('000)	169.2	198.5	192.6	190.4	182.3
Percent of population (%)	20.0	21.5	19.0	17.0	14.0
Memo item:					
Population (mid-year in '000)	846.0	923.2	1,013.9	1,120.2	1,301.8
Subsistence farm population ('000)		329.6	345.2	358.6	355.6

Note : Value added per worker is at 2000 constant prices.

Table 14 summarizes the implications of sustained strong growth for poverty reduction in the decade ahead. As the Table indicates, even with progress in reducing the incidence of poverty, continued rapid population growth results in a steady increase in the number of people in poverty. Strong growth beyond 2010 begins to have a more significant impact on poverty. With sustained strong growth of 7% a year or more, there is a reasonable expectation that the incidence of income poverty can be reduced to 20% by 2015. Even so, there would still be about 260,000 people below the income poverty line at that time. The core of the poverty problem over the longer term centers on the 180,000 in extreme poverty who, for various reasons, continue to subsist on the equivalent of less than \$1 a day. A significant number of these people will continue to be found in the subsistence farming sector. Over the longer term, poverty reduction programs must be able to identify these people and address the root causes of their poverty with appropriate targeted interventions.

Programs for Improved Access to Basic Services

The above prospects for income poverty reduction need to be balanced against progress in providing access to basic services. As the discussion in Part A indicated, there has been good progress in improving access to basic education and health services, although much remains to be done. Some 245,000 children now attend school. Health services have been expanded and now reach larger numbers of people. There has also been some progress in expanding access to safe water and improved sanitation in urban and rural areas, although much remains to be done on this front as there are still almost 130,000 households without access to safe water.

Table 15: Selected Indicators for Basic Services

Indicator	FY04/05	FY09/10	FY14/15
Education			
Number of students ('000)			
Primary	179.9	185.0	208.6
Junior secondary	41.5	57.9	68.2
Senior secondary	24.5	31.1	36.7
Total	245.9	274.0	313.5
Net enrolment ratio (%)			
Primary	86.2	91.0	95.0
Junior secondary	30.4	55.0	80.0
Health			
Life expectancy at birth (years)	57	60	62
Under 5 year mortality rate (per '000)	83	76	71
Under 1 year mortality rate (per '000)	60	55	50
Water & sanitation			
Access to safe water (%)			
Urban	44.0	60.0	80.0
Rural	35.0	60.0	80.0
Access to adequate sanitation (%)			
Urban	52.5	65.0	80.0
Rural	24.0	50.0	80.0
Households without access ('000)			
Safe water	126.8	94.1	54.4
Electrification			
Electrification ratio (%)	23.0	40.0	55.0
Households with electricity ('000)	46.1	94.1	149.7

Implementation of the programs set out in the various SIPs will result in significant increases in access to basic health and education services, a large increase in the number of urban and rural families that have access to safe water and sanitation, and, within the next five years, good progress in laying the foundations for substantially enhanced access to low cost electricity in many parts of the country. Table 15 provides selected social indicators from the SIP database. In drawing up the SIP expenditure plans for the medium-term, targets have been set for various key indicators and expenditures on programs designed to achieve these targets have been estimated. As Table 25 in Part D of this report indicates, expenditures on the health care and education and training sectors are estimated at about \$200 million and \$320 million respectively over the next five years. This

compares with about \$120 million for health care and about \$225 million for education and training in the last five years.

Support for Vulnerable Groups

Key social groups at risk. Living in the poorest country in Asia, all people in Timor-Leste are vulnerable to risk. However, some sections of the population are more vulnerable than others, and constitute at-risk groups. While family and kin support networks provide the most common form of insurance against physical, social and economic shocks, those who live in dysfunctional families, in single-parent households, or are dislocated from family and kin are at-risk of exploitation and of not being able to recover from minor crises without external assistance. In those areas where natural disaster hazards are most concentrated, the at-risk groups will be more vulnerable than others in their communities.⁸

⁸ For a more extensive discussion of those at risk to natural disasters, see Government of Timor-Leste, *Social, Civil and Heritage Protection*, March 2006.

Table 16: Societal Groups that are Vulnerable, 2004

Indicator	People	
	Number ('000)	% of total population
Children under 18 years	460.2	49.8
Children orphaned & in institutions	2.5	0.1
Children separated	2.4	0.1
Women aged 18-60 years	188.0	20.3
Widows	55.5	6.0
People 60 years and above	81.3	8.8
Disabled	22.0	2.4
Stateless persons & refugees	n.a.	
People below national poverty line	383.7	41.5
People living on less than US\$1 a day	198.8	21.5
Lack access to safe water (FY04/05)		
Urban households	22.2	56.0
Rural households	104.6	65.0

A number of surveys and studies have been conducted in Timor-Leste that identify groups at risk of exclusion from the general social well-being, and at risk of being unable to access a sustainable livelihood.⁹ A key objective of these reports has been to identify those segments of the population that are poor and most vulnerable. These assessments have identified the following vulnerable groups: children; women; widows, the aged and infirmed; stateless persons and refugees; people challenged by disabilities; and people in conflict with the law. As Table 16 indicates, children under the age of 18 make up half the population, women aged 18-60 years account for about 20% of the population, and people over the

age of 60 account for another 9%. These three groups account for almost 80% of the population.

Poverty and vulnerability to risk are not the same phenomenon, but poverty is a major factor in triggering vulnerability, and increases vulnerability. For these reasons, it is important to identify the poor, as well as other groups of the vulnerable. Reduction of overall poverty is a reduction of overall vulnerability to risk. In Timor-Leste, the poor are at risk from malnutrition, with attendant health risks, lack of access to education, lack of access to health care, weakness in labour negotiation, lack of equitable access to law. As noted earlier, those most likely to be poor are families who live in rural areas, have more family members, are headed by someone who has not completed primary education, has a lower standard of literacy, and are without electricity, safe water and improved sanitation. The various SIPs set out detailed programs for addressing both poverty and vulnerability.

Social protection and safety nets. With the very considerable progress that has been made in the past three years in articulating development strategies, priorities and policies for the future, and in building human and institutional capacities, the Government is increasingly concerned with policies and programs that meet the needs of vulnerable groups in society. In articulating the Government's poverty reduction strategy, the National Development Plan indicates that one of the key components of the strategy is to:

Provide or help to provide security of person and property, and protection from unforeseen shocks and disasters (vulnerability), including food security at both the household and national levels...

An array of social protection policies is available to the Government, along with considerable international experience in using these instruments to combat poverty and provide protection. The tools include labor market interventions, social insurance programs (such as pensions and unemployment benefits), social assistance (transfers of cash or goods, subsidies), and special

⁹ For more detailed discussion of these findings, see *Building Blocks for a Nation: The Common Country Assessment for East Timor* UN country team 2000; *East Timor Human Development Report 2002* UNDP 2002; *Facilitating Community Development: The Participatory Potential Assessment (PPA) component of the Poverty Assessment Project* UNDP, ADB, ET/TA/ETPA, World Bank 2000-2002; *Poverty in a New Nation: Analysis for Action 2 Vols.* World Bank, May 2003.

programs that help the most vulnerable groups in society, such as orphans and disabled people. The Government has already mounted a number of these programs. These include the following:

- Programs aimed at improving seed and other agricultural inputs that will reduce the vulnerability of farm families to food insecurity.
- Programs aimed at providing support for veterans from the fight for the restoration of independence.
- Special programs that are aimed at other vulnerable groups (such as orphans, the disabled) in society have also be put in place, although at this early stage the coverage of these programs remains limited.
- School feeding programs that can improve the nutritional status of children.
- Microfinance programs that help people manage risks and obtain access to financial resources.
- Mainstreaming a focus on gender issues throughout society.

The Government is conscious of the limited capacities with the country for the management of the foregoing types of targeted programs. It is important to ensure that such interventions do indeed reach the intended beneficiaries. The recently formulated Veterans Program has provided valuable experience in the design and development of such interventions. A transparent process of registration of veterans that began in 2004 by the commissions established under the Office of the President, led to the preparation of a veterans law that was passed by the National Parliament on March 2, 2006. The law provides for subsidies to veterans and under certain conditions, assistance to widows, orphans, surviving parents and siblings of deceased combatants who meet criteria of vulnerability. The next phase will be the design and implementation of the various programs provided for under the law. The ongoing Consolidated Support Program of the Government includes a range of measures that are to be implemented in the year ahead. These include a series of ceremonies that recognize the contributions made by veterans of the resistance, information campaigns to ensure smooth implementation of the law, introduction of pensions and for veterans, and various social services for vulnerable veterans, widows and orphans.

There has also been steady progress in mainstreaming gender issues within government and in society at large. Initiatives taken include training programs for police and other parts of the civil service, community consultation and awareness programs. Gender Mainstreaming Units have been established in several agencies, including the Ministry of Labor and Community Reinsertion that, among other things, is focusing on job creation in rural areas with a heavy emphasis on women who can benefit from employment creation and income generation. There has also been progress in increasing the representation of women in the political process. Following the recent Suco elections, there are now more than 1,300 women representatives in various positions in the 442 sucos of the country.

Part C: Macroeconomic Policies for Sustained Strong Growth

Policy Framework for Sustained Strong Growth

The Government is keenly aware of the multidimensional nature of the problem of poverty reduction. It also recognizes that international experience indicates that economic growth is the single most important factor that influences poverty reduction outcomes. A key element of the Government's poverty reduction strategy therefore is the adoption of a target for economic growth in the medium-term. Given that the population and labor force will continue to grow rapidly for some time to come, the Government believes that a non-oil GDP growth rate of at least 7% a year in real terms will be required to ensure a sustained decline in the incidence of income poverty in Timor-Leste.

Creating the conditions for sustained strong growth in the medium term is therefore central to the Government's efforts to reduce poverty. A successful poverty reduction strategy must be built around a multi-pronged approach, the main elements of which include:

- Maintenance of macroeconomic stability that is widely recognized as a necessary condition for strong growth.
- Pursuit of key structural reforms that aim to improve the business climate of the country and facilitate private investment.
- Improved infrastructure that will lower the cost of doing business and improve the international competitiveness of the country.
- An aggressive program aimed at building the skills of the work force.
- Policies and programs for strong growth will be complemented by a continued commitment to improving access to basic services, including education, health, safe water and adequate sanitation.
- Close attention to the distributional impact of growth will also be required to ensure that the benefits are widely shared.

Role of Public and Private Investment

Rising levels of investment will be required for sustained strong growth. In the immediate aftermath of the conflict in 1999, investment levels in Timor-Leste were high, with fixed capital formation averaging 35% of non-oil GDP during 2000-2003. These levels of investment were made possible by the international community who took the lead in rebuilding the infrastructure, schools and hospitals that had suffered extensive damage in 1999. With the immediate needs for reconstruction met and the subsequent decline in domestic demand that stemmed from the departure of many expatriate personnel, investment levels declined sharply. Fixed capital formation is estimated to have dropped to the equivalent of less than 20% of non-oil GDP during in 2004 (Table 17).

The Government recognizes that the recent levels of public and private investment are not sufficient to ensure a transition to the sustained strong growth that is needed for poverty reduction. A two pronged strategy is therefore being pursued:

- There would be a substantial increase in the level of public investment in basic infrastructure, hospitals, schools and other facilities. A planned big push in these areas would raise the annual level of public investment to about \$150 million by 2010 – equivalent to about 30% of non-oil GDP. As Table 17 indicates, relative to non-oil GDP this level of public investment would be comparable to that achieved during reconstruction in 2000 and 2001. With the big push to upgrade infrastructure and facilities completed by about 2011, public investment would then decline to lower levels.

By 2015 it would have dropped to about 18% of non-oil GDP – still high in comparison to many other developing countries.

- A program aimed at improving the climate for private investment has also been launched, along with active promotion of Timor-Leste with international investors. The Government hopes to lift private investment by local and international business to around \$55 million a year by 2010, rising then to more than \$100 million a year by 2015. These levels of investment would be required for a growth rate of around 8% in the non-subsistence private sector that, in turn, is needed to create productive employment opportunities for the growing numbers of new entrants into the labor force, increasing numbers of whom will have completed nine years of basic education.

Table 17: Trends in Public and Private Investment
(US\$ millions)

Indicator	2000	2001	2004	2005	2006	2010	2015
Fixed capital formation							
Public sector	94.5	115.2	52.4	66.4	104.3	183.9	190.4
Private sector	24.3	30.2	7.5	7.5	25.0	55.0	105.0
Sub-total	118.8	145.4	59.9	73.9	129.3	238.9	295.4
Change in inventories	11.9	14.5	6.0	7.4	12.9	23.8	29.5
Total investment	130.7	159.9	65.9	81.3	142.2	262.7	324.9
Investment as % non-oil GDP							
Public investment	29.9	31.3	15.5	19.0	27.7	33.5	21.3
Private investment	7.7	8.2	2.2	2.1	6.6	10.0	11.7
Total fixed investment	37.6	39.5	17.7	21.1	34.3	43.5	33.0
Non-oil GDP (at current prices)	316.3	367.9	338.6	349.9	376.7	549.0	893.9

This ambitious program aims to lay the foundations for sustained strong growth in the longer term, and through a sharp increase in construction activity, create a large increase in employment opportunities in the medium term. Under the proposed strategy, investment would be raised from about \$75 million in 2005 to about \$260 million by 2010 – a level that would be equivalent to about 40% of non-oil GDP, after which it would decline to around 30%. The experience of other developing countries points to sustained strong economic growth at these levels of investment relative to GDP. In fact, when investment levels are in the range of 30-40% of GDP, it is not uncommon to find economic growth in the range of 7-9 % a year in real terms. The Government's target growth rate of 7% a year may therefore err on the cautious side.

Management of the investment program. The Government is well aware that the proposed large build up in investment poses major challenges for the country. Several important issues arise:

- How will the public investment program be funded?
- What will be done to increase implementation capacities for public investment?
- Is there a risk that such a large increase in public and private investment will result in increased inflation and macro-economic instability?
- A range of initiatives will be required to improve the climate for private investment as well.

Arrangements for funding the build up in public investment are discussed at greater length in Part D of this report. As Table 18 indicates, existing CFET proposals would fund about \$120 million of the investment requirements over the next five years. The Government is currently working on the proposed Compact for submission later this year to the Millennium Challenge Corporation for

a program of \$350 million for the next five years.¹⁰ The provisional plan being drawn up for the Compact calls for a large allocation to basic infrastructure programs, support for skills development, and other programs identified in the SIPs that are not already well supported by the donor community. The Government intends to approach existing development partners for the balance of the funding required for the capital expenditure program over the next five years.

The second issue relates to measures needed to build capacities within the country for management and implementation of this much larger public investment program. The Government is well aware that the existing capacities of public sector and the domestic construction industry are not sufficient to implement such a large program in a timely manner. In recognition of this fact, work is underway on a number of fronts to address the problem of implementation capacity. It will likely involve several major new initiatives, including for example:

- The design of procurement packages for civil works and equipment supply that will attract international suppliers of these goods and services; for example, a portion of the proposed road improvement and maintenance programs may be built into a series of large tenders, each perhaps in the range of \$5-15 million, that would be attractive to international bidders. Similar steps can be taken for the design of procurement packages for construction of transmission and distribution systems in the power sector, water supply and sanitation systems and so on.
- With such a large build up in public investment, it will be essential to ensure appropriate site supervision of ongoing work prior to authorization of payments to contractors. Capacities within the government for such site supervision are limited. One option therefore is for the Government to retain the services of one or more qualified international companies with recognized capacities for such supervision. Such companies would be expected to undertake site supervision on behalf of the Government and, at the same time, develop training programs to build such capacities within the country.
- Given the limited supply of skilled labor within the country, the large build up in public works will inevitably require temporary heavy use of skilled labor from other parts of East Asia and elsewhere. The Government would, however, ensure that there are adequate arrangements in place for a greatly expanded program of skills development for Timorese nationals to allow an early transition from dependence on imported skilled labor. Such a program will be required not only for the public investment program, but also for the development of near-shore and onshore petroleum resources over the next 5-7 years. This program will also have large requirements, especially in the construction phase, for a wide range of semi-skilled and skilled workers.

The third key issue relates to the macroeconomic impact of the build up in public investment, along with a ramp up in private investment activities in oil and gas and other onshore commercial activities. There are several aspects related to the issue of macroeconomic stability.

- The enormous development challenges that face the country necessarily imply that the Government will continue to run large fiscal deficits. Government intends to continue with its prudent approach to the management of fiscal policy and to ensure that these deficits are financed in a sustainable manner consistent with continued macroeconomic stability. A continued commitment to low and stable inflation is therefore seen by Government as central to macroeconomic stability. Financing strategies for public sector activities are discussed in Part D below.

¹⁰ A MCC program of \$350 million would be equivalent to an allocation of \$65 per capita per year for the population during the next five years. The recent approval by the MCC of the program of \$65 million for Vanuatu, which has a population of about 200,000, implies an allocation of \$65 per capita per year.

- Large public and private investment programs run the risk of creating scarcities in the labor market and upward pressures on wages that may make other parts of the economy uncompetitive. Successful implementation of the program will therefore require a temporary increase in the use of imported skilled and semi-skilled labor and an aggressive program of training for Timorese who can gradually replace these imported workers. Similarly, international contractors will be required for implementation of significant parts of these programs because of the limited capacities of the domestic construction industry and related service industries. The Government hopes to encourage the use of sub-contracting and joint venture arrangements to build capacities within the local business community. There is also a risk of supply bottlenecks for other goods and services. These can be addressed in a variety of ways, including programs that provide local business with expanded access to working and investment capital from the financial services industry, and measures that ensure the timely import of goods and services through further improvements in customs and immigration services and port and airport operations.

