



# Country Partnership Strategy

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April 2016

## Timor-Leste 2016–2020

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Asian Development Bank

## CURRENCY EQUIVALENTS

The currency of Timor-Leste is the US dollar.

## ABBREVIATIONS

ADB	–	Asian Development Bank
ASEAN	–	Association of Southeast Asian Nations
COBP	–	country operations business plan
CPS	–	country partnership strategy
ESI	–	estimated sustainable income
GDP	–	gross domestic product
MOL	–	market-based ordinary capital resources lending
O&M	–	operation and maintenance
PMU	–	project management unit
RCI	–	regional cooperation and integration
SDP	–	strategic development plan
TA	–	technical assistance

## NOTE

In this report, “\$” refers to US dollars.

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## COUNTRY AT A GLANCE

<b>Economic<sup>a</sup></b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014<sup>b</sup></b>	<b>2015<sup>b</sup></b>
GDP (\$ million, current)	5,788.0	6,807.0	5,596.0	4,346.0	2,665.0
Non-oil GDP (\$ million, current)	1,138.0	1,295.0	1,319.0	1,402.3	1,467.9
Non-oil GDP per capita (\$, current)	1,017.2	1,127.1	1,117.7	1,156.9	1,178.9
Non-oil GDP growth (% in constant prices)	9.5	6.4	2.8	6.0	4.1
Agriculture	(19.9)	23.5	0.5	...	...
Industry	49.4	(4.0)	(8.0)	...	...
Services	10.6	8.5	1.4	...	...
Gross domestic investment (% of non-oil GDP)	65.7	55.4	39.1	...	...
Gross domestic saving (% of non-oil GDP)	...	...	...	...	...
Consumer price index (annual % change)	13.2	10.9	9.5	0.7	0.6
Liquidity (M2) (annual % change)	9.3	26.2	22.9	19.9	7.1
Overall fiscal surplus (deficit) (% of non-oil GDP)	217.6	223.9	225.6	69.2	(13.8)
Merchandise trade balance (% of non-oil GDP)	(32.8)	(49.3)	(51.4)	(53.9)	(39.8)
Current account balance (% of non-oil GDP)	206.7	211.3	181.3	75.9	14.2
External debt service (% of exports of goods and services)	0.0	0.0	0.0	0.0	0.0
External debt (% of non-oil GDP)	0.0	0.0	0.5	1.6	3.1

<b>Poverty and Social</b>	<b>2001</b>	<b>2007</b>	<b>2010</b>
Population ('000)	787.3	923.2 [2004]	1066.6
Population growth (annual % change)	0.5	3.2 [2004]	2.4
Maternal mortality ratio (per 100,000 live births)	660.0 [2000]	...	557.0
Infant mortality rate (0–1 year/per 1,000 live births)	60.0 [2003]	...	44.0
Life expectancy at birth (years)	59.0 [2004]	57.0	62.0
Adult literacy (% of population 18 years and older, est.)	37.6	50.6	53.4
Primary school gross enrollment (%)	113.0	96.2	104.6
Child malnutrition (% below 5 years old underweight)	45.8 [2003]	48.6	37.7 [2013]
Population below poverty line (%)	36.0	49.9	41.0 [2009]
Population with access to safe water (%)	50.1	63.1	65.9
Population with access to sanitation (%)	41.2	46.8	41.2

<b>Environment</b>	<b>2001</b>	<b>2010</b>
Carbon dioxide emissions (kilo tons)	161.0 [2002]	183.0
Carbon dioxide emissions per capita (tons)	0.2 [2002]	0.2
Forest area (million hectares)	8.3	7.3 [2011]
Urban population (% of total population)	...	29.1

<b>ADB Portfolio</b> (sovereign loans and grants, as of 31 December 2015)	<b>OCR</b>	<b>ADF</b>	<b>Total</b>
Total number of loans	4.00	3.00	7.00
Net loan and grant amount (\$ million, cumulative)	135.63	123.30	258.93
Disbursements			
Total funds available for withdrawal (\$ million)	82.63	100.25	176.00
Disbursed amount (\$ million, cumulative)	25.10	75.34	100.43
Percentage disbursed (disbursed amount/total available)	30.37	75.14	57.06

... = not available, ( ) = negative, [ ] = latest year for which data are available, ADB = Asian Development Bank, ADF = Asian Development Fund, GDP = gross domestic product, M2 = broad money.

<sup>a</sup> The Government of Timor-Leste receives taxes and royalties from offshore oil and gas production. Petroleum revenues are recorded as income in the current account and production is not recorded as a merchandise export. Import data excludes equipment and machinery used for offshore petroleum production.

<sup>b</sup> Includes some preliminary estimates.

