

CONGRESSIONAL NOTIFICATION TRANSMITTAL SHEET

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

The transmission of this notification to Congress on June 1, 2022, affirms that the Timor-Leste Compact may be signed and the funds obligated on or after 15 days from the date of this notice. Please find enclosed the notification with supplemental information regarding the compact.

If you require a meeting to discuss the compact with the Government of Timor-Leste, or MCC at large, please contact Brian Forni at (202) 521-2631 or ForniBJ@mcc.gov.

Sincerely,

/s/

Aysha House
Vice President
Congressional and Public Affairs

Enclosure as stated

**MILLENNIUM CHALLENGE CORPORATION
CONGRESSIONAL NOTIFICATION**

June 1, 2022

PROGRAM: Eligible Countries

APPROPRIATIONS CATEGORY: Fiscal Years 2020 and 2022 Program Funds

OBLIGATION AMOUNT: \$420,000,000

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, 2022 (P.L. 117-103); and section 610 of the Millennium Challenge Act of 2003, as amended (the “Act”), the Millennium Challenge Corporation (“MCC”) is notifying Congress of its intent to sign a Millennium Challenge Compact (the “Compact”) with the Government of Timor-Leste, through which MCC will grant an amount not to exceed \$420,000,000 to the Government of Timor-Leste under the Act. To facilitate implementation of the Compact, MCC intends to obligate up to \$51,051,629 (“Compact Facilitation Funding”) of the overall grant under section 609(g) of the Act, using fiscal year 2020 funds, when the Compact is signed by the parties. Under Section 605 of the Act, MCC intends to obligate up to \$368,948,371 when the Compact enters into force. After the Compact enters into force, Compact Facilitation Funding that is not needed to facilitate implementation of the Compact may be de-obligated, and up to an equivalent amount of funding may be obligated under section 605 of the Act. Such funding is included in the total amount of MCC funds under the Compact and will not increase the total Compact funding.

Compact funding will support economic growth in Timor-Leste through investments in water, sanitation, and drainage infrastructure and education.

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
WSD Project	7.5–11.7 percent
TALENT Project	15.6 percent

Water and Sanitation. The **WSD Project** invests in Timor-Leste's water and sanitation sector. In line with a master plan developed by the Government of Timor-Leste, the Compact would finance the construction 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 estimated 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. MCC forecasts that the ERR for the completed plan would be 11.7 percent.

The benefits of the WSD Project are derived from improved health outcomes of the beneficiary population. The largest benefit is children's lives saved due to improved water quality. 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 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.

Education and Labor Force. The estimated impact of the **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 the members of their households – an estimate of 957,721. Additionally, initial analysis suggests that the poor will be represented amongst those benefiting from the project, with an ERR estimated to be 15.6 percent.

SUPPLEMENTAL INFORMATION

Overview of MCC Timor-Leste Compact

In May 2022, MCC's Board of Directors ("Board") approved a five-year, \$420,000,000 Compact with the Government of Timor-Leste aimed at reducing poverty through economic growth, following completion of successful Compact negotiations in April 2022.

The Compact seeks to assist the Government of Timor-Leste in addressing the human capital constraint to economic growth through two primary projects: the Water, Sanitation, and Drainage ("WSD") Project and the Teaching and Leading the Next generation of Timorese ("TALENT") Project. The Government of Timor-Leste has demonstrated country ownership throughout compact development, including through a commitment to contribute up to \$64,000,000 to support the implementation of the WSD Project.

Background and Context

Timor-Leste is the world's second youngest democracy with a population of 1.3 million people, about 300,000 of whom reside in the capital city of Dili. In 2002, Timor-Leste voted for independence from Indonesia in a referendum that had substantial support from the United States and the international community. As the country emerged from its violent twenty-year struggle for independence, the Timorese faced enormous development needs. These included 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 institutional development and governance. Extreme poverty and hunger were widespread, and conflict and violence consistently threatened to, or in fact 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 that aims to invest 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.