Prospective Sources of Growth

As discussed in Part A above, in the past two years the economy has begun to recover from the contraction following the departure of large numbers of UN and other personnel beginning in 2002. Non-oil GDP is estimated to have grown by about 2% in real terms in 2005. With continued good performance in agriculture, and a large increase in public spending, the non-oil GDP growth rate is expected to rise to 5% in 2006 and then increase to about 7% a year by 2010.

Domestic and export markets are both expected to play an important role in providing the demand basis for accelerated growth. A major increase in government spending in the next five years will be a significant source of domestic demand that, in combination with rising real household incomes, will have important implications for local business activities. Increased levels of private investment in a range of opportunities that produce goods and services for the international market will also play an important role. These include further development of commercial agriculture for export markets, development of the near-shore and onshore oil and gas industry that will also have important multiplier effects for the local economy, and steady growth in services such as tourism.

Public investment and construction activity. The key driver for stronger growth in the medium-term will be an aggressive expansion of public spending, including implementation over the next five years of the proposed Millennium Challenge Account funded program of \$350 million that will aim to improve infrastructure services and expand skills development programs. The proposed public expenditure program is discussed in greater detail in Part D of this report. The Government intends to undertake an aggressive expansion of construction activity to rehabilitate and expand infrastructure and facilities, with an emphasis on labor-intensive methods to create employment. A series of measures are to be undertaken to help develop the capacity of the domestic construction industry.

The design of the proposed public investment program is drawn from the extensive work undertaken by government agencies over the past two years in the preparation of the SIPs for each of the 17 sectors of the economy. A large number of high priority proposals for new investment have been identified in the power, transport and communications sectors, along with the need for increased capital spending on schools and health facilities to improve access to basic services through the country. As noted earlier, the Government has also formulated an ambitious program for provision of safe water and adequate sanitation. This program aims to provide 80%

of the population with access to safe water and sanitation by 2015 – targets that were originally set for 2020 and 2025.

Table 18: Composition of Public Investment Program for FY2005/06-FY2009/10 (US\$ millions)

Activity	CFET	Donors & MCA	Total
Infrastructure & housing	120.0	320.0	440.0
Health & education	50.0	70.0	120.0
Other public investment	70.0	30.0	100.0
Total	240.0	420.0	660.0
Memo item:			
Construction expenditures	110.0	270.0	380.0

The broad outline of the proposed public investment program for the next five years is set out in Table 18. Approximately \$440 million would be spent on a major upgrading of the country's infrastructure, along with a start on creating serviced sites for private and public housing. In a number of cases, planning for these programs is well advanced. The ADB, for example, has assisted the Government in the formulation of a major program for upgrading the road network of the country. A large package of high priority road improvements amounting to about \$70 million has already been identified. Priority bridge improvements and riverworks amounting to some \$65 million have also been identified. Preliminary evaluation by the ADB suggests an economic rate of return of around 25% for the proposed road program. The master plan for electrification of the country will be completed later this year, along with assessments of the economic rates of return for the proposed investments in the sector. The SIPs for health and education have identified the need for immediate work on rehabilitation of existing facilities and construction of new facilities that will further improve access throughout the country to these basic services. In the education secondary, there will be a need to accommodate an additional 80,000 new students in primary and secondary schools by 2015. The number of new facilities will depend in part on the extent to which there are double shifts in some facilities, but more than 200 new schools may be needed to ensure children in all parts of the country have ready access to a basic nine years of education. The capital cost of new construction could be in the range of \$40 million, in addition to the need to rehabilitate many of the 980 schools already in use.

Development of private sector activity. In the longer term, growth would accelerate to around 7.5% a year in real terms, driven by substantially higher levels of private investment in commercial agriculture and the non-farm private sector, including increasing onshore activity in the petroleum sector as development of near-shore and onshore resources accelerates. The Government envisages a broad-based approach to private investment promotion by domestic and international business. There can be little doubt that strong growth in the private sector offers the best prospects for sustained growth in productive employment opportunities.

The agriculture sector is expected to continue to expand at around 3.5% a year in real terms as ongoing programs to improve food supply and reduce food insecurity and ongoing and planned new private investment in coffee, cassava, fresh and processed fish and other products for international and domestic markets all begin to have an impact. A wide range of other opportunities is currently under active discussion, including tourism, and various processing activities linked to the sustainable exploitation of the country's considerable natural resource base.

At present, the private sector currently accounts for about 65% of non-oil GDP, up from 56% in 2000. By 2015, value added in the private sector would rise to about \$370 million (at 2000 constant prices). The relative importance of subsistence farm production would decline steadily, whereas value added in the non-subsistence private sector would double to about \$270 million by 2015 (at 2000 constant prices). This implies a significant increase in domestic demand for an increasingly wide range of consumer goods, including food that would provide opportunities for subsistence families – the core of the poverty problem in the country. Increasing numbers of the

families could then produce larger amounts of marketable surpluses that, in turn, would bring them into the market economy and improve opportunities for a sustained reduction in the incidence of rural poverty. As noted elsewhere in this report, taking advantage of these opportunities will require a range of initiatives, including improvements in transport services and market access, and increased access to financial services.

Petroleum sector development. The Government has launched an ambitious program for the further development of the petroleum sector. While it is premature to make judgments on the likely economic impact of this program, the broad outlines of various possibilities are already emerging. In assessing these prospects, it is useful to distinguish between near-term, medium-term and longer term activities in the industry.

- In the near term (2006 and 2007), the emphasis is on further seismic work related to near-shore and onshore resources. Most of the near-shore activity will be concentrated around maritime vessels involved in the seismic work, although there will likely be some domestic economic impact as operators establish bases in Dili and elsewhere for refueling, maintenance, chandlery and related activities. Onshore exploration may begin some time next year. The expectation is that the transition to the production phase could occur quickly, perhaps in a year or less after exploration begins. Due to the high quality of the expected crude production onshore, very little refining will be required for the domestic use of the resource. The prospect therefore is that a series of mini-refineries could meet most of the nation's requirements for petroleum products within a relatively short period of time. Domestic production and refining would replace most of the \$40 million of petroleum products that are currently being imported.
- In the medium-term (2008 to 2010), the initial near-shore exploration drilling phase will begin. This will very likely result in increased levels of transportation from onshore bases to near-shore drilling units. Apart from the impact of increased personnel on domestic service industries such as housing, medical services, schools, hotels and restaurants, a range of possibilities are expected to open up from the creation of onshore supply bases for the drilling operations. The multiplier effects of these offshore operations are likely to be significant.¹¹
- In the longer term (2010 onwards), the commercial development of near-shore resources would begin. This phase would require development of a wide range of domestic services, including for example, engineering services, maintenance, fuel supply, catering and accommodation, and transportation. Development of LNG facilities and related pipelines will require fabrication, installation and maintenance. The fabrication would very likely be done in other countries, but installation and maintenance will create substantial employment opportunities for skilled and semi-skilled Timorese workers.

These prospects highlight the importance of an early start on the development of skills in the labor force so that the domestic impact of the industry on employment is maximized. There will be a need for people with advanced training in engineering, geology, accounting, finance and economics. Much of these requirements could perhaps be carried out under production sharing contracts. There will also be need for substantial numbers of welders, pipe-fitters, electricians, plumbers, plant and machinery operators, drill-floor workers, derrickmen, mechanics and so on. Domestic capacities for this type of training will need to be developed as a matter of priority so that there can be an early transition from the expected initial heavy dependence on expatriate workers.

¹¹ Norway's experience with offshore development suggests that each offshore job creates about five onshore jobs.

Table 19: Non-Oil Gross Domestic Product by Industrial Origin
(US\$ millions at 2000 constant market prices)

Sector	Value added				Growth rate (% p.a.)		
	2000	2005	2010	2015	2000-2005	2005-2010	2010-2015
Food, livestock fisheries	81.5	105.2	125.4	149.3	5.2	3.5	3.6
Non-farm private sector	98.2	110.5	140.6	217.7	2.4	4.9	9.1
Public sector							
Government	22.9	76.2	128.5	204.1	27.2	11.2	9.7
Public construction & utilities	30.3	22.1	49.2	64.3	(7.5)	17.5	5.5
United Nations	83.4	17.0	-	-	(27.2)	-	-
Sub-total	136.6	115.3	177.7	268.4	(3.7)	9.0	8.6
Non-oil GDP	316.3	331.0	443.7	635.4	0.8	6.0	7.5
Memo items:							
Non-oil GDP (at current prices)	316.3	349.9	548.9	894.0	2.0	9.4	10.1
Population ('000)	821.0	952.2	1,120.2	1,301.8	3.0	3.3	3.1
Non-oil GDP per capita (\$)	385	367	490	687	(1.0)	6.0	7.0
Non-oil GDP deflator (2000=100.0)	100.0	105.7	123.7	140.7	1.1	3.2	2.5

The sectoral composition of growth in the medium-term is set out in Table 19. Successful implementation of this growth strategy would raise non-oil GDP to around \$635 million (at 2000 constant prices) – a 90% increase over the current level. In nominal terms, non-oil GDP per capita would approach \$700 by 2015. After taking account of income flows from the petroleum industry, Gross National Income (GNI) may be in the range of \$1,500 per capita by 2015.

Implications for Creation of Employment

Steady progress towards sustained strong growth would provide productive employment for an additional 110,000 people. Achieving this outcome will be a major challenge. Employment opportunities outside of subsistence farming would have to grow by about 5.8% a year, with all but a small amount being created by private sector investment in rural and urban areas. The successful build up of private investment to meet domestic and international demand opportunities will be critical. Much depends on the way in which the subsistence part of the economy evolves and the success of efforts to promote greater involvement of these families in the market economy. Under the assumption that there is a modest decline in the share of people in the labor force who are employed primarily in subsistence farming, and that the open unemployment rate, which was 7.4% in 2004, also declines by a modest amount, the number of people gainfully employed outside of subsistence farming would rise from about 128,000 in 2004 to around 240,000 by 2015 (Table 20).

Table 20: Composition of the Work Force
(Thousands)

Indicator	2004	2007	2010	2015
Rural labor force	206.9	229.8	255.4	300.7
Subsistence farming	139.7	152.9	165.0	177.2
Commercial activities	67.2	76.8	90.4	123.5
Urban labor force	61.0	72.2	85.6	113.5
Public sector	17.5	19.5	23.0	30.0
Private sector	43.5	52.7	62.6	83.5
Unemployed	21.4	23.4	25.7	28.8
Total work force	289.3	325.4	366.7	443.0
Memo items:				
Subsistence farming (%)	48.3	47.0	45.0	40.0
Unemployed (%)	7.4	7.2	7.0	6.5
Rural labor force (%)	77.2	76.1	74.9	72.6

It is likely that the more acute problems of income poverty would then be found among the estimated 80,000 rural households whose livelihoods would continue to depend primarily on subsistence farming by 2015 and among the ranks of the unemployed. Increasingly, there will be a need for targeted interventions to support and assist these groups. The broad outlines of approaches now under consideration were discussed in Part B above.

Improving the Business Climate and Promoting Private Investment

Measures to improve the business climate. The Government is taking steps to improve the environment for domestic business. The important point about the formal and informal domestic business sector is that entities are typically very small in Timor-Leste, many with only a single worker and most of the remainder with less than 10 workers. Survey information indicates that most of these small enterprises are engaged in trading activities. There are very few large enterprises in Timor-Leste.

The transformation of this part of the economy so that local entrepreneurs can take full advantage of emerging new business opportunities presents a major challenge for the design of support programs and for improvements in the business climate. A number of actions are already underway or under consideration, including measures to streamline business registration. A recent World Bank survey found that the average time required to register a business in Timor-Leste is 92 days, which is high in comparison with many other countries that have been successful in developing the business sector. Business registration has been split between the Ministries of Development and Justice, which adds considerably to the time needed to register a business. Other survey data indicate that entrepreneurs in both the formal and informal economies believe that financial access is the most binding constraint on the capacity of their business to grow. As the discussion below indicates, the Government recognizes the need for improved access to financial services throughout the country. Additional measures will be required to address a range of issues in this sector.

Other initiatives that have been launched, including the following:

- Creation of a series of Business Development Centers (BDCs). These are now operating in Dili, Baucau, Maliana, Maubisse and Oecussi. More than 8,000 people have received various types of business training at these centers. More than 3,000 of those trained were existing entrepreneurs. Outside the BDC network, USAID and UNIDO are initiating separate business and economic education programs for delivery in primary and secondary schools.
- A first National Business Forum was held in Dili in June 2005, and a second is planned for end-March 2006 where the focus will be on business registration procedures. The Government expects that these Forums will meet on a regular basis thereby providing feedback from the private sector that can be incorporated into policies and programs for business promotion and development.
- A Commercial Registry Code has been approved by the Council of Ministers and is now awaiting promulgation. A significant improvement in the law is that requirements for annual renewal of business registration have been removed, although registration will still require multiple steps. Further work is planned to improve the administration of regulation procedures. The new code, which only covers registration of companies with paid-in capital of more than \$5,000, will be administered by the Ministry of Justice. The Ministry of Development will continue registering businesses with paid in capital of \$50 to \$5,000 as per UNTAET regulation 2000/2004. The Ministry is also taking action to reduce the average time required to register a small business to seven days.
- The Government established two new institutions in July 2005 to support foreign and domestic investment. The objective here is to establish “one stop shops” that will facilitate private investment. TradeInvest Timor Leste, which is responsible for promotion of foreign direct investment, held its first major investment conference in November 2005. The Instituto Apoio ao Desenvolvimento Empresarial (IADE) is responsible for domestic investment promotion and support. The intention is to build the

capacities of these two institutions to promote investment and provide support to the business community.

Trends and prospects for foreign investment. There are no reliable estimates of the amount of foreign investment in Timor-Leste. The most useful information comes from a survey of foreign-owned businesses that was undertaken in January 2005. The total amount of investment reported by these establishments amounted to about \$75 million (Table 21). The national income accounts suggest total private investment by domestic and foreign businesses of \$105 million for the period 2000-2003. After allowing for some repatriation of capital by overseas investors in 2004 in response to the sharp economic contraction of 2002-2003, and some domestic investment, it would appear that these two sources are roughly comparable. Not included in these estimates is the \$1.65 billion of investment in the offshore Timor Sea project.

Table 21: Foreign Direct Investment in Timor-Leste (US\$ millions)

Sector	Amount	Percent
Manufacturing	1.1	1.5
Construction	15.7	21.0
Telecommunications	22.3	29.8
Transportation	3.1	4.2
Retail, hotels, restaurants	18.3	24.5
Financial services	14.2	19.0
Total	74.8	100.0
Memo item:		
Oil and gas	1,649.6	

Source: TradeInvest

Anecdotal evidence suggests that in the face of the contraction in 2002 and 2003, there was a sharp decline in the inflow of foreign direct investment, but estimates for inflows in during 2004 and 2005 are incomplete. A number of new foreign investment projects have started in this period, including, for example, a project for export of fish.

In the past year, the Government has taken steps to promote increased inflows of foreign investment in Timor-Leste. A series of investment promotion road shows have been held in Asia, the United

States and Europe. In addition, there have been a number of investment promotion conferences in Timor-Leste, including one specifically for oil and gas in mid-2005 and a more general conference for a wider range of investors in November 2005. Both of these promotional efforts were well attended by international investors. As Table 17 indicates, if the growth rate of the private sector is to be lifted to 8% a year in real terms in the medium-term, private investment (other than for oil and gas) from domestic and foreign sources will need to be raised to around \$60 million a year by 2010 and \$100 million a year by 2015. The two newly created investment agencies are expected to play a major role in realizing these objectives.

But increased equity investment by the local and international business community must be complemented by further development of the financial services industry.

Development of the Financial Sector

The current outreach of the formal financial system remains very limited. It consists essentially of three commercial banks, each an overseas branch of a foreign institution, and one local institution operating with a limited banking license. Regulatory and supervisory functions for the banks are performed by the Banking and Payments Authority (BPA). There are no non-bank financial institutions subject to BPA supervision and there is no insurance company serving Timor-Leste; nor are there any leasing finance entities. In addition to the formal financial sector, there are number of microfinance institutions (MFIs), savings and loan cooperatives and pawnshops. While the MFIs are of limited significance in dollar terms, they have succeeded in reaching a significant number of poor households.

The Government recognizes that the further development of financial sector is another of the key elements of the strategy to accelerate growth and reduce poverty. The policy of the Government, as set out in the Private Sector Development SIP, calls for a shift in emphasis away from direct

interventions by donors in the provision of credit to increased emphasis on use of domestic savings that are intermediated through the financial system, along with increased emphasis on building the capacities of the financial sector to provide a wider range of services and extend greatly the coverage of the banking sector. More work is needed to refine and elaborate the strategy for the further development of the financial sector, but the broad outlines are as follows:

- Coverage of financial services needs to be expanded.
- Domestic savings should be mobilized
- The legal and regulatory framework should be strengthened
- The number of financial institutions can be expanded and wider range of products offered
- The capacities and outreach of microfinance institutions should be expanded.

