



CONGRESSIONAL NOTIFICATION TRANSMITTAL SHEET

This Congressional Notification outlines the Millennium Challenge Corporation's intent to negotiate a Millennium Challenge Compact with the Government of Timor-Leste.

If you or your staff would like to arrange a meeting to discuss the proposed negotiations with the Government of Timor-Leste, please contact Brian Forni at (202) 521-2631 or ForniBJ@mcc.gov.

The attached notification is being transmitted to the Congress on March 15, 2022, and negotiations with Timor-Leste may be started on or after 15 days from the date of this notification.

In addition to the enclosed notification, we have attached supplemental information regarding the planned compact.

Sincerely,

/s/

Aysha House
Vice President
Congressional and Public Affairs

Enclosure as stated

**MILLENNIUM CHALLENGE CORPORATION
CONGRESSIONAL NOTIFICATION**

March 15, 2022

Pursuant to Division G, Title III under the heading “Millennium Challenge Corporation” of the Further Consolidated Appropriations Act, 2020 (P.L. 116-94); Division K, title III under the heading “Millennium Challenge Corporation” of the Consolidated Appropriations Act, 2021 (P.L. 116-260), as carried forward by the Continuing Appropriations Act, 2022 (P.L. 117-43), as amended by the Further Extending Government Funding Act (P.L. 117-70), as further amended by the Further Additional Continuing Appropriations Act, 2022 (P.L. 117-86); and section 610(a) of the Millennium Challenge Act of 2003, as amended, this notification is (1) to advise you that the Millennium Challenge Corporation (MCC) intends to start negotiations with the Government of Timor-Leste for a Millennium Challenge Compact and (2) to initiate Congressional consultation before the start of negotiations.

The following identifies the objectives and mechanisms to be used for the negotiation of this Compact.

Economic Justification

The Timor-Leste Compact aims to improve the health and skills of people in Timor-Leste by reducing the disease burden caused by contaminated water sources and enhancing teaching and learning at the secondary school level. The proposed compact program is designed to achieve its objective through two primary projects: the Water, Sanitation, and Drainage (WSD) Project and the Teaching and Leading the Next Generation of Timorese (TALENT) Project. A summary of the estimated economic rate of return (ERR), cost-benefit analysis, and impact on beneficiary populations is described below for each project.

Project	ERR
Water, Sanitation, and Drainage (WSD) Project	7.5–11.7 percent
Teaching and Leading the Next Generation of Timorese (TALENT) Project	15.6 percent

WSD Project. The proposed WSD Project invests in Timor-Leste's water and sanitation sector, in line with a master plan developed by the Government of Timor-Leste. Specifically, the compact would finance the constructions of a wastewater infrastructure backbone in Dili, which will later be expanded upon so that the system can function efficiently and at a low cost. MCC evaluated a range of plausible scenarios based on the extent to which additional investments leverage MCC-funded infrastructure. The ERR for the backbone project without any subsequent investments to complete water, sanitation and drainage connections to all households and businesses in Dili is 7.5 percent. However, other financiers (including the Government of Timor-Leste) have indicated strong interest in completion of the full master plan by 2036. In that event, MCC projects that the ERR for the completed plan would be 11.7 percent. MCC has determined that these subsequent investments are sufficiently probable to recommend the project for approval consistent with MCC’s investment criteria.

The benefits of the WSD Project are derived from improved health outcomes of the beneficiary population. The largest benefit is children's lives saved. The proposed project will initially supply disinfected water to approximately 108,000 Dili residents who are currently connected to the water supply network and is expected to serve 429,000 total residents in Dili's water service area by 2036. The Timorese water utility will also supply disinfected water to up to 64,000 residents in the other four districts of Timor-Leste. The WSD Project also presents an opportunity to leverage the private sector. The proposed compact will deliver new water and sanitation assets to Timor-Leste, which will require expert operations support during the initial years of service. A private operator will be retained for a period of five years (beginning in year four of the compact) to provide operations and maintenance while building capacity for local utility staff.

TALENT Project. The economic analysis of the proposed TALENT Project is based on the aggregate earnings of all projected upper secondary graduates who enter the labor force. People benefiting from the proposed TALENT Project include all upper secondary graduates who were taught by project-trained teachers and who subsequently entered the labor force, as well as their co-householders – an estimate of 957,721. Additionally, analysis suggests that at least initially, the poor will be moderately represented amongst those benefiting from the project, with an ERR estimated to be 15.6 percent.



