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PROGRAM ASSISTANCE

THE DEMOCRATIC REPUBLIC OF TIMOR-LESTE

COUNTRY CASE STUDY



Acknowledgements

Research provided by Jeff Malick, Anne Beasley, and Andrew Melnyk of USAID's Development Information Services project. Technical contribution provided by Shinichi Mizuta, Mitsubishi Research Institute.

Related Publications

General Budget Support: An Alternative Assistance Approach. Mozambique Country Case Study. PPC Evaluation Working Paper No. 18, August 2004. <http://www.dec.org/pdf_docs/PNACW878.pdf>

General Budget Support; An Alternative Assistance Approach. Nicaragua Country Case Study. Forthcoming.

General Budget Support and Sector Program Assistance: Malawi Country Case Study. PPC Evaluation Working Paper No. 19. November 2004. <http://www.dec.org/pdf_docs/PNADA999.pdf>

General Budget Support in Tanzania: A Snapshot of Its Effectiveness. April 2004. <http://www.dec.org/pdf_docs/PNADA029.pdf>

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Editorial, design, and production assistance was provided by IBI-International Business Initiatives, Arlington, VA, under contract no. HFM-C-00-01-00143-00. For more information, contact IBI's Publications and Graphics Support Project at 703-525-2224 or pgsp@ibi-usa.

Cover photo: About 85 percent of Timor-Leste's poor lived in rural areas in 2001. Though education levels are low, the primary school enrollment rate is about 76 percent. Education is one of the priorities of Timor-Leste's national budget and its donor-supported Transition Support Program. © Daniel J. Groshong, Centro de Fotografia

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Abbreviations

AAP	annual action plan (Timor-Leste)
ADB	Asian Development Bank
ADS	Automated Directives System (USAID)
BPA	Banking and Payments Authority (Timor-Leste)
CDIE	Center for Development Information and Evaluation (USAID)
CFET	Consolidated Fund for East Timor
DAC	Development Assistance Committee (OECD)
DFID	Department for International Development (UK)
DIS	Development Information Services
FY	fiscal year
GBS	general budget support
IMF	International Monetary Fund
MPF	Ministry of Planning and Finance (Timor-Leste)
NDP	National Development Plan (Timor-Leste)
NGO	nongovernmental organization
OECD	Organisation for Economic Co-operation and Development
SWAp	sector wide assistance program
TFET	Trust Fund for East Timor
TSP	Transition Support Program (Timor-Leste)
UNDP	United Nations Development Programme
UNMISSET	United Nations Mission in Support of East Timor
UNTAET	United Nations Transitional Administration in East Timor

Executive Summary

This study, initiated by USAID's Center for Development Information and Evaluation (CDIE) and conducted with the Government of Japan, is one of a five-part USAID series on program (or nonproject) assistance.¹ The study's objectives were to review the Democratic Republic of Timor-Leste's experience with program assistance, determine its appropriateness as a method of disbursing aid, and identify country conditions that favor

for development, based on an agreed program. Since countries with weak and unaccountable governments, low capacity, or insufficient public financial management are usually poor candidates for GBS—as are those with systematic or large-scale corruption and inadequate or nonexistent monitoring and evaluation systems and audit agencies—these factors were evaluated in the course of examining Timor-Leste's two-year experience with its donor-funded Transition Support Program (TSP).²

GBS aims to shift the responsibility of development from donors to host governments by providing flexible resources for development, based on an agreed program.

this kind of assistance. The study's conclusions may be applicable to similar postconflict countries or, more generally, to countries where donors are considering program assistance as their main strategy.

The study team, fielded by CDIE's Development Information Services project, also reviewed definitions of program assistance, a category that encompasses general budget support (GBS). GBS aims to shift the responsibility of development from donors to host governments by providing flexible resources

The TSP is perhaps best categorized as GBS, though USAID does not regard Timor-Leste as a GBS-recipient country and classifies its own support for the TSP as project assistance. Other donors may categorize Timor-Leste's TSP differently. As the primary program using GBS in Timor-Leste, the TSP is funded by the World Bank and 10 bilateral donors, and coordinated and managed by the World Bank. Donations for the 2003–05 period totaled approximately US\$91 million, including USAID's contribution of \$12 million. The Agency transferred these funds to the Bank in the form of a grant to be placed in a World Bank-managed account, and they were later disbursed to the Government of Timor-Leste in the

¹ Other countries studied are Mozambique, Malawi, Tanzania, and Nicaragua. The Tanzania study was initiated by USAID's Bureau for Africa.

² The study team's conclusions were informed by three weeks of in-country work, an extensive literature review, and numerous interviews with Timor-Leste government officials, donors, NGOs, and individuals in Timor-Leste and Washington, D.C.

form of GBS (or program assistance). However, from a legal perspective, USAID regards its contribution to the TSP as project assistance, not GBS, since resources are in the form of a grant to a multilateral institution and not directly channeled to the recipient government.

Local NGOs are not involved in TSP consultation in a systematic or meaningful way. The task of involving a large and diverse group in an organized, representative, and substantive manner presents a challenge, requiring effort by the NGO community in concert with the host government and donor community.

Timor-Leste was chosen as a case study for the following reasons:

- It is a new, postconflict country, with a new government, new institutions, little revenue outside of foreign assistance, and the need for financial resources to be provided through a flexible instrument.
- Timor-Leste's human and administrative capacity are especially low, forcing the government to rely on large numbers of foreign advisors and staff.
- There is little tradition of entrepreneurship, and few natural resources that can be exploited.
- Unlike most postconflict countries, there is stability and little chance of renewed violence.
- Offshore oil and gas deposits are expected to generate significant revenue, most likely by 2007.

The Government of Timor-Leste faces a limited time period in which to build sufficient capacity to effectively man-

age oil revenues. This provides further incentive to manage funds responsibly and deepens government commitment to development. The expectation of oil revenues offers the government and donors a natural and obvious exit strategy for discontinuing GBS. In part, this exit strategy is based on Timor-Leste having the foundational capacity to manage its budget, albeit with the assistance of expatriate advisors.

TSP donors have been concerned about Timor-Leste's high incidence of poverty, rudimentary human resource base, shortage of government revenue, and the expectation of oil revenues. As a result, the TSP aims to provide a temporary source of funding to augment government revenue, enable implementation of Timor-Leste's National Development Plan, and build sufficient government capacity to appropriately manage future oil and gas revenues.

Because of the government's heavy reliance on foreign assistance to fund recurrent and capital expenditures, reconstruction, and development, donors engaging in policy dialogue have considerable influence. This is especially true of the TSP, where program design has facilitated frequent discussion and donor harmony and coordination are reportedly excellent. Much of the success of the TSP may also be attributed to donor actions and, specifically, to World Bank oversight and program design. The Bank's close involvement in TSP implementation and monitoring provides other donors with an effective way of managing their assistance with minimal staff support. Host government officials and bilateral donors found the program relatively easy to manage and the current

method of reporting and administration satisfactory.

Though there is no explicit conditionality, donors and high-level Timor-Leste government officials meet biannually to review progress and set new goals and priorities. Donors discuss issues of importance in a forum where they voice their concerns. When agreement is reached, goals and priorities are placed on an action matrix, which is used to plan the following year.

An area of interest to donors and line ministries is the degree to which authority to expend funds is delegated by Timor-Leste's Ministry of Planning and Finance. Its vice minister coordinates TSP implementation and prepares quarterly reports for the Bank and other donors that—along with extensive biannual reviews—serve as a monitoring tool and help to achieve donor coherence and harmony. From the host government's perspective, the reviews and strong donor harmony are a source of pressure that encroaches on its sovereignty to some degree. But the Timor-Leste government has manifested ownership of the TSP's agenda-setting process, evidently viewing the action matrix and its objective setting as a policymaking tool as much theirs as the donors, notwithstanding the rigor of the review process.

Nevertheless, though the Government of Timor-Leste has had insufficient experience to state a strong preference for particular types of assistance, it is leaning toward projects. When managed jointly with donors, projects are viewed as a means of providing needed capacity building assistance.

Although TSP donors had some concerns about fiduciary risk, they consistently report that the current system of public expenditure is sound and that the incidence of corruption is minimal and low level. The capacity building aspects of the TSP were crucial to instilling public expenditure management skills within the new government and its fledgling institutions. In Timor-Leste's postconflict environment, this capacity building (largely under World Bank auspices) was key to engendering donor support for the TSP. Indeed, this type of capacity building ought to be considered in countries where donors intend to channel large amounts of assistance through a GBS mechanism.



Introduction

Study Objectives and Methodology

This study reviews Timor-Leste's experience with program assistance, including the use of general budget support (GBS) for its Transition Support Program (TSP). The study analyzed whether GBS has been an effective and appropriate method of disbursing aid and sought

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to identify country conditions that led many donors to allocate a substantial portion of their foreign assistance in this way. The study was one of a five-part series that examines GBS. Other countries studied for the series were Mozambique, Nicaragua, Malawi, and Tanzania. This study also looked at factors contributing to the success of program assistance tools. In Timor-Leste, this consisted principally of GBS, which provides financial support to the government's national budget rather than to specific sectors. The TSP focuses on the implementation of a development plan and does not entail conditionality.

The study team, fielded by USAID's Center for Development Information and Evaluation's (CDIE) Development Information Services (DIS) project, comprised three researchers from DIS and one from the Mitsubishi Research Institute, who was a contractor to the Government of Japan. The DIS project director led the study team, which was accompanied by a research fellow (sponsored by the World Bank) from the UK's Institute of Development Studies during one week of in-country work.

The team reviewed an array of documents and conducted extensive interviews with donors, NGOs, private individuals, and Government of Timor-Leste officials in Washington, D.C., and Timor-Leste. The literature review and interviews gathered information regarding the selection, design, and effectiveness of the TSP. The review included program assistance in general, the TSP, Timor-Leste's recent political history and economy, and donor programs. Preliminary interviews in preparation for in-country work were conducted in Washington, D.C., with World Bank staff involved in the design and implementation of the TSP, USAID personnel involved with Timor-Leste programs, and the deputy chargé d'affaires of the Embassy of Timor-Leste.