Expanding the coverage of the financial services sector. The great majority of the population is currently beyond the reach of formal financial services. There are now about 200,000 households in the country, but less than 60,000 had deposit accounts in 2005. An important objective for the sector is to ensure that much larger numbers of households have access to financial services. Data from 2005 indicated, for example, that nine of the 13 district capitals were without financial services. Moreover, financial services were not available in any of the 65 sub-district towns of the country.

Promotion of domestic savings. For an effective transition to private sector led growth, the financial sector must be able to meet the demands of business and household for loans and other financial services. Following the destruction of the financial system in 1999, there has been impressive growth in bank deposits and lending to the private sector. As Table 22 indicates, deposits have risen to about 27% of non-oil GDP and lending to the private sector is now equivalent to about 25% of non-oil GDP. But the latter ratio is still only half that of other low income developing countries. The banking system is now intermediating around 90% of deposits in the form of loans to the private sector. There appears to continuing considerable excess demand for bank credit by individuals and small business. If the growing demand for financial services is to be met, there must be increased emphasis on savings mobilization throughout the country. This means, among other things, building a more extensive banking network throughout the country. If bank lending to the private sector were to grow to 45% of non-oil GDP by 2015, which is the current average for all low income developing countries, loans outstanding would amount to about \$360 million at that time. This would imply an average increase in lending of about 15% a year and mobilization of an additional \$350 million or more in deposits.

Table 22: Selected Indicators for the Financial Sector
(US\$ millions)

Indicator	2000	2001	2002	2003	2004	2005
Demand & term deposits	20.0	51.1	54.6	72.3	83.0	95.5
Loans to private sector	1.8	7.0	6.8	20.9	68.6	87.2
Ratio of credit to deposits (%)	9.0	13.7	12.5	28.9	82.7	91.3
Broad money as % non-oil GDP	6.3	13.9	15.9	21.5	24.5	27.3
Private sector loans as % non-oil GDP	0.6	1.9	2.0	6.2	20.3	24.9

Strengthening the legal and regulatory framework for the financial services sector. Following the impending transformation of the BPA into the central bank of the country, there will be a need for emphasis on further development of the legal and regulatory framework for the financial services industry. The agenda includes, for example, the further improvement in the legal framework related to land and property, and the provision of insurance and leasing services. The financial services sector, under the leadership of the BPA, is currently working towards the

creation of a credit registry. Once appropriate land laws are in place, consideration can then be given to the creation of a collateral registry.

Increasing the number of financial institutions and expanding the range of financial products.

With continued growth in the sector, there will be scope for new entrants into the banking system, particularly institutions that have the experience and technology to bring banking services small towns and rural communities throughout the country. Increased competition in the banking sector may also help lower interest rates. According to BPA data, lending rates are around 13% p.a. while rates on savings deposit are under 1% p.a. With inflation currently running at 1-2% p.a., the spread in real terms is in the range of 10%. A gradual reduction in lending rates and a reduction in lending margins will be an important stimulus for the further development of the small business sector in the country.

There is also a noticeable absence of remittance services that can facilitate the domestic transfers of money from urban to rural areas, as well as international transfers from abroad. The latter is likely to become increasingly important as the Government's plans for export of labor to other countries progress. The first batch of 100 workers is to be sent to South Korea this year for employment in the construction industry. The Government expects to place an additional 500 to 1,000 workers overseas during FY2006/07. Depending on experience with these programs, it is possible that the number of workers overseas could grow to several thousand. International experience indicates that overseas workers regularly remit a portion of their earnings to relatives in their home countries. By way of illustration, an overseas work force of 3,000 people, each remitting an average of \$500 per year, would imply the transfer of \$1.5 million a year to families in Timor-Leste. A greatly expanded network of outlets will be required in Timor-Leste to facilitate these transfers to home communities.

Strengthening the capacities and reach of the microfinance institutions and credit unions.

Given their important role in bringing financial services to low income families, especially in rural areas, the capacities and outreach of microfinance institutions will need to be strengthened. The Association of Microfinance Institutions in Timor-Leste, which consists of 11 member institutions, reports that as of end 2004, the Association served some 26,600 savers and 19,200 borrowers. Deposits amounted to about \$1.28 million with loans outstanding at \$2.36 million. The Association members operated in 10 of the 13 districts of the country. These data indicate that the present coverage of microfinance institutions is very limited, perhaps providing services to no more than 25,000 to 30,000 households. As the foregoing discussion in Part B indicates, a key part of the rural transformation of the economy must focus on the needs of the 95,000 households whose livelihood depends on subsistence farming and who, at this time, are essentially outside the monetized part of the economy. Moreover, there are another 70,000 families in rural areas who are small-scale producers of marketable agricultural products, primarily rice and coffee. Improved access to credit for much larger numbers of these households must be seen as an essential part of the transition to sustained strong growth and to poverty alleviation.

Consequences of a Weak Economic Performance

What are the consequences of a weak economic performance over the next 5-10 years? They are indeed potentially serious. With weak economic growth in the face of a population growth at more than 3% a year and a labor force growing at 4% a year, the economy would struggle to create enough productive employment. The incidence of income poverty would not decline, and may well increase. The major downside risks for the economy include the following:

- Poor growth performance in agriculture.

- An inability of Timor-Leste to attract increasingly large amounts of private capital for investment in the non-food private sector. As a result, the growth of the non-food private sector is much lower, as is non-oil GDP growth.
- Higher population growth as a result of a successful reduction in mortality rates, but with no corresponding reduction in fertility rates.
- An even more rapid growth in the labor force as a result of rising participation rates.
- Inadequate progress in building capacities to implement a substantially larger program of public investment.
- Failure to reach agreement with the MCC for the \$350 million program of funding that would quickly improve infrastructure and other basic services.

For the purposes of this report, one alternative growth scenario has been modeled. It is based on the following assumptions:

- Slower growth in agriculture and in the non-farm private sector as a result of lack of progress in improving the climate for business activities and investment.
- Continued weak budget execution and inability to attract foreign contractors to ramp up implementation capacities quickly.
- Failure to reach agreement with the MCC regarding arrangements for the implementation of the proposed \$350 million of MCA funding over the next five years. It is assumed that the Petroleum Fund is able to transfer some additional resources to the budget to compensate for the loss of the MCA, but continued weak implementation capacities limit the step up in Petroleum Fund transfers.

Table 23: Slow Economic Growth Scenario
(Non-oil GDP in US\$ millions at 2000 constant market prices)

Sector	Value added			Growth rate (% p.a.)	
	2005	2010	2015	2005-2010	2010-2015
Food, livestock fisheries	105.2	123.1	144.1	3.2	3.2
Non-farm private sector	110.5	125.2	149.7	2.5	3.7
Public sector					
Government	76.2	123.8	163.2	10.2	5.7
Public construction & utilities	22.1	29.4	37.0	5.7	5.0
United Nations	17.0	-	-	-	-
Sub-total	115.3	153.2	200.2	5.9	5.5
Non-oil GDP	331.0	401.5	494.0	4.0	4.2
Memo items:					
Non-oil GDP (at current prices)	349.9	496.7	695.1	7.3	7.0
Population ('000)	952.2	1,120.2	1,301.8	3.3	3.1
Non-oil GDP per capita at 2000 prices (\$)	348	358	379	0.7	1.1
Value added per laborer at 2000 prices (\$)	114	109	112	(1.3)	0.6
Non-oil GDP deflator (2000=100.0)	105.7	123.7	140.7	3.2	2.5

The results of this alternative scenario are set out in Table 23. In this scenario the economy grows at about 4% a year for the next decade. In real terms, there is very little increase in the real non-oil GDP per capita, and value added per worker declines. These indicators point to a likelihood that there would be no reduction in the incidence of poverty, and quite possibly an increase. If the incidence of poverty remained at the current estimated level of 41.5%, there would be about 465,000 people below the poverty line by 2010, compared with 390,000 in the high growth scenario. By 2015, the number of people in poverty would have risen to about 540,000, more than double the number in the high growth scenario. This alternative scenario underscores the importance of a successful implementation of the strategies set out in the SIPs for growth, investment and service delivery.

Part D: Role of Fiscal Policy and Donor Assistance

Petroleum Fund and Domestic Resource Mobilization

The Government has reiterated on many occasions the importance that it attaches to avoiding the mistakes made by other resource rich countries that have led to macroeconomic instability and worse. As mentioned elsewhere in this report, the Government is well aware that macroeconomic stability is required for sustained strong growth that can reduce poverty. Consistent with this commitment to sound management of the country's rich resource endowment, the Government has adopted a savings policy that aims to ensure effective management of petroleum revenues.

To implement this policy, a Petroleum Fund was established in September 2005, following promulgation of the Petroleum Act on August 3, 2005. All revenues from petroleum production are paid into the Petroleum Fund. The Fund will act to accumulate large amounts of savings from petroleum revenues and will provide a buffer to fund budget expenditures should there be any temporary shortfall in petroleum revenues. The Act provides for the transfer of revenues from the Petroleum Fund to the budget. The key to the savings policy of the Fund is that transfers to the budget should adjust over the medium-term to the sustainable level of expenditure. This sustainable level of transfers to the budget is based on estimated current and future petroleum revenues. It is the level of expenditure that can be sustained indefinitely, after allowing for inflation. In this way, withdrawals from the Petroleum Fund can fund stable and sustainable levels of expenditure even though petroleum revenues may fluctuate considerably from year to year. Four key principles have shaped the design of the Fund.

- The Petroleum Fund should accumulate significant levels of savings to benefit future generations of Timorese.
- The Petroleum Fund savings should generate significant interest income, particularly when petroleum revenues have ceased.
- Temporary fluctuations in world oil prices will have little effect on expenditure, as savings will fluctuate instead.
- Permanent changes in revenue will change the estimated sustainable level of expenditure by the Fund, and this will result in adjustments of expenditure over the medium-term, so as to minimize disruptive changes in expenditure plans.

The Petroleum Fund builds on international best practice and reflects the circumstances of Timor-Leste with additional accountability, transparency and public information features. The Act requires that the Petroleum Fund be prudently managed, investing securely in low-risk financial assets abroad.

The revenue position of the Government has undergone a major change in the past year, largely as a result of increased production from the Bayu Undan field in the JPDA and high international prices for petroleum. The prospect is for substantial further increases in these revenues. As a result, the sustainable level of funds that can be transferred from the Fund to the budget at the present time is about \$260 million. Based on current forecasts of future production and international prices for oil, the sustainable income of the Fund that can be transferred is projected to rise to about \$370 million by FY2014/15.

There has been steady improvement in the revenue performance of the National Government in the past four years. In FY2000/01, tax and non-tax revenue collections were equivalent to only 4% of non-oil GDP; but by FY2004/05, collections had risen to the equivalent of 10% of non-oil

GDP. With the prospect of substantial increases in petroleum revenues flowing into the Petroleum Fund, the central policy issue for Government is future levels of domestic tax and non-tax revenues, as judged from two distinct vantage points:

- What is the likely impact of the existing tax regime on the poor and on efforts to reduce poverty?
- To what extent does the present tax regime promote or deter private investment by local or international business?

The Government is examining the current tax regime from these perspectives to determine whether further changes would facilitate progress towards the over-arching objective of poverty reduction.

Table 24: Revenues for Whole of Government
(US\$ millions)

Revenue Source	FY04/05	FY05/06	FY06/07	FY07/08	FY08/09	FY09/10	FY14/15
Direct and indirect taxes	29.7	31.1	32.9	36.0	39.9	44.7	75.8
Non-tax revenues	4.4	4.5	6.0	6.9	7.8	8.6	13.2
Autonomous agency revenues	8.0	10.5	12.1	15.6	17.5	19.7	30.6
Interest income	2.7	5.1	2.7	2.8	2.9	3.0	3.4
Timor Sea revenues	209.4	-	-	-	-	-	-
First tranche petroleum royalties	55.6	9.0	-	-	-	-	-
Transfer from Petroleum Fund	-	-	143.0	107.1	106.0	111.7	222.3
Total receipts	309.8	60.2	196.7	168.4	174.1	187.7	345.3
Memo items:							
Domestic tax & non-tax revenues							
Total	34.1	35.6	38.9	42.9	47.7	53.3	89.0
As % non-oil GDP	9.9	9.8	9.9	10.0	10.1	10.2	10.3
Sustainable petroleum income	-	265.3	283.3	291.2	300.5	310.2	359.3
Transfer as % sustainable income	-	-	50.5	36.8	35.3	36.0	61.9
Non-oil GDP at current prices	344.3	363.2	393.2	429.5	472.2	522.3	861.1

The scenario for revenue mobilization set out in Table 24 is based on the assumption that tax and non-tax collections will remain at about 10% of non-oil GDP. In other words, the Government would look to transfers from the Petroleum Fund rather than increasing tax collections relative to non-oil GDP. A low tax regime that is simple to administer may improve the attractiveness of Timor-Leste as a designation for local and international investors. However, the revenues of autonomous agencies would continue to increase in line with the growth of these services and continued adherence to the principle that users of the services should pay for them.

When combined with domestic tax and non-tax revenues, the financing capacity of the Whole of Government is currently estimated to be in the range of \$320 million a year, rising to about \$380 million by FY2009/10, and almost \$500 million by FY2014/15. As the discussion in Part A indicated, in recent years total public spending on a combined sources basis has been stable at about \$235 million a year, well below the current funding capacity of the Government. The major challenge that now faces the Government is building national capacities for effective implementation of a much larger program of development that can accelerate growth, improve the amount and quality of basic services, and reduce poverty.

Priorities for Public Expenditures

The SIP process, which was launched by the Government in mid-2003, has emerged as a valuable tool for planning and management of development expenditures for the medium-term. With the

completion of all 17 SIPs in mid-2005, the Government subsequently launched the first annual update of the SIP expenditure programs to cover the five-year period FY2005/06 through FY2009/10. The results of the update process are now being incorporated into the Combined Sources Budget for FY2006/07.

Table 25: Sectoral Allocations of Combined Sources Expenditures (US\$ millions)

Sector	FY00/01-FY04/05		FY05/06-FY09/10	
	Amount	Percent	Amount	Percent
Basic services				
Health care	118.1	11.6	205.4	11.6
Education & training	222.6	21.9	320.0	18.0
Social, civil & heritage protection	6.8	0.7	30.5	1.7
Sub-total	347.4	34.1	555.9	31.3
Production-related sectors				
Agriculture, forestry, fisheries	71.6	7.0	123.3	7.0
Natural resources & environment	11.9	1.2	21.1	1.2
Private sector development	15.5	1.5	29.5	1.7
Sub-total	99.0	9.7	173.9	9.8
Infrastructure and housing				
Communications	9.7	1.0	22.0	1.2
Housing & urban development	6.7	0.7	20.0	1.1
Power	83.3	8.2	215.0	12.1
Transport	95.6	9.4	220.9	12.5
Water supply & sanitation	52.5	5.2	118.5	6.7
Sub-total	247.8	24.3	596.4	33.6
Governance				
Pillars of the State	38.7	3.8	68.5	3.9
Public sector management	135.6	13.3	110.4	6.2
Local development	23.3	2.3	47.6	2.7
Rights, equality & justice	37.8	3.7	64.5	3.6
Sub-total	235.5	23.1	291.0	16.4
Security & external relations				
Security & peacebuilding	74.4	7.3	128.3	7.2
External relations & cooperation	14.2	1.4	28.5	1.6
Sub-total	88.6	8.7	156.8	8.8
Total	1,018.3	100.0	1,774.0	100.0

The SIP expenditure proposals have been evaluated in the light of the levels of donor funding that may be available to the country in this five year period and judgments about the pace at which implementation capacities can be built up within the country. Moreover, the Government has been prudent in its judgments about the extent to which funds should be transferred from the Petroleum Fund so soon after its creation. The expenditure program also makes allowance for early approval by the MCC of the Compact that is currently under preparation within government. This program would make a total of \$350 available over a five-year period. The Government has designed the development expenditure program based on the MCC program starting implementation in the second half of FY2006/07.

After taking account of these various factors, the Government

believes that a combined sources expenditure program of about \$1.77 billion should be undertaken during the five year period, FY2005/06 through FY2009/10. This compares with actual expenditures of \$1.018 billion in the past five years – an increase of some 70% in nominal terms and about 50% in real terms.¹²

A program of this magnitude will have five main benefits:

- It will lay the foundations for a transition to sustained strong economic growth that is essential for job creation and poverty reduction.
- It will ensure substantial progress towards the MDGs that have been set for 2015, especially in areas related to health care, access to education and to safe water supply and adequate sanitation.

¹² It is important to note that the CFET expenditures included in this section of the report are provisional and subject to change. At the time that the report went to print, discussions were ongoing on the final budget proposals that would be submitted to Parliament.

- It will result in a major improvement in the infrastructure of the country that, among other things, will lower business costs and improve the international competitiveness of the country.
- It will lay the foundations for a major improvement in the skills of the work force thereby reducing dependence on imported semi-skilled and skilled labor.
- It will result in a major improvement in implementation capacities within the country.