SUPPLEMENTAL INFORMATION—PROPOSED TIMOR-LESTE COMPACT

Overview

The proposed Timor-Leste Compact seeks to assist the Government of Timor-Leste in addressing one major constraint to economic growth: low human capital. The proposed compact will address this constraint through a water, sanitation, and drainage project and an education project.

Background and Context

Timor-Leste is the world's second youngest democracy. The mountainous island nation of 1.3 million people is located in the Timor Sea just north of Australia and shares a border with Indonesia to the west. Although there are thirty-two indigenous languages spoken in addition to Indonesian and English, Portuguese and Tetum are the official languages. About two-thirds of the population are rural subsistence farmers. The capital city is Dili, with 300,000 inhabitants. The climate is tropical, with a distinct rainy season from December through April.

In 2002, Timor-Leste voted for independence from Indonesia in a referendum that had substantial support from the United States and the international community. When the Indonesian military pulled out of the country, nearly all of Timor-Leste's public infrastructure was destroyed—including health clinics, schools, roads, ports and airports, water and sanitation systems, and government facilities. As the country emerged from its violent twenty-year struggle for independence, the Timorese faced enormous development needs. There were exceptionally weak governing institutions and a lack of human resources across many sectors. Few Timorese had access to formal education and an even smaller number had experience with governance. Extreme poverty and hunger were widespread, and conflict and violence consistently threatened to (and sometimes did) break out, leading to instability. In the twenty years since independence, the Timorese have overcome many of these early challenges and built a vibrant democracy aimed at investing in its people. Nonetheless, Timor-Leste remains one of the poorest countries in the world, with 41.8 percent of the population living below the national poverty line in 2014.

Timor-Leste closed out a \$10.5 million threshold program in March 2014, which focused on strengthening anti-corruption efforts and enhancing access to immunization services. In December 2016, MCC's Board of Directors (Board) selected Timor-Leste to develop a second threshold program in recognition of the strong partnership MCC and Timor-Leste had made during the first threshold program. In December 2017, MCC's Board moved Timor-Leste from the threshold program to the compact program due to the progress Timor-Leste had made on its policy performance and the opportunity to have a greater impact on poverty reduction. Timor-Leste maintains strong performance on the MCC scorecard. In Fiscal Year 2022, it passes 15 of 20 scorecard indicators with particularly strong performance on both the Democratic Rights and Control of Corruption hard hurdles.

The Government of Timor-Leste has shown strong commitment to an inclusive and transparent compact development process to identify investments that will drive poverty reduction through economic growth. In 2016, the government provided staff and resources to conduct a constraints analysis to identify the key factors inhibiting economic growth. That analysis identified four primary constraints: (a) an uncompetitive real exchange rate (Dutch disease); (b) ineffective public financial management; (c) a weak business enabling environment; and (d) low human capital attributed to poor nutrition outcomes and lack of skilled workers.

In October 2018, during the root cause analysis stage, the Government of Timor-Leste and MCC narrowed the focus of the compact to pursue interventions that addressed i) the high stunting prevalence due to the large disease burden and inadequate nutrition, ii) the lack of “high-level” skills in the workforce, and iii) the unclear legal framework and limited capacity of the judicial system to resolve commercial disputes. In September 2019, the Government of Timor-Leste ultimately decided to submit two project proposals in water, sanitation, and drainage and in education to address the human capital constraint, recognizing the importance of a more skilled, healthier workforce in improving the business environment for investments and generating significant and sustainable economic returns for the country. The Government of Timor-Leste has closely engaged on the technical details of both projects and has committed to provide both in-kind and financial resources to support implementation and sustainability, signs of strong country ownership and commitment to the Compact.

Due to global travel restrictions and health and safety policies enacted in response to the COVID-19 pandemic, preparatory activities including critical feasibility studies were delayed, impacting the timeline for compact development. Nevertheless, MCC expects to conclude compact development and submit a compact for MCC Board of Directors approval in Fiscal Year 2022.

Compact Overview and Budget

Over a five-year period, the proposed Timor-Leste Compact will address the human capital constraint to economic growth through two projects aimed at improving the health and skills of the Timorese people.

Below is a summary describing the budget and components of the proposed Compact with the Government of Timor-Leste. The anticipated budget for the Compact is up to \$420,000,000. Table 1 presents an approximate budget for the proposed compact based on initial due diligence and appraisal.

