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East Timor's transition to independence: Building up an economy from scratch

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KIELER DISKUSSIONSBEITRÄGE

KIEL DISCUSSION PAPERS

368

East Timor's Transition to Independence: Building Up an Economy from Scratch

by Rainer Thiele

Contents

- After the extensive destruction caused by the violence that followed the vote for independence on August 30th, 1999, the reconstruction of East Timor's infrastructure inevitably was the top priority. Supported by massive aid inflows, achievements in this area have been quite remarkable. As a result, East Timor's production capacity is likely to return to pre-crisis levels within a few years. The much more difficult task is to initiate and then sustain a long-run development process. This requires a whole bundle of measures of which only a part has been introduced up to now.
- At the macroeconomic level, three policy areas figure most prominently. First, to ensure a certain degree of macroeconomic stability as a prerequisite for growth, it is recommended to implement a combination of a Currency Board regime for the exchange rate and a sound fiscal policy based on a broad domestic revenue base. Second, permanent growth can only be achieved via the accumulation of physical and human capital. Secure property rights and a transparent investment code are among the essential conditions for physical capital formation. Human capital formation can be fostered by reallocating public resources towards basic services, which were seriously neglected under Indonesian rule. Third, a country like East Timor with its very small domestic market and its limited technical knowledge can reap large benefits from adopting an open trade and foreign investment regime.
- From a sectoral perspective, agriculture will remain the backbone of the economy in the foreseeable future. Incentives that lead to a more dynamic development of this sector are thus of particular importance, not only for growth but also for poverty alleviation as the vast majority of poor people live in rural areas. Such incentives include a market-oriented pricing policy, a stable and competitive exchange rate, access to credit, a basic rural infrastructure, and the provision of adequate research and extension facilities.
- A development strategy based on agriculture alone would, however, leave the economy vulnerable to shocks. Only a diversification of production will open the way to more robust growth. One significant step in this direction could be the exploitation of existing oil fields. If future oil revenues live up to expectations, the main policy challenge will be to avoid an overvaluation of the domestic currency (Dutch Disease). In the medium run, the establishment of labor-intensive industries could be another step towards a more diversified economy. Whether this option can be realized will depend to a large extent on East Timor's ability to import capital and know-how via foreign direct investment.
- Overall, if political stability prevails, the outlook for sustained progress seems better than in many other low-income countries, where the international community is less consistently engaged and where much stronger vested interests block reform efforts. At the moment, the most significant danger for long-term development in East Timor arises from the uncertainty of land and property rights, which is likely to hamper investment and agricultural development. Moreover, it has to be kept in mind that various important measures, such as investments in education, will take considerable time to materialize fully.

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I. Introduction

After the vote for independence on August 30, 1999, East Timor experienced a wave of violence. As a consequence, an estimated 75 percent of the population was displaced, and almost 70 percent of the physical infrastructure was destroyed or rendered inoperable. Moreover, a large part of the senior civil service staff, which mainly consisted of Indonesians, left the country. This, together with the inevitable fact that a new nation lacks a number of essential institutions, implies that East Timor virtually has to start from scratch in creating the prerequisites for sustained economic and social development. The challenge for the country is further compounded by the low standard of living that already prevailed before the referendum took place.

Against this background, the present paper has two major objectives: to survey the current economic and social situation in East Timor, and to outline the core steps which have to be taken in order to establish a basic framework for future growth and poverty alleviation. The paper is structured as follows. Chapter II presents the available facts concerning East Timor's current development status. It also provides some tentative conclusions on the developments which are most likely to occur in the foreseeable future. Chapters III and IV deal with those policy measures and institutions, respectively, which are supposed to have a crucial impact on East Timor's future development path. The scope for facilitating efforts at the national level via external support is discussed in Chapter V. The report closes with some concluding remarks.

II. Economic and Social Situation and Outlook

1. Core Macroeconomic and Social Indicators

East Timor was one of the poorest Indonesian provinces. With an estimated GNP per capita of \$430 in 1996, it reached less than half the national average (Table 1). In Southeast Asia, only the three Indochinese countries – Cambodia, the Lao PDR, and Vietnam – were poorer than East Timor. East Timor lagged behind the rest of Indonesia although officially recorded investment per capita ran at approximately double the Indonesian average. This points towards a severe misallocation of investable funds (see also Section II.2). Exceptionally high growth rates in some periods – e.g., the average growth rate of 10 percent between 1994 and 1996 – were fueled by transfers from the central government and increases in the world market price for coffee. They did not reflect improvements in the domestic production capacity.