The proposed program is summarized in Table 25. It is important to note that these expenditures include existing and proposed new CFET appropriations and donor expenditures on development and technical assistance. Not included in this table are donor expenditures on development and technical assistance that are treated as “off-budget”, humanitarian and emergency assistance, direct budgetary support by donors, and bilateral military assistance. As the Table indicates, there are some important shifts in allocations of resources among sectors. The key points about the proposed program are as follows:

- Health care and education continue to account for about 30% of total spending on a combined sources basis, reflecting the very high priority the Government attaches to these sectors.
- There is a sharp increase in allocations for infrastructure and housing from 24% of spending in the past five years to 34% for the next five years. This increase stems from major increases in spending on water supply and sanitation, the transport sector and the power sector. Smaller increases are planned for communications, housing and urban development.
- The share of resources allocated to the production sectors remains essentially unchanged at a little under 10% of the program.
- The share of spending on security and external relations remains unchanged at a little under 9% of the total program, reflecting the commitment of the Government to ensuring adequate internal security in the country and an increasingly active role in regional and international affairs of particular interest to Timor-Leste.
- Spending on governance related programs rises to about \$290 million, but the share of these sectors drops to about 16% of the program. The decline is due to lower levels of spending on public sector management. The drop in spending in this sector reflects the reduction in dependence on expensive expatriate advisory services that characterized the past five years.

As Table 26 indicates, the intention is to step up public spending on a combined sources basis from the past levels of about \$235 million a year. Outlays for the current year are expected to rise to about \$260 million, followed by another large increase next year. Disbursements from programs funded by current Development Partners decline, but this is more than offset by planned large increases in CFET expenditures and the launch of the proposed MCC program next year. The Government is very aware of the challenges involved in this ramp up in development spending, including the need to strengthen implementation capacities and to ensure continued macroeconomic stability. As discussed earlier, consideration is being given to increased use of international contractors to bring about an immediate increase in implementation capacities. As provided for in the ongoing Consolidated Support Program, a number of additional measures will be taken in the year ahead to improve budget execution and procurement.¹³ Successful

¹³ The macroeconomic model that underpins the analysis in this report includes assumptions about the budget execution rate for CFET expenditures. Over the next five years, the assumption is that there will be a steady improvement in budget execution rates.

implementation of the program is expected to boost economic growth and job creation in the near term that, in turn, will contribute to a reduction in the incidence of poverty.

Table 26: Trends in Recurrent and Capital Expenditures on a Combined Sources Basis
(US\$ millions)

Type of expenditure	FY00/01	FY03/04	FY04/05	FY05/06	FY06/07	FY07/08	FY08/09	FY09/10	FY14/15
Recurrent expenditures									
CFET	34.1	62.5	65.8	89.8	122.1	129.9	129.7	137.1	193.0
Donor programs	97.8	123.9	111.6	97.6	86.4	79.7	68.0	55.3	10.0
Sub-total	131.9	186.4	177.4	187.4	208.5	209.6	197.7	192.4	203.0
Capital expenditures									
CFET	5.7	10.0	12.7	29.3	81.9	45.6	39.2	43.9	118.1
Donor programs	50.2	40.6	42.3	46.3	47.6	44.1	47.2	49.1	80.0
MCA funding	-	-	-	-	25.0	45.0	50.0	65.0	-
Sub-total	55.9	50.6	55.0	75.6	154.5	134.7	136.4	158.0	198.1
Total expenditures									
CFET	39.8	72.5	78.5	119.1	204.0	175.5	168.9	181.0	311.1
Donor programs	148.0	164.5	153.9	143.9	134.0	123.8	115.2	104.4	90.0
MCA funding	-	-	-	-	25.0	45.0	50.0	65.0	-
Total	187.8	237.0	232.4	263.0	363.0	344.3	334.1	350.4	401.1
Memo items:									
CFET as % total expenditures	21.2	30.6	33.8	45.3	56.2	51.0	50.6	51.7	77.6
CFET share of recurrent (%)	25.9	33.5	37.1	47.9	58.6	62.0	65.6	71.3	95.1
Recurrent as % non-oil GDP	38.6	55.3	51.7	51.9	53.8	50.2	43.9	39.6	26.5
Capital as % non-oil GDP	16.3	15.0	16.0	20.9	39.9	32.3	30.3	32.5	25.9

Note: CFET capital expenditures include minor capital works.

Changing Role of CFET Funding

In the course of preparing individual SIPs, care has been taken to estimate, as best as possible, capital and recurrent expenditures by donors and CFET. The CFET estimates come direct from budget documents, but information on donor funded recurrent and capital spending is incomplete. Estimates have therefore been prepared for all completed, ongoing and proposed new donor projects and programs. The results are summarized in Table 26. As with Table 25, these data include all CFET expenditures, but only “on-budget” development and technical assistance provided by donors. As noted elsewhere in this section, the various categories of CFET expenditures include assumptions about future budget execution rates. They are therefore somewhat lower than planned appropriations.

The Table highlights important changes that have been taking place with respect to the role of CFET funding of the combined sources budget, including changes in the allocations of expenditures between capital and recurrent outlays. The key points are as follows:

- Recurrent expenditures currently account for about three-quarters of total outlays, but this share is projected to decline steadily as the proposed public expenditure programs place increased emphasis on capital replacement expenditures on existing public assets and on the creation of new assets essential for service delivery and strong economic growth.
- CFET funding accounts for a growing share of total outlays. In FY2000/01, CFET funded only 21% of total outlays (and most of that was, in turn, financed by donor budget support). CFET currently funds about 45% of total outlays and by FY2014/15, is expected to fund about three-quarters of total spending.
- CFET funding of recurrent outlays currently stands at about 50%. By FY2009/10, CFET will fund three-quarters of recurrent spending and by FY2014/15 around 95% will be covered by CFET. The primary recurrent expenditure financed by donors is expatriate advisory services. The Government expects to reduce gradually its dependence on donor

funding of these services as capacities among national staff are strengthened and as the Government increasingly funds international advisory services from its own resources.

The other point that emerges clearly from Table 26 is the earlier-discussed large build up in capital spending. The Government is proposing capital spending of about \$160 million a year by FY2009/10, led by the MCA funded program from FY2006/07 and a modest increase in such funding by existing development partners. CFET funding of capital outlays is expected to grow slowly for several more years – a reflection of the work that remains to be done in building capacities within the government for effective design and management of capital expenditure programs.

Table 27: Projected Requirements for External Assistance
(US\$ millions)

Type of expenditure	FY04/05	FY05/06	FY06/07	FY07/08	FY08/09	FY09/10	FY14/15
Development & TA on -budget							
Ongoing	135.8	121.6	90.3	60.1	25.2	9.4	-
Proposed new	-	12.5	40.0	60.0	90.0	105.0	90.0
MCA	-	-	25.0	45.0	65.0	65.0	-
Sub-total	135.8	134.1	155.3	165.1	180.2	179.4	90.0
Development & TA off-budget	18.1	9.8	3.7	3.7	-	-	-
Humanitarian assistance	1.1	0.2	-	-	-	-	-
Budget & commodity support	34.2	10.0	10.0	10.0	-	-	-
Donor administrative expenses	5.2	3.6	0.4	0.2	0.2	0.2	0.2
Total assistance	194.4	157.7	169.4	178.9	180.4	179.6	90.2
Memo items:							
Per capita development & TA (\$)							
Existing donors	145	139	131	116	108	104	70
MCA	-	-	25	44	61	59	-

An issue of continuing concern for the Government is the provision of sufficient budgetary resources for capital replacement expenditures. In the past year, the Government has launched an initiative that is designed to provide reliable estimates of the capital stock of the public sector. At present there are no reliable estimates for the replacement cost of the infrastructure, equipment and facilities that are owned by the State. In the event that the replacement cost is in the range of \$1 billion, and assets have an average life of 15 years, replacement capital spending would need to average about \$65 million a year – clearly a level of capital spending that is beyond what is currently provided for in the CFET budget. Moreover, the proposed program calls for capital spending of \$650 million over the next five years, a portion of which is replacement capital spending to rehabilitate roads, schools and so on. However, new asset formation under the program is probably in the range of \$450 million, which would add another \$30 million a year for replacement spending in the longer term. Once the ongoing work on building up the asset registry for public assets is well advanced, it should be possible to formulate more realistic capital replacement programs for consideration in the budget.

Role of Donor Assistance

As noted in Part A above, the role of the donor community has undergone significant change in the past six years. The Government expects that there will be further change in the next five years as Timor-Leste strengthens its capacity to finance development from its own resources and as internal capacities for design and implementation of development programs continue to strengthen. A major challenge for the country at this juncture is that financing capacities now

exceed implementation capacities by a large margin thanks to rising revenues from oil and gas. The Government attaches great importance to the continuing partnership with the international community. This partnership is the most effective way in which international experience and lessons from successes and failures in other developing countries can be brought to bear on the design of programs for poverty alleviation and strong, but equitable economic growth.

The Government continues to look beyond the immediate future in drawing up its plans and programs for donor assistance. Levels of assistance are monitored on a continuing basis and comparisons with other countries are used to guide decisions on likely future levels of assistance. The Government's current outlook for future inflows of assistance is set out in Table 27. The basis for this projection is as follows:

- The proposed MCC program of \$350 million would be approved later this year, with implementation over five years beginning in FY2006/07. The allocation of \$350 million implies an annual average level of assistance of \$ 65 per capita. This level of support is roughly comparable to that provided by the MCC in other small economies that have also demonstrated a strong commitment to development.
- In the coming years, support from the existing donor community will be primarily in the form of development and technical assistance. Direct budget support is expected to phase out over the next three years. It is likely that the steady decline in the level of development and technical assistance per capita – evident since FY2001/02 – will continue. For planning purposes, the Government assumes that this assistance will decline to about \$100 per capita by FY2009/10.

Management and Coordination of Donor Assistance

Issues in donor coordination. The Government recognizes that the proposed program for accelerated growth and sustained progress towards the MDGs for 2015 will not be without difficulties. The Development Partners of Timor-Leste have an important role in providing assistance, advice and support. Successful implementation of the ambitious program will require close collaboration with the donor community and a range of initiatives in the immediate future aimed at building a substantially larger capacity for program design and execution.

The experience of the past three years has highlighted the importance of improved coordination among government agencies within individual sectors, among donors, and between donors and government agencies. The importance of coordination has been reinforced by the identification in the SIP process of new projects and programs that are of high priority and that are proposed for funding by CFET or donors. The most recent update of the 17 SIPs indicates that there are now more than 400 new projects and programs proposed for the next five years – an average of 25 per sector. The agencies concerned have made concerted efforts to establish clear priorities within their sectors, but experience shows that early understandings about the extent of donor interest in particular proposals is central to effective management of the sectoral programs. In the event that there is little or no donor interest in particular projects and programs, the Government must decide whether the project should go ahead with CFET funding, or whether it should be deferred for reconsideration at a later date.

Analysis of the Registry of External Assistance database provides ongoing information about potential coordination issues in each sector (Table 28). Several important points emerge from the analysis.

- The number of active donors in each sector varies widely.
- Annual disbursements per donor have averaged about \$1 million a year over the past three years, but there is wide variation among sectors.

- Several sectors have a large number of active donors and a low level of annual disbursements per donor.

Table 28: Number of Active Donors by Sector
(Three year average FY02/03--FY04/05)

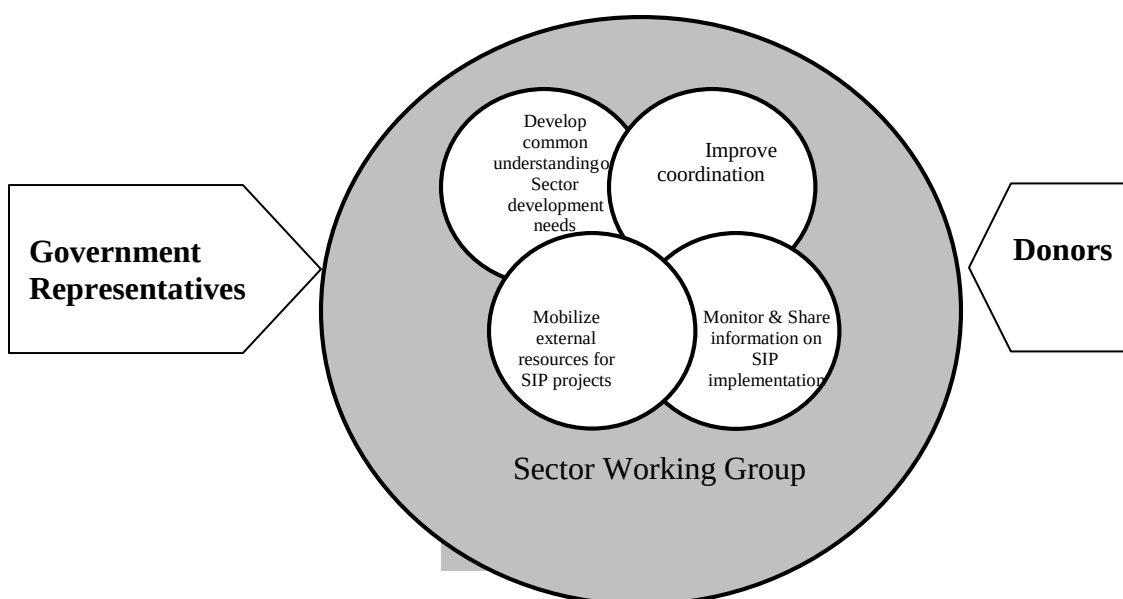
Sector	Donors	Annual Disbursement (\$ mill)	
		Amount	Donor average
Public sector management	22	29.9	1.359
Rights, equality, justice	15	6.5	0.433
Health care	14	16.7	1.192
Education	14	27.0	1.932
Local development	14	14.5	1.035
Agriculture, forestry, fisheries	12	14.1	1.177
Security, peacebuilding, reconciliation	12	5.0	0.416
Pillars of the State	10	3.7	0.369
Social, civil & heritage protection	10	6.1	0.611
Natural resources & environment	8	3.2	0.403
Private sector development	8	5.8	0.727
Communications	8	2.6	0.323
Power	6	7.3	1.210
Transport	6	6.9	1.158
Water supply & sanitation	6	13.6	2.259
External relations & cooperation	6	1.6	0.270
Housing & urban development	2	0.5	0.255

The Public Sector Management sector continues to attract the largest number of donors. In the past three years, an average of 22 donors has had active programs in the sector. Several other sectors also have large numbers of active donors. Effective arrangements for coordination among donors and between donors and the Government are essential in these sectors. At the other end of the spectrum are the Infrastructure sectors, Housing and Urban Development, and External Relations and Cooperation, where only small numbers of donors are active. Coordination issues in these sectors are more manageable. The Public Sector Management and Infrastructure sectors also have, on average, larger disbursements per donor which points to larger individual projects in these sectors.

Effective coordination will also be required in those sectors where there is a large number of active donors with relatively small individual programs. These include, for example: Rights, Equality and Justice; Pillars of the State; and Social, Civil and Heritage Protection. Past experience indicates that sectors with these characteristics typically encounter coordination issues; on occasions these may also impose additional burdens on the government agencies responsible for these sectors.¹⁴

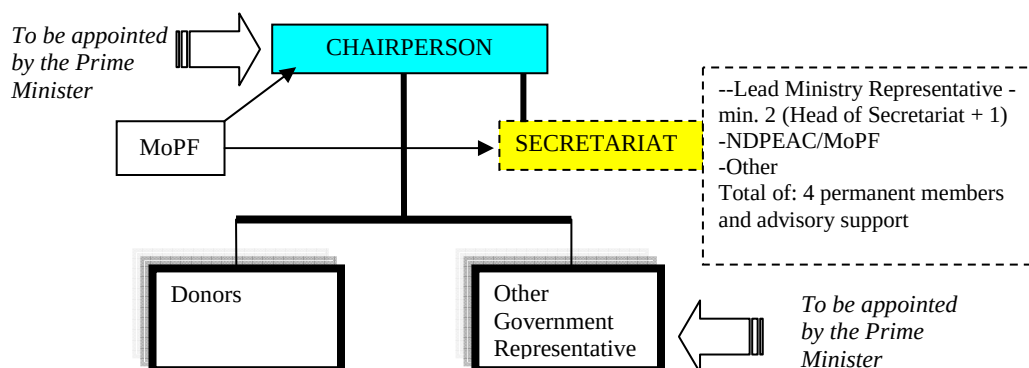
Creation of Sector Working Groups. The SIP process has emerged as an important part of the Government's efforts to build mechanisms for the effective management of programs in individual sectors. At the Development Partner Meeting in April 2005, the Government had indicated that Sector Working Groups (SWGs) would be set up for key sectors in an effort to strengthen further cooperation and coordination among government agencies and donors. Subsequent to that meeting, the groundwork was laid for the formation of 11 SWGs during FY2005/06.

¹⁴ The SIP Overview Report of 2005 drew attention to a number of examples in these sectors where lack of coordination among donors had imposed particular burdens on government agencies. See *Overview of Sector Investment Programs, Volume I: Strategies and Priorities for the Medium-Term*. April 2005. p.21.

Figure 2: Role of the Sector Working Group

The Government has developed procedures and guidelines for the operation of the SWGs, the broad outlines of which are as follows:

- The SWGs are to be the focal point for a dialogue about sector policies and programs and their financing, and a mechanism whereby issues of coordination among donors and between donors and Government can be addressed. They will also provide a forum for ensuring that cross-sectoral linkages among projects and programs are recognized and taken into account in program design and implementation.
- The SWGs are not responsible for actual implementation of projects and programs. These responsibilities remain with the individual agencies concerned.
- The Chairperson of each SWG is appointed by the Prime Minister. Membership of each Group includes representatives of government agencies that have responsibilities for the sector, and donors who have active programs or an interest in the sector.