Table 1: Timor-Leste Compact Budget (million in US\$)

MCC Funding by Compact Components	Total MCC Funding
1. Water, Sanitation, and Drainage Project	
1.1 Water Disinfection	\$8,270,509
1.2 Sanitation	\$278,846,498
1.3 Associated Drainage	\$8,938,044
1.4 Institutional Strengthening and Regulatory Reform	\$6,950,000
1.5 Household Sanitation and Water Management	\$5,200,000
Subtotal	\$308,205,050
2. Teaching and Leading the Next Generation of Timorese Project	
2.1 Forming a New Center of Excellence	\$14,599,454
2.2 Teacher Training	\$14,664,142
2.3 School Leadership Training	\$5,039,535
2.4 Ensuring Excellence	\$5,887,407
Subtotal	\$40,190,538
3. Monitoring and Evaluation	\$6,800,000
4. Program Administration and Oversight	\$64,804,412
Total MCC Funding	\$420,000,000
Additional Government of Timor-Leste Contribution	Up to \$64,000,000¹

Proposed Projects

The projects and activities to be negotiated are:

The **Water, Sanitation, and Drainage (WSD) Project** aims to reduce the prevalence of fecal pathogens in piped and stored drinking water and groundwater. The proposed project includes investments in infrastructure that will introduce the country’s first central wastewater system, make related improvements to the drainage network, and build a plant to produce disinfectant chemical that will be used to treat the city water supply across the capital city of Dili and four nearby municipalities. The project will also support key policy and institutional reforms to support long-term sustainability of the infrastructure and social and behavior change efforts to improve household water management and hygiene practices.

¹ Per MCC’s Guidelines for Country Contributions (February 10, 2021), lower income countries (LICs) such as Timor-Leste are not required by the Millennium Challenge Act of 2003 to “make a Country Contribution to their first compact program. However, MCC and the partner country may agree to include a Country Contribution in the first compact.”

The **Teaching and Leading the Next Generation of Timorese (TALENT) Project** aims to improve student learning outcomes. It will do so by improving secondary school teaching and school leadership. The proposed project will establish the country's first formal pre-service teacher certification institution, the Center of Excellence, which will offer training and professional certification for future and current secondary school teachers and leaders. Trainings developed and delivered by the Center of Excellence, and school-based teams, will seek to enhance both pedagogical and leadership skills. The project will also seek to increase the number of women in secondary school training and leadership positions through a Women's Economic Empowerment sub-activity.

Policy Reform and the Compact

MCC has identified the following key policy reform areas to support the sustainability of the proposed compact, the timing and content of which will be negotiated with the Government of Timor-Leste and will be included in the compact.

The **WSD Project** includes several institutional and policy reforms to ensure long-term operations and maintenance of the infrastructure built under the project. This includes capacity building support to Timor-Leste's newly established independent water utility and water regulator and the adoption and implementation of specific sanitation system regulations.

There are two key reforms for sustaining the results of the **TALENT Project**. This includes the legal establishment of the Center of Excellence as an independent, autonomous education provider, and regulatory reform to require future secondary school teachers to hold professional certification from the Center of Excellence to be eligible for Government-supported teaching positions.

Update and Sustainability of the 2010 Timor-Leste Threshold Program

In September 2010, MCC and Timor-Leste signed a \$10,496,000 threshold program. The Timor-Leste Threshold Program was funded by MCC with implementation supervised by the United States Agency for International Development. The program worked to tackle corruption through an integrated approach involving several key institutions and actors and improved access to immunization services through the creation of a more effective community health system. The program began on February 1, 2011 and concluded on March 31, 2014.

The Fostering Transparency Initiative (FOTI) worked to reduce corruption and emphasized building human and institutional capacity. FOTI assistance delivered a broad suite of activities to build corruption fighting capacity that included coaching and mentoring to enhance the government's capacity to investigate corruption crimes. The components were also effective in increasing the audit capacity of staff in the Government of Timor-Leste's Office of Inspector General and developing principles of procurement and trainings on public procurement that were rolled out nationwide. The program resulted in legislative achievements, including amendments to the country's law for preventing and combating money laundering and the financing of

terrorism, and passage of a law creating a Financial Intelligence Unit, which was established in September 2014. These measures were unanimously approved by Parliament.

The Imunizasaun Proteje Labarik (Immunization Protects Children or IPL) program assisted the Ministry of Health in improving immunization coverage and strengthening routine immunization services. At the start of the threshold program, Timor-Leste's immunization coverage was among the lowest in Asia. The program provided support, facilitation, and funding for the Ministry of Health to conduct micro-planning sessions at the 35 community health centers in its seven focus districts (covering approximately two-thirds of the national population). Over the course of the program, IPL raised the national average of DTP3 and measles vaccination in infants from 67.5 percent to 81.5 percent in those districts. The program's tools and approaches were viewed positively at all levels with beneficiaries who were directly involved in the intervention at subdistrict and village levels being most appreciative of the collaborative approach of the program.