Sources: (i) Asian Development Bank Statistical Database System. <https://sdfs.adb.org/sdfs/index.jsp> (accessed 10 August 2014); (ii) Government of Timor-Leste, Ministry of Finance. 2014. *Timor-Leste: The Millennium Development Goals Report, 2014*. Dili; (iii) Government of Timor-Leste, Ministry of Finance, General Directorate of Statistics. 2010. *Timor-Leste Demographic and Health Survey, 2009–10*. Dili; (iv) Government of Timor-Leste, Ministry of Finance, General Directorate of Statistics; and United Nations Population Fund. 2011. *Population and Housing Census 2010: Suco Report. Volume 4*. Dili; (v) Government of Timor-Leste, Ministry of Health. 2015. *Timor-Leste Food and Nutrition Survey 2013: Final Report 2015*. Dili; (vi) Timor-Leste Budget Transparency Portal. <http://www.budgettransparency.gov.tl> (accessed 10 August 2014); (vii) United Nations Development Programme. Human Development Reports. <http://hdr.undp.org/en/data> (accessed 10 April 2016); (viii) ADB estimates.



## I. DEVELOPMENT TRENDS AND ISSUES

### A. Country Background

1. Timor-Leste has a limited opportunity to use its petroleum wealth to establish a pattern of growth that is enduring and inclusive. Strong leadership and targeted transfers have supported peace and stability since the 2006 crisis, and a transition to a new generation of political leaders is underway.<sup>1</sup> The process of state building is progressing well: key public sector institutions have been established, service delivery is improving, and the building blocks for an enabling business environment are coming into place. Timor-Leste remains fragile, however. While rapid increases in public spending have stimulated growth, current levels of expenditure are unsustainable and cannot deliver widespread reductions in poverty. Future progress hinges on the emergence of a private sector that can drive growth.

2. Poverty stems from low productivity in the agriculture sector and limited employment opportunities. The national poverty rate rose from 36% in 2001 to 50% in 2007 due to a sharp decline in household consumption and the dislocation associated with the 2006 crisis. In 2007, the last year for which household poverty data are available, 76% of poor people lived in rural areas while 88% of all poor people relied on farming for their livelihoods.<sup>2</sup> Crop yields were extremely low and markets were underdeveloped, with more than half of all farming households not selling any of their crops. Approximately one-quarter of the poor lived in urban areas, where poverty was linked to informal and poor quality employment.

3. Access to health and education services has improved and there has been progress toward gender equality since 2002. Timor-Leste is unlikely to have achieved any of the Millennium Development Goals but is on track to meet its targets for nine of the 29 indicators.<sup>3</sup> There has been good progress in improving basic education and health care. The net enrollment rate for primary school rose from 65% in 2001 to 92% in 2013. Since independence in 2002, infant and maternal mortality rates have fallen rapidly, vaccination rates have improved, and the incidence of malaria has fallen by 95%.<sup>4</sup> Gender equality has also improved. Women hold 38% of seats in Parliament and 21% of the positions in the executive branch of government. Women outnumber men in secondary and tertiary education, and the gender gap in adult literacy rates is narrowing. However, women remain at high risk of domestic violence and suffer disproportionately from poor quality water and sanitation services.

4. Infrastructure is improving, but additional investments are needed to support inclusive growth. Real progress has been made in restoring and upgrading a core network of national, district, and rural roads. Public investment has transformed the electricity sector while deregulation has delivered transformative gains in telecommunications. Improving access to clean water and sanitation has been slower. Many rural communities lack access to basic

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<sup>1</sup> In 2006, divisions emerged within Timor-Leste's defense forces, which contributed to a security crisis with political and humanitarian dimensions.

<sup>2</sup> World Bank. 2008. *Timor-Leste: Poverty in a Young Nation*. Washington, DC. A national household income and expenditure survey was conducted in 2011 but no official poverty estimate was produced. A national survey of living standards was completed in 2015 and updated poverty estimates are expected in 2016.

<sup>3</sup> Government of Timor-Leste, Ministry of Finance. 2014. *Timor-Leste: The Millennium Development Goals Report, 2014*. Dili.

<sup>4</sup> Country and Portfolio Indicators (accessible from the list of linked documents in Appendix 2).

services, and urban water supply, sewerage, and solid waste management are in poor condition. Prudent investment in new assets and the development of systems for operation and maintenance (O&M) will help sustain recent progress and provide the conditions needed for inclusive growth.

5. Despite good progress since independence, poverty reduction has not matched growth, and a self-sustaining non-oil economy has yet to emerge. A fivefold increase in public spending during 2007–2013 saw non-oil gross domestic product (GDP) growth average 9.5%.<sup>5</sup> However, available data suggests that poverty reduction since 2007 has been modest. The government has initiated programs to stimulate job creation and rural development but there is little evidence of sustained increases in agricultural productivity. Labor market participation has increased but opportunities are concentrated in urban areas and average household consumption remains below the levels seen at independence. Social transfer programs have also been an important part of the government's strategy, accounting for 9% of public spending in 2014. While these have helped to maintain stability, their impact on poverty is modest.<sup>6</sup> Adjustments in public spending could help to address immediate needs, but in the longer term, inclusive growth and job creation must be driven by the private sector.

## **B. Economic Assessment and Outlook**

6. Timor-Leste is one of the world's most oil-dependent countries. Production from current oil and gas fields began in 2004 and is forecast to end in 2021. Proven reserves are small relative to other oil producers, and the prospects for new developments are uncertain. The petroleum sector operates as an enclave; public spending of taxes and royalties is virtually the only link with the onshore economy. In light of the short time horizon for current petroleum production, the volatility of petroleum income, and the separation of the petroleum sector from the rest of the economy, economic monitoring is focused on the non-oil economy and non-oil GDP.