Nearly all of Timor-Leste's public infrastructure—including health clinics, schools, roads, ports and airports, water and sanitation systems, and government facilities—was destroyed as the Indonesian military pulled out of the country in 1999. The effects of this destruction are still visible today. The poor condition of piped water infrastructure and lack of a centralized sanitation system have resulted in widespread contamination of drinking water and groundwater and contribute to the country's high incidence of disease and rate of stunting. Further, nearly 30 percent of the population of Dili lives in "unstructured areas," which are densely populated and have limited access to modern sanitation infrastructure.

When Timor-Leste declared independence, the country also confronted a shortage of teachers and administrators. As is the case in many post-conflict settings, schools were opened with the few individuals who remained and already resided in school communities. While this played an important role in stabilization and helped restore a sense of post-conflict normalcy, it meant that few teachers and school leaders had received professional training and had to provide instruction in severely damaged schools with limited resources. This has had a negative impact on the quality of education delivered to students entering tertiary education and the workforce.

As the country enters its third decade of independence, the Government of Timor-Leste seeks to better coordinate aid financing to make the strategic investments necessary to address critical development priorities and generate sustained job-creating growth, as reflected in the Government of Timor-Leste's Timor-Leste Aid Management Effectiveness Policy. The Government of Timor-Leste has developed a Water Supply Master Plan, which identifies capital investments needed to rehabilitate the public drinking water supply for Dili. Timor-Leste's 2011-2030 National Education Strategic Plan envisions areas for improvement in the education sector. A recent donor mapping carried out by the Global Partnership for Education indicated that there has been limited donor engagement in general secondary education, with only modest investments in language training.

MCC Eligibility Background

MCC's Board approved a \$10,490,000 threshold program for Timor-Leste in 2010. The program aimed to reduce corruption by building a network of anti-corruption institutions and actors and improving access to immunization services through the creation of a more effective community health system. The program was administered by USAID and completed in 2014.

In December 2016, MCC's Board selected Timor-Leste to develop a second threshold program in recognition of the strong partnership MCC and Timor-Leste had during the prior threshold program. Then, 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 has maintained strong performance on the MCC scorecard since its December 2016 selection and passes 15 of 20 indicators in Fiscal Year 2022, with particularly strong performance on both the Democratic Rights and Control of Corruption hard hurdles.

MCC continues to emphasize to the Government of Timor-Leste the importance of strengthening its efforts to combat trafficking in persons given the country's placement on the Tier 2 Watch List of the U.S. Department of State's Trafficking in Persons report.

Economic Constraints Analysis

The constraints analysis for Timor-Leste represented a combined effort by MCC and the Government of Timor-Leste to identify potential sectors for investment. The constraints analysis identified four primary constraints that presented the opportunity to invest in four different sectors: a) an uncompetitive real exchange rate (Dutch disease); b) low sustainability and effectiveness of fiscal expenditures; c) weak policies and institutions to enable market transactions; and d) low human capital attributed to poor nutrition outcomes and lack of skilled workers. The Government of Timor-Leste and MCC narrowed the focus of the potential compact during the root cause analysis stage 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. The Government of Timor-Leste ultimately submitted two project proposals in water, sanitation, and drainage and in education to address the human capital constraint.

The onset of the COVID-19 pandemic in March 2020 delayed preparatory activities, including critical feasibility studies, which impacted the timeline for compact development. However, through the use of remote data collection techniques and the resumption of travel to Timor-Leste in summer 2021, MCC and the Government of Timor-Leste were able to reach technical agreements needed to finalize compact development.

Compact Overview and Budget

Over a five-year period, the 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 Compact with the Government of Timor-Leste. The budget and expected impacts are preliminary based on initial due diligence and project appraisal and are subject to change. The anticipated budget for the compact is up to \$420,000,000.

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

Project/Activity	Budget (US\$)
Water, Sanitation, and Drainage (“WSD”) Project	308,205,050
Activity 1: Water Disinfection	8,270,509
Activity 2: Sanitation	278,846,498
Activity 3: Associated Drainage	8,938,044
Activity 4: Institutional Reform	6,950,000
Activity 5: Household Water and Hygiene	5,200,000
Teaching and Leading the Next generation of Timorese (“TALENT”) Project	40,190,538
Activity 1: Center of Excellence	14,599,454
Activity 2: Teacher Training	14,664,142
Activity 3: School Leadership Training	5,039,535
Activity 4: Ensuring Excellence	5,887,407
Monitoring and Evaluation	6,800,000
Program Administration	64,804,412
Total MCC Funding	420,000,000
Total Government Contribution¹	64,000,000
Total Program	484,000,000

Project Summaries

The projects and activities to be completed are:

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.”