Table 1: GNP Per Capita in East Timor and Other Southeast Asian Countries, 1996 and 1998 (in dollars)

| | East Timor | Indonesia | Cambodia | Lao PDR | Vietnam |
|--------------------|------------------|-----------|----------|---------|---------|
| 1996 | 430 | 1,070 | 285 | 400 | 290 |
| 1998 | 240 ^a | 895 | 275 | 420 | 325 |
| ^a 1999. | | | | | |

Source: UNTAET and World Bank (2000); World Bank (2000).

The low average standard of living in East Timor corresponded with a poverty rate double the Indonesian average and limited achievements in various health and education indicators (Table 2). Particularly striking were the low net school enrollment rates. Even Cambodia, the poorest Southeast Asian country with its long history of civil war, clearly outperformed East Timor in this respect.

Table 2: Social Indicators in East Timor, Indonesia, and Cambodia, 1997

| Indicator | East Timor | Indonesia | Cambodia |
|-----------------------------------|------------|-----------|----------|
| Poverty rate | 36 | 18 | 39 |
| Life expectancy | 55–58 | 65 | 54 |
| Infant mortality ^a | 85 | 43 | 102 |
| Under five mortality ^a | 124 | 52 | 143 |
| Adult illiteracy | 59 | 15 | 63 |
| Net primary enrollment | 70 | 99 | 97 |
| Net secondary enrollment | 39 | 56 | 42 |

^aPer 1,000 live births.

Source: UN and World Bank (1999); World Bank (2000).

The post-ballot violence is likely to have reduced East Timor's per capita income to a level comparable to that in Cambodia and Vietnam. Virtually every piece of equipment and physical infrastructure of the urban economy was destroyed. Generalized insecurity and the substantial population relocation disrupted most agricultural production in 1999 and prevented land preparation and planting for the next year. The markets for goods and services completely collapsed, as did administrative structures. In all, GNP per capita is estimated to have declined by 40–45 percent in 1999. Adding to this the negative effect of the Asian crisis, which peaked one year before, a rough estimate puts GNP per capita for 1999 at about \$300. As a result of the economic breakdown, the vast majority of the East Timorese population was forced into poverty, and social services such as health care and education further deteriorated.

Despite the dramatic crisis, the reconstruction of East Timor's economy seems possible within a relatively short period of time. It will be facilitated by the huge efforts of the international community to rebuild the infrastructure and by the specialization of the economy towards activities that do not need large amounts of capital (Section II.2). The much more difficult task will be to start a long-run development process once precrisis levels of economic activity have been reestablished. This requires high rates and an efficient allocation of investment. In this respect, there are already some positive signs such as the beginning inflow of foreign direct investment. Most significantly, two foreign banks from Australia and Portugal have built up facilities in East Timor, while some Indonesian banks consider to reopen their former branches.¹ It is an open question whether these single events will be followed by a steady flow of investment. Some insecurity arises in particular from the fact that the regulatory framework for investment has not yet been fully spelled out (Section III.3).

2. Sectoral Breakdown of Economic Activities

Prior to the recent crisis, East Timor was primarily an agricultural economy, with about 90 percent of the population living in rural areas, and a single significant export good, coffee, which contributed about 90 percent to overall foreign exchange earnings. In 1996, agriculture's share in GDP amounted to more than double the Indonesian average (Table 3). Other striking features were the very low importance of mining and manufacturing and the enormous size of construction and public administration.

¹ The presence of Indonesian banks would not only contribute to the creation of a financial infrastructure. It would also help East Timorese recover existing deposits at Indonesian banks.

Table 3: GDP by Sector of Origin in East Timor and Indonesia, 1996 (percent)

| | East Timor | Indonesia |
|-------------------------------|------------|-----------|
| Agriculture | 36.8 | 16.7 |
| Mining and quarrying | 1.2 | 8.7 |
| Manufacturing | 3.0 | 25.6 |
| Electricity and water | 1.1 | 1.3 |
| Construction | 15.0 | 7.9 |
| Trade, hotels and restaurants | 9.9 | 16.4 |
| Transport and communication | 8.5 | 6.6 |
| Banks and finance | 2.3 | 5.7 |
| Rents | 1.8 | 2.6 |
| Government | 19.2 | 6.3 |
| Other services | 1.1 | 2.4 |

Source: BPS (1998).