7. The framework for managing petroleum revenues is robust and transparent. Timor-Leste was the first country in Asia to comply with the Extractive Industries Transparency Initiative, and a sovereign wealth fund, the Petroleum Fund, was established in 2005 to support prudent management of petroleum income.<sup>7</sup> The fund's design and operation is consistent with the Santiago Principles on sovereign wealth fund management.<sup>8</sup> It is managed transparently and detailed reports are published online. The Central Bank of Timor-Leste assumes direct responsibility for managing part of the investment portfolio and also appoints professional investment managers to manage fund assets. The fund's balance was initially invested in low-risk sovereign bonds. The investment portfolio began to diversify in 2011, and by 2015 40% of the fund's balance was invested in international equities. This strategy will increase the fund's exposure to short-term losses but is generally viewed to be an appropriate and relatively low-risk investment strategy over the long term.

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<sup>5</sup> Economic Analysis (Summary) (accessible from the list of linked documents in appendix 2).

<sup>6</sup> Most of the funds are allocated to pensions for veterans of the fight for independence and are not means-tested. A recalibration of the payments could help to reduce poverty but would be politically challenging.

<sup>7</sup> The Extractive Industries Transparency Initiative is a global standard to promote open and accountable management of natural resources.

<sup>8</sup> The Santiago Principles consist of 24 generally accepted principles and practices that have been voluntarily endorsed by members of the International Forum of Sovereign Wealth Funds.



8. All petroleum income is paid into the Petroleum Fund. By law, the government is entitled to withdraw the estimated sustainable income (ESI) from the fund each year to finance public spending. The ESI is defined as the maximum annual withdrawal that could be sustained indefinitely in real terms and is calculated as 3% of estimated petroleum wealth. High oil prices during the years of peak production led to a rapid buildup of savings in the Petroleum Fund, with the fund's balance rising from \$370 million in 2005 to \$16.2 billion at the end of 2015 (about \$13,000 per capita). However, production downgrades and the weaker outlook for oil prices since 2014 saw estimated petroleum wealth fall from \$26.2 billion in 2013 to \$18.2 billion in 2015, with a corresponding reduction of the ESI from \$787 million to \$545 million.

9. Rising public spending has driven growth but threatens long-term fiscal sustainability. Public expenditures, excluding grants, rose from \$241 million in 2007 to \$1.37 billion in 2014 (\$1,135 per capita) as the government scaled up investment in infrastructure and rolled out large social transfer programs. Withdrawals from the Petroleum Fund financed 85% of budgeted expenditures in 2015 and were almost double the ESI. A continuation of recent spending growth will threaten the long-term sustainability of the Petroleum Fund. Withdrawals must return to sustainable levels in the medium term to avoid depleting the fund and reaching a fiscal cliff, which would require a large and abrupt reduction in public spending. In the absence of fiscal stimulus, prospects for growth will depend on the private sector.

10. The private sector is at an early stage of development. With the exception of small amounts of coffee, Timor-Leste has virtually no non-oil merchandise exports. Business activity is constrained by limited human capital, poor quality infrastructure, and gaps in the basic legal framework for commerce. The public sector dominates the economy, providing approximately half of all formal employment in 2013 and spending an equivalent of 99% of non-oil GDP in 2014.<sup>9</sup> The surge in public spending during 2007–2014 has boosted construction and other non-tradable services, but progress in developing tradable sectors, such as agriculture, tourism, and manufacturing, has been much slower.

11. The government has identified agriculture, tourism, and petrochemicals as the leading sectors in its strategy for economic growth and diversification. Developing tourism and petrochemicals production may prove challenging given competition from other tourist destinations in Southeast Asia and the Pacific, and the uncertain prospects for new oil and gas production. Agriculture offers the clearest opportunities for widespread poverty reduction. Average yields of key crops such as rice, coffee, and maize, are far below the yields achieved in neighboring countries under similar conditions. There is also untapped potential for high-value exports of fresh produce, spices, tree crops, and marine produce.

12. Most farming households have minimal engagement with agricultural markets and can be characterized as low-input, low-output producers. The proximate factors that contribute to low productivity include poor infrastructure and connectivity, limited availability of extension services, low usage of agricultural inputs, and low uptake of improved crop varieties. In some cases these factors may be linked to deeper issues of low social trust and high risk aversion caused by past conflicts.

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<sup>9</sup> This excludes expenditures financed by development partner grants. If these expenditures are included then the total is estimated to be 116% of non-oil GDP.

13. Long-term economic prospects hinge on the successful use of the country's petroleum wealth to improve competitiveness and diversify the economy (footnote 5). Non-oil GDP growth has been driven by trends in public spending, but sustainable and inclusive growth will require the development of more productive agriculture and a vibrant private sector. Timor-Leste is seeking full membership of the Association of Southeast Asian Nations (ASEAN), which would provide direct benefits through closer trade, investment, and labor market linkages with Southeast Asia. Making the most of these opportunities will require further investments in infrastructure and education, and sustained improvement of the business-enabling environment.