Figure 3: Structure of an Individual Sector Working Group

Each SWG is supported by a Secretariat located within the lead ministry for the sector (Figure 3). The responsibilities of the Secretariat include, for example, provision of administrative support to the Chairperson and the SWG itself, monitoring and reporting on proposals by donors or CFET for funding new activities that may emerge from SWG deliberations, periodic update of Project Information Sheets, promotion of coordination and cooperation among agencies involved in the sector and provision of information to donors about activities in the sector.

Table 29: Status of Sector Working Groups
(As of March 2006)

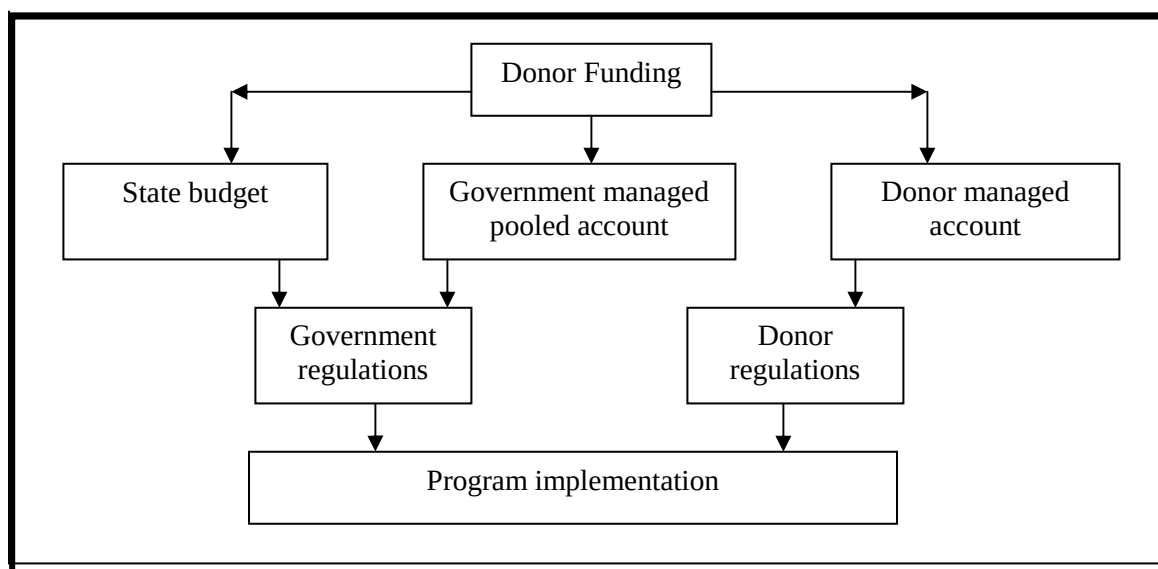
Sector Working Group	Date established	Meetings with donors	
		Initial Meeting	First Follow-up
Agriculture, forestry & fisheries	Dec-05	Feb-06	Aug-06
Health care	Dec-05	Feb-06	
Basic infrastructure	Dec-05	Feb-06	
Education & training	Dec-05	Feb-06	
Local development	Dec-05	Feb-06	
Rights, equality & justice	Dec-05	Feb-06	
Private sector development	Dec-05	Feb-06	
External relations and security	Dec-05	Feb-06	
Natural resources & environment	Dec-05	Feb-06	
Social, civil & heritage protection	Dec-05	Feb-06	
Public service	Dec-05	Feb-06	

The current status of the SWGs is set out in Table 29. All 11 of the SWGs were formally established in December 2005. After a series of internal meetings, the first round of meetings with donors began in February 2006 and will extend through March 2006. The intention is to hold a second round of meetings with donors in August/September 2006 prior to the start of the mid-year update of the combined sources budget and the start of preparations for the FY2007/08 budget. In this way

decisions on funding arrangements and donor support can feed into the annual budget cycle.

Modalities for donor assistance. With the phase down of TFET activities in Timor-Leste, the Government has given considerable attention to the modalities for donor assistance that are able to best meet the needs of the country in the medium-term. In January of this year, the Government issued guidelines for the modalities that will be used to channel donor assistance to Timor-Leste.

Figure 4: Financing Modalities for Donor Assistance



Under these new guidelines, donor funding can use any one of three different modalities for the transfer of funds (Figure 4).

- Funds may be channeled directly into CFET. This mechanism is a continuation of the established arrangements for provision of direct budget support by donors. Donors may deal directly with CFET or may collaborate with other agencies in making arrangements for the provision of direct budget support.
- Donors may undertake projects and programs using existing bilateral mechanisms, or may enter into cofinancing arrangements with one or more other donors.
- Donors may deposit funds into a special account created by the Government. In this case, the funds are not disbursed into CFET and are subject to separate disbursement arrangements that are outside the CFET but within the framework of the Combined Sources budget. The utilization of these funds will adhere to established budgetary and procurement procedures and will not be subject to any additional restrictions or controls.

Part E: Building Institutional and Human Capacities

Sustainability of the National Program for Poverty Reduction

One of the most important transformations underway in Timor-Leste is the gradual shift from heavy reliance of donor funding for the majority of public outlays for development and poverty reduction. The process is well advanced, but not yet complete. As the discussion in Part D indicated, the Government expects that with the completion of the MCA funded program of assistance in FY2010/11, there will be a sharp decline in overall levels of donor support and assistance. For planning purposes, the assumption is that levels of donor support will decline to about \$90 million a year by FY2014/15, with CFET funding then running at about \$250 million a year. The implication is that the Government will then be funding the bulk of the development programs in the country.

It will be essential to ensure that these public funds are indeed achieving specified objectives and that poverty reduction and other programs are sustainable. Experience with development programs in many countries over the past four decades indicates that sustainability requires that programs should be responsive to the needs and capacities of the country and the intended beneficiaries, and that the available financial and human resources are able to ensure continuation of programs where that is required. The Government has already set in motion a wide-ranging and ambitious program that aims to ensure future sustainability of current programs as dependence on donor support declines. The range of actions being undertaken is extensive. It is sufficient for the purposes of this report to list the broad range of activities now underway, or under preparation, that will help ensure the future sustainability of the national program for poverty reduction. At the most general level, these programs are built around three broad sets of interventions:

- Ensuring that processes and capacities are in place for a continuing national dialogue on the priorities and needs of communities throughout the country and that once articulated, these aspirations can be translated into policies and programs for poverty reduction. The Government has attached considerable importance to building capacities for a national dialogue, starting with the extensive consultations in 2002 that led to the Vision 2020 statement. These initiatives have been followed by the preparation of the National Development Plan and, more recently, the development of sector investment programs for 17 sectors that provide clear guidance on expenditure priorities and programs for the medium term that are aimed at achieving the national goal of poverty reduction.
- Ensuring there is a continuing capacity for adequate public funding of the recurrent and capital costs of the ambitious program of development being undertaken by the government. The prospect of large inflows of revenues from oil and gas will give Timor-Leste some latitude in its funding of development programs. But as the previous section of this report indicated, steps are being taken to ensure that the mistakes made by other resource rich countries are not repeated in Timor-Leste. In this connection, the Government will continue with its prudent approach to macroeconomic and financial management. The establishment of the Petroleum Fund in September 2005 was an important step forward in this regard.
- Strengthening the capacities of national government agencies, regional and local government and communities and civil society to design, participate in and as appropriate, implement poverty reduction programs throughout the country. Some of the key initiatives being taken in these areas of capacity building are discussed in the sections below.

Strengthening Capacities within the National Government

From very modest beginnings, Timor-Leste's civil service has been built to a complement of almost 18,000 people, which includes permanent civil servants, teachers, medical personnel, police and members of the armed forces.

The vision for public sector management in Timor-Leste is captured in Section 137 of the Constitution, which states that "public administration shall aim at meeting public interest, and that it shall be structured so as to prevent excessive bureaucracy, provide more accessible services to the people, and ensure the contribution of individuals interested in efficient management." Effective public sector management requires a legal and ethical framework of people sufficiently skilled to comprehend their responsibilities, to carry them out as required and to disclose and be accountable for their actions. This requires an environment where people know what is expected of them and are prepared and able to deliver those requirements. The goals for the sector draw heavily on the National Development Plan, which states "that the economy and finances of the State will be managed efficiently, transparently, and will be free from corruption." The Plan focuses on promoting good governance through a responsible and responsive government including a lean, efficient, effective, accountable, and transparent civil service.

It is widely recognised that building the capacities of the Government remains as a formidable challenge and one that will occupy the country for some years to come. Various studies have drawn attention to a wide range of problems, including: poor quality of services to the public at large, inadequate skills and knowledge among many civil servants; lack of understanding among civil servants of the core functions of their agencies; weak management and leadership; inadequate information systems seen as essential for effective management, administration and service provision. Ownership, diligence, honesty, and integrity are most often cited as shared values that public servants would like to see their Government exemplify.

To achieve the vision for effective public sector management, Timor-Leste will continue to develop its laws, regulations and human resources to achieve a well structured environment and a well trained staff to adapt to best practice in public sector management and governance elsewhere in the world. The essential objective is to develop a professional civil service that is capable of guiding the long-term development of the country, of ensuring that the people have adequate access to the full range of services expected in a market-oriented democratic society, and that adheres to a clearly articulated set of principles for good governance.

The proposed work program for the medium-term is built around the above-mentioned four main objectives set out in the National Development Plan. First is the definition and dissemination of rights and obligations of public servants. The passage of the Civil Service Act was a significant step forward. The strategy for the medium-term is to implement the provisions of the Act with additional supporting legislation and regulations. Moreover, a number of additional organic laws remain to be put in place to clarify the roles and responsibilities of particular line ministries.

The second key element of the program relates to improving the quality and cost effectiveness of service provision. As many of the other SIPs make clear, the ambitious goals called for by the NDP and Millennium Development Goals will require significant improvements in the service delivery capacity of the National Government as well as local governments. Policies and programs related to service delivery for the medium and longer term are built around five broad principles.

- For those services that are to remain the responsibility of the National Government, at least for the foreseeable future, the objective is to build capacities for their

effective delivery. Almost all the SIPs include specific proposals for strengthening particular line ministry capacities for service delivery.

- There will be a continuing evolution of responsibilities for service provision. Specific action will be taken to build the service capacities of local government and public enterprises. Service demands of the public will continue to change, and a growing range of private services can be expected to emerge in competition with the Government.
- Fees for service delivery. The Government intends to review periodically the scope for introducing fees for delivery of public services to determine whether fees will be charged for at least some of these services.
- Strengthening capacities for oversight and regulation of private service provision. As the range of private service provision evolves, the Government will be increasingly concerned with regulatory arrangements and oversight of these private services, the objective of which will be to protect the public interest.
- Strengthening capacities to plan for anticipated changes in service provision. The Government intends to strengthen capacities to plan for service mix changes. Such changes have implications for various aspects of public sector management, including for example, acquisition or disposal of capital equipment and facilities, changes in staff numbers as well as responsibilities and skills, and decisions on the physical location of services.
- To meet its own internal needs and contribute to growth and employment, the Government will continue to outsource to the private sector, with particular emphasis on local supply, consistent of course with competitive prices for such goods and services. In this connection, the Government will continue to strengthen procurement and related processes.

The third element of the work program relates to the need to improve the capacities and performance of the civil service itself. A detailed program of work has been drawn up for the medium-term. The design of the program has been shaped by past experience with the heavy reliance on expatriate advisers. Dependence on such services would be steadily reduced over the next four years. The main elements of the program are as follows:

- Better definition of assignments and objectives that civil servants are expected to achieve.
- Increased emphasis on training for civil servants to the required level to undertake their stated assignments.
- Strengthened planning processes that facilitate policy-making as well as the definition of assignments and objectives.
- A more comprehensive budget framework for revenue capture and expenditure management, including a more complete accounting of external assistance from Development Partners.
- Strengthening of performance setting and monitoring from the personal to the organisational and Government level.
- A significant investment in data systems that record required information to support and to report upon actions.

- Increased emphasis on cooperation within and among agencies and with Development Partners.
- Improved internal controls and oversight that ensure transparency and accountability.

The fourth component of the program concerns gender mainstreaming, which is an important objective for the Government as a whole. The Rights, Equality and Justice SIP includes a more complete treatment of the proposed program for gender mainstreaming. Within the Government, the proposed program will initially pilot approaches in four ministries. The experience and insights gained from this pilot will then be used to develop broader approaches for more general application throughout the Government.¹⁵

Role of Regional and Local Government

The establishment of a viable local government system is central to promoting good governance, and to ensuring more effective, efficient, and accountable service delivery to the population. The relationship between strengthening the local levels of government and the NGO community and attainment of the two over-arching development goals of the Government (“to reduce poverty” and “to promote economic growth that is equitable and sustainable”) is manifest. The Government recognizes that popular participation in local affairs will increase the viability and legitimacy of national and local programs. Decentralization of power away from Dili and increased local capacities for service provision are therefore important components of the Government overall strategy for good governance.

The Government’s goal for local governance is straightforward: to strengthen the capacity of relevant national government staff – as well as locally elected leaders – to deliver efficient and effective services to citizens, to contribute to the development of a viable, efficient, and accountable local public administration, and to strengthen mechanisms that support great involvement of communities in local affairs and programs. In trying to meet this goal, however, the Government faces several challenges. These include legitimizing local leaders, providing resources to these leaders for their affairs as well as local development funds for larger scale development projects, and increasing human resource capacity of local governments to manage in an increasingly complex environment.

The Government’s preferred model for local governance is:

- Regional coordination, through five Regional Secretaries of State.
- A staged move to a devolved system of municipal local government. The 13 Districts would be abolished and replaced as the country’s other level of government by Municipalities. The final number of Municipalities is as yet undetermined, but is expected to range between 30 and 40.
- There will be a system of elected local assemblies, but it is not yet clear how they will be constituted.
- The sucos will continue as at present.

With the assistance of the UNDP and UNHCR, a Local Development Fund (LDF) has been established within the Government budget, and recurrent costs for operations of the Local Assemblies are fully funded by the Government. Experience and lessons provided by the programme will play an essential role for the functioning and understanding of future reforms of

¹⁵ In 2005, some 2,740 of the 11,290 civil servants were female. Almost 90% of the female staff was in grades N-3 and N-4. Females accounted for about 10% of the staff at levels N-6 and N-7.

the local government sector. The program will provide important policy lessons to the Government.

The programme is being piloted in two districts (Bobonaro and Lautem) at this time, and has assisted the Government in establishing thirteen Local Assemblies; two District Assemblies and eleven Sub-District Assemblies. The institutional arrangements entrust full control of the decision-making process to the elected community representatives, thus ensuring a proper division between “legislative and executive powers” within the Local Assemblies.

This approach allows for local problems to be addressed in specific ways and thus take into account differences in the factors underlying poverty from place to place. Devolving planning responsibilities to the local level also increases the opportunities for the poor to express themselves and to ensure that their priorities become a part of the development agenda. In turn, devolving implementation responsibilities to sub-national levels will increase local ownership of development initiatives and improve the efficiency with which

Community Development and Civil Society

Role of civil society in the national fight against poverty. The Government has on a number of occasions explicitly stated that NGOs play an important role in national life and this contribution to national development has been duly recognized. The NGO Forum is currently, through UNDP, undertaking a study of the future role of CSOs. The Government hopes that the Forum will be able to set out a clear strategy of support for the national effort to combat poverty.

Timor-Leste has a solid base of involvement in community organizations and voluntary activity. Local NGOs are operational in the following areas: agriculture, education, health, economy, water and sanitation, children, and media. These do not include church groups and various other civil society groups (such as the National Council of Youth Organizations, farmer groups, etc.) that are also active in the country. These civil society organizations – that serve more as task-based vehicles for collective action – are nevertheless involved in advocacy, provision of education and other services, and often serve as channels for donor activities in the regions. According to the NGO Forum, international NGOs were operational in Timor-Leste in 2003 in food security, nutrition, community rehabilitation, education, human rights, vocational training, English language, youth activities, advocacy, medicine, legal aid, water and sanitation, gender awareness, conflict transformation and teaching tolerance, community-based health care, income generation activities, land use planning, and others. As with local NGOs, recent survey data indicate that the number of international NGOs that are active in Timor-Leste had declined by late 2004.

NGOs have a good relationship with the National Government, although there are indications of lack of coordination and cooperation at sub-national levels. The Government finds that some NGOs do not always seek coordination with other agencies and especially with government departments, and/or do not sufficiently disclose the scope of their activities and the use that they make of the funds received. As in most developing countries, international NGOs that are operational in Timor-Leste have asked for – and receive from Government – import tax exemptions so that they can get relief from the high costs of importing needed equipment and machinery. However, given concerns about possible misuse of this concession, the Government introduced a formal NGO registration scheme under the 2005 Decree on Non-Profit-Making Organizations.