The distorted structure of the East Timorese economy under Indonesian rule is further highlighted by the sectoral breakdown of real GDP growth, as shown in Table 4. The largest contributors to real growth in the three years 1994–1996 were construction, public administration, and other services, which together accounted for 7.5 percentage points of the average 10.1 percent real growth over these years. All of these sectors produced nontradables, were highly dependent on central government transfers, and benefited primarily the urban population. Assuming that the trade, hotels and restaurants sector mainly serves the urban, government-paid population, the contribution of this sort of activities increases to 8.8 percentage points out of the 10.1 percent total. Agriculture accounted for less than 1 percent real growth, and this above-zero average was largely due to the dramatic increase in world coffee prices in 1996. Overall, the data strongly support the picture of growth generated by government transfers into a modern sector focused on the urban population, with a parallel low-growth rural economy.

After the crisis, the share of agriculture in the overall economy has even increased because the urban economy was hit much harder by the post-ballot violence. Activities in the manufacturing and services sector almost came to a standstill. The urban unemployment rate has been estimated to exceed 90 percent, with international organizations being the only significant employer. In agriculture, a substantial part of the production capacity survived the violence. The coffee sector, in particular, has remained nearly intact. It is expected that the coffee crop of the year 2000 will come in at above average levels in nearly all coffee-producing districts. The situation for food crops is somewhat less favorable. The production of rice is estimated to reach 58–70 percent of 1999 levels in the year 2000, for other food crops estimates range from 60 to 75 percent.

Table 4: Real GDP Growth in East Timor by Sector of Origin, 1994–1996 (percent)

| | Average growth per year | Contribution to real growth |
|-------------------------------|-------------------------|-----------------------------|
| GDP | 10.1 | 10.1 |
| Agriculture | 2.7 | 0.7 |
| Mining and quarrying | 11.0 | 0.1 |
| Manufacturing | 15.0 | 0.4 |
| Electricity and water | 19.1 | 0.1 |
| Construction | 12.1 | 2.7 |
| Trade, hotels and restaurants | 11.6 | 2.6 |
| Public administration | 13.8 | 1.3 |
| Other services | 15.1 | 2.2 |

Source: UN and World Bank (1999).

For the time being, agriculture will continue to dominate East Timor's economy, especially in terms of employment. With a more balanced sectoral allocation of investment and better incentives for farmers, it can be expected that the contribution of agriculture to overall growth will increase. Since most of the poor live in rural areas, a more dynamic agricultural sector will also be the most promising means for poverty alleviation. It should, however, be kept in mind that East Timor's agricultural sector will not be able to emulate the spectacular success in other East Asian regions such as Java because the terrain is more erosion-prone, the soils are less fertile, and rainfall is less predictable.

In the urban sector, a quick recovery of various services seems possible. Services such as trade and transport are likely to become the main source for the absorption of urban labor in the near future. In the medium run, East Timor may have a comparative advantage in some labor-intensive manufacturing sectors, e.g., clothing or agricultural processing. Whether this potential can be realized depends at least in part on the country's attractiveness for foreign direct investment as it does not seem realistic to build up manufacturing capacities based on domestic capital and know-how alone.

One further commodity that has the potential to affect East Timor's future development path is oil. A project has been approved to exploit the oil fields in the Timor Gap. The project involves a consortium of international companies and entails an investment of \$1.4 billion. Production is scheduled to commence in 2004. Projections on the prospective oil revenues vary widely, ranging from less than \$5 million to \$30 million per year. If actual revenues come anywhere close to the more optimistic scenarios, this will definitely strengthen the tax base given that East Timor's recurrent budget around 2005 might have a size of about \$60 million. Moreover, oil would then join coffee as the second major foreign exchange earner, thereby reducing the dependence of the economy on a single commodity that faces extremely volatile world market prices. But as the experience of many developing countries shows, oil revenues are a mixed blessing. The East Timorese government will face the politically difficult task to abstain from spending too much of the revenues on nontradable goods such as public buildings in order to avoid a marked increase in the price of nontradables relative to tradables which would deteriorate the competitive position of tradable goods and thereby endanger macroeconomic stability and economic growth.²

