



Technical Assistance Concept Paper

Project Number: 53104-001
Knowledge and Support Technical Assistance (KSTA)
September 2019

Democratic Republic of Timor-Leste: Implementing Reforms for Growth and Competitiveness

Asian Development Bank

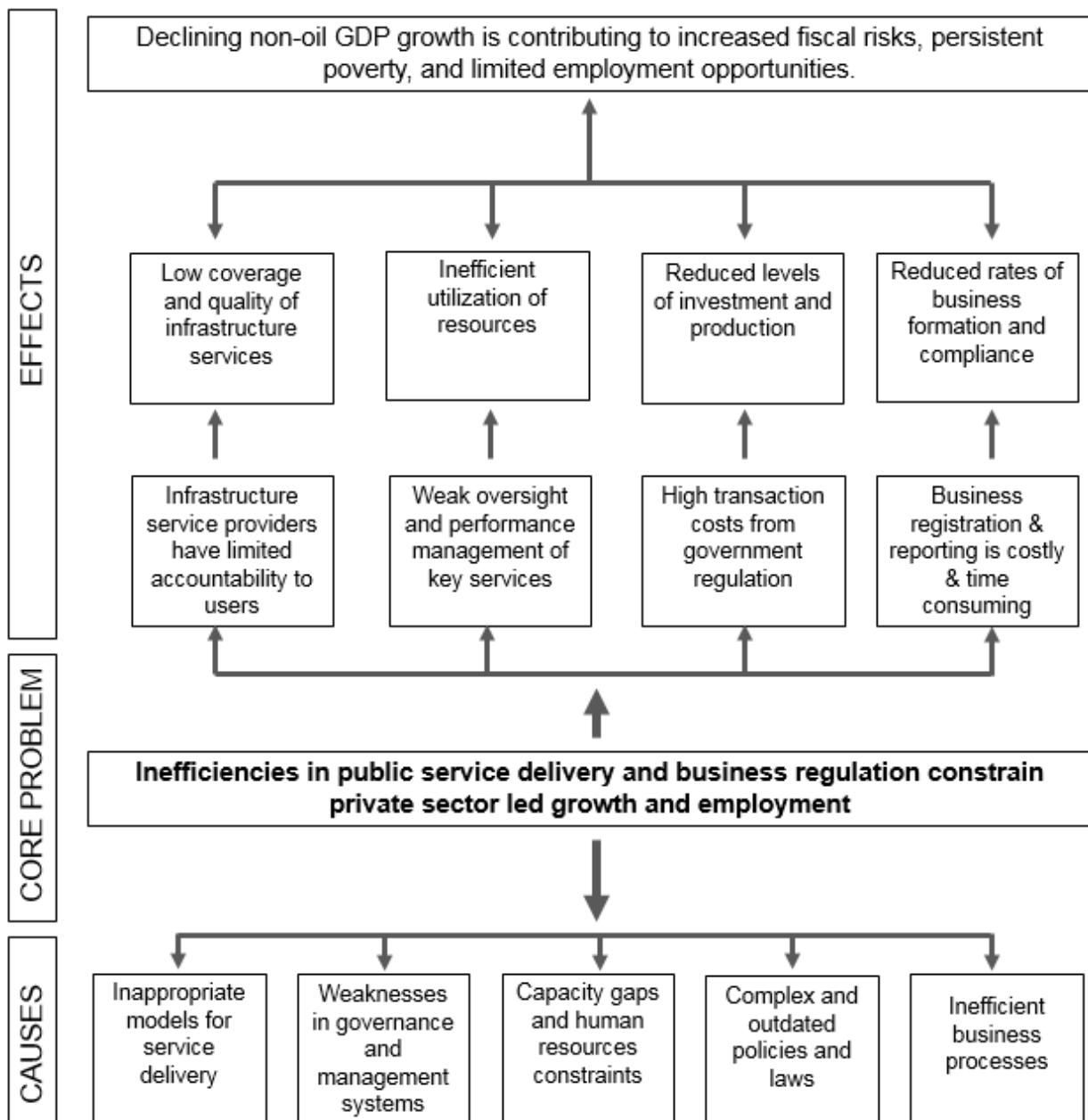
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KNOWLEDGE AND SUPPORT TECHNICAL ASSISTANCE AT A GLANCE