### **C. Highlights of Previous ADB Country Strategy**

14. The Asian Development Bank (ADB) country partnership strategy (CPS), 2011–2015 for Timor-Leste supported implementation of the first phase of the Timor-Leste Strategic Development Plan, 2011–2030 (SDP).<sup>10</sup> The strategy maintained ADB's strong focus on infrastructure, which was a priority for the government and an area where ADB had developed a comparative advantage. It identified five sectors in which ADB would contribute to development outcomes: transport, water and other urban infrastructure and services, energy, finance, and education. Since 2011, ADB has invested in road transport, urban water supply, and technical and vocational education and training. Complementary technical assistance (TA) has supported infrastructure management, financial and private sector development, preparations for regional economic integration, and regional cooperation on marine conservation.

15. The government has leveraged ADB assistance to build capacity and scale up investment. Timor-Leste was reclassified as a group B country with access to ordinary capital resources in 2012. This change enabled ADB to provide additional financing for national road upgrading and prepare larger investment projects for urban and municipal services. ADB-financed projects have helped to alleviate capacity constraints and support the achievement of high-quality outcomes. They have also provided a mechanism to help the government use budgetary resources efficiently. Government revenues have funded up to 60% of the cost of ADB-supported investments, thus enabling the government to leverage its borrowing.

16. Implementation of the CPS, 2011–2015 was reviewed by ADB and its Independent Evaluation Department.<sup>11</sup> These reviews confirmed that a consistent focus on a small number of sectors has enabled ADB to improve the efficiency and effectiveness of its support. ADB-financed projects are alleviating institutional constraints by supporting government-led capacity development, but ADB can strengthen its contribution to capacity building and play a more active role in policy dialogue. Projects can be designed to ensure financial and operational sustainability in the short term, but enduring solutions will require new operating models and financing mechanisms at the sector level. ADB is helping the government to develop sustainable operating models and address some of the key constraints to inclusive growth. In future, ADB can increase its contribution to inclusive growth by targeting investments toward lagging areas and disadvantaged groups.

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<sup>10</sup> Government of Timor-Leste. 2011. *Timor-Leste Strategic Development Plan, 2011–2030*. Dili (accessible from the list of linked documents in Appendix 2).

<sup>11</sup> Country Partnership Strategy Final Review; Timor-Leste: Supplementary Self-Evaluation of the Country Partnership Strategy Final Review 2011-2015; Country Partnership Strategy Final Review Validation (all accessible from the list of linked documents in Appendix 2).

## II. THE COUNTRY STRATEGY

### A. Government National Strategy

17. The Government of Timor-Leste prioritizes stability as a prerequisite to development. Successive governments have used public resources to deliver a peace dividend and manage immediate threats to stability. The government's long-term vision and development priorities are presented in the SDP, which targets upper middle-income status and a healthy, well-educated, and safe population by 2030 (footnote 10). The SDP identifies reforms to develop human capital, upgrade infrastructure, diversify the economy, and develop a legal and institutional framework. It addresses each of the three pillars of ADB's inclusive growth framework, with an emphasis on achieving rapid growth and ensuring that no part of the country is left behind. Approved by the Parliament in 2011, the SDP is supported by a strong political consensus and has formed the basis of the official program of each of the governments formed since 2012.

18. The SDP identifies infrastructure development, human resource development, and market formation as key pillars of the strategy for 2016–2020. Detailed plans and targets for progress in education, health, infrastructure, security, foreign affairs, and rural and industrial development underpin a broader goal that, by 2020, Timor-Leste will have completed the major productive investments and economic reforms needed for the private sector to drive growth. The SDP intersects with ADB's Strategy 2020 and Midterm Review of Strategy 2020 in the areas of infrastructure development, education, and regional cooperation and integration (RCI).<sup>12</sup> By 2020, Timor-Leste aims to be a full and valued member of ASEAN, and to have developed a comprehensive and integrated system of higher education. For infrastructure, SDP priorities include (i) completion of the upgrading of all national and regional roads to international standards, (ii) expansion of access to improved water and sanitation in rural and urban areas, and (iii) an increase in the share of electricity generated from renewable sources.

19. The government has asked ADB to continue support for infrastructure, education, RCI, and private and financial sector development. Development assistance is coordinated through the Timor-Leste development partner coordination mechanism. This operationalizes the government's aid policy and development partners' commitments under the New Deal for Engagement in Fragile States.<sup>13</sup> The national priorities presented in the SDP are grouped into four strategic sectors that are led by relevant government ministries and supported by development partners chosen by the government.<sup>14</sup> ADB is the lead development partner for the infrastructure strategic sector. A development coordination matrix is presented in Table 5 of the country and portfolio indicators (footnote 4).

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<sup>12</sup> ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank, 2008–2020*. Manila; ADB. 2014. *Midterm Review of Strategy 2020: Meeting the Challenges of a Transforming Asia and Pacific*. Manila.

<sup>13</sup> International Dialogue on Peacebuilding and Statebuilding. 2011. *New Deal for Engagement in Fragile States*. [http://www.pbsdialogue.org/media/filer\\_public/07/69/07692de0-3557-494e-918e-18df00e9ef73/the\\_new\\_deal.pdf](http://www.pbsdialogue.org/media/filer_public/07/69/07692de0-3557-494e-918e-18df00e9ef73/the_new_deal.pdf)

<sup>14</sup> The World Bank leads coordination of development partners supporting the economic sectors, the United Nations leads coordination of support for governance and institutional strengthening, and the Government of Australia leads the coordination of support for the social sectors.