Field work (August 24–September 11, 2004) encompassed 34 interviews with 66 people, including private Timor-

Leste citizens and representatives of government ministries, donor organizations, and NGOs (annex 4). Subsequently, questions were raised with Japan's Ministry of Foreign Affairs to gain insight into its commodity support program for Timor-Leste.

GBS and Its Definitions

To effectively tailor development assistance to a country's needs, USAID and other donors may choose one or more modalities. In addition to traditional project assistance, donors and host governments may opt for a form of program assistance, including GBS, balance of payments support, sector program assistance, a commodity import program, or a sector wide approach (SWAp).³ Within the international development community, definitions of GBS vary, as do notions of how it differs from other forms of program assistance. But, unlike other forms of assistance entailing conditionality, GBS is usually based on performance.

USAID divides foreign assistance into project assistance and program assistance (sometimes referred to as nonproject assistance). Program assistance is of two types: sector program assistance (SPA) and balance of payments support (fig. 1). Though USAID recognizes that balance of payments support and GBS are separate tools, definitions in USAID's official guide to policies and procedures do not address them separately and implies the two are closely related (USAID 2004b). The guide offers no official

USAID definition for direct budget support.

Unlike USAID, the network on development evaluations of the Development Assistance Committee (DAC) of the Organisation for Co-operation and Development (OECD) adopted a specific definition for GBS, one that divides program aid into food aid and financial program aid (DFID 2004). This definition further subdivides financial program aid into budget support (sometimes referred to as direct budget support) and balance of payments support (such as debt relief and import support). According to the DAC network, there are two types of budget support: GBS and sector budget support (fig. 2).

Why the Interest in GBS?

Some donor observers believe that traditional, bilateral, donor-managed projects have several disadvantages. First, project assistance can potentially limit hostcountry ownership of the development process and, as a result, hostcountry commitment. Second, though host governments are often better able than donors to identify critical development priorities, they are in less of a position to do so when project assistance is used. Finally, transaction costs associated with project assistance may be higher than with program assistance, for both donors and recipients. For these reasons, many projects are seen as inappropriate and unsustainable, affecting both the return to donor investment and long-term development.

When recipients have greater control over how money is spent, as well as greater flexibility, the responsibility of

Figure 1: USAID Categorization of Program Assistance

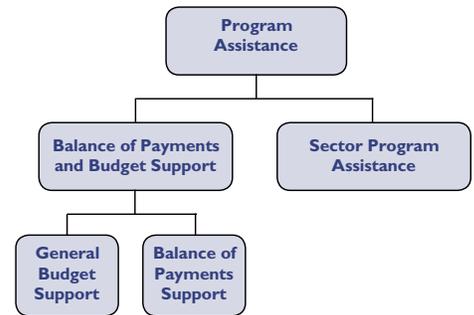
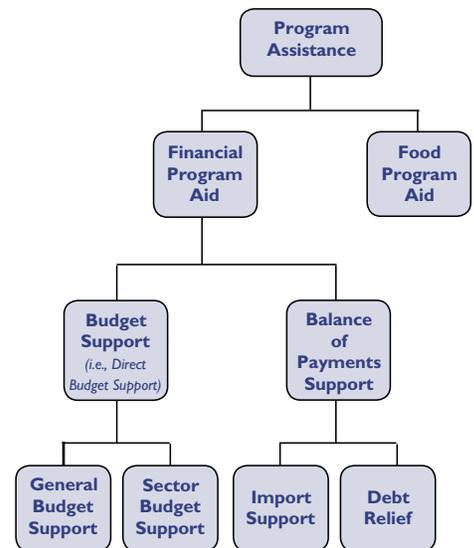


Figure 2: OECD/DAC Categorization of Program Assistance



managing development shifts from donors to host governments. Governments assume a more active role in their own development, gain greater ownership of the process, and become more committed to sustaining progress. With greater control, host governments are better able to identify development priorities, and development programs are likely to be more efficiently managed. The primary objectives of GBS are to provide flex-

³ See annex 1 for explanations of these program assistance mechanisms and more detailed definitions of GBS.

ible resources for development, based on an agreed program, and to encourage recipient governments to take a more active role in their own development.

Proponents point to additional advantages of GBS. Specifically, they say GBS will

- harmonize and align bilateral aid with the host government's budget and policy priorities and improve donor coordination
- foster policy dialogue between donors and recipients to reform overall government policies and budget priorities, rather than concentrating resources on individual projects or sectors with little or no discussion of policy
- improve the efficiency of public expenditure management by not pursuing unnecessary or low-priority bilateral aid projects
- foster, encourage, and support government accountability
- reduce long-term management costs for donors because fewer bilateral aid projects will be funded
- reduce management costs for host governments because there will be fewer donor projects and reporting requirements

For GBS to be effective, however, host governments must be capable of responsibly managing donor funds. Countries with weak and unaccountable governments, low capacity, or insufficient public financial management are usually poor candidates for GBS. The same is true of countries with systematic or large-scale corruption and inadequate or

nonexistent monitoring and evaluation systems and audit agencies.

Understandably, many donors have reservations about providing large cash transfers to countries that lack the essential capability of adequately accounting for funds. Among specific concerns are

- budget discipline and the quality of financial management and financial management systems
- corruption and misappropriation of funds
- the presence and use of skilled managers and technicians
- whether the finance ministry is willing and able to manage budget allocation efficiently and transparently
- whether the central government is interested in empowering civil society and the private sector
- the potential or tendency for GBS to encourage centralization of resources, potentially harming grassroots development
- whether donors have opportunities to consult directly with line ministries and encourage policy reform at the sector level

GBS in Timor-Leste

The study team found that the GBS that funds the World Bank-led TSP provided a measure of ownership to the Government of Timor-Leste and further strengthened a commitment to government-identified development priorities. However, because Timor-Leste is a new nation with scant donor experience, the study team found it difficult to make

conclusive statements about the effectiveness of long-term projects. Many high-level Timorese government officials interviewed feel that project-funded assistance may be preferable to GBS once steady oil resources are generated, but only in specific contexts. GBS and project assistance are seen as complements, not substitutes.



Political and Economic Overview of Timor-Leste

Recent Political Events

In 1975, Indonesia occupied and annexed East Timor, a small, poor Portuguese colony with a population of about 500,000. For 20 years, the Timorese Front for National Liberation resisted the occupation and the country's status as a province of Indonesia. After the Suharto regime fell in May 1999, the new Indonesian government asked the United Nations to supervise a referendum to decide East Timor's future.

Despite heavy reliance on assistance, an overt mentality of aid dependence is not evident.

On August 20, 1999, the Timorese overwhelmingly rejected autonomy in favor of independence, but promptly faced opposition by organized militias supported by Indonesia's military leaders. The resistance proved devastating: thousands of Timorese were murdered, more than half the population was internally displaced, and another 150,000 were forced into the Indonesian territory of West Timor. Infrastructure was affected, and over 70 percent of the country's public structures were destroyed.⁴

⁴ In spite of significant reconstruction, damaged and burned-out buildings are still evident throughout Dili, the capital city.

After two weeks of violence, a UN peacekeeping force was deployed. In October 1999, the Indonesian government declared the 1975 annexation void, opening the door to the establishment of the United Nations Transitional Administration in East Timor (UNTAET). Until May 20, 2002, when Timor-Leste became an independent country,⁵ the UN administered the peace, and UNTAET was the de facto government.

The UN maintains a small peacekeeping force in the country. The country has a sovereign parliamentary form of government, which functions with a president and prime minister, both of whom are committed to tackling the country's many economic and social challenges.

Though Timor-Leste is a new postconflict country, there is little prospect of a return to ethnic violence. The government enjoys universal support and little political opposition. Because the population has been unified by the struggle for independence, the commitment to development is strong.

Economic and Social Status

Despite heavy reliance on assistance, an overt mentality of aid dependence is not evident. However, under Indonesian and Portuguese rule, personal initiative

⁵ Timor-Leste's official name is now the Democratic Republic of Timor-Leste.

and entrepreneurship were not encouraged. This is evidenced by the limited number of Timorese-owned businesses and the underutilization of fertile farmland. The country lacks a significant domestic private sector to generate tax revenues and employment.

Though Timor-Leste's economy grew 8 percent in 2000 and 13 percent in 2001, much of this growth was attributed to a significant international presence—now diminishing—and immediate postconflict reconstruction. Real GDP growth slowed to an estimated 3 percent in 2002, and the economy contracted by 3 percent in 2003. Growth in 2004 was projected at 1 percent (IMF 2004a, 10). However, Timor-Leste's large offshore oil and gas deposits will provide a major boost to the economy within several years.

The official currency of Timor-Leste is the U.S. dollar, which helps avoid monetary issues that the government is not yet equipped to handle. But use of the dollar also means that the government has little control over domestic monetary policy and exchange rates. Though national coins with a one-for-one value with the U.S. dollar have been issued, there are no plans to introduce a new national currency in the short term. The Banking and Payments Authority (BPA), officially the central bank, oversees Timor-Leste's four commercial banks but has little control over money supply.

Timor-Leste household surveys in 2001 indicated a poverty incidence of 41 percent; about 85 percent of the poor live in rural areas. Education levels are low, and only about 43 percent of the

population are literate. Though primary school enrollment rates have increased to about 76 percent, universal primary education has not been achieved and educational quality is poor. Though official data is unavailable, donors estimate that the unemployment rate in Dili may be as high as 20 percent, and 43 percent for young males. Life expectancy is estimated at 57, and infant mortality is high—80 per 1000 live births. Malaria and TB, the two most serious diseases in Timor-Leste, are commonplace. Given these problems, health, education, and urban works have priority in the national budget. Since independence, 35 percent of these budgets has been allocated to health and education.

Other than oil and gas, coffee is Timor-Leste's largest export and is marketed to Australia, Europe, Japan, and the United States. According to some donor experts, live animals, candlenut oil, and copra have export potential. Neighboring countries—particularly Indonesia—are the largest prospective markets, though Indonesian trade barriers hamper exports and encourage smuggling, and Australia has highly restrictive regulations governing agricultural imports.