1. Basic Data		Project Number: 53104-001	
Project Name	Implementing Reforms for Growth and Competitiveness	Department/Division	PARD/TLRM
Nature of Activity	Policy Advice	Executing Agency	Ministry for Legislative Reforms and Parliamentary Affairs
Modality	Regular		
Country	Timor-Leste, The Democratic Republic of		
2. Sector	Subsector(s)	ADB Financing (\$ million)	
✓ Water and other urban infrastructure and services	Urban policy, institutional and capacity development	0.64	
Public sector management	Law and judiciary	0.36	
		Total	1.00
3. Strategic Agenda	Subcomponents	Climate Change Information	
Inclusive economic growth (IEG)	Pillar 2: Access to economic opportunities, including jobs, made more inclusive	Climate Change impact on the Project	Low
4. Drivers of Change	Components	Gender Equity and Mainstreaming	
Governance and capacity development (GCD)	Institutional development Institutional systems and political economy	No gender elements (NGE)	
Knowledge solutions (KNS)	Knowledge sharing activities		✓
Partnerships (PAR)	Implementation Regional organizations		
Private sector development (PSD)	Promotion of private sector investment		
5. Poverty and SDG Targeting		Location Impact	
Geographic Targeting	No	Nation-wide	High
Household Targeting	No		
General Intervention on Poverty	Yes		
SDG Targeting	Yes		
SDG Goals	SDG10, SDG11, SDG16		
6. Risk Categorization	Low		
7. Safeguard Categorization	Safeguard Policy Statement does not apply		
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		1.00	
Knowledge and Support technical assistance: Technical Assistance		1.00	
Special Fund		1.50	
Cofinancing		1.50	
To be determined (Full ADB Administration)		0.00	
Counterpart		0.00	
None		0.00	
Total		2.50	
Currency of ADB Financing: USD			

PROBLEM TREE



I. KNOWLEDGE AND SUPPORT TECHNICAL ASSISTANCE

1. Implementing Reforms for Growth and Competitiveness is a knowledge and support technical assistance (TA) that will help Timor-Leste to become more economically competitive. The TA will provide advisory support to guide corporatization of water and electricity services and will help to reduce the transaction costs faced by private businesses by advising on implementation of Timor-Leste's Companies Law and streamlining other government business-processes. The TA is aligned to ADB's Strategy 2030 operational priority on strengthening governance and institutional capacity, and operationalizes ADB's commitment to implementing a differentiated approach in small island developing states and fragile and conflict affected situations. The TA is included in PARD's 2019 TA commitment program.

A. Rationale

2. **Growth of Timor-Leste's non-oil economy has slowed since 2010.** The three-year moving average for non-oil GDP growth peaked at 10.4% in 2009 and has declined steadily since then. The growth slowdown is reflected in the slow pace of job creation and poverty reduction. In 2013, 59,000 adults, or 9.5% of the working age population were formally employed by private businesses. While average wages have increased significantly, formal employment has declined. As a result, only 8.4% of working-age adults had formal private sector employment in 2017. Prospects for job creation and poverty reduction hinge on sustained expansion of the non-oil economy through improved public-sector efficiency and increased private investment.

3. **Government effectiveness has improved but remains relatively low.** Timor-Leste has made excellent progress in state-building and institutional development. It has established core institutions and expanded access to basic services including primary education, healthcare, and electricity. Assessments of government effectiveness and regulatory quality show improvement but the overall efficiency and effectiveness of the public sector remains low.¹ Recent in-depth assessments of the government systems for public financial management (PFM) and public investment also identified significant weaknesses.²

4. **Institutional strengthening is a key focus of Timor-Leste's new government.** The Program of the VIIIth Constitutional Government, 2018-2023, includes ambitious targets for growth and job creation through improved government effectiveness. Government reform efforts are organized under four main programs: (i) Public Administration Reform; (ii) Fiscal and Public Financial Management Reform; (iii) Decentralization Reform; and (iv) Legal and Judicial Reform. The Public Administration Reform is coordinated by the Ministry for Legislative Reforms and Parliamentary Affairs (MRLAP).

5. **Improvements in government effectiveness would help stimulate private investment.** Capital formation by private businesses in Timor-Leste averaged 5.8% of non-oil GDP during 2013-2017. This is low when compared to other Southeast Asian countries. For example, private capital formation in Brunei Darussalam, Lao PDR, Malaysia, Philippines, and Thailand averaged 16.1% of GDP in 2017.³ A range of factors contribute to low private investment. Timor-Leste's domestic market is small and accessing land, skilled labor, and credit can be

¹ In 2017, Timor-Leste was placed in the 15th percentile on the government effectiveness dimension of the Worldwide Governance Indicators, and the 24th percentile for regulatory quality. Timor-Leste's scores on both dimensions show some improvement since 2013.