III. Key Economic and Social Policy Decisions

1. Macroeconomic Management

A certain degree of macroeconomic stability is a prerequisite for economic growth. This involves the establishment of internal equilibrium (a sustainable fiscal position and low inflation) as well as external equilibrium (a sustainable balance of payments). The policy areas relevant for macroeconomic stability – fiscal, monetary and exchange rate policy – will be reviewed in the following.

a. Fiscal Policy

Under Indonesian rule, up to 85 percent of East Timor's current and investment expenditures were covered by transfers from the central government in Jakarta. This option is now gone. At present, international aid substitutes for the losses of transfers from Jakarta, but there are also serious efforts to create a domestic revenue base. A provisional tax and customs regime has been established which contains detailed provisions for imports into East Timor, exports from East Timor and the domestic

² In the economic literature, this effect is called the Dutch disease after the experience of the Netherlands with natural gas revenues in the 1970s (see, for example, Corden and Neary 1982).

production of goods in East Timor.³ Every importer of goods has to pay an import duty equivalent to 5 percent of the customs value, i.e., the transaction value of the good including cost, insurance and freight. Domestic producers have to pay excise taxes and importers excise equivalent taxes for the goods listed in Table 5. Exports are exempt from these duties. Furthermore, a 5 percent sales tax is added to the bill for hotel accommodations, restaurants, and the housing and office space rentals. For importers, there is also a sales tax equivalent to 5 percent of the sum of the customs value, the import duty payable, and any excise equivalent duty payable. Some imported goods, such as humanitarian relief goods, are exempt from all three duties. Finally, exporters of coffee beans, whether processed or unprocessed, are charged a presumptive income tax equivalent to 5 percent of the value of the coffee beans measured on a free-on-bord basis.

Table 5: Excise and Excise Equivalent Duties for Certain Goods

| Harmonized classification system number | General description of good | Rate |
|---|--|--|
| 2202 | Soft drinks and other flavored waters | \$0.50 per liter |
| 2203 | Beer | \$1.50 per liter |
| 2204-2206 | Wine, vermouth and other fermented beverages | \$1.50 per liter |
| 2207, 2208 | Ethyl alcohol and other alcoholic beverages | \$1.50 per liter |
| 2401-2403 | Tobacco and tobacco products | \$15.00 per kg |
| 2710 | Gasoline, diesel fuel and other petroleum products | \$0.05 per liter |
| 3303 | Perfumes | 15% of the customs value |
| 8519-8524 | Audio electronic goods | 10% of the customs value |
| 8525 20100 | Mobile phones | 10% of the customs value |
| 6528 | Televisions and video monitors | 10% of the customs value |
| 8529 1031 | Motor cars principally designed for the transport of persons | 15% of the customs value (with a minimum of \$200 per vehicle) |
| 8711 | Motorcycles | 10% of the customs value |

Source: UNTAET (2000).

Overall, the provisional tax and customs regime puts a rather high weight on international trade as it concentrates on duties which can be collected relatively easily. In the medium run, it is likely to be transformed into a more comprehensive regime with a stronger focus on the domestic tax base. An option that has proved successful in many developing countries, and is expected to be chosen in East Timor as well, is to focus the tax system on one indirect tax (a value-added tax) and one direct tax (an income tax).

In the year 2000, tax revenues are projected to add up to about \$10 million. In addition, receipts from the rental of public buildings and the sale of public services are expected to yield at least \$5 million. Domestic revenues would thus cover half the current expenditures projected for the year 2000 (Table 6). With projected capital expenditures of \$77 million, the total external financing requirements for the East Timorese budget of this year would amount to \$92 million. Such a large financing gap definitely cannot be sustained over a longer time period.⁴ It is, however, likely that aid requirements will decrease markedly in the foreseeable future. On the one hand, a more broadly based tax system should yield revenues of, say, 15 percent of GDP as in other developing countries with a comparable living standard, instead of the current 5.6 percent. According to IMF projections (IMF 2000), revenues could double between the fiscal years 2000/2001 and 2002/2003. On the other hand, as soon as the reconstruction phase is over, capital demand for infrastructure will slow down. Nevertheless, given urgent public investment needs, East Timor will probably run a budget deficit for a certain time to

³ The only exception is the taxation of oil revenues which has not yet been decided upon.

⁴ For a discussion of the problems arising from large and permanent aid inflows, see Chapter V.