The Government recognizes the importance of CSOs in local service provision. More than \$80 million of donor assistance has been channeled through NGOs and civil society during the past

five years, primarily to provide services to individuals, communities and various other groups in Timor-Leste. The largest amounts of assistance managed by NGOs have been in the following SIP sectors: Health Care; Education and Training; Rights, Equality and Justice; Local Development; and Water Supply and Sanitation. These five sectors account for 85% of the assistance channeled through CSO organizations. The amount of resources channeled through NGOs peaked at close \$30 million in FY2001/02, but allocations to NGOs have sharply declined since then and are currently running at about \$10 million a year. The decline stems from much less reliance on NGOs in the Education Sector now that the formal system is functioning and in the Water Supply and Sanitation Sector where capacities of government agencies have also been built up. It also stems from the large reduction in support for community radio programs, as discussed in the Communications SIP.

Experience from these programs has highlighted several important issues for the future role of NGOs in service provision. The first concerns balance to be struck between the respective roles of national government, local government and CSOs in service provision. As the foregoing discussion indicates, the Government is proposing to expand the service provision capacities of local governments in a number of areas. These new programs would require the support of donors if they were to be implemented. Given the increasingly constrained levels of donor assistance available to Timor-Leste, the issue is whether these programs would represent a net increase in service provision capacities at the local level or a shift in responsibilities for service provision from civil society and national government that would, in turn, require a reallocation of donor resources away from service provision by civil society and government programs. Government policy on this issue is unambiguous. While the Government is committed to building capacity of local government, this build-up would not be at the expense of service providers in civil society, but would be incremental. The need for additional services is clear, given prevailing low and poor levels of service.

A second issue relates to the geographic focus of service provision programs provided by civil society. There have been some tendencies towards concentration of NGO activities in Dili and other centers. The Government would like to see increased emphasis on service provision by NGOs in rural areas currently not well served by other national and sub-national agencies.

Support for community development. A series of community development and community empowerment programs have been launched since 2000. These programs have been a central feature of local development initiatives in the country over the past five years. They have generally emphasized establishment of local capacities through village, sub-district and district councils, provision of grant and micro-credits for the rehabilitation of infrastructure and recovery of economic activities, support to vulnerable groups, including victims of violence, female-headed households, the elderly and physically handicapped and/or traumatized people. In a number of cases, these programs also included cultural heritage programs that encouraged reconciliation and nation-building.

A number of donors were active in supporting these various types of community development programs. A total of \$40 million was disbursed in these programs over the past five years. For the most part, they take a multi-sectoral approach to community development, necessitated by the absence of integrated administrative structures and capacities for service delivery by line agencies and local governments. It is clear that such projects implemented by villagers increased access to basic services and helped revive local economies. Most local development was carried out by communities themselves through elected committees and supported by NGOs and other civil society groups.

Valuable lessons have been gained from these programs. In the recent past, there have been as many as 23 separate community and rural development programs ongoing at the same time throughout the country, many with different objectives, policies and procedures. Experience with these diverse programs demonstrates clearly the importance of bringing greater uniformity to policies and procedures for community and rural development.

Experience with some of these programs has raised questions about the role and capacity of local councils that were responsible for the programs. Lessons from the past underscore the importance of capacity building for individual council members and for increased understanding of the councils' roles in the programs. Such programs need to give close attention to clear and transparent disclosure of the use of funds within communities. These programs have also highlighted the importance of close attention to provision of technical services that are needed to underpin the development actions taken by local communities.

In regard to future program/project management, there is a need to look beyond external structures that may be used by individual donors for program implementation, and focus on capacity building of local structures to improve service delivery, promote participatory approaches, and to build good links between the communities and the government in terms of channeling community needs into government priorities. These past experiences with community development programs have also highlighted the importance of ensuring a coordinated development strategy, where both community and government are involved in the process in terms of deciding on development priorities, development planning, and implementation. A mix between governmental technical input and general knowledge of development needs and internal/external development initiatives, and community participation, is preferable.

An important new initiative that is being piloted in several districts is the use of the recently created Local Development Fund. Under this program, the Government is developing modalities for increased transfer of national resources to local communities via the Fund. The Government would like to explore with Development Partners the possibility of channeling donor funds through this mechanism as well, once suitable modalities and capacities for the management of the funds are established. Procedures and criteria are being developed for allocation of funds to all Sucos. This would gradually move the community development program away from large numbers of individual donor funded programs to the nationwide Local Development Fund. This mechanism would be a possible first step towards a more decentralized pattern of expenditures funded by growing transfers of financial resources from the National Government.

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Appendix Table 1: Demographic Indicators for Timor-Leste

	1999	2000	2001	2002	2003	2004	2005
Population							
Female	-	402,457	415,521	428,292	441,057	454,177	467,666
Male	-	418,543	430,479	443,708	456,934	470,438	484,529
Total	779,567	821,000	846,000	872,000	897,991	924,615	952,195
Population age structure							
Less than 1 year	-	29,700	30,600	31,540	32,480	33,446	35,706
1-4 years	-	104,840	108,030	111,350	114,665	118,066	122,880
5 years	-	23,920	24,650	25,410	26,170	26,944	27,617
6-11 years	-	133,820	137,890	142,630	147,370	152,112	154,074
12-14 years	-	62,830	64,740	66,410	68,080	69,747	72,030
15-17 years	-	51,810	53,390	55,570	57,750	59,934	63,002
18-24 years	-	97,700	100,670	104,235	107,800	111,367	116,452
25-64 years	-	287,980	296,750	304,695	312,626	321,071	327,289
65 years and over	-	28,400	29,280	30,160	31,050	31,928	33,145
Total	-	821,000	846,000	872,000	897,991	924,615	952,195
Urban-Rural population							
Urban population	-	168,666	194,580	213,640	228,988	241,337	253,404
Rural population	-	652,334	651,420	658,360	669,003	683,278	698,791
Total population	-	821,000	846,000	872,000	897,991	924,615	952,195
Memo items:							
Urban population growth (% p.a.)	-	-	15.4	9.8	7.2	5.4	5.0
Urban population (% of total)	-	20.5	23.0	24.5	25.5	26.1	26.6
Number migrants to urban areas	-	-	-	-	-	4,100	4,868
Number of households							
Urban	-	35,825	37,685	39,636	41,716	43,880	46,074
Rural	-	138,658	141,940	145,333	148,568	151,082	154,512
Total	-	173,097	178,237	184,969	190,284	194,962	200,586
Memo items:							
Average size of urban household	-	4.7	5.2	5.4	5.5	5.5	5.5
Average size of rural household	-	4.7	4.6	4.5	4.5	4.5	4.5
Average household size	-	4.7	4.7	4.7	4.7	4.7	4.7

Source: Statistics Directorate of Ministry of Planning and Finance.

Appendix Table 2: Labor Force Indicators for Timor-Leste

Indicator	1999	2000	2001	2002	2003	2004	2005
Population 15-64 years							
Female		212,021	219,773	227,793	236,115	244,758	251,875
Male		214,513	222,193	230,204	238,656	247,614	254,868
Total		426,534	441,966	457,997	474,771	492,372	506,743
Labor force							
Female		99,862	104,201	108,543	113,064	117,729	122,663
Male		147,529	153,024	158,928	165,150	171,597	177,898
Total		247,391	257,225	267,472	278,214	289,325	300,561
Annual increase in labor force		-	9,834	10,246	10,742	11,111	11,236
Labor force participation (%)							
Female		47.1	47.4	47.7	47.9	48.1	48.7
Male		68.8	68.9	69.0	69.2	69.3	69.8
Average		58.0	58.2	58.4	58.6	58.8	59.3
Urban/rural labor force							
Rural labor force		-	-	-	-	212,201	218,649
Urban labor force		-	-	-	-	77,124	81,912
Total labor force		247,391	257,225	267,472	278,214	289,325	300,561
Rural labor force % total		-	-	-	-	73.3	72.7
Labor force growth rate (% p.a.)							
Rural		-	-	-	-	-	3.0
Urban		-	-	-	-	-	6.2
Total		-	-	-	-	-	3.9

Source: Staff estimates based on 2004 Census and other sources.

Appendix Table 3: Gross Domestic Product by Industrial Origin at 2000 Constant Market Prices
(US\$ millions)

Sector	1999	2000	2001	2002	2003	2004	2005
Agriculture, forestry & fisheries							
Food sector		69.9	76.4	75.4	70.2	75.1	80.4
Commercial agriculture		10.1	10.7	17.0	21.6	22.2	23.0
Commercial forestry & fisheries		1.5	1.5	1.5	1.7	1.8	1.9
Sub-total	95.1	81.5	88.6	93.9	93.5	99.1	105.3
Industry & services							
Mining & quarrying	3.1	3.8	3.8	3.2	2.5		
Manufacturing	7.9	8.7	10.9	11.0	11.0		
Private construction	12.5	15.8	16.2	15.1	13.8		
Transport & communications	15.9	22.9	25.4	27.5	29.2		
Wholesale & retail trade	17.4	24.6	25.6	23.9	23.3		
Financial & other services	18.6	22.4	26.0	26.8	26.4		
Sub-total	75.4	98.2	107.9	107.5	106.2	108.0	110.5
Public Sector							
Government services	58.5	22.9	51.1	57.7	65.9	70.8	76.2
Public utilities	2.3	2.7	1.4	2.7	3.4	3.9	4.7
Public construction	21.9	27.6	27.9	21.8	15.0	13.9	17.4
United Nations	25.0	83.4	91.5	60.3	38.6	28.0	17.0
Total public sector	107.7	136.6	171.9	142.5	122.9	116.6	115.3
Non-oil GDP	278.2	316.3	368.4	343.9	322.6	323.8	331.0
Oil and gas	58.1	77.5	50.4	47.8	52.9	-	-
GDP	336.3	393.8	418.8	391.7	375.5	-	-
Memo items:							
Non-oil GDP at current market prices	270.1	316.3	367.9	343.3	335.7	338.6	349.9
Non-oil GDP deflator (2000=100.0)	97.1	100.0	99.9	99.8	104.1	104.6	105.7

Source: data for 1999, 2004 and 2005 are staff estimates; data for 2000-2003 provided by Statistics Directorate of the Ministry of Planning and Finance.

Appendix Table 4: Gross Domestic Product by Expenditure at Current Market Prices
(US\$ millions)

Sector	1999	2000	2001	2002	2003	2004	2005
Consumption							
Private		206.0	213.0	203.8	200.0	205.0	211.0
Government		170.0	225.2	199.2	193.0	177.0	168.0
Total consumption		376.0	438.2	403.0	393.0	382.0	379.0
Investment							
Gross fixed capital formation							
Public sector		94.5	115.2	91.3	82.0	52.4	60.3
Private		24.3	30.2	27.6	23.0	7.5	7.5
Sub-total		118.8	145.4	118.9	105.0	59.9	67.8
Changes in inventories		11.9	14.5	11.9	10.5	6.0	6.8
Total investment		130.7	159.9	130.8	115.5	65.9	74.6
Exports		89.4	50.5	43.6	53.9	105.9	43.5
Imports		(202.4)	(236.5)	(192.6)	(174.0)		
GDP	-	393.7	412.1	384.8	388.4		

Source: data for 1999, 2004 and 2005 are staff estimates; data for 2000-2003 provided by Statistics Directorate of the Ministry of Planning and Finance.

Appendix Table 5: Merchandise Exports and Imports
(US\$ thousands)

Product Group	2004					2005				
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total
Merchandise Exports										
Coffee	1,219	725	2,868	2,080	6,892	1,653	260	3,119	2,602	7,634
Other merchandise exports	125	27	371	438	961	137	118	206	7	468
Total merchandise exports	1,344	752	3,239	2,518	7,853	1,790	378	3,325	2,609	8,102
Merchandise Imports										
Consumer goods										
Cereals	2,051	2,331	1,745	2,121	8,248	1,087	1,429	835	2,452	5,803
Food products	2,617	2,104	2,517	2,433	9,671	2,556	1,896	2,718	2,452	9,622
Beverages, alcohol & tobacco	817	990	919	1,187	3,913	752	786	999	1,120	3,657
Clothing & apparel	285	375	533	425	1,618	190	494	723	401	1,808
Pharmaceuticals	558	771	734	591	2,654	1,327	757	319	235	2,638
Furniture & furnishings	219	219	332	418	1,188	280	190	309	471	1,250
Other consumer goods	729	613	900	939	3,181	610	575	840	843	2,868
Sub-total	7,276	7,403	7,680	8,114	30,473	6,802	6,127	6,743	7,974	27,646
Raw materials & manufactures										
Petroleum products	9,365	5,920	11,774	9,412	36,471	10,938	7,974	10,373	5,852	35,137
Wood & paper products	279	466	699	330	1,774	428	1,024	1,220	526	3,198
Textiles & fibers	13	20	42	39	114	63	23	26	10	122
Other raw materials & manufactures	2,133	2,199	3,184	3,632	11,148	4,102	3,136	5,706	968	13,912
Sub-total	11,790	8,605	15,699	13,413	49,507	15,531	12,157	17,325	7,356	52,369
Capital goods										
Electrical equipment	1,429	1,787	5,416	1,185	9,817	1,131	1,045	2,344	951	5,471
Vehicles	3,056	3,568	4,879	3,219	14,722	2,128	1,226	1,923	1,740	7,017
Other transport equipment	70	5	1,380	9	1,464	13	42	446	71	572
Other equipment	1,363	852	1,838	3,246	7,299	1,743	1,022	4,203	1,574	8,542
Sub-total	5,918	6,212	13,513	7,659	33,302	5,015	3,335	8,916	4,336	21,602
Adjustments	15	2	8	3	28	7	1			8
Total merchandise imports	24,999	22,222	36,900	29,189	113,310	27,355	21,620	32,984	19,666	101,625
Merchandise trade balance	(23,655)	(21,470)	(33,661)	(26,671)	(105,457)	(25,565)	(21,242)	(29,659)	(17,057)	(93,523)

Source: Statistics Directorate, Ministry of Planning and Finance.

Appendix Table 6: Revenues and Expenditures of Whole of Government
(US\$ millions)

Indicator	FY99/00	FY00/01	FY01/02	FY02/03	FY03/04	FY04/05	FY05/06
Central government accounts							
Receipts							
Direct & indirect taxes	-	12.2	17.8	16.8	24.8	29.7	25.9
Non-tax revenue	2.0	1.4	2.1	2.3	4.4	4.4	4.5
Interest income	-	0.5	0.6	0.2	0.1	2.7	5.0
Domestic tax & non- tax revenues	2.0	14.1	20.5	19.3	29.3	36.8	30.7
Timor Sea revenues	-	9.9	6.5	26.4	38.0	209.4	-
First tranche royalties	-	3.0	4.2	3.0	3.3	55.6	9.0
Total revenues	2.0	27.0	31.2	48.7	70.6	301.8	39.7
Expenditures							
Recurrent expenditures	18.9	24.0	31.6	47.0	51.8	53.3	76.9
Minor capital works	-	-	1.5	1.9	2.0	2.9	5.3
Capital expenditures	10.9	5.2	9.8	11.4	7.8	8.8	12.2
Sub-total	29.8	29.2	42.9	60.3	61.6	65.0	94.4
Transfers to BPA	-	5.0	1.4	1.0	0.3	-	10.5
Transfer to Timor-Telecom	-	-	-	-	-	0.5	-
Transfer of interest income	-	0.5	0.6	0.2	0.1	2.7	5.0
Transfer of first tranche royalties	-	3.0	4.2	3.0	3.3	55.6	9.0
Transfers to autonomous agencies	6.2	9.2	6.8	6.1	6.6	5.5	8.3
Total expenditures	36.0	46.9	55.9	70.6	71.9	129.3	127.2
Overall balance	(34.0)	(19.9)	(24.7)	(21.9)	(1.3)	172.5	(87.5)
Financing							
United Nations contributions	33.0	27.7	5.4	-	-	-	-
Budget support by donors	2.6	3.9	17.3	32.5	34.8	34.2	10.0
Sub-total	35.6	31.6	22.7	32.5	34.8	34.2	10.0
Change in cash balance (- = increase)	(1.6)	(11.7)	2.0	(10.6)	(33.5)	(206.7)	77.5
Accounts of autonomous agencies							
Revenues							
EDTL	-	0.3	2.1	2.9	3.5	6.2	8.3
Airport authority	-	0.4	1.1	1.0	1.1	0.8	1.0
Port authority	-	0.7	1.3	1.1	1.0	1.0	1.2
Other	-	-	-	-	-	-	-
Total	-	1.4	4.5	5.0	5.6	8.0	10.5
Transfers from central government	6.2	9.2	6.8	6.1	6.6	5.5	8.3
Total receipts	6.2	10.6	11.3	11.1	12.2	13.5	18.8
Recurrent expenditures							
Fuel	4.2	6.0	6.1	7.9	7.7	8.6	9.2
Other	1.0	4.1	2.8	1.7	3.0	3.9	7.1
Total	5.2	10.1	8.9	9.6	10.7	12.5	16.3
Capital expenditures	1.0	0.5	0.2	0.3	0.2	0.3	2.5
Total expenditures	6.2	10.6	9.1	9.9	10.9	12.8	18.8
Change in cash balances	-	(0.0)	2.2	1.2	1.3	0.7	-
End year cash balance	-	(0.0)	2.2	3.3	4.6	5.3	5.3

Source: Budget Office of Ministry of Planning and Finance.