² International Monetary Fund. 2016. *Timor-Leste Public Investment Management Assessment*. Unpublished; World Bank. 2019. *Timor-Leste PEFA Assessment 2018*. Unpublished.

³ World Bank. 2019. *World Development Indicators*. Washington DC.

difficult. Property rights are weak, and contract enforcement is costly. Regulation of business activities is also inefficient. The Government has established a one-stop-shop for business registration and updated the Companies Law. These changes have led to improvements in Timor-Leste's score on the Starting a Business dimension of the Doing Business Indicators, however implementation of the new law is yet to deliver all of the expected improvements in efficiency of business registration and reporting.⁴ Other government business processes are often inefficient and there are also gaps in infrastructure and associated services.

6. Infrastructure management is relatively weak. Since 2010, the government has invested approximately \$1.5 billion in upgrading airports and electricity systems, equivalent to around 100% of non-oil GDP in 2018. Further investment is planned in these sectors, and it is estimated that \$1.3 billion of new investment will be needed to achieve universal access to sanitation and clean water. Electricity and water services are currently managed as General Directorates of the Ministry of Public Works and use general government systems for human resource management, planning, budgeting, financial management, etc. International experience has shown that restructuring public utilities as state-owned enterprises (SOEs) can help to improve efficiency and service quality.⁵ However, ADB analysis of SOE performance in the Pacific shows that much of the benefit of corporatization is contingent on good corporate governance.⁶

7. Timor-Leste's 2003 Public Enterprise Law provides a legal framework for SOEs. Reviews of this law and associated policies have identified several key gaps.⁷ ADB has shared lessons from SOE reform in the Pacific with the Government and has agreed to support development of a new SOE policy and legal framework.⁸ Previous corporatization efforts in Timor-Leste failed to deliver the expected benefits. Independent assessments of the SOEs that manage drug supply, airports, and public broadcasting found that they failed to comply with their own statutes, lacked autonomy, and remained highly dependent on government funding.⁹ These issues point to the challenges of establishing well-governed and effective SOEs in Timor-Leste.

8. ADB has supported governance reforms at Timor-Leste's National Commercial Bank (BNCTL). BNCTL has grown rapidly since being restructured as a state-owned bank in 2011. ADB has been helping to address governance issues that emerged after the restructuring, including weak separation between the Board of Directors and management, and gaps in shareholder supervision. ADB helped prepare new by-laws for the bank that were approved in February 2019. Successful implementation of the by-laws will help to create a living example of good corporate governance that can guide management of other SOEs in the country.

B. Proposed Solutions

9. The TA will support the design and implementation of priority reforms to improve competitiveness and stimulate growth. TA activities and outputs have been prioritized according to four criteria: (i) alignment with government priorities; (ii) harmonization with the support

⁴ Timor-Leste's score for the Starting a Business indicator increased from 15.94 in 2005 to 89.41 in 2019. This indicator is scored on a scale of 0-100 and larger numbers indicate improved performance.

⁵ ADB. 2018. *Global experience with SOE reforms*. Manila

⁶ ADB. 2016. *Finding Balance 2016. Benchmarking the Performance of State Owned Enterprises in Island Economies*. Manila

⁷ ADB. 2017. *State-owned enterprises in Timor-Leste*. Pacific Economic Monitor, Manila

⁸ ADB. 2016 *TA-9122-TIM, Fiscal Policy for Improved Service Delivery*. Manila

⁹ World Bank. 2009. *Starting From Scratch in Timor-Leste – Establishing a Pharmaceutical and Medical Supplies System in a Post-Conflict Society*. Washington DC; Court of Accounts. 2014. Report 1/2014 – On-site verification of ANATL E.P. Dili.

provided by other partners; (iii) feasibility of interventions; and (iv) synergies with other ADB operations. Based on these criteria, the TA will have two outputs as described below.

10. Output 1. Improved governance of infrastructure and financial services. The TA will provide inputs to support the transformation of public water and electricity services into SOEs.¹⁰ In the water sector, the TA will support a comprehensive assessment to guide subsequent reforms and investments. The TA will then support implementation of agreed corporatization work plans. This support is likely to include development of asset registers and balance sheets, business planning, analysis of staffing and human resource management, and development of corporate statutes and other management tools. Corporatization is likely to require unbundling of economic and technical regulation from asset management and service delivery. The TA will analyze options for efficient regulation of the new SOEs and support implementation of practical solutions. The TA will also provide support for good governance of the SOEs that are responsible for electricity, water, and financial services. This will include support for implementation of BNCTL's new by-laws and development of robust procedures for appointing board members, formal contracting community service obligations, and monitoring performance of the SOEs.