Wage policies enacted during the UN administration, a high demand for labor during that time, and a fairly large and well-paid civil service distorted Timor-Leste's labor market, eroding the country's potential comparative advantage of inexpensive, unskilled labor. Wages considerably higher than in Indonesia are thus potentially a disincentive for foreign investment. Additionally, the high cost of electricity (\$0.20/kWh), the absence of a regulatory framework and leasing regulation, and an inefficient

judicial system are major constraints to private sector development. Nevertheless, the Government of Timor-Leste secured a production-sharing agreement with foreign investors for the Bayu-Undan oil and gas fields. Timor Telecom has also attracted investment, and the banking and insurance sector is expected to do so as well.

Oil Revenues

Through an interim arrangement with Timor Leste's Joint Development Authority, oil production at the Bayu-Undan fields is already well underway. Production has also started at the Greater Sunrise field, which holds even greater oil deposits. Once international agreements with Australia are resolved, Timor-Leste's oil and gas resources are expected to generate significant revenues that, if managed wisely, will reduce the country's dependence on donor assistance. Timor-Leste's oil and gas reserves are expected to provide revenues for about 20 years.

Most recent estimates report that oil and gas revenues totaled US\$29.5 million in fiscal year (FY) 2002–03.⁶ Though much depends on world oil prices, projected total revenues for FY 2004–05 are approximately \$44.2 million (IMF 2004c, 22). If the market price of oil or gas increases, Timor-Leste's dependence on donors will diminish, along with donors' influence on policy. However, if this occurs before Timor-Leste builds sufficient capacity to manage oil revenues, a "resource curse" becomes a potential danger. The prospect of

⁶ The Government of Timor-Leste's fiscal year runs from July 1 to June 30.

significant oil revenues will be a mixed blessing if government spending exceeds absorptive capacity and incurs unsustainable recurrent expenditures, or if fiduciary integrity is compromised.

Timor-Leste seems determined to avoid this resource curse, which is common in many developing countries rich in natural resources. With assistance from the International Monetary Fund (IMF), the Government of Timor-Leste is establishing a petroleum fund based on the Norwegian model. This fund was expected to be established by December 2003, but mid-2005 appears more likely. The government has clearly stated that accountability and transparency will be the cornerstones of the fund. Donors, the IMF, and most NGOs find this a credible assessment.

The National Development Plan

During the preparation of Timor-Leste's National Development Plan (NDP), the government consulted a significant cross-section of society, including national and international NGOs, private and public sector groups, and the church. By some estimates, up to 40,000 individuals were involved in the process in some way. In close collaboration with foreign advisors, the NDP's long-term vision for Timor-Leste was designed by 120 senior government officials, and the plan is held in high regard by donors and government officials.

The NDP is a comprehensive document, similar to a poverty reduction strategy paper, that presents an ambitious development strategy and outlines specific long-term goals and objectives.

It focuses primarily on institutional development, particularly providing basic education, health, and infrastructure. It also concentrates on job creation, improved governance, and sustained internal security. Though numerous goals are presented, the overriding short-term objectives for FYs 2002–06 are poverty reduction and rapid, equitable, and sustainable economic growth. As is typical of most poverty reduction strategies, the NDP does not offer specifics on implementation or adequately prioritize objectives. It does, however, offer a much needed visionary framework for the TSP and provides Timorese with a sense of ownership of their own development.

Donor Role and Coordination

Donor involvement began with an informal meeting in September 1999 to identify postconflict assistance strategies and programs for Timor-Leste. Timorese representatives, bilateral donors, and UN agencies participated. In December, donors pledged \$520 million and endorsed two separate funds administered by different international development agencies. Approximately \$343 million of this amount was administered by the UN prior to independence; the remaining \$177 million was managed by the World Bank and the Asian Development Bank (ADB).

The UN-administered fund financed recurrent expenditures, while the World Bank and ADB fund—known as the Trust Fund for East Timor (TFET)—was used for reconstruction and rehabilitation projects. With independence and the departure of

the UN transitional authorities, the recurrent-cost fund was handed over to the Timorese. It is now known as the Consolidated Fund for East Timor (CFET), and the TSP forms a part of it. However, some residual reconstruction and rehabilitation projects continue to be funded by TFET, which is considered separate from the CFET budget.

Under TFET, monthly donor meetings to monitor reconstruction progress and biannual donor meetings set the tone for donor harmony and established a precedent for good coordination. Because donor offices are based in the small city of Dili, informal and highly collegial relationships between donors were easily established and greatly reduced the burden of coordination on the new government, whose main priorities were establishing stability and restoring normalcy.

As a management strategy, the World Bank pooled donor resources for postconflict reconstruction, contributing to donor harmony and management efficiency. Though local ownership varied by project, Timorese were involved in project design and the staffing of individual project management units, the usual management mechanism employed by the World Bank and ADB. The study team found that host government officials had greater involvement in the design of the TSP than was the case in some of the reconstruction projects.

In some instances, the short-term, urgent objectives of postconflict reconstruction and rehabilitation and the lack of an official Timor-Leste government resulted in a tradeoff between local ownership and the overall management efficiency of donors. A preliminary

European Commission evaluation of TFET confirms this. Largely because TSP objectives differ from those of TFET, the problem of lack of local ownership has been avoided. Most donors in Timor-Leste currently contribute to the TSP while funding bilateral programs, though the proportion of their assistance devoted to the TSP varies.

The TSP first implemented in 2002–03 is known as TSP I. It continued in 2003–04 as TSP II, and in 2004–05 as TSP III. The Government of Timor-Leste has requested that the program be continued until 2007.

USAID's Role

USAID provided \$41 million to Timor-Leste following the violence and destruction of September 1999. Subsequently, Congress provided an annual earmark of \$25 million, \$4 million of which is committed to the TSP each year for at least three years. USAID funded the TSP through a public international organizational grant to the World Bank for FYs 2002–04. As such, the USAID contribution is considered legally to be an activity or project, though it is (in effect and in all other respects) a form of program assistance.

Apart from the TSP, the USAID supports the revitalization of Timor-Leste's economy and democratic institutions. All work is done under USAID's transition strategy. A new country strategy will continue support for current programs and contribute to health services.

Japan's Role

Japan does not contribute to the TSP, but has provided substantial funding for

postconflict reconstruction and humanitarian assistance since 1999. Priorities include infrastructure, agriculture, and human resource development. Japan is one of the largest bilateral donors, pledging over \$190 million since 1999. It provided approximately \$2.4 million in assistance in 2003 and approximately \$4.5 million in 2004. Grant funds are used to purchase imported commodities, which are sold and proceeds used for program purposes.

Japan has also funded projects to rehabilitate roads, ports, and irrigation and water supply systems. It has extended technical assistance to improve Timorese capacity to maintain these facilities and increase agricultural production capacity. Japan has also provided training courses for civil servants, engineers, and technicians, both inside and outside Timor-Leste.

General Budget Support In Timor-Leste

The Design of the TSP

The foremost considerations of the TSP, which was designed specifically for Timor-Leste, were the country's low administrative capacity, weak human resource base, high incidence of poverty, and expectation of oil revenues. As such, the TSP's goals are to

- provide a source of government revenue until oil and gas revenues are generated
- enable implementation of the NDP
- build sufficient government capacity to appropriately manage future oil and gas revenues

A central feature of the TSP's design is the World Bank's active management and its oversight role in program implementation, monitoring, and accounting.

A central feature of the TSP's design is the World Bank's active management and its oversight role in program implementation, monitoring, and accounting. The size of TSP in relation to the overall budget gives the World Bank and other donors sufficient leverage to effectively fulfill this role.

Donors and the TSP

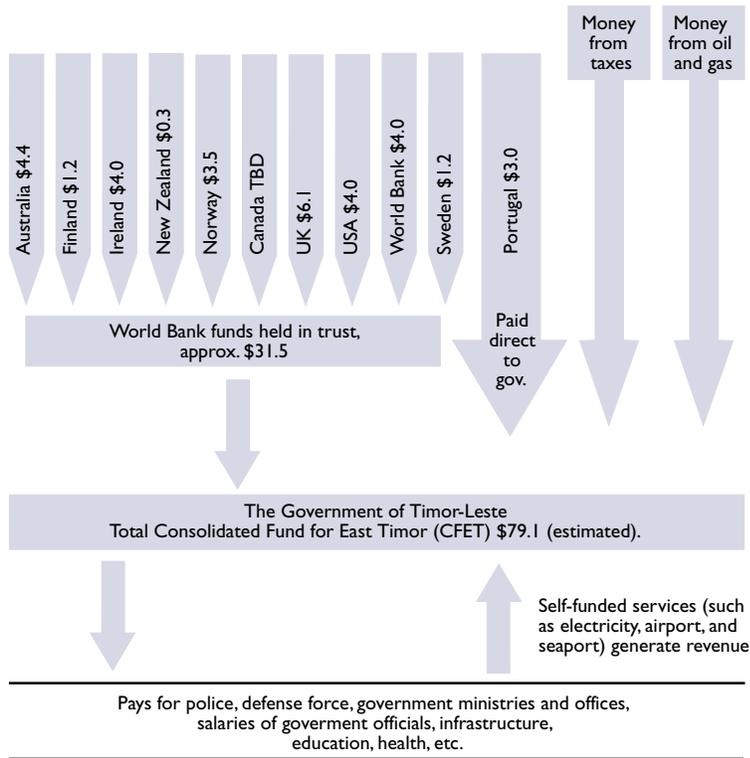
The TSP, coordinated by the World Bank, is funded by the Bank and 10

bilateral donors: Australia, Canada, Finland, Ireland, New Zealand, Norway, Portugal, Sweden, the United Kingdom, and the United States. Unlike the other bilateral donors, Portugal does not contribute funds through the World Bank, but directly to the national budget. Nevertheless, Portugal is engaged in the TSP process and is invited to participate in World Bank missions as a full partner (fig. 3). Donors choosing to contribute funds through the Bank are charged a 2 percent administrative fee.

Total commitments for 2002–05 were approximately \$91 million, with the UK, Australia, the United States, and Norway being the largest donors (table 1). However, given limited data, a short timeframe, and differences between countries in assistance reporting and measurement, it is difficult to identify a discernible trend in the proportion of donor assistance devoted to the TSP.

Under the TSP, most bilateral donors contribute to a World Bank-managed account. Donors do not designate their TSP funds for specific purposes, though they can have a say regarding their use. Such donor preferences or issues of concern can be voiced during the consultation process, which is frequent and comprehensive, and usually focuses on development issues and fiscal policy. All donors participate, not just those providing funding. For example, UNICEF and the United Nations Development

Figure 3: Timor-Leste's TSP, in \$US millions, FY 2003–04



Note: Grants are provided in local country currency. There is some fluctuation in currency rates in the exchange to dollars.