1. Water, Sanitation, and Drainage (“WSD”) Project

The primary objective of the WSD Project is to reduce fecal pathogens in piped and stored drinking water and groundwater. The project aims to mitigate exposure to sanitary waste and pathogens in water, households, and the environment through investments in infrastructure, policy and institutional reform, and social and behavior change. The project will focus its interventions in the capital city of Dili and four nearby municipalities (Aileu, Ermera, Liquica, and Manatuto). Specifically, the WSD Project will support the following activities:

- **Activity 1: Water Disinfection.** This activity will supply disinfected water to Dili and the four municipalities of Timor-Leste through the design and construction of an onsite sodium hypochlorite generation plant.
- **Activity 2: Sanitation.** This activity includes the design and construction of a new wastewater treatment plant, an ocean outfall framework, wastewater collection systems, and wastewater connections to households and businesses.
- **Activity 3: Associated Drainage.** This activity supports the implementation of the sanitary sewer system described in Activity 2 above through the construction of in-street drainage infrastructure in areas where conflicts with sewer lines would otherwise occur.
- **Activity 4: Institutional Reform.** To ensure long-term sustainability of the WSD Project’s infrastructure investments, this activity will support the capacity building and institutional development of Timor-Leste’s independent public water utility with a focus on strengthening asset management expertise and operations and maintenance capacity. The activity will further promote sustainability through targeted assistance to Timor-Leste’s independent water regulator to develop and implement regulations and public awareness around sanitation and disinfection.
- **Activity 5: Household Water and Hygiene.** This social and behavior change activity includes interventions to increase household and community awareness of the benefits of, and support for, the construction and maintenance of household sanitation units as well as the adoption and maintenance of key behaviors to secure sustained community buy-in for household sanitation infrastructure

2. Teaching and Leading the Next generation of Timorese (“TALENT”) Project

The primary objective of the proposed TALENT Project is to improve student learning outcomes. To achieve this objective, the project will invest in teacher and school leader education and training, which are critical to improving student learning. The project will establish the Center of Excellence and improve the pedagogical and leadership skills of existing and future secondary school teachers and leaders through the development and deployment of targeted trainings. Future teachers and a subset of existing teachers will receive professional certification through the Center of Excellence during the life of the Compact. Ultimately, it is expected that all secondary teachers will be required to have Center of Excellence certification in order to be eligible for employment in a government secondary school in Timor-Leste. The

project will employ a gender-responsive approach in all its activities and place a concerted focus on increasing the number of women as teachers and school leaders in secondary schools through a dedicated sub-activity. Specifically, the TALENT Project will support the following activities:

- **Activity 1: Center of Excellence.** This activity will establish a new autonomous institution in Timor-Leste to provide professional training and certification to future secondary teachers entering the workforce, as well as training and certification of a portion of current secondary teachers.
- **Activity 2: Teacher Training.** This activity involves the development of curriculum, materials, and faculty to train current and future teachers to improve their pedagogical skills that lead to improvements in numeracy, literacy, and soft skills. It also includes the professional certification of all newly trained secondary teachers and a subset of current teachers.
- **Activity 3: School Leadership Training.** This activity will support the training of school leaders to create effective schools through strong school leadership, both in school management and in terms of instructional leadership. It includes the development of curriculum and training materials and the delivery of trainings to current and future school leaders. Training will focus on competencies in school leadership, including gender and social inclusion and information communications technology in education.
- **Activity 4: Ensuring Excellence.** This activity ensures accessibility and quality of all activities carried out under the Center of Excellence. It includes support for quality assurance and monitoring, information and communication technology, and language needs, as well as a specific sub-activity focused on increasing the number of women in teaching and leadership positions in secondary schools.

Policy Reform and the Compact

MCC has identified the following key policy reform areas to support the sustainability of 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. The project will provide sustained support to Timor-Leste's newly established independent water utility and water regulator and guide the water regulator as it adopts and implements 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 in order 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 of Timor-Leste'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.