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Viewing cable 08DILI323, MAJOR PROJECTS AND GOVERNMENT PROCUREMENT IN TIMOR-LE

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SUBJECT: MAJOR PROJECTS AND GOVERNMENT PROCUREMENT IN TIMOR-LESTE

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¶1. (SBU) The poorest country in Asia, Timor-Leste faces large gaps in public infrastructure, from roads to ports, electricity, schools and hospitals. Early decisions after independence in 2002 to eschew international debt and to conserve most of the country's future petroleum wealth constrained the financing available for large-scale infrastructure. Even as the government begins to enjoy greater fiscal flexibility due to rising petroleum revenues, however, fundamental shortages of planning, engineering and organizational skills in Timor's public and private sectors have hindered improvements in the implementation of even minor capital projects. Recent decisions by Timor's government on the procurement of new patrol boats and the installation of two power plants raised serious questions regarding the transparency of Timor's procurement practices and the quality of its decision-making. Reform is possible. Key ministers now openly discuss the former taboos of taking on concessional financing from sovereign lenders and outsourcing project management. The Prime Minister sought assistance from Australia on infrastructure planning, and the World Bank may augment ongoing ADB-AusAID programs to develop procurement capacity. The U.S. could assist through a possible future MCC Threshold Program. End summary.

MAJOR GAPS IN SOCIAL INFRASTRUCTURE

¶2. (U) Timor-Leste is burdened by zero international debt and has more than \$3.8 billion in its sovereign wealth fund due to

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accruals from its modest oil deposits. These outcomes are the consequences of a fiscal policy approach that until recently emphasized the building up of savings, the avoidance of gross corruption and other expressions of the "resource curse," and self-reliance, including a reluctance to outsource project management. This prudence has also resulted in astounding gaps in social infrastructure. Timor-Leste is distinguished by a poor national road network; inadequate telecommunications (less than 1% of households has a landline telephone); a single, increasingly congested seaport; an electricity grid that supplies power to only a third of the country's households and then only for short segments of the day; a health services infrastructure barely able to cope with one of the world's highest rates of maternal and child mortality; an education system in which less than a fifth of schoolchildren have chairs or desks, and more than half are without textbooks; poor water and sanitation facilities (two-thirds of adults fetch water at least once a week); and a single international airport that can handle planes no larger than a Boeing 737.

¶3. (U) Poor executive capacity within the government also has hamstrung efforts to invest in social infrastructure. Timorese governments have consistently missed spending targets for capital projects, regardless of the party (or parties) in power. On a cash basis, the current government by the end of September 2008 had spent barely ten percent of the funds appropriated for major capital projects in 2008.

¶4. (U) Timor-Leste's infrastructure needs are becoming an increasingly animated topic of public concern and debate. The Prime Minister has declared infrastructure to be one of the country's three priorities in 2009, together with rural development and human capital development. During the course of 2008, the government announced major procurements of power generation and transmission facilities, and patrol boats intended to protect Timor's fishing resources. Timor also sought overseas financing for major expansions or improvements of its road network, seaport and airport. The Prime Minister publicly spoke of breaking the taboo on outsourcing of project management and the Finance Minister privately indicated the government's growing support for abandoning its denial of debt to finance major infrastructure projects. Concurrently, the boost in actual or potential infrastructure spending triggered alarms of increased corruption, often expressed as brickbats hurled by the opposition at the government.

POOR PROCUREMENT DECISIONS

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¶5. (SBU) Regrettably, a few of the government's recent procurements likely added to public perceptions of corruption and, even in the absence of any malfeasance, raise questions about the quality of the government's decision-making. Common elements to these procurements have been a reliance on sole-sourcing and opaque decision-making among a very small leadership group. Timorese businessmen, typically veterans of the resistance to the Indonesian occupation and well-known to the prime minister, serve as brokers between foreign firms and senior government representatives. The consequences at minimum include the purchase of inappropriate and possibly wasteful or ecologically harmful technologies.