Programme (UNDP) were particularly active in the TSP process, though they do not provide funding, and Japan is invited as an observer.

After the Bank, other donors, and the government officially agree on goals and priorities for the following fiscal year and goals and priorities are documented in an action matrix, the World Bank transfers funds in a single tranche to the CFET. The TSP is a major component—approximately 40 percent—of the CFET. In practice, the CFET is Timor-Leste's national budget, and it is used for both recurrent and capital expenditures (fig. 3). Effectively, there is no distinction between government revenue from other sources and the TSP.

The TSP's Action Matrix

Each fiscal year, the Government of Timor-Leste, the World Bank, and other TSP donors agree on specific goals, objectives, and measures to be enacted the following year and includes them on an action matrix (annex 2). In effect, the matrix outlines broad policy priorities to be pursued during the year, as well as specific actions to be taken and milestones to be met. The action matrix is also entirely transparent. Line ministries can ascertain the agenda and progress of other line ministries and are provided with a sense of ownership, peer review, and inclusion.

The action matrix is thus an effective tool for organizing priorities and helping to track TSP progress against agreed

policy measures. Targets, organized by sector, are tracked quarterly on a publicly available chart. This lists expected outcomes, the host government office responsible for the outcome, and the donor providing appropriate technical assistance. Developing and updating the action matrix is an intensive and participatory process involving line ministries.

The World Bank, in collaboration with other donors, conducts two three-week missions each year to review the progress of the TSP and assist the government in setting new priorities for the coming year. These are placed on the action matrix. The World Bank-led reviews, all based on the action matrix, serve as the TSP's only external monitoring framework and reporting mechanism.

Though there is no explicit conditionality associated with the action matrix for the disbursement of funds, the framework provides a single forum where donors and the recipient can voice concerns and discuss issues, and donors can influence policy decisions. Several donors commented that the most effective way to encourage the host government to take a certain policy measure is to ensure its inclusion on the action matrix. As such, the matrix represents an understanding between the government and a donor and ensures that their objectives are similar.⁷ When engaging in dialogue, the World Bank negotiates with the government through the minister of planning and finance and typically seeks donor support to reinforce its position. In effect, intense dialogue with the gov-

⁷ Previous research found that GBS works best in countries where the priorities of donors and recipient are closely aligned (Cordella and Dell'Ariccia 2003).

Table 1: TSP Contributions, FYs 2003–05

Donor	\$US millions
UK	20.0
Australia	16.1
United States	12.0
Norway	11.1
Portugal	9.0
Finland	4.4
Ireland	2.8
Canada	1.7
Sweden	1.4
New Zealand	1.2
Total Bilateral	79.7
World Bank	11.3
Total	91.0

Source: IMF 2004c.

ernment and close collaboration with donors substitute for explicit conditionality.

After donors and the government agree on items in the action matrix, Timor-Leste’s prime minister and the minister of planning and finance obtain parliamentary approval. The Office of the Vice Minister of Planning and Finance is then responsible for TSP implementation and coordinates monitoring and reporting. During implementation, the office coordinates with line ministries and external partners and supervises a program management team of ministry officials who play a monitoring role. This team prepares quarterly progress reports that serve as an internal monitoring mechanism.

Over time, the preparation of the action matrix has become routine. The first TSP action matrix for FY 2003 (July 1, 2002—June 30, 2003) stressed creating

institutions, establishing a legislative and regulatory framework, and strengthening management of core government functions. The TSP II action matrix (FY 2004) was concerned with policy measures in governance, employment creation, private sector development, and improved service delivery for poverty reduction in health and education. The goals of TSP III (FY 2005) are to further support policy measures in governance, improve service delivery, create jobs, develop the private sector, and improve agricultural production.

Though some donors advocated a more modest program, the government insisted that specific milestones and actions outlined in TSP I and TSP II be intentionally ambitious in range, number, and timing. Consequently, not all action matrix measures could be achieved. But this approach fostered policy dialogue and shifted the emphasis from achieving goals to making progress toward goals. The donors agreed that if the government did not accomplish a policy measure but made progress toward an objective, policy dialogue would ensue, and funds would be released. At the urging of the World Bank and other donors, TSP III measures are less ambitious, and are now thought to be attainable.

In addition to closing the finance gap and contributing to implementing the NDP, the TSP assists the Government of Timor-Leste in building sufficient capacity to effectively and responsibly manage future oil revenues. There has been progress: the government is establishing a petroleum fund based on the Norwegian model, and stressed that it will be transparent and accountable. In essence, the responsible use of TSP

funds is an indicator of the government’s ability to manage oil wealth as well as of the likelihood of avoiding a resource curse.

One underlying TSP strategy was to allow recurrent expenditures to remain constant or grow only moderately, while capital expenditures grew more quickly. The rationale is that the government would be forced to set priorities and less likely to launch unnecessary or unsustainable programs if recurrent expenditures were kept low initially. Under an appropriate framework, resources would not all be spent as they flow in, and any excess could be invested and used in future years. By establishing fiscal discipline in this way, the Government of Timor-Leste would be better prepared to use oil revenues effectively. This is important, because Timor-Leste’s petroleum fund will not have a built-in savings component.

Concerns About Local Ownership

In part because of the rigorous monitoring and review process, the Government of Timor-Leste expressed some concern regarding ownership. Theoretically, GBS gives the government full ownership over setting its development priorities, but ownership comes at the price of intensive biannual reviews and the quarterly monitoring required by the Bank on behalf of donors. Though the reviews are an effective and efficient way to monitor progress and achieve donor coherence, the government’s perception is that they generate external pressure and, possibly, diminish its sovereignty.

Though the TSP is not tied to conditionality, donor partners and host government interlocutors acknowledge that quarterly reports, biannual reviews, and the donors' constant focus on the action matrix result in a great deal of pressure on the government. But interviewees also recognized that this is the cost of a predictable flow of funds that finances the budget deficit and helps ensure the success of the TSP and the future of Timor-Leste.

Advantages and Shortcomings of the TSP

The TSP's design—particularly its continual collaboration, quarterly reporting, and semiannual reviews—offers a way the World Bank can effectively mobilize resources to assist the Timorese as they prepare for oil revenues. The primary reason the TSP has succeeded is likely that the World Bank and the Ministry of Planning and Finance (MPF) have been closely involved in implementation and monitoring. Overall, donors agree that the TSP has provided the Government of Timor-Leste with a good approach to coordinating and monitoring its program and an effective framework for harmonizing external partner support.

For bilateral donors with minimal staff, the TSP offers an effective method for managing their assistance. The biannual reviews are a highly effective way to gain access to the highest levels of the government. Donors are also satisfied with the World Bank-led monitoring, reporting, and administrative process. Additionally, the action matrix has proven to be a critical tool for synchronizing donor and recipient priorities, organizing government activities, obtaining donor buy-in, and

generating a predictable flow of funds to finance the budget deficit—all of which are essential for a new, poor country with minimal experience in managing the institutions of government.

One area of concern for donors and line ministries is the concentration of disbursement authorities in the MPF, which also serves as the primary conduit between donors and government. The ministry argues, however, that centralization of resources is preferable, and decentralized modalities such as SWAps would be inappropriate for Timor-Leste.

TSP Implementation

Management Implications

Management capacity and government institutions have been areas of concern for donors. Before independence, about 28,000 of the country's high- and mid-level civil servants were ethnic Indonesians, most of whom fled after 1999 (annex 3). Timorese currently lack the capacity to fill this gap.

The study team found that low capacity of staff in all ministries, particularly the MPF, is of great concern to government officials and donors. Because GBS requires that a host government take an active role in its own development, this lack of capacity puts additional pressure on the government and makes TSP implementation more challenging. Indeed, most donors and government officials report low capacity as the greatest obstacle to long-term development.

To supplement Timorese skills while capacity is being built, the UN identified critical governmental posts that needed be filled by expatriate advisers.

From May 20, 2002, to May 20, 2004, the United Nations Mission in Support of East Timor (UNMISSET) identified about 100 stability positions, and the UNDP identified about 200 positions related to development. Not all of these positions have been filled. Currently, UNMISSET has expatriate advisers in 58 critical governmental posts: 19 are allocated to the MPF, 15 to the Ministry of Justice, 16 to other ministries, and 8 to other offices.

An additional 102 positions were identified for financing by donors through UNDP, but only 33 had been filled by the end of July 2004. Recruitment was underway for an additional seven (United Nations Security Council 2004). Thus, of 300 positions identified as stability and development oriented, only 91—less than a third—had been filled. This attests to funding and recruiting problems and the overall shortage of trained staff.

Both donors and the Government of Timor-Leste recognize that international advisors carry out critical technical and line functions, and some may be needed for the medium- to long-term. However, some donors and government officials complained that the quality of these advisors is uneven. The UN and the Government of Timor-Leste initially expected advisors to work closely with counterparts to transfer knowledge and foster a type of on-the-job training. Though some advisors resisted such duties, others found the discrepancy between their skill level and that of local counterparts too great to foster meaningful knowledge transfer. Some Timor-Leste counterparts lack the knowledge, skills, and ability to carry out even the most basic duties, making

mentoring and training for some positions difficult. But experienced observers stated that standards and procedures may be higher than needed for specific jobs in certain ministries. If standards and skill levels were lowered, this would facilitate training and mentoring.

Additionally, donors view Portuguese and Tetum language requirements for advisers as a further obstacle to mentoring. The government's resistance to the use of Bahasa Indonesian as a working language is an impediment to drawing competent but less expensive experts from the region, since Bahasa Indonesian is commonly spoken in Timor-Leste and is a written language, unlike Tetum. The use of experts from the region who speak languages other than Portuguese and Tetum would lower the cost of advisers and enable communication with counterparts.

Staff Intensity and Transaction Costs

Staff intensity and transaction costs refer to the time, manpower, and financial cost of managing, administering, monitoring, and reporting on the TSP by donors and the government. A frequent argument in favor of GBS is that it requires less staff time for the host government than projects, in part because the government does not have to deal with numerous donor requirements for financial management, reporting, and monitoring. In the case of the TSP, the staff of the World Bank, other donors, and the host government have a managerial and administrative role, though the World Bank has the greatest management responsibilities.