## B. ADB Country Strategy

20. **Strategic objective.** The strategy will support economic growth and diversification by removing infrastructure bottlenecks and institutional constraints, and investing in human capital. This is fundamental for widespread poverty reduction and continued state building. The strategy builds on Timor-Leste's achievements in peace and stability and is aligned with the SDP and the Midterm Review of ADB's Strategy 2020.

21. **Operational priorities.** The strategy focuses on national priorities where ADB has a clear comparative advantage. ADB will work with the government and other development partners to ensure that new infrastructure is appropriately scaled and that services are delivered with improved efficiency, cost recovery, and sustainable O&M. This will help to expand access to key services while ensuring fiscal sustainability. Climate proofing of new infrastructure and increased use of renewable energy resources will support environmental sustainability. Support for education will be broadened to address skills shortages and expand opportunities for Timorese citizens. Economic diversification will be supported through targeted knowledge to improve the business-enabling environment, expand access to financial services, and strengthen linkages with regional and global markets.

22. **Guiding principles.** ADB will maintain a coherent and focused program that builds on previous support. Knowledge and international experience are an essential part of what ADB offers to Timor-Leste. Knowledge solutions will be integrated into sector operations and coordinated through a country knowledge plan that is regularly updated. Sector programs will be designed to leverage private sector expertise and support growth of the non-oil economy by focusing on the binding constraints to economic diversification. Support for capacity development will be aligned with long-term government-led programs. ADB will seek to leverage the contribution that project management units (PMUs) make to capacity development by strengthening the integration of these units into their host ministries. Each of ADB's sector programs and project designs will include specific measures to mainstream gender equity.

23. **Strengthened resident mission.** The Timor-Leste Resident Mission will continue to play a leading role in programming, delivering ADB assistance, and facilitating policy dialogue. Increased lending and engagement in knowledge-intensive sectors underscores the importance of in-country capacity and responsiveness. Financial and human resources of the resident mission will be strengthened, particularly in support of policy dialogue, project administration, and monitoring.

24. **Sector focus.** ADB support will focus on five sectors. Investments in transport, energy, and urban services will use the majority of the CPS resource envelope. ADB will take the following approach to supporting each sector:

- (i) **Transport.** Poor transport links increase costs, reduce competitiveness, and magnify the constraints on growth of Timor-Leste's small and isolated markets. ADB support will focus on completing the rehabilitation of the core network of national roads, establishing an effective system for road maintenance, and developing a new international seaport. The cost of restoring district and national roads to good condition has been estimated at \$1.5 billion (100% of non-oil GDP), so ADB will work with the government and other development partners to prioritize new investments. ADB will continue to emphasize safety and proper regulation of road transport, and will help to build local contractors' capacity. Plans for a new international port at Tibar Bay are well advanced, and the government is also considering new port developments on the south coast and in Oecusse. The Tibar Bay port project has

- been prepared as a public–private partnership using a concession modality and will require a capital contribution from the public sector to ensure viability. ADB will consider loan financing for this.
- (ii) **Energy.** ADB will help make the electricity sector more efficient and sustainable. Public investment has improved services, but the sector now has large excess generation capacity and requires annual subsidies of about \$100 million (7% of non-oil GDP). Electricity is generated from diesel, which is expensive and polluting, and cost recovery is low. ADB will help the government to design and implement a reform program that leverages private sector expertise to reduce public subsidies, extend service coverage to the 30% of the population that is off-grid, and increase the use of renewable energy sources.
  - (iii) **Water and other urban infrastructure and services.** Rapid urbanization is straining basic services in Dili and other district capitals. Most urban households do not have piped water supplies, and waste management is also a concern. Service delivery is constrained by weak capacity, overlapping operational and regulatory functions, and a lack of performance incentives. ADB will support institutional reforms that strengthen the autonomy and accountability of service providers, and will finance investments that are aligned with sector reforms. It will coordinate closely with other development partners on integrated urban planning, particularly for Dili which is a commercial hub and is home to the majority of the urban poor.
  - (iv) **Education.** Poor education constrains growth and limits Timorese citizens' opportunities. Gaps in the education system have led to low levels of education among the adult population and acute skills shortages in growing sectors. Primary enrollment and literacy rates have increased, but secondary enrollment remains low, and the quality and relevance of education across all levels is lacking. ADB will work with the government, development partners, and the private sector to support development of an integrated system for technical education with closer links between secondary education, technical and vocational education and training, and higher level technical training.
  - (v) **Finance.** Timor-Leste's financial sector is underdeveloped because of the risks created by gaps in the legal and regulatory framework and a weak environment for contract enforcement. Credit is scarce and expensive, and the coverage and penetration of financial services is low. ADB will provide specialist knowledge to support the implementation of the Master Plan for Financial Sector Development in Timor-Leste, 2014–2015, with a focus on reforms to increase lending and expand access to financial services.<sup>15</sup> TA will support the commercial transformation of the state-owned National Commercial Bank of Timor-Leste, prudential regulation of the banking sector, and implementation of systemic reforms, such as a framework for secured transactions and a bankruptcy and insolvency law.<sup>16</sup>

25. **Drivers of change.** The CPS, 2016–2020 will use the following thematic drivers of change to increase the effectiveness and impact of ADB support for Timor-Leste:

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<sup>15</sup> Central Bank of Timor-Leste. 2013. *Spurring Growth: Master Plan for Financial Sector Development in Timor-Leste, 2014–2025*. Dili.