11. Output 2. Reduced transaction costs for private businesses. The TA will support a review of the Companies Law and design and implementation of a workplan to improve the efficiency of business registration. The TA will also support the review and updating of at least two government business processes that have a significant impact on private business.¹¹

12. The TA will build on the work completed through ADB's previous and ongoing support to BNCTL. Evaluation of previous TA support to Timor-Leste has highlighted that successful reform requires flexibility. This is reflected in the indicative TA implementation period which is aligned to the Government's mandate. The TA outputs will result in the following outcome: The quality of infrastructure services and business regulation is improved. The TA will be aligned with the following impacts, which are Government targets for the next five years: (i) Average non-oil GDP growth rises to 7% per annum; (ii) Private investment increases by 10% per annum.¹² TA is a suitable modality for this support given Timor-Leste's fragility.

C. Indicative Technical Assistance Budget and Financing Sources

13. The proposed TA budget is \$1 million which will be financed on a grant basis by ADB's Technical Assistance Special Fund (TASF-6).¹³

D. Implementation Arrangements

Table 1: Indicative Implementation Arrangements

Aspects	Arrangements
Indicative implementation period	OCTOBER 2019 – OCTOBER 2023
Executing agency	MINISTRY FOR LEGISLATIVE REFORMS AND PARLIAMENTARY AFFAIRS
Implementing agencies	MINISTRY OF PUBLIC WORKS, SERVE,

¹⁰ This will build on the analytical work and advisory support to EdTL to begin preparations for corporatization under ADB TA 9075: Electricity System Strengthening and Sustainability Program, and ADB TA 9495: Policy and Planning Development for Public Investments

¹¹ Business processes will be selected in collaboration with the Ministry of Legislative Reforms and Parliamentary Affairs with priority given to those processes that are currently imposing the most burden on private businesses.

¹² Government of Timor-Leste. 2018. *Program of the VIIIth Constitutional Government, 2018-2023*. Dili

¹³ Additional co-financing of up to \$1.5 million will be sought from ADB managed trust funds and bilateral donors.

Consultants	Package title	Selection method	Engaged by
	SOE Corporatization	QCBS ^a	ADB
	Company Registration	ICS	ADB
	Corporate Governance	ICS	ADB
	BPI	ICS	ADB

ADB = Asian Development Bank, BPI = business process improvement, ICS = individual consultant selection, QCBS = quality and cost based selection, SOE = state owned enterprise

Detailed cost estimates for each package will be confirmed during TA factfinding

^a The proposed quality:cost ratio is 90:10

Source: Asian Development Bank

E. Application of Optional Provisions

Table 2: Proposed Optional Provisions

Optional provisions	Indicative Scope of Application
Advance contracting	SOE Corporatization package

SOE = state owned enterprise

Source: Asian Development Bank

II. DELIBERATIVE AND DECISION-MAKING ITEMS

A. Risk Categorization

14. The TA is classified as low risk. Proposed ADB financing does not exceed \$1.5 million and the TA concept does not propose exemptions from ADB policies, cost recovery, TA delegation or other provisions that would result in the TA being classified as complex.

B. Scope of Due Diligence

15. Factfinding will be used to confirm the proposed Executing and Implementing agencies and finalize the TA scope including the design and monitoring framework, budget, and consultants' terms of reference. The mission's findings will be recorded in an Aide Memoire that will be submitted to the Government for endorsement. For output 1, factfinding will be used to confirm the proposed focus on water and electricity and how TA support will be coordinated with related activities that will be financed through the state budget. For output 2, the proposed focus on implementation of the Companies Law and government business process reform will be discussed with government counterparts and other stakeholders to ensure alignment and maximum impact. Potential for co-financing of TA activities will be confirmed with Timor-Leste's main development partners and the TA scope will be adjusted accordingly.