Donor Perspective

The World Bank administers individual donor grants, which channel resources to the TSP. This involves separately tracking the inflow and outflow of funds that each donor transfers to a World Bank account. The funds remain in this account until transferred to the government's treasury. This time-consuming administrative process is managed by the Bank and the government, but it is less time-consuming than managing the procedures of numerous individual projects.

The Bank also takes the lead in coordinating biannual review missions, which include high-level meetings with key representatives of the government ministries, donors, and the local and international NGO community. However, the NGO role in the consultative process for the action matrix is undefined. This has become a contentious issue. NGOs are invited to a separate wrapup meeting of the review mission, but only after major decisions and discussions have occurred; they are provided little opportunity to change what has been decided.

The review teams draft aide-mémoires that report on the status of actions listed in the action matrix. In addition, the World Bank may organize supplemental missions to address problem areas when specific governmental needs are identified. TSP donors have the option of providing experts for these assessment teams, but typically do not have the resources to do so.

The World Bank charges a flat 2 percent administrative fee of the donors' contributions, since its lead role reduces staff intensity and transaction costs for other donors. Because the TSP does not

have a component devoted to measuring donors' transaction costs, it is difficult to assess the degree of cost savings, even accounting for the Bank's administrative charges. Donors, however, report considerable time savings.

Host Government Perspective

The MPF coordinates meetings that review targets established in the action matrix. Because these are multisectoral, and World Bank scrutiny is comprehensive and exhaustive, meeting preparations entail gathering materials from different ministries, comparing planned activities to those achieved, and carefully reviewing budget execution.

Governmental staff time required to manage the TSP varies by ministry and time of year. The most intensive weeks for the MPF are those prior to and during review missions, which occur after the government prepares quarterly reports. Review teams include many specialists—18 attended the May 2004 mission—and government officials noted this presence as a bit overwhelming at times.

To lighten the government's administrative burden, the World Bank schedules review missions to correspond with the government's budget calendar, which begins in July. Scheduling missions for May thus feeds into the government's budget planning process. Followup missions in November or December facilitate a review of budget execution, accomplishments, and shortfalls, which can be addressed during the remainder of the fiscal year.

The review missions provide a structured framework that enables the MPF to fulfill its functions, because the TSP process

(including quarterly reports) is integrated into the government's reporting system. Line ministers believe that working through the TSP is more efficient than managing bilateral projects, and ministries use review missions to report how they spent their budgeted funds.

Starting in 2005, the World Bank will initiate a two-step process: the task manager will lead a mission to develop a broad outline for FY 2006, and the review mission will examine progress on the FY 2005 action matrix two months later.

Monitoring and Reporting

Monitoring and reporting by donors, the host government as a whole, and individual ministries focuses on the action matrix and specific targets. The World Bank takes the lead by organizing three-week review missions that examine action matrix targets. Missions are organized around a series of meetings planned by the MPF. The prime minister chairs an initial meeting with mission team members and the government. A series of sector meetings chaired by the vice minister of finance follow. Final meetings bring together the government, the review team, development partners, and civil society representatives.

Donors can negotiate with the government to have issues of interest—such as gender, security, civil society, and subsidies to the power sector—placed on the action matrix. Since ministry-level officials attend the meetings, such issues can be addressed effectively. A report, written shortly after each review mission and distributed to donors and the government, provides a record of ongoing monitoring

and feeds into the government's monitoring and reporting system.

Two planning and monitoring tools developed by the government feed into the action matrix. The first tool is an annual action plan (AAP), which is formulated by each ministry and specifies planned activities and corresponding expenditures by quarter for the fiscal year. Ministries submit these plans to the MPF for incorporation into an overall government action plan. Overall, this system has proven effective, though AAPs are not regularly updated.

The second monitoring tool is quarterly reports, which address progress on activities and expenditures presented in the AAP and facilitate monitoring of the budget execution process. These tools help guide donor decisionmaking and determine issues of prime importance. The action matrix is developed to be compatible with the AAPs and these quarterly reports. Donors receive AAPs and quarterly reviews directly from the government, and these help monitor the use of funds and performance. The government does not use indicators, though these are being developed. Progress toward achieving objectives listed in the AAP and the NDP thus cannot yet be easily measured. As yet, there has been no formal evaluation of the TSP program.

Fiduciary Risk

Fiduciary risk is always a concern for donors providing GBS to a host government. This concern applies to Timor-Leste, particularly since government capacity to manage and account for financial resources is still evolving. The study team thus focused on two areas where

governments with limited capacity may be especially weak: whether the government has the ability to formulate and execute budgets consistent with national development priorities, and whether it has systems in place to maintain budget discipline and account for funds.

In Timor-Leste, the budget formulation process is led by the MPF. It is an open process, which calls for input from line ministries and follows the priorities outlined in the NDP. The budget is formulated each January and vetted by the Council of Ministers, approved by the Timor-Leste National Parliament, and finalized for implementation at the start of the new fiscal year in July. The MPF produces quarterly reports that track expenditures and allow for midyear adjustments in the event of revenue shortfalls. In addition to informing the World Bank and other donors that the use of funds is consistent with budgetary allocations and priorities, quarterly reports also ensure that public funds are used appropriately.

Representatives of seven bilateral donors and the World Bank told the study team that the public expenditure system is sound. The donors further reported that the core treasury management system is strong: it has a centralized payments system that provides for multiple commitment and payment controls, and is supported by an online payments tracking system. The books close on time, and quarterly reports are submitted 15 days after closing. Currently, the risk of deviating from the intricate system of controls is minimal. In large part, this is due to World Bank oversight, a highly centralized and hierarchical internal system of authority, 20–30 expatriate personnel

in the MPF, and expatriate staff in key advisory and line positions in ministries.

As the trustee, the World Bank oversees separate donor funds, which are disbursed by separate grant agreements into a government account and commingled in the central treasury account. The government's published quarterly reports are reviewed by the World Bank. Annual audits are conducted by a private, independent auditor based in Australia. Audit reports are publicly available six months after the books are closed. However, the study team's interviews and document review suggested two potential areas of weakness in checks and controls. First, because the BPA reports to the MPF, there is no check on payments. Second, the auditor reports directly to the prime minister, thus affecting the perception that findings are completely independent.

Coupled with the financial management system, there is a centralized system of procurement built on competitive bidding and an open and transparent award process. The procurement system uses procedures put in place under UN-TAET. Manuals have been prepared, standard specifications are published, and the institutional value of procurement integrity is gradually taking root. Ironically, the government's procurement and payments system is so rigorous and centralized that most budget execution problems can be attributed to the absence of trained Timorese staff.

Surges in procurement activity and spending occur at the end of the fiscal year. To avoid these problems, the government established a budget execution committee to monitor expenditures and

drafted legislation to delegate procurement and financial authority to line ministries. The government learned that a balance between control and flexibility must be struck, but in tandem with an increasing capacity to delegate authority.

Because of the absence of trained financial analysts and other staff with the ability to minimize fiduciary risks, the MPF has a tendency to centralize: it is reluctant to delegate across line agencies or within the ministry itself. However, the World Bank is designing a capacity building program that will emphasize financial and planning skills, one expected to have a positive impact over the next five years. In a further effort to build capacity, the UNDP is piloting a project to provide block grants to rural districts that have no developed banking networks. In the meantime, expenditures tend to be concentrated in Dili.

Interviews with donors and NGOs led the study team to conclude that there is no credible evidence of systematic, large-scale corruption. Though donors acknowledge the potential for corruption—in part because of an inherited value system that may make Timorese susceptible to rentseeking behavior—corruption is not seen as a serious problem. The hope is that a lasting sense of integrity will be inculcated by the basic systems in place, the presence of a large international staff, and the development dialogue with the World Bank and other donors during TSP reviews. Though it is too soon to tell, the litmus test will be the government's management of its offshore oil revenues, which are scheduled to come on stream in the next two to three years.

Impact and Results of TSP I and II

Numerous positive results have been produced from the TSP, which has been in place for just over two years. However, these should be considered as outputs, rather than impacts or lasting, sustainable results.⁸

TSP I

Broad in focus, TSP I was primarily concerned with creating institutions and a legislative and regulatory framework, and with strengthening core government functions. TSP I concentrated on four thematic areas: continued poverty reduction planning, governance and private sector development, public expenditure policy and management, and the power sector. Representative results within these areas are shown in table 2.

TSP II

TSP II concentrated on governance, service delivery for poverty reduction, and job creation. Within each category, specific areas were stressed (World Bank 2004c). Improvements in governance focused on strengthening oversight institutions, public sector management, strengthening the justice sector, and planning and public expenditure management. Service delivery for poverty reduction focused on health, education, and vulnerable groups such as veterans. Job creation focused on private sector development and agriculture. Representative results for TSP II are seen in table 3.

8 Annex 2 illustrates detailed results in TSP II.

Table 2: Representative Results of TSP I, FY 2002–03

Thematic Area	Output
Continued poverty reduction planning	<ul style="list-style-type: none"> • authored and published the NDP • restored primary education* • provided technical assistance and training to education, health, and justice ministries to improve planning • restored public health network • started to address vulnerable groups by establishing a social services department and authorizing a veterans' affairs unit
Governance and private sector development	<ul style="list-style-type: none"> • drafted a commercial code and notary note • finalized a draft investment law
Public expenditure policy and management	<ul style="list-style-type: none"> • maintained macroeconomic stability • instituted routine reporting on the consumer price index • drafted terms of reference for expenditure review and launched review • prepared and adopted criteria for prioritizing in-year funds release
Power sector	<ul style="list-style-type: none"> • reduced subsidy to sector by \$2.8 million • initiated and completed external audit of the sector • signed management contract and handed over electricity assets to management contractor • instituted incentives for improved commercial performance within the contract and identified performance indicators • established a system to monitor sector's monthly financial performance

*Timor-Leste's primary school enrollment rate is 76 percent, and 7,132 schools are in operation with 3,901 teachers. Nearly half the students are girls.