¶6. (SBU) A few examples follow. In April 2008, reports emerged that the government had purchased two military patrol boats from a Chinese firm to boost Timor's capabilities to protect its maritime domain including its fishing resources. The purchase was sole-sourced and the decision made by the prime minister. Both the secretary of state for defense and the chief of defense told an embassy officer that the purchase was made without their input. A veteran of the liberation struggle served as the primary broker with the Chinese firm. The purchase remains controversial in Dili due to questions regarding the vessels' capabilities, their compatibility with current Timorese military equipment, and their national provenance.

¶7. (SBU) In July 2008, news surfaced that the government would

purchase two large electricity generating plants from a Chinese firm that would also be contracted to put into place a nationwide transmission grid. On this occasion, the government issued an international tender, although the widespread understanding in Dili was that the purchase had been agreed before the government announced the tender. Although observers described the tender announcement as insubstantial and technically inadequate, fourteen international firms submitted bids. The decision to award the contract to the Chinese firm again was made by the prime minister with very little consultation with line ministers. The power plants are old equipment (with some 40 years of service in China already behind them) that will be disassembled, exported and refitted in Timor-Leste. They will burn heavy oil that Timor will have to import. Experts describe the contracted installation of a national transmission grid within two years as a fantasy. The World Bank reportedly has urged the government to cancel the contract, absorb the penalty, and re-tender the project. There is no indication that the government intends to follow this advice.

¶8. (SBU) Another energy related incident has to do with the sad recent history of the Dili power plant. A Canadian operator took charge of the Dili generating facilities in September 2007 as a result of a contract signed with the previous government. It arrived to find existing equipment in complete disrepair and bought two new, large, top-of-the line generating units as replacements, the first of which was installed in October 2007. The new generator promptly went out of service, however, due to a mechanical failure and Dili found itself in frequent blackouts, with electricity on many days in late-2007 available for only 8-10 hours. Inheriting this mess at the very beginning of his term, facing sharp public criticism of incompetence, and having lost confidence in the Canadian firm, the Prime Minister acted. He purchased in late-2007 five medium-sized generators manufactured by an Indonesian firm and had them shipped and installed in the Dili power station on an expedited basis. The purchase was again sole-sourced, brokered by a veteran and in violation of the contract with the Canadian operator. The equipment arrived speedily, but in poor condition and remains in a constant state of fuel and lubricant leakage. The Canadian firm under government instructions cancelled the purchase of its second high-end, large generator. It is only now beginning to repair relations with senior government leaders (the PM continues to refuse to meet with the company) and warns that Dili will again face serious blackouts by April 2009 due to surging demand if sound procurement decisions are not made soon.

¶9. (SBU) Similar tales are told regarding the purchase of a fleet of vehicles for members of parliament, acquisition of rice

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for a large food subsidy program, and the procurement of fuel oil. The SUVs were funded only after vigorous legislative debate and university student-led public protests, but their delivery has been repeatedly delayed to problems with the sole-sourced vendor. In the other cases, a relative of one government minister or another is believed to have personally profited by being selected as the supplier or supplier's agent.

LEGAL INFRASTRUCTURE SOUND

¶10. (U) Timor-Leste has laws and regulations governing official procurements that, when followed, provide full transparency and enable sound decision-making. Indeed, the procurement regime is so complex that it arguably has hindered effective capital investment due to the relative low executive capacity of both Timorese public authorities and private firms. Consequently, there have been frequent efforts at reform designed to decentralize and streamline procurements and contracting, with bilateral and multilateral donors providing substantial support in the form of technical assistance and capacity building. Fundamentally, Timor's procurement rules enshrine the principles of open international tendering and discourage the use of sole-sourcing. And the country's leadership regularly espouses an open, transparent procurement system. The president generated controversy in mid-2007 after he straightforwardly told a gathering of the local chamber of

commerce that he would never agree to quotas or set-asides of government contracts for Timorese businesses.

BUT PRACTICE LESS SO

Â¶11. (SBU) So why has practice been so divergent on occasion? The prime minister reportedly has dismissed procurement guidelines as a bureaucratic luxury and several in the government have expressed doubt that international firms would even be interested in doing business in small, faraway and impoverished Timor. The inclination therefore is to do business with the first apparently legitimate foreign firm that comes along and makes an offer. When fourteen international firms actually submitted serious bids for the power plant project, ministers were simply astonished.