<sup>16</sup> Legal and regulatory reforms will be supported through the ADB-cofinanced Pacific Private Sector Development Initiative. <http://www.adbpsdi.org>

- (i) **Knowledge.** Knowledge will be used in sector operations to address the cross-cutting challenges of economic competitiveness, inclusive growth, fiscal sustainability, RCI, and environmental sustainability. A mapping of knowledge gaps and knowledge priorities for each CPS sector is summarized in the country knowledge plan.<sup>17</sup> The plan identifies practical actions to better integrate knowledge into the operations cycle; build links with non-state actors; enhance knowledge coordination; facilitate access to international experience; and strengthen the dissemination, monitoring, and evaluation of knowledge support. The country knowledge plan will be updated regularly to maintain relevance.
- (ii) **Private sector development.** Sector projects will address the most binding constraints to private sector development, including poor connectivity, skills shortages, and limited access to finance. ADB will help the government leverage private sector expertise to improve service delivery, and to improve the legal and regulatory framework for business. Targeted knowledge solutions will provide actionable policy advice on economic diversification and development of non-oil exports such as coffee. ADB will seek to use private sector operations such as loans, equity investments, and credit enhancement, to accelerate development of the private sector. It will work with the government and other stakeholders on the possibility of replicating the Pacific Business Investment Facility in Timor-Leste.<sup>18</sup>
- (iii) **Governance and capacity development.** ADB will continue to advocate transparency and good governance. As far as possible, country systems will be used for project preparation and project implementation. ADB's sector programs will support gradual government-led capacity development and delegation of certain functions to the private sector. ADB will support the shared use of PMUs by multiple development partners and the increasing integration of PMUs into their host ministries. ADB will also help the government to design and implement public-private partnerships and outsourcing arrangements that improve service quality outcomes and reduce public sector capacity requirements.
- (iv) **Partnerships.** ADB will strengthen its partnerships with civil society, the private sector, and international development partners. It will explore opportunities to increase civil society participation in project design and implementation, and invite civil society partners to take part in biannual updates on ADB's program and activities. Partnerships with the private sector will be strengthened through collaboration on knowledge work relating to private sector development and economic diversification. ADB will continue to help the government coordinate development assistance in the infrastructure subsectors and encourage closer partnerships among development partners on critical sector issues such as investment planning and O&M. ADB will work to secure cofinancing for investments in infrastructure services and education.
- (v) **Environmental sustainability.** ADB will help Timor-Leste to achieve environmental sustainability by strengthening the legal and regulatory frameworks for environmental protection and building government capacity for implementation. ADB-supported programs will ensure long-term environmental sustainability by making use of the latest technologies to climate proof new infrastructure and make services resilient to the possible impacts of natural disasters. ADB will also help Timor-Leste access

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<sup>17</sup> Country Knowledge Plan (Summary) (accessible from the list of linked documents in Appendix 2).

<sup>18</sup> Pacific Business Investment Facility. <http://bifadb.org/>

additional resources for environmental management and climate change mitigation from global financing mechanisms.

- (vi) **Gender equity.** ADB will continue to incorporate support for gender equality in its infrastructure investments and TA programs. Support for education and urban and municipal services will address key areas in which women are disadvantaged, including access to employment, clean water, and improved sanitation. Sector- and project-specific gender analysis will support the development of gender actions plans with measurable indicators.

### III. STRATEGY IMPLEMENTATION

#### A. Indicative Resource Parameters

26. Timor-Leste is a group B developing member country with access to concessional ordinary capital resources lending and market-based ordinary capital resources lending (MOL).<sup>19</sup> During 2016–2019, the indicative allocation for concessional ordinary capital resources lending is \$102.84 million while that for MOL is \$225.00 million. Timor-Leste is assessed as being at low risk of debt distress.<sup>20</sup> ADB will be able to provide up to 99% of loan and TA funding where required, but it will encourage the Government of Timor-Leste to continue to provide high levels of counterpart financing to leverage ADB systems and ensure government ownership. Cofinancing with the Global Environment Facility to support climate proofing of upgraded roads is in place, and additional cofinancing will be sought.

#### B. Program Overview

27. ADB-financed investments will focus on strengthening infrastructure services and developing skills that are relevant to a growing economy. An indicative lending pipeline is presented in the country operations business plan (COBP).<sup>21</sup> The composition of the investment portfolio is expected to change significantly. While further investments in road transport are planned, the proportion of the portfolio that is allocated to this subsector will decline as investment in other sectors is scaled up. Substantial investments are planned for improved water supply and municipal services in Dili and other urban centers. Support for a new policy and regulatory framework in the energy sector will be followed by a loan-financed investment to improve operational efficiency and financial performance, and to expand access. In the education sector, ADB will help develop a policy framework for technical education and support linkages between training providers and employers. ADB will mobilize grant financing to support education and will consider providing loan financing for the sector if requested.