Table 3: Representative Results of TSP 2, FY 2003–04

Thematic Area	Output
Governance	<ul style="list-style-type: none"> • established the Office of the Provedor (ombudsman) • prepared a law to establish the Office of the Inspector General • established the public service statute that lays out the framework for personnel management and disciplinary procedures • made progress on improving the discipline of the budget process • prepared a draft budget and financial management law to be submitted to Council of Ministers
Service delivery for poverty reduction	<ul style="list-style-type: none"> • exceeded service delivery targets for DPT3 and measles immunization and outpatient attendance • established curriculum working groups and prepared draft curriculum • completed identification and registration of veterans
Job creation	<ul style="list-style-type: none"> • made progress in establishing a regulatory framework for development of the private sector and creating interventions intended to create employment opportunities

Conclusions

International donors pledged substantial amounts of assistance well before the independence of Timor-Leste, a new nation that had immediate reconstruction and rehabilitation needs as well as the need to provide social sector services—primarily health and education—to its people.

GBS Mechanism

Unable to generate sufficient revenue, the Government of Timor-Leste required assistance in financing its budget deficit. For this reason, and because of unique country conditions, most donors and government officials agreed that GBS offered an appropriate way to meet Timor-Leste's short-term assistance requirements. The TSP was designed specifically for a new government possessing the will and commitment to govern responsibly but hampered by a lack of capacity. It is therefore not surprising that the World Bank assumed a strong oversight role, one that imparted to Timorese officials the discipline needed to manage a national budget and account for public funds. In essence, the World Bank played a positive role in building the capacity of the MPF.

In implementing and overseeing the TSP, donors report that the World Bank instilled confidence in the program and provided sufficient justification to continue funding it, thus ensuring a predictable flow of funds to the government. Government officials and donors alike expressed satisfaction with the ease of management and administration of the TSP, with GBS as its principal funding mechanism. Since—like the host government—many bilateral donors are thinly

The TSP was designed specifically for a new government possessing the will and commitment to govern responsibly but hampered by a lack of capacity.

staffed, they view the TSP as a useful and effective vehicle for providing assistance.

Ownership

Though the tasks of managing the budget and the rigor of the TSP reporting and review processes may sometimes seem overwhelming to the Timorese, the team did not discern any compromise in their ownership of decisionmaking about major policy items. Government officials consider the action matrix to be a policy tool that is as much theirs as the donors', as evidenced in the government's active participation in policy discussions. The action matrix also proved to be a useful way to engender donor harmony, though donor unity may sometimes be perceived as pressure that interferes with a sense of local sovereignty.

Centralizing Versus Delegating

The tendency for decisionmaking to be centralized in the MPF is an unintended side effect of the World Bank's active participation in the TSP. This may have grown out of concern for ministries that seemed incapable of sound budgetary and financial management or out of a heightened sense of fiduciary responsibility. While centralizing might be laudable from a fiduciary perspective, the downside is the government's inability to disburse funds in a timely manner. Since the host government was

sensitive to the political ramifications of poor budget execution, it took steps to minimize the problem by setting up a committee, chaired by the prime minister, to review budget expenditures periodically through the fiscal year.

Program Versus Project Aid

Interviews with Timorese officials did not reveal strong opinions about the merits of different types of assistance. This is not surprising, since the government has had little time to experience a variety of strategies and approaches. However, sector support or SWAs have not been considered, since line ministries had yet to develop coherent sector priorities.

The Timorese experience with projects is limited to TFET-financed short-term rebuilding efforts. According to a draft EC evaluation, they were a mixed success. Though the imperatives of short-term objectives were met in some cases, it was sometimes at the expense of local involvement. Because anecdotal evidence suggested Timorese government officials were dissatisfied with these outcomes, the team initially concluded that projects might not be the preferred mode of assistance. This, however, was erroneous: the team learned the government intends to phase out the TSP and opt for project assistance once significant oil and gas revenues are generated.

The Timorese believe that project assistance can address their capacity constraints at the microlevel through joint planning and implementation. This belief may have some merit, if the shortcomings of project assistance are studied. However, the study team believes that project assistance is not sufficient to address capacity constraints throughout Timor-Leste's institutions of government.

Conditionality

The literature and donor experience suggest that GBS excludes normal conditionality (where host governments receive funds in exchange for certain reforms). Though the TSP has no apparent conditionality, there is a strong incentive for the government to work toward goals specified in the action matrix. Under the TSP, donors and the Government of Timor-Leste agree on policy measures to be taken the following year. Once this agreement is reached, funds are released. There is an implicit understanding that if the government makes less than satisfactory progress toward such measures, donors have the option of withholding funds after the next round of discussions.

Capacity Building

Timor-Leste's new government and fledgling institutions meant that capacity building was essential. The World Bank and other donors could not buy into existing capabilities and systems, as in countries with established development histories. Nonetheless, when GBS is a major component of an assistance strategy, the Timor-Leste case suggests that donors should carefully scrutinize a

host government's capability to manage its budget processes and, where necessary, incorporate capacity building as a design component. This has worked effectively in Timor-Leste, where one donor assumed the burden of leadership, management, and administration.

Exit Strategy

Because oil and gas revenues will soon be generated, Timor-Leste has an obvious and natural exit strategy for GBS. In part, the strategy is also based on whether the country has the foundational capacity to manage its budget, albeit with the assistance of expatriate advisors. Though Timor-Leste faces special circumstances, the notion of an exit strategy is applicable to the design of other GBS programs, where host government capacity and revenue factors both play a determining role. This is especially important when GBS is a large component of the national budget or central to donor assistance strategies.

Donor Harmony

Given Timor-Leste's significant development needs, some donors may have been tempted to impose their particular assistance programs on the government, perhaps with minimal concern for overlap, duplication, or conflict with the efforts of other donors. Largely under World Bank's leadership, the TSP avoided such fragmentation and engendered strong donor harmony. At the TSP's inception, the World Bank insisted on unified administrative and reporting procedures that reduced the management burden on other donors and host government ministries.

While donor harmony is generally viewed in a positive light, it may have some negative implications. While donors were unified on key budgetary or policy issues—a positive development from their perspective—the study team believes the host government found the pressure of unified donors problematic and is phasing out of the TSP partly for this reason. In opting for project assistance, the government feels it may be easier to deal with donors on an individual basis. It is not clear whether Timorese officials are aware of the potential shortcomings of this approach or remedies needed to minimize them.

Fiduciary Risks and Corruption

The team found no evidence of large-scale corruption in government circles, likely owing to the World Bank's role and recognition of the importance of wisely managing the country's natural resources. The government instituted a sound system of financial controls to manage funds. Decisionmaking is centralized, and fiduciary risks are minimal.

However, donors also want to see that funds are steadily expended. Poor budget execution has occurred as a result of a highly centralized financial system. Donors noted the tendency toward centralization and included it on a recent action matrix. This resulted in legislative measures to streamline procurement and a UNDP pilot program to test the viability of decentralizing authority to districts. These steps are aimed at striking the right balance between concerns for risks and funds flowing through the system to provide needed services.

Annex I: Definitions of Nonproject Assistance

Balance of Payment Support

Balance of payments support refers to resource transfers, whether in foreign exchange, cash, or as a commodity import program. The primary purpose is to promote economic and political stability.

It is intended as short- or medium-term assistance to address immediate gaps in a country's balance of payments.

Sector Program Assistance (SPA)

SPA focuses on constraints to sustainable growth at the sectoral level, usually in broad areas such as agriculture, industry, education, health, or exports. SPA supports the implementation of reforms intended to overcome sector development constraints, and promotes medium- to long-term increases in production or efficiency in a specific sector or sectors. SPA includes an agreed policy and expenditure plan. An individual donor usually negotiates its own sector agreement, and its disbursements are based on policy conditionality set out such an agreements. In USAID's case, disbursements depend on the government meeting the agreed conditionality.

Sector Wide Approach (SWAp)

A SWAp aims to coordinate all donor assistance in support of a common sector expenditure program. SWAp financing

typically includes donor budget support, project aid, and technical assistance. The funds may or may not be earmarked to specific expenditures or disbursed through the government's own budget process. The defining characteristic is that donor funding for a sector supports a single sector policy and expenditure program. The government provides the leadership, and donors adopt a common approach to support the government's effort.

General Budget Support (GBS)

GBS is a mechanism for cash transfer disbursed into the general budget of a recipient government rather than into a segregated account. GBS is usually performance-based. USAID and all development organizations agree that GBS funds should not be earmarked. USAID's ADS notes that GBS "implies support to a host government budget at the level of the general fund... [including] funding host governments' budget deficits," but cannot specify the use for such funds (USAID 2004b, 624).

Within the international development community, definitions of GBS vary, as do notions of how it differs from other forms of program assistance. The ADS divides foreign assistance into project assistance and program assistance. It offers no official definition for direct budget

support, but recognizes two types of program assistance: SPA and balance of payments and budget support. Though ADS recognizes balance of payments support and GBS as separate tools, it implies they are closely related and does not address them individually. It also states that “the objective of balance of payments and budget support” is to provide “a generalized resource transfer to the recipient country,” which, in some cases, “is designed to support short- and medium-term economic or political stabilization through measures which address immediate gaps in the country’s balance of payments or budget.”

The DAC network on development evaluations offers a more specific definition, and—unlike USAID—divides program aid into food aid and financial program aid. The DAC definition also further subdivides financial program aid into budget support—sometimes referred to as direct budget support—and balance of payments support, such as debt relief and import support. GBS and sector budget support are two types of budget support.⁹

Further, the DAC definition characterizes budget support as a system where funds are channeled directly to recipient governments using the country’s procurement and accounting systems. Budget support entails a lump sum transfer of foreign exchange, but there may be differences among donors relating to the extent of earmarking and levels and focus of the policy dialogue and conditionality (DFID 2004, 3). If

budget support has conditionality, it is usually “focused on improving public financial management and the effectiveness of the overall budget.” Funds are not earmarked.

⁹ Though not explicitly stated in this definition, the team assumes that sector budget support refers to SWAPs as well as sector program support.