Appendix Table 7: Financial Asset Accounts of Whole of Government
(US\$ millions)

Indicator	FY99/00	FY00/01	FY01/02	FY02/03	FY03/04	FY04/05	FY05/06
CFET reserves account balance							
Interest income	-	0.5	0.6	0.2	0.1	2.7	5.0
Change in cash balance	1.6	11.7	(2.0)	10.6	33.5	206.7	(77.5)
Transfer out of account	-	-	-	-	-	-	125.0
Cash balance (end year)	1.6	13.8	12.4	23.2	56.8	266.2	68.7
Autonomous agencies							
Closing balances (end year)	-	-	2.2	3.3	4.6	5.3	5.3
First tranche petroleum fund							
Interest income	-	0.1	0.1	0.1	0.1	0.6	0.5
Royalty receipts	-	3.0	4.2	3.0	3.3	55.6	9.0
Transfers out of account	-	-	-	-	-	-	79.6
Closing balance (end year)	-	3.1	7.4	10.5	13.9	70.1	-
Petroleum Fund							
Transfer from CFET reserve acc't							-
Transfer from FTP fund							-
Petroleum revenues							
Bayu Undan							380.8
EKKN							14.0
Wages tax							5.5
Sub-total							394.8
Investment income							18.6
Total receipts							413.4
Transfer to Government account							-
Closing balance (end year)							413.4
Total investment account balance	1.6	16.9	22.0	37.0	75.3	341.6	487.4

Appendix Table 8: Annual Disbursements of External Assistance to Timor-Leste
(US\$)

Sector	FY1999/00	FY2000/01	FY2001/02	FY2002/03	FY2003/04	FY2004/05	FY2005/06
Development and technical assistance							
'On-budget' assistance	72,307,512	118,101,418	147,027,212	139,256,016	134,618,550	135,754,678	121,567,076
'Off budget' assistance	7,294,759	29,911,565	33,027,293	30,998,783	29,854,893	18,108,583	9,828,838
Sub-total	79,602,271	148,012,983	180,054,505	170,254,799	164,473,443	153,863,261	131,395,914
Humanitarian assistance	81,965,912	29,599,136	11,936,809	3,472,856	3,081,690	1,124,245	206,094
Budget & commodity assistance	35,600,000	31,600,000	22,700,000	32,500,000	34,800,000	34,200,000	10,000,000
Bilateral military assistance	16,973	1,706,358	2,399,331	2,268,761	605,009	-	3,300,000
United Nations PKF	65,615,900	231,069,400	145,019,900	104,406,500	74,655,700	12,870,200	-
United Nations UNPOL	33,073,700	51,925,500	45,441,100	26,703,700	15,669,700	5,059,400	-
Donor administrative expenses	1,108,032	7,009,384	4,924,580	4,604,125	7,523,756	4,252,581	3,598,627
Total external assistance	296,982,788	500,922,761	412,476,225	344,210,741	300,809,298	211,369,687	148,500,635

Source: Registry of External Assistance, Ministry of Planning and Finance.

Note: Data records for bilateral military assistance are incomplete.

Appendix Table 9: Sectoral Allocation of CFET Total Appropriations (US\$)

Sector	Annual Appropriations						Total	
	FY1999/00	FY2000/01	FY2001/02	FY2002/03	FY2003/04	FY2004/05	Amount	Percent
Basic services								
Health care	5,535,000	5,095,000	5,354,000	7,786,000	8,852,850	9,806,000	42,428,850	10.7
Education and training	11,100,000	12,495,000	12,728,500	17,942,500	16,100,760	16,666,500	87,033,260	21.9
Social, civil & heritage protection	500,300	500,000	634,500	939,500	876,400	744,000	4,194,700	1.1
Sub-total	17,135,300	18,090,000	18,717,000	26,668,000	25,830,010	27,216,500	133,656,810	33.6
Production related sectors								
Agriculture, forestry & fisheries	658,000	820,000	888,000	1,512,000	1,578,000	1,382,000	6,838,000	1.7
Natural resources & environment	35,000	125,000	159,000	394,000	388,550	336,000	1,437,550	0.4
Private sector development	-	305,000	330,000	894,000	1,058,850	726,000	3,313,850	0.8
Sub-total	693,000	1,250,000	1,377,000	2,800,000	3,025,400	2,444,000	11,589,400	2.9
Infrastructure & housing								
Communications	140,000	155,000	268,000	1,134,750	865,251	1,023,000	3,586,001	0.9
Housing & urban development	1,000,000	1,445,000	982,500	521,750	815,676	182,000	4,946,926	1.2
Power	7,500,000	8,379,000	8,853,000	11,350,420	10,085,298	12,118,000	58,285,718	14.6
Transport	5,855,000	7,008,000	3,850,000	5,566,250	7,300,776	9,074,500	38,654,526	9.7
Water supply and sanitation	1,150,000	1,713,000	1,516,500	2,503,250	2,387,250	2,380,000	11,650,000	2.9
Sub-total	15,645,000	18,700,000	15,470,000	21,076,420	21,454,251	24,777,500	117,123,171	29.4
Governance								
Pillars of the State	-	520,000	2,413,000	2,970,000	3,337,010	3,073,000	12,313,010	3.1
Public sector management	1,483,750	1,902,500	2,314,500	3,977,000	3,256,608	3,471,000	16,405,358	4.1
Local development	600,000	630,000	637,000	2,300,000	1,799,205	1,770,000	7,736,205	1.9
Rights, equality & justice	968,000	1,525,000	2,553,000	1,968,000	1,856,180	2,129,000	10,999,180	2.8
Sub-total	3,051,750	4,577,500	7,917,500	11,215,000	10,249,003	10,443,000	47,453,753	11.9
Security and external relations								
Security, peacebuilding, reconciliation	5,075,000	7,700,000	11,499,000	14,107,000	15,532,100	15,570,000	69,483,100	17.5
External relations & cooperation	211,250	282,500	352,500	1,292,000	1,336,263	2,592,000	6,066,513	1.5
Subtotal	5,286,250	7,982,500	11,851,500	15,399,000	16,868,363	18,162,000	75,549,613	19.0
Total	41,811,300	50,600,000	55,333,000	77,158,420	77,427,027	83,043,000	385,372,747	96.8
Unallocated (net)	1,788,700	1,720,000	1,952,000	1,495,580	1,838,973	3,919,000	12,714,253	3.2
Grand total for CFET	43,600,000	52,320,000	57,285,000	78,654,000	79,266,000	86,962,000	398,087,000	100.0

Source: Ministry of Planning and Finance.

Appendix Table 10: Sectoral Allocation of CFET Appropriations for Recurrent Expenditures (US\$)

Sector	Annual Appropriations						Total	
	FY1999/00	FY2000/01	FY2001/02	FY2002/03	FY2003/04	FY2004/05	Amount	Percent
Basic services								
Health care	4,035,000	4,095,000	4,767,000	6,704,000	7,684,850	8,127,000	35,412,850	11.0
Education and training	8,100,000	8,895,000	11,963,500	16,097,500	15,291,760	15,495,500	75,843,260	23.6
Social, civil & heritage protection	500,300	475,000	579,500	765,000	741,400	711,500	3,772,700	1.2
Sub-total	12,635,300	13,465,000	17,310,000	23,566,500	23,718,010	24,334,000	115,028,810	35.7
Production related sectors								
Agriculture, forestry & fisheries	583,000	700,000	757,000	1,121,000	1,391,000	1,199,000	5,751,000	1.8
Natural resources & environment	35,000	115,000	117,000	352,500	352,550	336,000	1,308,050	0.4
Private sector development	-	285,000	281,000	557,500	607,850	674,000	2,405,350	0.7
Sub-total	618,000	1,100,000	1,155,000	2,031,000	2,351,400	2,209,000	9,464,400	2.9
Infrastructure & housing								
Communications	90,000	105,000	206,000	874,250	751,251	1,010,500	3,037,001	0.9
Housing & urban development	150,000	184,500	204,250	239,750	301,576	171,500	1,251,576	0.4
Power	7,000,000	7,886,000	8,031,000	9,152,350	9,943,370	11,727,000	53,739,720	16.7
Transport	2,355,000	2,508,000	2,448,000	3,785,150	2,933,176	4,379,000	18,408,326	5.7
Water supply and sanitation	650,000	963,000	1,110,000	1,835,590	1,173,515	1,208,000	6,940,105	2.2
Sub-total	10,245,000	11,646,500	11,999,250	15,887,090	15,102,888	18,496,000	83,376,728	25.9
Governance								
Pillars of the State	-	95,000	1,560,000	1,870,000	2,189,010	2,997,000	8,711,010	2.7
Public sector management	1,133,750	1,402,500	1,686,500	2,500,000	2,687,608	3,174,000	12,584,358	3.9
Local development	600,000	610,000	604,000	1,953,000	1,680,205	1,620,000	7,067,205	2.2
Rights, equality & justice	968,000	1,025,000	1,418,000	1,806,000	1,725,180	2,021,000	8,963,180	2.8
Sub-total	2,701,750	3,132,500	5,268,500	8,129,000	8,282,003	9,812,000	37,325,753	11.6
Security and external relations								
Security, peacebuilding, reconciliation	4,075,000	5,700,000	9,023,000	11,958,000	13,522,100	13,871,000	58,149,100	18.1
External relations & cooperation	211,250	282,500	299,500	1,146,000	1,336,259	2,441,000	5,716,509	1.8
Subtotal	4,286,250	5,982,500	9,322,500	13,104,000	14,858,359	16,312,000	63,865,609	19.8
Total	30,486,300	35,326,500	45,055,250	62,717,590	64,312,660	71,163,000	309,061,300	96.0
Unallocated (net)	1,788,700	1,720,000	1,952,000	1,495,580	1,838,973	3,919,000	12,714,253	4.0
Grand total for CFET	32,275,000	37,046,500	47,007,250	64,213,170	66,151,633	75,082,000	321,775,553	100.0

Source: Ministry of Planning and Finance.

Appendix Table 11: Sectoral Allocation of CFET Appropriations for Capital Expenditures (US\$)

Sector	Annual Appropriations						Total	
	FY1999/00	FY2000/01	FY2001/02	FY2002/03	FY2003/04	FY2004/05	Amount	Percent
Basic services								
Health care	1,500,000	1,000,000	587,000	1,082,000	1,168,000	1,679,000	7,016,000	9.2
Education and training	3,000,000	3,600,000	765,000	1,845,000	809,000	1,171,000	11,190,000	14.7
Social, civil & heritage protection	-	25,000	55,000	174,500	135,000	32,500	422,000	0.6
Sub-total	4,500,000	4,625,000	1,407,000	3,101,500	2,112,000	2,882,500	18,628,000	24.4
Production related sectors								
Agriculture, forestry & fisheries	75,000	120,000	131,000	391,000	187,000	183,000	1,087,000	1.4
Natural resources & environment	-	10,000	42,000	41,500	36,000	-	129,500	0.2
Private sector development	-	20,000	49,000	336,500	451,000	52,000	908,500	1.2
Sub-total	75,000	150,000	222,000	769,000	674,000	235,000	2,125,000	2.8
Infrastructure & housing								
Communications	50,000	50,000	62,000	260,500	114,000	12,500	549,000	0.7
Housing & urban development	850,000	1,260,500	778,250	282,000	514,100	10,500	3,695,350	4.8
Power	500,000	493,000	822,000	2,198,070	141,928	391,000	4,545,998	6.0
Transport	3,500,000	4,500,000	1,402,000	1,781,100	4,367,600	4,695,500	20,246,200	26.5
Water supply and sanitation	500,000	750,000	406,500	667,660	1,213,735	1,172,000	4,709,895	6.2
Sub-total	5,400,000	7,053,500	3,470,750	5,189,330	6,351,363	6,281,500	33,746,443	44.2
Governance								
Pillars of the State	-	425,000	853,000	1,100,000	1,148,000	76,000	3,602,000	4.7
Public sector management	350,000	500,000	628,000	1,477,000	569,000	297,000	3,821,000	5.0
Local development	-	20,000	33,000	347,000	119,000	150,000	669,000	0.9
Rights, equality & justice	-	500,000	1,135,000	162,000	131,000	108,000	2,036,000	2.7
Sub-total	350,000	1,445,000	2,649,000	3,086,000	1,967,000	631,000	10,128,000	13.3
Security and external relations								
Security, peacebuilding, reconciliation	1,000,000	2,000,000	2,476,000	2,149,000	2,010,000	1,699,000	11,334,000	14.9
External relations & cooperation	-	-	53,000	146,000	4	151,000	350,004	0.5
Subtotal	1,000,000	2,000,000	2,529,000	2,295,000	2,010,004	1,850,000	11,684,004	15.3
Total	11,325,000	15,273,500	10,277,750	14,440,830	13,114,367	11,880,000	76,311,447	100.0

Source: Ministry of Planning and Finance.

Appendix Table 12: Approved Donor Funding for "On-Budget" Development and Technical Assistance (US\$)

Sector	Annual Disbursements						Total	
	FY1999/00	FY2000/01	FY2001/02	FY2002/03	FY2003/04	FY2004/05	Amount	Percent
Basic services								
Health care	12,769,158	14,743,351	16,400,543	13,881,758	15,440,960	20,733,678	93,969,448	12.6
Education and training	8,023,071	30,775,322	34,365,352	26,648,490	30,642,031	24,196,569	154,650,835	20.7
Social, civil & heritage protection	-	-	623,313	1,101,421	617,967	755,469	3,098,170	0.4
Sub-total	20,792,229	45,518,673	51,389,209	41,631,669	46,700,958	45,685,716	251,718,454	33.7
Production related sectors								
Agriculture, forestry & fisheries	5,072,031	11,621,782	12,466,567	14,723,990	16,995,321	9,649,614	70,529,305	9.4
Natural resources & environment	1,297,500	366,929	983,125	3,082,011	3,366,746	2,685,127	11,781,438	1.6
Private sector development	103,500	614,605	2,460,137	2,271,594	3,837,867	2,969,129	12,256,832	1.6
Sub-total	6,473,031	12,603,316	15,909,829	20,077,595	24,199,934	15,303,870	94,567,575	12.7
Infrastructure & housing								
Communications	938,566	1,407,986	1,693,939	1,261,119	890,700	1,039,436	7,231,746	1.0
Housing & urban development	-	382,812	832,366	689,566	453,133	390,000	2,747,877	0.4
Power	466,767	5,432,618	5,248,294	3,234,008	9,145,845	9,406,826	32,934,358	4.4
Transport	1,053,397	20,216,209	21,727,802	4,044,500	5,169,534	11,622,299	63,833,741	8.5
Water supply and sanitation	1,127,009	4,993,131	11,641,300	15,455,206	4,074,759	5,854,246	43,145,650	5.8
Sub-total	3,585,739	32,432,756	41,143,701	24,684,399	19,733,971	28,312,807	149,893,372	20.1
Governance								
Pillars of the State	331,158	6,316,389	10,105,248	3,827,518	2,396,596	3,729,968	26,706,877	3.6
Public sector management	2,480,637	13,476,788	17,532,260	38,163,051	25,180,774	26,369,372	123,202,882	16.5
Local development	54,991	2,032,002	3,483,478	2,914,063	3,009,674	4,770,248	16,264,456	2.2
Rights, equality & justice	1,643,563	3,427,664	4,945,641	5,457,601	7,574,432	6,359,278	29,408,179	3.9
Sub-total	4,510,349	25,252,843	36,066,627	50,362,233	38,161,476	41,228,866	195,582,394	26.2
Security and external relations								
Security, peacebuilding, reconciliation	245,258	511,752	573,402	693,441	3,724,227	4,475,679	10,223,759	1.4
External relations & cooperation	36,700,906	1,782,078	1,944,444	1,806,679	2,097,984	747,740	45,079,831	6.0
Subtotal	36,946,164	2,293,830	2,517,846	2,500,120	5,822,211	5,223,419	55,303,590	7.4
Total	72,307,512	118,101,418	147,027,212	139,256,016	134,618,550	135,754,678	747,065,385	100.0
Memo item: Off budget assistance								
Basic services	20,940	1,047,543	4,398,315	4,563,566	3,267,497	345,647	13,643,508	9.1
Production sectors	925,000	5,771,016	6,376,948	5,184,887	3,942,376	782,744	22,982,971	15.4
Infrastructure & housing	2,383,266	4,272,736	6,600,663	8,609,378	7,089,577	4,153,362	33,108,983	22.2
Governance	2,696,250	15,963,826	12,471,514	9,213,723	13,089,446	11,658,550	65,093,309	43.6
Security & external relations	1,269,303	2,856,444	3,179,853	3,427,229	2,465,997	1,168,280	14,367,106	9.6
Total	7,294,759	29,911,565	33,027,293	30,998,783	29,854,893	18,108,583	149,195,877	100.0

Source: Registry of External Assistance, Ministry of Planning and Finance.

Note: excludes bilateral military assistance.