Â¶12. (SBU) Gaps in executive capacity throughout the capital project lifecycle are substantial and bedevil every aspect of public sector infrastructure development. An Asian Development Bank (ADB) representative shared with us the broad array of shortcomings, from the absence of engineering and planning skills in the design phase of a project, to the dearth of funding for, and skills to conduct, maintenance after a project is completed. Ministries put forward and receive project funding with only the sketchiest of design work completed, and then offer these projects for tender with little refinement. Companies selected for project implementation have only vague specifications to meet and face little in terms of contractual disciplines. Consequently, the government's record of completing capital projects is poor and the amount of funds carried over unspent from one fiscal year to another is high. The equivalent managerial, technical and organizational limitations of Timorese private firms also have hindered progress, as the Prime Minister has bemoaned to the ambassador on several occasions.

Â¶13. (SBU) Haste born of political pressure on the government to speed economic development and protect the national interest also has played a role. In the parliamentary election of 2007, Xanana Gusmao campaigned on the message that he could bring development and prosperity to Timor, including providing electricity throughout the country, far more quickly and effectively than Fretilin (the former governing, now leading opposition party). An urgency to deliver on these pledges and demonstrate the government's capabilities remains, including undertaking big, highly visible projects with the promise of raising standards of living, providing jobs and improving stability. Indeed, senior government officials regularly cite their anxiety regarding Timor's political stability as justification for policy decisions, pointing to public

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discouragement with poverty, food insecurity and unemployment as potential triggers for renewed conflict. A second source of potential instability also generated ministerial anxiousness: a possible collapse of the ruling coalition and a return to power by Fretilin. Consequently, there was a whiff of panic about the decisions to buy patrol boats, power plants and subsidize rice imports. Ministers appeared to be motivated by a need to show quickly and dramatically that their government can defend Timor's interests and build the country, lest the people lose confidence, riot in the streets, turn their backs on the coalition, and opt for Fretilin's early return to power.

PROSPECTS FOR REFORM

Â¶14. (SBU) There are signs of willingness to reform. The Prime Minister has acknowledged to the World Bank and Australia that he needs assistance in managing major projects and the procurement process. He told the ambassador of his concern that Timorese brokers are failing to add value to the projects they tout, could be representing international firms of poor quality, and are undermining the ability of legitimate Timorese firms from developing needed experience and capacity. In August 2008, Australian PM Rudd committed to help Timor-Leste develop a medium term public infrastructure plan, to include a phased strategy for the construction of key projects and potential

sources of financing. The Australian plan will be ready shortly. Recognizing where the center of decision-making now resides, the World Bank is considering financing the establishment of a unit within the Prime Minister's office to help shape, direct and make more transparent procurement policy and practice. While preparing for a possible Millennium Challenge Corporation (MCC) Compact, the Finance Minister foresaw a partnership with MCC as providing an exemplar to Timorese politicians and the public on outsourcing large-scale public sector project management. The ADB, a co-partner with AusAID of a project within the Ministry of Infrastructure to improve government contracting, has agreed to make modifications to improve its credibility and influence with the minister, and build capacity in this critical area.

OPPORTUNITIES FOR THE U.S.

¶15. (SBU) The decision to make Timor-Leste eligible for an MCC Threshold Program also provides the USG with an opportunity to improve the government's procurement practices. Programs to enhance Timor's control of corruption will be a pillar of any Threshold Program, and a concept paper developed by Timor's MCC team includes the government's procurement practices as a key area needing reform. To improve the government's effectiveness in managing large projects, and the transparency of its procurement practices, we may wish to explore coordinating with the World Bank should it move forward with its planned procurement unit in the PM's office. As major public sector infrastructure projects inevitably require land, and decisions regarding the government's use and allocation of public land remain strikingly opaque and erratic, we should continue to urge Timor to move expeditiously to introduce a land law into parliament. Finally, we must continue to encourage the country's leadership that transparent procurement programs managed in accordance with international standards are key to ensuring Timor receives the best value for its investments in the country's future.

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