Annex 2: Sample Status Report on Programmed Actions for TSP II (FY 2004)

Governance—Strengthening Oversight Institutions					
TSP II	Output/Indicator and Target	Changes in Programmed Actions	Completed	In Implementation	Rescheduled to TSP III
A.1.1	Annual legislative program of Council of Ministers for FY 2004; policy and legislative process	Approved draft terms of reference; technical assistance (TA) under recruitment	×		
A.1.2	Office of the Provedor de Direitos Humanos e Justica operationalized	Provedor law passed April 2004; Provedor to be appointed by Sept. 2004			×
A.1.3	Strategy for investigation of complaints regarding civil service; review previous investigations	Program of audits investigations; reports completed	×		

Governance—Public Sector Management					
TSP II	Output/Indicator and Target	Changes in Programmed Actions	Completed	In Implementation	Rescheduled to TSP III
A.2.1a	Legislation on state administration and local government	Pending decisions on options and comparative studies and policy formulation			×
A.2.1b	Legitimized community authorities in sucos and aldeias according to program	Legislation on suco councils approved; electoral registration scheduled early FY 2005		×	
A.2.1c	Strengthen staff capacity to implement the reforms on administrative decentralization and local government	Deleted—part of National Institute of Public Administration program; specific actions related to A.2.1.a not foreseen			
A.2.2a	Civil service statute	Approved April 2004; TSP III will follow up with supplementary regulations	×		
A.2.2b	Disciplinary procedures manual approval and management trained in implementation	Manual drafted; disciplinary proceedings identified as priority		×	
A.2.3a	Human resources (HR) policy addressing recruitment, appraisal, information, and other areas	No action taken; pay and career progression identified as FY 07 outcome			×
A.2.3b	Line agency HR management units in all agencies	Gradually, on the basis of the organic laws in process of approval by each line agency			
A.2.3c	25% of permanent staff on payroll registered in CHRIS database with supporting personnel files	Pending decision on options raised by human resource management information systems; manual recording ongoing		×	

Governance—Strengthening the Justice Sector					
TSP II	Output/Indicator and Target	Changes in Programmed Actions	Completed	In Implementation	Rescheduled to TSP III
A.3.1	Law on public prosecutors and public defenders	Draft public prosecutor law to be submitted to Parliament; draft public defenders law under consultation with Ministry of Justice		×	
A.3.1a	At least eight sessions of Superior Council for the Judiciary conducted	Gradually, on the basis of the organic laws in process of approval by each line agency	×		
A.3.1a	Improved annual ratio of cases taken to courts and cases accepted in courts	Baseline data still to be obtained			×
A.3.1a	Improved ratio of cases resolved and cases lodged	Baseline data partially available; registration system requires review			×
A.3.1b	Decree law on notary and civil registration codes, and laws on civil identification and public registry codes; related systems established and services delivered	Changes from decree law (passed by Council of Ministers) to law (enacted by National Parliament) implied rescheduling		×	×

Governance—Planning and Public Expenditure Management					
TSP II	Output/Indicator and Target	Changes in Programmed Actions	Completed	In Implementation	Rescheduled to TSP III
A.5.1	Human resource development strategy in place and is monitored each quarter	Proposed actions shifted to TSP III; priority given to disciplinary regulation and planning of action required			×
A.5.2a	Annual and midyear budget update cycle managed within legislative and administrative timeframes and agreed TSP parameters		×		
A.5.2b	Power management contract deliverables	Contract approved handover March 2004; monitoring to begin shortly thereafter	×		
A.5.3	Government annual planning exercise well understood by ministries, and AAPs are consistent with road map and annual budgets	Training activities implemented		×	
A.5.4	High-level mechanism, which represents key stakeholders, able to establish itself as a fully independent body by end of March 2004	Further actions and schedule will be determined by a steering committee		×	
A.5.5	Budget support and TA mobilized			×	
A.5.6	Accurate, comprehensive, and timely data on economic and social indicators available to all	Some delays to production of national accounts will now be addressed in Q2		×	

Governance—Planning and Public Expenditure Management (continued)					
TSP II	Output/Indicator and Target	Changes in Programmed Actions	Completed	In Implemen- tation	Rescheduled to TSP III
A.5.7a	Citizens informed about government revenue, budget and programs	Citizen's guide prepared but not yet distributed; some urgency, given forthcoming midyear budget update			×
A.5.7b	Internal and external audits confirm financial management is complaint with revised budget and financial management act	Revised budget law still has not been submitted to the Council of Ministers by MPF	×		
A.5.8a	Timely completion of procurement requests in line with targets	Reports prepared but show significant lags in procurement; expect improvement in Q2	×		
A.5.8b	FY 2004 procurement strategy in place and efficient delivery of procurement services; procurement legislation in place by end 2003	Procurement legislation requires further revision		×	
A.5.8c	Agency finance officers able to manage procurement processes; enhanced capacity of procurement officers	Some training delivered		×	

Service Delivery for Poverty Reduction—Health					
TSP II	Output/Indicator and Target	Changes in Programmed Actions	Completed	In Implemen- tation	Rescheduled to TSP III
B.1.1	Nine priority micropolicies developed	28 micropolicies at various stages, broadly meeting original target	×		
B.1.2	Hospitals: less than or equal to 40% of core CFET health expenditure	41%, consistent within margin of error	×		
B.1.3	Children under age 1 immunized with DPT3; base 58%; target 68% (annual average)	71% at Q3	×		
B.1.3	Children under age 1 immunized against measles; base 49%; target 58% (annual average)	66% at Q3	×		
B.1.3	Deliveries attended by skilled health staff; base 40%; target 45% (annual average)	43% at Q3, with expectation that annual target will be met	×		
B.1.3	Outpatient visits per capita annum: base 1.65; target 1.8 (excluding Dili and Baucau hospitals)	2.4 at Q3	×		
B.1.3	District health plans (DHPs) in place and monitored in all districts	Planning methodology and tools developed and disseminated; DHPs now reproduced routinely	×		

Service Delivery for Poverty Reduction—Education					
TSP II	Output/Indicator and Target	Changes in Programmed Actions	Completed	In Implemen- tation	Rescheduled to TSP III
B.2.1	Approved education policy framework paper; draft national education law	Draft policy prepared; approval expected May 2004		×	
B.2.2	Overall curriculum framework and program for primary education developed, adopted, and implemented	Completion delayed; curriculum to be piloted at start of 2003–04 school year			×
B.2.3	D3 bachelorato program for primary education developed, adopted, and implemented	1,000 students enrolled rather than 300; instructors being identified for next stage	×		
B.2.4	50 key managers complete educational management training program; process for channeling funds through school councils piloted	Procurement for course delayed until May 2004; school funds pilot deferred to TSP III			×

Annex 3: Management Capacity of Timor-Leste Government

Management capacity and institutional strengthening have been ongoing issues since Timor-Leste's independence. Prior to that time, most of the country's civil service—some 28,000 employees—were Indonesian. After independence, many left, and new institutions had to be established. Bilateral and multilateral donors as well as Timor-Leste government officials recognize the importance of strengthening staff in all ministries, especially the Ministry of Planning and Finance (MPF).

Donor Perspective

Capacity building is directly linked to the TSP. Indeed, managing the budget under the TSP is a type of on-the-job training and capacity building mechanism. It is hoped that this process will help Timorese to learn to manage their own governmental affairs. Accordingly, capacity building is an inherent TSP objective, and its provision has been a critical element to the smooth functioning of the program.

Currently, 58 critical Government of Timor-Leste posts are filled with UN-MISET II expatriate advisers. These posts are allocated to the MPF (19), Ministry of Justice (15), other ministries (16), and other government offices (8). An additional 102 positions were identified for financing by donors through UNDP, but only 33 had been filled by

the end of July 2004. Recruitment was underway for an additional seven (UN Security Council 2004). Donors and the Government of Timor-Leste recognize that some of the international staff who carry out critical technical and line functions may be needed for the medium to long term.

A further problem is the discrepancy between skill levels of advisers and local counterparts, or, in some cases, the lack of a local counterpart due to delays in recruitment. Standards and procedures may be higher than needed for jobs in certain ministries. If standards were lowered, skill levels could also be lowered, and it would be easier to train people for such jobs. Donors view the Portuguese and Tetum language requirements for advisers as an obstacle that drives up costs and impedes drawing experts from neighboring countries such as Indonesia and Australia.

The World Bank is keenly aware of the ongoing need to strengthen management and technical capabilities of Timorese staff. The TSP Review Mission in May 2004 designated MPF capacity building and line agency financial management as a high-risk area. To address this issue, the Bank prepared a concept paper for a program to strengthen local personnel skills. Training directed at both the MPF and line ministries would focus on

- the ability to link budget allocation decisions to spending priorities

- the ability to carry out efficient and accountable budget execution
- the strengthening of skills in macro-economic forecasting, which would facilitate predicting and managing oil and gas revenues

Such training would be implemented with on-the-job international advisers and facilities in Timor-Leste to minimize time away from jobs for key staff members. The training would be directed toward 10 offices in the MPF and other ministries targeted in the NDP. In some offices, language training would be a priority. There is a World Bank proposal to fund this program with a multidonor trust fund for capacity building.

TSP review missions recognize that developing a personnel management system is also critical to improving skills of government staff. Such a system would include a central registry of personnel, position descriptions and standards, a performance evaluation system, and salary levels within each of the seven grades delineated for civil service personnel. This has been included in the TSP action matrix. When this system is functioning, it will be easier to match skills with job requirements and fill positions with competent people.

Host Government Perspective

The Government of Timor-Leste also recognizes that a critical component of effective government is personnel with management and technical competence. The government would like the TSP to finance more projects and strengthen

Timorese capabilities in project design and management. It would also like to have experts available to offer advice when requested, but the preference is for personnel to learn by doing, not watching others work.

Expatriate technical advisers with key roles in the MPF and line ministries often have dual roles: they carry out government functions and train their Timor-Leste counterparts. In offices where local staff have had little time on the job, advisers are critical to operations, and ministers rely on them extensively. In worst-case scenarios, advisers have sufficient power to determine the course for specific offices. The prime minister recognizes this, and has been critical of international advisers who make themselves indispensable rather than transferring skills to Timorese.

Foreign advisers are frequently paired with local counterparts to facilitate and encourage on-the-job training. The government and donors collaboratively identify positions for foreign advisers and work together to develop terms of reference. Some advisers have been more effective than others, and well-developed, specific terms of reference can contribute to their effectiveness.