C. Processing Schedule

Table 4: Processing Schedule by Milestone

Milestones	Expected Completion Date
1. Concept Clearance	10 September 2019
2. Fact-finding completed	20 September 2019
3. Aide-mémoire confirmed	30 September 2019
4. TA approved	11 October 2019
5. TA letter signed	18 October 2019

TA = technical assistance

Source: Asian Development Bank

PRELIMINARY DESIGN AND MONITORING FRAMEWORK

Impacts the TA is Aligned with Average non-oil GDP growth rises to 7% per annum ^a Private investment increases by 10% per annum ^a			
Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting	Risks
Outcome The quality of infrastructure services and business regulation is improved.	a. Timor-Leste's percentile rank in the Regulatory Quality dimension of the Worldwide Governance Indicators reaches 27.7 by 2023 (2019 baseline 24.4).	a. Worldwide Governance Indicators	
Outputs 1. Improved governance of infrastructure and state-owned financial services.	1a. Timebound corporatization work-plans prepared for DGAS and EdTL (2019 baseline – no workplans)	1a. MRLAP, MOPW and consultants reports	Political instability interrupts the design and implementation of reforms
	1b. Asset registers and balance sheets prepared for DGAS and EdTL (2019 baseline, none prepared)	1b. MRLAP, MOPW and consultant reports	
	1c. HR analysis and transition plans prepared for DGAS and EdTL (2019 baseline, none prepared)	1c. MRLAP, MOPW and consultant reports	Vested interests obstruct or subvert the restructuring of water and electricity services
	1d. BNCTL, DGAS, and EdTL have achieved Level 2 in the progression matrix for the structure and functioning of the Board of Directors by 2023 (2019 baseline tbc). ^b	1d. MRLAP, and consultant reports	Capacity constraints undermine corporatization and the establishment of external monitoring
	1e. Clear performance monitoring and CSO frameworks prepared for BNCTL, DGAS, and EdTL by 2023 (2019 baseline, no frameworks)	1e. MRLAP, and consultant reports	Capacity constraints undermine the establishment of external regulatory functions

	1f. Unbundling of service delivery and technical and economic regulation completed for electricity and water by 2023. (2019 baseline, None)		
2. Reduced transaction costs for private businesses	<p>2a. Reduction in average time and cost for business registration and annual reporting for different classes of business by 2023. (2019 baselines tbc)</p> <p>2b. At least 2 government businesses reviewed and updated by 2023 (2019 baseline None)</p>	<p>2a. MRLAP, SERVE, and consultant reports</p> <p>2b. MRLAP and consultant reports</p>	<p>The time and cost for implementation of recommended system and business process improvements exceeds expectations.</p> <p>Gaps in inter-agency coordination undermine business process improvement.</p>

Key Activities with Milestones
1. Improved governance of infrastructure services.
1.1 Background assessments on the water sector
1.2 Development of corporatization work-plans for DGAS and EdTL.
1.3 Development of asset registers and balance sheets for DGAS and EdTL.
1.4 Review of current and required staffing for DGAS and EdTL.
1.5 Analysis of options for technical and economic regulation of electricity supply and water and sanitation
1.6 Preparation of recommended governance structure, transitional arrangements and business plans for DGAS and EdTL.
1.7 Support for implementation of agreed actions under transition plan
1.8 Development of performance monitoring and CSO framework for shareholder representative for BNCTL and infrastructure SOEs
1.9 Provision of training and mentoring support to SOE board members
1.10 Capacity development support to support shareholder monitoring of infrastructure and finance SOEs
2. Reduced transaction costs for private businesses
2.1 Review of business registration services and implementation of the Companies Law by SERVE
2.2 Design and implementation of workplan to improve efficiency of company registration and reporting
2.3 Review and updating of at least 2 government business processes that directly impact on private businesses
TA Management Activities
Recruitment of consultants (dates tbc)
TA Inception and review missions (dates tbc)
Inputs
ADB: \$1 million
TBC: \$1.5 million
Note: The government will provide counterpart support in the form of counterpart staff, office accommodation, secretarial assistance, and other in-kind contributions.
Assumptions for Partner Financing
Outputs not administered by ADB that are necessary to reach the outcome include: TBC

ADB = Asian Development Bank, BNCTL = National Commercial Bank of Timor-Leste, CSO = community service obligation, DGAS = General Directorate for Water and Sanitation, EdTL = Electridade de Timor-Leste, GDP = gross domestic product, HR = human resources, MOPW = Ministry of Public Works, MRLAP = Ministry of Legislative Reforms and Parliamentary Affairs, NA = not applicable, SERVE = Business Registration Service, SOE = state owned enterprise, TA = technical assistance, TBC = to be confirmed

^a Government of Timor-Leste. 2018. *Program of the VIIIth Constitutional Government*. Dili

^b World Bank. 2014. *Corporate Governance of State Owned Enterprises, a toolkit*. Washington DC
Source: Asian Development Bank.