28. TA programs will address cross-cutting themes and provide knowledge support to ADB's sector operations. Knowledge activities will be coordinated around the five priority themes of economic competitiveness, inclusive growth and development, fiscal sustainability, RCI, and

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<sup>19</sup> Terminology reflects the combination of Asian Development Fund lending operations with the ordinary capital resources balance sheet that will take effect on 1 January 2017. For 2016, concessional ordinary capital resources lending and MOL should be understood as Asian Development Fund lending and ordinary capital resources lending.

<sup>20</sup> International Monetary Fund. 2013. *Democratic Republic of Timor-Leste: Staff Report for the 2013 Article IV Consultation*. Washington, DC.

<sup>21</sup> Country Operations Business Plan (accessible from the list of linked documents in Appendix 2).

environmental sustainability. An indicative nonlending pipeline is presented in the COBP. Regional TA programs will support trade facilitation, private and financial sector development, and economic policy. Ongoing TA programs will support preparations for ASEAN accession and capacity development in the infrastructure sector; ADB will also provide TA to strengthen national safeguard systems.<sup>22</sup> The Timor-Leste Resident Mission will support the efficient implementation of a growing portfolio and will participate in policy dialogue on infrastructure management, governance, economic policy, and private sector development.

#### IV. RESULTS MANAGEMENT

##### A. Monitoring

29. The CPS and COBP results frameworks are the main tools for monitoring implementation and will be updated annually.<sup>23</sup> Systems to monitor investment projects will be strengthened to track project activities and outputs. Enhanced monitoring will be used to provide regular updates on project implementation to the government, civil society, and other development partners through the Timor-Leste development partner coordination mechanism and any successor mechanisms for project monitoring and development partner coordination.

##### B. Risks

30. Despite recent progress, public sector capacity remains limited.<sup>24</sup> Recent assessments identified significant weaknesses in the systems for planning, implementation, and O&M of public investments.<sup>25</sup> These weaknesses create a risk that public investment will fail to address the key constraints to inclusive growth and will undermine long-term fiscal sustainability. ADB will help the government to manage these risks by supporting the selection and preparation of projects with high economic rates of return, building capacity for project implementation, and helping the government to leverage private sector expertise for O&M.

31. ADB will help strengthen systems for public financial management, procurement, and corruption prevention. Well-staffed PMUs will support project implementation and capacity development. A shift to funding PMUs through budget appropriations will strengthen links to national systems but risks undermining effectiveness if funding is delayed or insufficient. As the public sector delegates maintenance and service delivery functions to the private sector, it must build capacity in contract management. Loans and technical assistance will pay particular attention to these demands, including regulatory needs.

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<sup>22</sup> ADB. 2012. *Technical Assistance to the Democratic Republic of Timor-Leste for Infrastructure Management*. Manila.

<sup>23</sup> The CPS results framework is in Appendix 1. The country assistance results area is in Appendix 1 of the COBP (accessible from the list of linked documents in Appendix 2).

<sup>24</sup> Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

<sup>25</sup> World Bank and Government of Timor-Leste, Ministry of Finance. 2015. *Timor-Leste Public Expenditure Review: Infrastructure*. Dili; Pohl Consulting & Associates. 2014. *Repeat Public Expenditure and Financial Accountability Assessment 2013: Timor-Leste*. Berlin.





CPS Objectives and Related Impacts	CPS Priority Areas	Key Outcomes that ADB Contributes to	Outcome Indicators	CPS Resources
	Environmental sustainability	Climate proofing of new and existing infrastructure  Application of social and environmental safeguard  Increased use of renewable energy resources and clean fuels	Level of unaccounted water supplied in Dili reduced to 30% by 2020 (2014 baseline: 96%) <sup>b</sup>  Climate resilience incorporated into all ADB-supported project designs <sup>d</sup>  At least 20% of electricity generated from sources other than diesel by 2020 (2014 baseline: 0%) <sup>b</sup>	
(ii) Improved human capital	Technical education    Urban water supply and other services	A skilled workforce with improved technical and vocational training   Increased access among urban households to reliable clean drinking water supplies  Improved environmental health conditions in urban centers	Proportion of technicians with secondary and post-secondary qualifications increased to 50% by 2030 (2010 baseline: 30%) <sup>e</sup>  Urban residents' access to improved water supply increased to 100.0% by 2030 (2014 baseline: 94.5%) <sup>j</sup>  Urban residents' access to improved sanitation increased to 100.0% by 2030 (2014 baseline: 86.4%) <sup>f</sup>	
(iii) A more diversified and productive economy	Business-enabling environment    Finance sector development	Improved legal and regulatory frameworks for private investment, production, and trade   Improved availability and efficiency of financial services	Compliance with binding ASEAN legal agreements increased to 100.0% by 2020 (2015 baseline: 1.6%) <sup>g</sup>  ASEAN Economic Community Scorecard reaches 100 by 2020 <sup>g</sup>  Ratio of bank credit to the private sector to non-oil GDP increased to 70% by 2025 (2013 baseline 12.6%) <sup>h</sup>	