Other modes of training may take place in local facilities or offshore. For example, personnel may be sent to the National Academy of Civil Service or trained at the Ministry of State Administration. Bilateral donors also provide training. The Japan International Cooperation Agency sent Timorese civil servants to Malaysia and Japan to attend courses.

Language is an issue affecting training. Though English is now a working language, and most Timorese educated after 1977 speak Bahasa Indonesian rather than Portuguese, the government prefers advisers who speak Portuguese or Tetum. The Japanese found that questions were more forthcoming when Timorese were trained in Malaysian (which is similar to Bahasa Indonesian) than when training was in English. The Ministry of Health is among those taking a practical approach to the problem, recognizing the need for a compromise between the government's preferred languages and the efficient imparting of knowledge. Accordingly, the ministry may hire experts who speak English and offer English-language courses for counterparts working with these experts.

Government leaders would like their staff to have the capacity to develop and run a much larger capital investment program. They would like all donor activities to include a component aimed at training staff in the MPF and line ministries. The government believes that once its staff learn how to design and manage projects, they can then progress into sector investment programs. Bilateral assistance provides technical assistance, but donors may be more interested in completing their projects than teaching Timorese. Instead of a donor sending technical specialists to design a project and implement it, the government prefers technical assistance that transfers skills to Timor-Leste.

Annex 4: Interviews

Multilateral Donors

Asian Development Bank (ADB)

Helen Baxter, Social Protection Specialist,
Pacific Department
Lacarias da Costa, Inter-Agency Coordinator

European Commission (EC)

Guglielmo Colombo, Representative in
Timor-Leste

International Monetary Fund (IMF)

Insu Kim, Resident Representative

United Nations Development Programme (UNDP)

Naoki Takyo, Assistant Resident
Representative and Chief of Poverty
Reduction & Community Development
Unit
Janne Niemi, Programme Officer

World Bank/Timor-Leste

Kathy Khuu, Public Sector/Private Sector
Development Specialist

World Bank/Washington, D.C.

Adrian Fozzard, Senior Public Sector
Specialist and Task Team Leader
Helen Sutch, Sector Manager, Public
Sector Governance
Rosa Maria Alonso i Terme, Senior
Public Sector Specialist

Bilateral Donors

Australia: Australian Agency for International Development (AusAID)

Peter Ellis, Counselor (Development
Cooperation)

Canada: Canadian International Development Agency (CIDA)

Melanie Alton, First Secretary
(Development), Embassy of Canada in
Indonesia
Oscar da Costa Belo, Director, Program
Support Unit, Timor-Leste

Germany: German Technical Cooperation (GTZ)

Günther Kohl, Team Leader, Food Security
Programme, Baucau and Viqueque

Ireland: Embassy of Ireland/Development Cooperation Ireland

Carol Hannon, Chargé d'Affaires

Japan: Embassy of Japan

Hideaki Asahi, Ambassador of Japan,
Timor-Leste
Toshimichi Koga, Second Secretary
Kanakano Nozawa, Second Secretary
Yukako Sakabe, Researcher

Japan International Cooperation Agency (JICA)

Toshiaki Tanaka, Resident Representative
Yoshikazu Wada, Assistant Resident
Representative

New Zealand: Consulate-General of New Zealand

Peter Guinness, Consul-General

Portugal: Embassy of Portugal

Isabel Brilhante Pedrosa, Counselor
Marta Garcia Ribeiro, Secretary

United Kingdom: Embassy of the United Kingdom

Tina Redshaw, UK Ambassador to
Timor-Leste

United States of America: Embassy of the United States of America

Grover Joseph Rees, U.S. Ambassador to Timor-Leste
Myrna F. Farmer, Secretary to the Ambassador

USAID/Timor-Leste

Charles Oliver, Senior Program Manager
Nicole Seibel, Program Manager, Democracy and Governance
Kimberly Jones, Team Leader, Economic Growth Program
Maria Isabel Ximenes, Project Management Specialist, Democracy and Governance
Sidonio Freitas, Program Manager, Democracy and Governance

USAID/Washington

Robert Dakan, USAID consultant
David Schroder, Indonesia and Timor-Leste Desk Officer

Government of Timor-Leste

Banking and Payments Authority

Abraão de Vasconcelos, General Manager
Maria Jose Sarmento, Deputy General Manager for Supervision
Samuel V. Robinson, Deputy General Manager for Payments

Embassy of the Democratic Republic of Timor-Leste to the United States

Constancio Pinto, Minister-Counselor/DCM

Office of Prime Minister

Jose Medrano, Senior Economic Advisor

Ministry of Development and Environment

Abel da Costa Freitas Ximenes, Vice Minister

Cosme F.B. da Silva, Director, Development Support Division

Carlos Ximenes

Raimundo Gusmão
Bonifácio Correia

Ministry of Education, Culture, Youth, and Sports

Armindo Maia, Minister of Education, Culture, Youth and Sports
Marcial Salvatierra, Senior Education Advisor

Ministry of Foreign Affairs and Cooperation

José Ramos-Horta, Minister of Foreign Affairs and Cooperation

Ministry of Health

Rui Maria de Araujo, Minister of Health
Feliciano da C.A. Pinto, Director General
Erling Larson, Senior Advisor

Ministry of Planning and Finance

Aicha Basserawan, Vice Minister of Planning and Finance
Gregorio Ferreira da Silva, Chief Procurement Officer
Russell J. Cheetham, Senior Advisor
Takeshi Watanabe, Advisor, National Directorate for Planning and External Assistance Cooperation

Local NGOs and Institutions

ALOLA Foundation

Kirsty Sword Gusmão, Founding Director and First Lady of Timor-Leste
Toola Andrianopoulos, Office Manager

Lao Hamutuk

Charles Scheiner
Simon Foster
Cassia Bechara
Tomas Freitas

NGO Forum

Dinorah Granadeiro, Deputy Director, NGO Forum
James Nowlan, NGO Forum Advisor, UNDP

Timor Institute of Development Studies

João M. Saldanha, Executive Director, Fellow in Economics and Politics

International NGOS

CARE

Jill Umbach, Timor-Leste Country Director and Asia Regional Manager
H. K. Banskota, Medical/ Nutrition Advisor

Oxfam

Keryn Clark, Country Program Manager, Timor-Leste Program
Frank Elvy

Pacific Asia Resource Center (PARC)

Junko Ito, Timor-Leste Office

Other Individuals

Bishop Ricardo, Archdiocese of Dili

Father Locatelli, Salesian Missions

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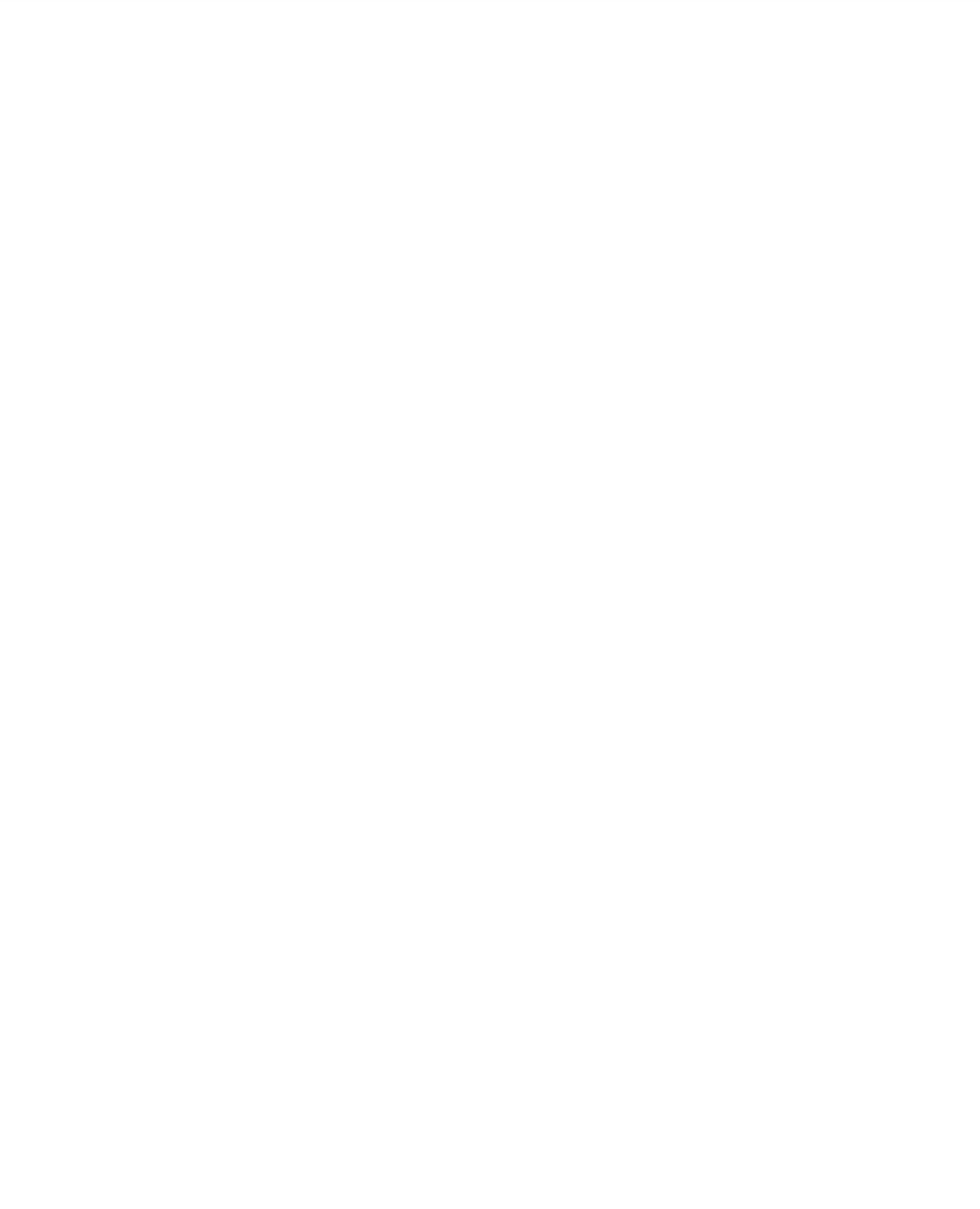
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Washington, DC 20523

Telephone: 202-712-4810

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