Appendix Table 13: Approved Donor Funding for "On-Budget" Recurrent Expenditures on Development and Technical Assistance (US\$)

Sector	Annual Disbursements						Total	
	FY1999/00	FY2000/01	FY2001/02	FY2002/03	FY2003/04	FY2004/05	Amount	Percent
Basic services								
Health care	9,580,128	13,647,793	14,271,944	11,784,462	13,279,817	15,939,366	78,503,509	16.0
Education and training	5,363,271	21,667,943	17,064,311	17,517,071	22,398,261	16,472,338	100,483,196	20.5
Social, civil & heritage protection	-	-	23,313	501,421	617,967	755,469	1,898,170	0.4
Sub-total	14,943,399	35,315,736	31,359,568	29,802,954	36,296,045	33,167,173	180,884,875	37.0
Production related sectors								
Agriculture, forestry & fisheries	1,543,085	3,720,745	4,947,266	6,592,620	7,526,849	6,715,754	31,046,319	6.3
Natural resources & environment	237,500	366,929	983,125	2,338,151	2,566,746	2,291,062	8,783,513	1.8
Private sector development	-	366,105	2,144,216	2,042,820	3,837,867	2,969,129	11,360,137	2.3
Sub-total	1,780,585	4,453,779	8,074,607	10,973,591	13,931,462	11,975,945	51,189,969	10.5
Infrastructure & housing								
Communications	772,911	877,637	1,528,285	986,065	709,416	858,376	5,732,690	1.2
Housing & urban development	-	382,812	832,366	689,566	453,133	390,000	2,747,877	0.6
Power	-	-	277,000	436,000	350,000	1,100,000	2,163,000	0.4
Transport	246,265	2,519,666	1,574,143	395,544	483,614	2,459,620	7,678,852	1.6
Water supply and sanitation	-	746,054	1,599,458	1,558,835	1,037,382	408,791	5,350,520	1.1
Sub-total	1,019,176	4,526,169	5,811,252	4,066,010	3,033,545	5,216,787	23,672,939	4.8
Governance								
Pillars of the State	331,158	6,271,632	8,357,034	3,708,149	2,396,596	3,129,968	24,194,537	4.9
Public sector management	2,229,831	11,598,066	15,673,508	34,139,883	22,527,142	23,631,098	109,799,528	22.4
Local development	54,991	1,999,502	3,450,978	2,914,063	3,009,674	4,770,248	16,199,456	3.3
Rights, equality & justice	1,643,563	3,382,377	4,849,124	5,119,627	7,574,432	6,359,278	28,928,401	5.9
Sub-total	4,259,543	23,251,577	32,330,644	45,881,722	35,507,844	37,890,592	179,121,922	36.6
Security and external relations								
Security, peacebuilding, reconciliation	245,258	324,173	385,822	693,441	3,724,227	4,475,679	9,848,600	2.0
External relations & cooperation	36,700,906	1,688,249	1,847,266	1,692,339	1,994,745	747,740	44,671,245	9.1
Subtotal	36,946,164	2,012,422	2,233,088	2,385,780	5,718,972	5,223,419	54,519,845	11.1
Total	58,948,867	69,559,684	79,809,159	93,110,057	94,487,868	93,473,916	489,389,550	100.0

Source: Registry of External Assistance, Ministry of Planning and Finance.

Note: excludes bilateral military assistance.

Appendix Table 14: Approved Donor Funding for "On-Budget" Capital Expenditures on Development and Technical Assistance (US\$)

Sector	Annual Disbursements						Total	
	FY1999/00	FY2000/01	FY2001/02	FY2002/03	FY2003/04	FY2004/05	Amount	Percent
Basic services								
Health care	3,189,031	1,095,558	2,128,600	2,097,296	2,161,143	4,794,312	15,465,939	6.0
Education and training	2,659,800	9,107,379	17,301,041	9,131,419	8,243,770	7,724,231	54,167,640	21.0
Social, civil & heritage protection	-	-	600,000	600,000	-	-	1,200,000	0.5
Sub-total	5,848,831	10,202,937	20,029,641	11,828,715	10,404,913	12,518,543	70,833,579	27.5
Production related sectors								
Agriculture, forestry & fisheries	3,528,946	7,901,037	7,519,301	8,131,370	9,468,472	2,933,860	39,482,986	15.3
Natural resources & environment	1,060,000	-	-	743,860	800,000	394,065	2,997,925	1.2
Private sector development	103,500	248,500	315,921	228,774	-	-	896,695	0.3
Sub-total	4,692,446	8,149,537	7,835,222	9,104,004	10,268,472	3,327,925	43,377,606	16.8
Infrastructure & housing								
Communications	165,655	530,349	165,654	275,054	181,284	181,060	1,499,056	0.6
Housing & urban development	-	-	-	-	-	-	-	-
Power	466,767	5,432,618	4,971,294	2,798,008	8,795,845	8,306,826	30,771,358	11.9
Transport	807,132	17,696,543	20,153,659	3,648,956	4,685,920	9,162,679	56,154,889	21.8
Water supply and sanitation	1,127,009	4,247,077	10,041,842	13,896,371	3,037,376	5,445,455	37,795,130	14.7
Sub-total	2,566,563	27,906,587	35,332,449	20,618,389	16,700,425	23,096,020	126,220,433	49.0
Governance								
Pillars of the State	-	44,757	1,748,214	119,369	-	600,000	2,512,340	1.0
Public sector management	250,806	1,878,722	1,858,752	4,023,168	2,653,632	2,738,274	13,403,354	5.2
Local development	-	32,500	32,500	-	-	-	65,000	0.0
Rights, equality & justice	-	45,287	96,517	337,974	-	-	479,778	0.2
Sub-total	250,806	2,001,266	3,735,983	4,480,511	2,653,632	3,338,274	16,460,472	6.4
Security and external relations								
Security, peacebuilding, reconciliation	-	187,579	187,580	-	-	-	375,159	0.1
External relations & cooperation	-	93,829	97,178	114,340	103,239	-	408,586	0.2
Subtotal	-	281,408	284,758	114,340	103,239	-	783,745	0.3
Total	13,358,645	48,541,734	67,218,053	46,145,959	40,130,682	42,280,762	257,675,835	100.0

Source: Registry of External Assistance, Ministry of Planning and Finance.

Note: excludes bilateral military assistance.

Appendix Table 15: Approved Combined Sources Funding for "On-Budget" Development and Technical Assistance (US\$)

Sector	Annual Disbursements						Total	
	FY1999/00	FY2000/01	FY2001/02	FY2002/03	FY2003/04	FY2004/05	Amount	Percent
Basic services								
Health care	18,304,158	19,838,351	21,754,543	21,667,758	24,293,810	30,539,678	136,398,298	12.0
Education and training	19,123,071	43,270,322	47,093,852	44,590,990	46,742,791	40,863,069	241,684,095	21.3
Social, civil & heritage protection	500,300	500,000	1,257,813	2,040,921	1,494,367	1,499,469	7,292,870	0.6
Sub-total	37,927,529	63,608,673	70,106,209	68,299,669	72,530,968	72,902,216	385,375,264	34.0
Production related sectors								
Agriculture, forestry & fisheries	5,730,031	12,441,782	13,354,567	16,235,990	18,573,321	11,031,614	77,367,305	6.8
Natural resources & environment	1,332,500	491,929	1,142,125	3,476,011	3,755,296	3,021,127	13,218,988	1.2
Private sector development	103,500	919,605	2,790,137	3,165,594	4,896,717	3,695,129	15,570,682	1.4
Sub-total	7,166,031	13,853,316	17,286,829	22,877,595	27,225,334	17,747,870	106,156,975	9.4
Infrastructure & housing								
Communications	1,078,566	1,562,986	1,961,939	2,395,869	1,755,951	2,062,436	10,817,747	1.0
Housing & urban development	1,000,000	1,827,812	1,814,866	1,211,316	1,268,809	572,000	7,694,803	0.7
Power	7,966,767	13,811,618	14,101,294	14,584,428	19,231,143	21,524,826	91,220,076	8.1
Transport	6,908,397	27,224,209	25,577,802	9,610,750	12,470,310	20,696,799	102,488,267	9.1
Water supply and sanitation	2,277,009	6,706,131	13,157,800	17,958,456	6,462,009	8,234,246	54,795,650	4.8
Sub-total	19,230,739	51,132,756	56,613,701	45,760,819	41,188,222	53,090,307	267,016,543	23.6
Governance								
Pillars of the State	331,158	6,836,389	12,518,248	6,797,518	5,733,606	6,802,968	39,019,887	3.4
Public sector management	3,964,387	15,379,288	19,846,760	42,140,051	28,437,382	29,840,372	139,608,240	12.3
Local development	654,991	2,662,002	4,120,478	5,214,063	4,808,879	6,540,248	24,000,661	2.1
Rights, equality & justice	2,611,563	4,952,664	7,498,641	7,425,601	9,430,612	8,488,278	40,407,359	3.6
Sub-total	7,562,099	29,830,343	43,984,127	61,577,233	48,410,479	51,671,866	243,036,147	21.5
Security and external relations								
Security, peacebuilding, reconciliation	5,320,258	8,211,752	12,072,402	14,800,441	19,256,327	20,045,679	79,706,859	7.0
External relations & cooperation	36,912,156	2,064,578	2,296,944	3,098,679	3,434,247	3,339,740	51,146,344	4.5
Subtotal	42,232,414	10,276,330	14,369,346	17,899,120	22,690,574	23,385,419	130,853,203	11.6
Total	114,118,812	168,701,418	202,360,212	216,414,436	212,045,577	218,797,678	1,132,438,132	100.0

Source: Registry of External Assistance, Ministry of Planning and Finance.

Note: excludes bilateral military assistance.

Appendix Table 16: Approved Combined Sources Funding for "On-Budget" Recurrent Expenditures on Development and Technical Assistance (US\$)

Sector	Annual Disbursements						Total	
	FY1999/00	FY2000/01	FY2001/02	FY2002/03	FY2003/04	FY2004/05	Amount	Percent
Basic services								
Health care	13,615,128	17,742,793	19,038,944	18,488,462	20,964,667	24,066,366	113,916,359	14.3
Education and training	13,463,271	30,562,943	29,027,811	33,614,571	37,690,021	31,967,838	176,326,456	22.1
Social, civil & heritage protection	500,300	475,000	602,813	1,266,421	1,359,367	1,466,969	5,670,870	0.7
Sub-total	27,578,699	48,780,736	48,669,568	53,369,454	60,014,055	57,501,173	295,913,685	37.1
Production related sectors								
Agriculture, forestry & fisheries	2,126,085	4,420,745	5,704,266	7,713,620	8,917,849	7,914,754	36,797,319	4.6
Natural resources & environment	272,500	481,929	1,100,125	2,690,651	2,919,296	2,627,062	10,091,563	1.3
Private sector development	-	651,105	2,425,216	2,600,320	4,445,717	3,643,129	13,765,487	1.7
Sub-total	2,398,585	5,553,779	9,229,607	13,004,591	16,282,862	14,184,945	60,654,369	7.6
Infrastructure & housing								
Communications	862,911	982,637	1,734,285	1,860,315	1,460,667	1,868,876	8,769,691	1.1
Housing & urban development	150,000	567,312	1,036,616	929,316	754,709	561,500	3,999,453	0.5
Power	7,000,000	7,886,000	8,308,000	9,588,350	10,293,370	12,827,000	55,902,720	7.0
Transport	2,601,265	5,027,666	4,022,143	4,180,694	3,416,790	6,838,620	26,087,178	3.3
Water supply and sanitation	650,000	1,709,054	2,709,458	3,394,425	2,210,897	1,616,791	12,290,625	1.5
Sub-total	11,264,176	16,172,669	17,810,502	19,953,100	18,136,433	23,712,787	107,049,667	13.4
Governance								
Pillars of the State	331,158	6,366,632	9,917,034	5,578,149	4,585,606	6,126,968	32,905,547	4.1
Public sector management	3,363,581	13,000,566	17,360,008	36,639,883	25,214,750	26,805,098	122,383,886	15.3
Local development	654,991	2,609,502	4,054,978	4,867,063	4,689,879	6,390,248	23,266,661	2.9
Rights, equality & justice	2,611,563	4,407,377	6,267,124	6,925,627	9,299,612	8,380,278	37,891,581	4.7
Sub-total	6,961,293	26,384,077	37,599,144	54,010,722	43,789,847	47,702,592	216,447,675	27.1
Security and external relations								
Security, peacebuilding, reconciliation	4,320,258	6,024,173	9,408,822	12,651,441	17,246,327	18,346,679	67,997,700	8.5
External relations & cooperation	36,912,156	1,970,749	2,146,766	2,838,339	3,331,004	3,188,740	50,387,754	6.3
Subtotal	41,232,414	7,994,922	11,555,588	15,489,780	20,577,331	21,535,419	118,385,454	14.8
Total	89,435,167	104,886,184	124,864,409	155,827,647	158,800,528	164,636,916	798,450,850	100.0

Source: Registry of External Assistance, Ministry of Planning and Finance.

Note: excludes bilateral military assistance.

Appendix Table 17: Approved Combined Sources Funding for "On-Budget" Capital Expenditures on Development and Technical Assistance (US\$)

Sector	Annual Disbursements						Total	
	FY1999/00	FY2000/01	FY2001/02	FY2002/03	FY2003/04	FY2004/05	Amount	Percent
Basic services								
Health care	4,689,031	2,095,558	2,715,600	3,179,296	3,329,143	6,473,312	22,481,939	6.7
Education and training	5,659,800	12,707,379	18,066,041	10,976,419	9,052,770	8,895,231	65,357,640	19.6
Social, civil & heritage protection	-	25,000	655,000	774,500	135,000	32,500	1,622,000	0.5
Sub-total	10,348,831	14,827,937	21,436,641	14,930,215	12,516,913	15,401,043	89,461,579	26.8
Production related sectors								
Agriculture, forestry & fisheries	3,603,946	8,021,037	7,650,301	8,522,370	9,655,472	3,116,860	40,569,986	12.1
Natural resources & environment	1,060,000	10,000	42,000	785,360	836,000	394,065	3,127,425	0.9
Private sector development	103,500	268,500	364,921	565,274	451,000	52,000	1,805,195	0.5
Sub-total	4,767,446	8,299,537	8,057,222	9,873,004	10,942,472	3,562,925	45,502,606	13.6
Infrastructure & housing								
Communications	215,655	580,349	227,654	535,554	295,284	193,560	2,048,056	0.6
Housing & urban development	850,000	1,260,500	778,250	282,000	514,100	10,500	3,695,350	1.1
Power	966,767	5,925,618	5,793,294	4,996,078	8,937,773	8,697,826	35,317,356	10.6
Transport	4,307,132	22,196,543	21,555,659	5,430,056	9,053,520	13,858,179	76,401,089	22.9
Water supply and sanitation	1,627,009	4,997,077	10,448,342	14,564,031	4,251,111	6,617,455	42,505,025	12.7
Sub-total	7,966,563	34,960,087	38,803,199	25,807,719	23,051,788	29,377,520	159,966,876	47.9
Governance								
Pillars of the State	-	469,757	2,601,214	1,219,369	1,148,000	676,000	6,114,340	1.8
Public sector management	600,806	2,378,722	2,486,752	5,500,168	3,222,632	3,035,274	17,224,354	5.2
Local development	-	52,500	65,500	347,000	119,000	150,000	734,000	0.2
Rights, equality & justice	-	545,287	1,231,517	499,974	131,000	108,000	2,515,778	0.8
Sub-total	600,806	3,446,266	6,384,983	7,566,511	4,620,632	3,969,274	26,588,472	8.0
Security and external relations								
Security, peacebuilding, reconciliation	1,000,000	2,187,579	2,663,580	2,149,000	2,010,000	1,699,000	11,709,159	3.5
External relations & cooperation	-	93,829	150,178	260,340	103,243	151,000	758,590	0.2
Subtotal	1,000,000	2,281,408	2,813,758	2,409,340	2,113,243	1,850,000	12,467,749	3.7
Total	24,683,645	63,815,234	77,495,803	60,586,789	53,245,049	54,160,762	333,987,282	100.0

Source: Registry of External Assistance, Ministry of Planning and Finance.

Note: excludes bilateral military assistance.

Abbreviations and Acronyms

ADB	Asian Development Bank
BDC	Business Development Center
BPA	Banking and Payments Authority
CDR	Crude Death Rate
CFET	Consolidated Fund for East Timor
CoM	Council of Ministers
CSO	Civil Society Organization
FAO	Food and Agriculture Organization
FY	Fiscal Year
GDP	Gross Domestic Product
GNI	Gross National Income
IMF	International Monetary Fund
JPDA	Joint Petroleum Development Authority
LDF	Local Development fund
LNG	Liquefied Natural Gas
M&E	Monitoring and Evaluation
MCA	Millennium Challenge Account
MCC	Millennium Challenge Corporation
MDG	Millennium Development Goal
MFAC	Ministry of Foreign Affairs and Cooperation
MFI	Microfinance Institutions
MICS	Multiple Indicator Cluster Survey
MoPF	Ministry of Planning and Finance
NDMO	National Disaster Management Office
NDP	National Development Plan
NDPEAC	National Directorate for Planning and External Assistance Coordination
NGO	Non-Government Organization
PKF	Police Keeping Force
PSM	Public Sector Management
REA	Registry of External Assistance
SIP	Sector Investment Program
SWG	Sector Working Group
TA	Technical Assistance
TFET	Trust Fund for East Timor
TFR	Total Fertility Rate
TLDHS	Timor-Leste Demographic and General Health Survey
TLSS	Timor-Leste Living Standard Measurement Survey
TSP	Transition Support Program
UN	United Nations
UNDP	United Nations Development Program
UNPOL	United Nations Police
UNTAET	United Nations Transitional Administration for Timor-Leste
USAID	United States Agency for International Development
WTO	World Trade Organization