CPS Objectives and Related Impacts	CPS Priority Areas	Key Outcomes that ADB Contributes to	Outcome Indicators	CPS Resources
	Regional integration	Regional economic integration and market linkages	Proportion of adult population with a bank account increased to 90% by 2025 (2013 baseline 16.6%) <sup>h</sup>  Annual average direct investment from ASEAN+6 countries increased from \$25 million (2011–2014) to \$50 million (2016–2020) <sup>m</sup>	

ADB = Asian Development Bank; ASEAN = Association of Southeast Asian Nations; ASEAN+6 = ASEAN, Australia, the People's Republic of China, India, Japan, Republic of Korea, and New Zealand; COL = concessional ordinary capital resources lending; CPS = country partnership strategy; GDP = gross domestic product; km = kilometer; MOL = market-based ordinary capital resources lending; PPP = purchasing power parity; TBC = to be confirmed; TEU = twenty-foot equivalent unit.

<sup>a</sup> Indicator calculated using a weighted average of travel times between the national and district capitals based on road condition data from the Government of Timor-Leste, Ministry of Public Works, Transport and Communications.

<sup>b</sup> Government of Timor-Leste, Ministry of Public Works, Transport and Communications.

<sup>c</sup> Government of Timor-Leste, Ministry of Finance, External Loan and Public-Private Partnerships Unit.

<sup>d</sup> Excludes nonsovereign financing operations, technical assistance, and performance-based lending.

<sup>e</sup> Government of Timor-Leste, Ministry of Finance and Secretariat of State for Vocational Training, Policy and Employment. 2015. *Timor-Leste Labour Force Survey 2013*. Dili. [http://www.statistics.gov.tl/wp-content/uploads/2015/04/LFS\\_2013\\_ENGLISH\\_VERSION.pdf](http://www.statistics.gov.tl/wp-content/uploads/2015/04/LFS_2013_ENGLISH_VERSION.pdf)

<sup>f</sup> Baseline estimates have been extrapolated using logit transformation estimation methods based on national survey estimates during 2001–2010.

<sup>g</sup> Government of Timor-Leste, Ministry of Foreign Affairs and Cooperation, Ministry of Justice, Coordinating Ministry of Economic Affairs.

<sup>h</sup> Central Bank of Timor-Leste. 2013. *Spurring Growth: Master Plan for Financial Sector Development in Timor-Leste, 2014–2025*. Dili.

<sup>i</sup> Timor-Leste Specialized Investment Agency.

Sources: (i) Central Bank of Timor-Leste. 2013. *Spurring Growth: Master Plan for Financial Sector Development in Timor-Leste, 2014–2025*. Dili; (ii) Government of Timor-Leste. 2011. *Timor-Leste Strategic Development Plan, 2011–2030*. Dili; (iii) Government of Timor-Leste, Ministry of Education. 2011. *National Education Strategic Plan, 2011–2030*. Dili; (iv) Government of Timor-Leste, Ministry of Finance, General Directorate of Statistics. 2010. *Timor-Leste Demographic and Health Survey, 2009–10*. Dili; (v) Government of Timor-Leste, Ministry of Finance, General Directorate of Statistics; and United Nations Population Fund. 2011. *Population and Housing Census 2010: Suco Report. Volume 4*. Dili; (vi) Timor-Leste Specialized Investment Agency, 2015. *Final List of Approved Investments, 2006–2014*; (vii) World Bank. 2015. *World Development Indicators 2015*. Washington, DC; (viii) ADB estimates.

### LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/CPS/?id=TIM-2016>

1. Economic Analysis (Summary)
2. Poverty Analysis (Summary)
3. Gender Analysis (Summary)
4. Environment Assessment (Summary)
5. Private Sector Assessment (Summary)
6. Sector Assessment (Summary): Transport (Road Transport [Nonurban])
7. Sector Assessment (Summary): Transport (Water Transport [Nonurban])
8. Sector Assessment (Summary): Water Supply and Other Urban Infrastructure and Services
9. Sector Assessment (Summary): Education
10. Sector Assessment (Summary): Energy
11. Sector Assessment (Summary): Finance
12. Sector Assessment (Summary): Agriculture, Natural Resources, and Rural Development
13. Risk Assessment and Risk Management Plan (Summary)
14. Social and Environmental Safeguards Assessment (Summary)
15. Regional Cooperation and Integration Assessment (Summary)
16. Country and Portfolio Indicators
17. Country Performance Assessment Ratings
18. Country Cost-Sharing Arrangements and Eligible Expenditure Financing Parameters
19. Country Partnership Strategy Formulation
20. Country Partnership Strategy Final Review
21. Country Operations Business Plan, 2016–2018
22. Country Knowledge Plan (Summary)
23. Supplementary Self-Evaluation of Timor-Leste: Country Partnership Strategy Final Review, 2011–2015
24. Country Partnership Strategy Final Review Validation, 2011–2015

#### Supplementary Documents

25. Fragility Assessment in Timor-Leste (Summary Report)
26. Timor-Leste Strategic Development Plan, 2011–2030