



CONGRESSIONAL NOTIFICATION TRANSMITTAL SHEET

We wish to inform you that the Millennium Challenge Corporation intends to obligate up to \$750,000 to facilitate the development and implementation of a Millennium Challenge Compact with the Government of Timor-Leste.

The attached notification is being sent to the Congress on April 5, 2018. Obligation of funds may be incurred on or after 15 days from the date of this notification.

In addition, we have attached supplemental information that further describes the planned use of the funds.

Sincerely,

/s/

Karen Sessions
Vice President
Congressional and Public Affairs

Enclosure: As stated

**MILLENNIUM CHALLENGE CORPORATION
CONGRESSIONAL NOTIFICATION**

April 5, 2018

PROGRAM:	Eligible Countries
APPROPRIATIONS CATEGORY:	Fiscal Year 2018 Program Funds
OBLIGATION AMOUNT:	\$750,000

Pursuant to section 7015(c) of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2018, this is to advise that the Millennium Challenge Corporation (“MCC”) intends to obligate up to \$750,000 under section 609(g) of the Millennium Challenge Act of 2003, as amended, for the purpose of facilitating the development and implementation of a Millennium Challenge Compact (“Compact”) with the Government of Timor-Leste.

MCC plans to finance compact development activities, including but not limited to preliminary analyses, an economic root cause analysis, and sector analyses for identified binding constraints.

SUPPLEMENTAL INFORMATION

MCC 609(g) Funding for Timor-Leste

Background

Timor-Leste, Asia's youngest country and a burgeoning democracy, has moved past the strife of recent years and is undertaking the difficult task of building a strong, resilient economy that benefits all Timorese. When Timor-Leste gained independence in 2002, the new country faced extremely high rates of poverty with almost no infrastructure to support development. The Timorese have made considerable progress over the last fifteen years by building their young institutions and investing proceeds from off-shore oil fields in infrastructure. While the country has made great strides, significant work remains to consolidate these gains and lift the estimated 42% of the population who still lived below the national poverty line in 2014. The public sector dominates the economy, providing approximately half of all formal employment in 2013, while the private sector is at an early stage of development, constrained by limited human capital and gaps in the basic legal framework for commerce. Future progress hinges on the emergence of a private sector that can drive growth. MCC will work with the Government of Timor-Leste and its partners in identifying an economic strategy to develop new engines for poverty-reducing growth powered by the private sector and create an enabling environment for good policy-making, economic growth, and inclusivity.

MCC collaborated with the Government of Timor-Leste on a constraints analysis that identified four binding constraints to private sector-led growth:

- **Low sustainability and effectiveness of fiscal expenditures:** Government expenditures are on an unsustainable path that could lead to the depletion of resources in the Petroleum Fund. The Fund was established in 2005, into which all revenues from petroleum are deposited, thereby allowing Timor-Leste to convert its natural resource into a financial resource. While the fund is healthy in the near term, with withdrawals currently exceeding sustainable levels, the fund will be exhausted in roughly ten years. The efficiency and targeting of government expenditures could also be improved to better promote private investment and economic growth.
- **An uncompetitive real exchange rate (Dutch disease):** An increase in revenues from oil has resulted in a large inflow of foreign money, making Timor-Leste's currency stronger compared to other nations. As a result, Timor-Leste's exports are more expensive for others to buy, which makes sectors such as manufacturing and tourism less competitive.
- **Weak policies and institutions to enable market transactions:** Timor-Leste has not yet fully put into place the policies and institutions needed to support a market economy. The country lacks a legal framework and judicial institutions to support contracts and their enforcement. This leads to inefficiencies and limits the number of business transactions that can occur, especially within the finance and land markets.
- **Low human capital; poor nutritional outcomes and lack of high-skilled workers:** While Timor-Leste has made progress developing its human capital from a very low base, more gains are needed. Early childhood health and nutrition are poor; over half of children

under the age of five are stunted. In the workforce, the lack of tertiary education is costly to firms and has resulted in 30-40 percent of professional jobs being filled by foreign nationals.

Process and Country Engagement

Timor-Leste was initially selected by MCC as eligible to develop a compact in 2005. However, as a result of civil unrest in the country in 2006, among other factors, MCC downgraded Timor-Leste to a threshold program. That threshold program, which was successfully implemented in collaboration with the United States Agency for International Development from 2010 to 2014, established the Anti-Corruption Commission and improved access to immunization services. In December 2016, MCC selected Timor-Leste for a second threshold program. As the first step in the development of a threshold program, MCC undertook an integrated constraints analysis in collaboration with the Government of Timor-Leste. The Government of Timor-Leste also facilitated coordination among donors, and the Asian Development Bank and World Bank's collaboration in the analysis contributed significantly to the findings.

Since Timor-Leste's selection for the threshold program in December 2016, the Government of Timor-Leste has demonstrated a clear commitment to good governance, investing in its people and economic freedom, as evidenced by Timor-Leste's 2018 MCC scorecard. Considering this continued strong performance, MCC's Board of Directors selected Timor-Leste as eligible to develop a compact on December 19, 2017.

Planned 609(g) Expenses

The next step in the compact development process is to perform an analysis of the root causes that give rise to the binding constraints to economic growth and, through this analysis, identify specific core problems around which to organize potential investments and other activities. Once the root causes are diagnosed through a participatory process, the Government of Timor-Leste will choose one or more core problems that it proposes to address through a compact program, along with the outcomes it expects to achieve by addressing each problem. The Government of Timor-Leste will then summarize this information in concept notes that form the basis of proposals for future MCC compact projects.

MCC intends to use 609(g) funding to finance initial administrative expenses necessary to ensure timely completion of a comprehensive and rigorous root cause analysis and related analyses. Such expenses may include, but are not limited to, initial salaries for critical, dedicated technical experts, such as economists, social, gender and private sector experts, monitoring and evaluation expertise, and a designated national coordinator; support for public consultations; and related administrative expenses. The planned funding will ensure that the Government of Timor-Leste and MCC have early access to the technical expertise needed to conduct a rigorous root cause analysis, as well as related analyses, thereby setting the stage for robust project proposal(s) and facilitating the development of an MCC compact.