Table 6: East Timor: Consolidated Budget for 2000

| | First semester | Second semester | One year |
|--------------------------------|----------------|-----------------|----------|
| <i>in millions of dollars</i> | | | |
| Revenues | 4.3 | 11.0 | 15.3 |
| Direct taxes | 0.5 | 0.5 | 1.0 |
| Indirect taxes | 1.8 | 7.5 | 9.3 |
| Nontax revenues | 2.0 | 3.0 | 5.0 |
| Expenditures | 38.6 | 68.7 | 107.4 |
| Current expenditures | 10.1 | 19.9 | 30.0 |
| Basic wage compensation | 2.7 | 4.2 | 6.9 |
| Goods and services | 0.3 | 0.6 | 1.0 |
| Others | 7.09 | 15.0 | 22.1 |
| Capital expenditures | 28.8 | 48.8 | 77.4 |
| Balance | -34.3 | -57.8 | -92.1 |
| <i>in percent of GDP</i> | | | |
| Revenue | | | 5.6 |
| Expenditure | | | 39.4 |
| Balance | | | -33.8 |
| <i>Memorandum item:</i> | | | |
| GDP at market prices (\$ mil.) | | | 272.5 |

Source: IMF and UNTAET (1999).

come. To avoid inflationary pressure and the crowding-out of private activities, the deficit should, however, be kept under control by limiting the growth of current expenditures and by providing the right incentives for domestic private savings and foreign direct investment, which could increasingly become a substitute for aid.

b. Exchange Rate Regime and Monetary Policy

After the ballot, several currencies circulated in East Timor. The United Nations Transitional Administration in East Timor (UNTAET) decided after consultations with local stakeholders on the US dollar as official currency of East Timor during the transition period. The banknotes and coins of this currency are the legal tender for all private and public transactions in East Timor. This implies that no payments in dollars can be refused. The main reason for choosing the US dollar as the official currency was practical: it was already used by the international organizations who administer most of East Timor's transactions.

A second regulation by UNTAET allows parties to a contract or any other voluntary transaction to denominate payment obligations in any currency they agree upon. There are no restrictions on the possession, use, or disposition of any currency. The import into East Timor of any currency exceeding the equivalent of \$10,000 or the export from East Timor of any currency exceeding the equivalent of \$5,000 must, however, be reported to the authority.

Generally, for the transition period, a definitely fixed exchange rate against the US dollar via a full dollarization of the economy makes sense. As long as the flows of foreign exchange are dominated by foreign aid denominated in US dollar, the adoption of the dollar guarantees the real value of aid flows. Additionally, any possibility of speculative capital flows would only add to the already high level of uncertainty prevailing in East Timor.

However, the arrangement is clearly meant to end after independence. This is demonstrated by the current activities to build up an independent central bank. The smoothest transition for East Timor would be to introduce a new currency that is definitely fixed to the U.S. dollar in a currency board.

Without causing much disruption, such a step would have some advantages. An own currency helps to build up a national identity and to improve government revenues via the collection of the seigniorage earned on the holdings of foreign exchange against the issue of domestic currency. For a new state to be built up from scratch these are clearly important aspects.

At the same time, a currency board provides a clear rule for money supply which depends on the net flows of foreign exchange resulting from current and capital account transactions. This kind of rule avoids credibility problems which are faced by a newly created central bank in a highly uncertain environment when trying to define an independent monetary policy. This holds especially for a very small economy like East Timor for which external transactions will become dominant in determining monetary stability.

Notwithstanding these clear advantages of a transition to a currency board regime there are also some problems. First, it can be expected that external transactions of East Timor will increasingly be dominated by Indonesia and Australia. This implies that a fixed parity against the U.S. dollar will lead to changes in the effective real exchange rate whenever the value of the dollar against the rupiah or the Australian dollar changes. Second, as trade with Indonesia and Australia expands this will imply that any terms-of-trade shocks affecting these trade relations will not lead to real exchange rate changes and thus cause external disequilibria. Finally, as soon as East Timor starts to build up own banks, there will be a demand for a lender of last resort, a central bank function that a currency board can only provide in a very restricted form. The first two problems can be compensated at least to some extent by wage flexibility. It would also make sense to introduce a new anchor currency (the rupiah or the Australian dollar) as soon as the U.S. dollar loses its dominance in East Timor's international transactions. Risk provisions for domestic banks could, for example, take the form of international contingency credit lines as in Argentina.

The most realistic alternative would be to have an own currency with a clearly defined exchange rate regime but some flexibility for the nominal exchange rate. This would, however, raise some formidable problems. First, the construction of an optimal basket against which to peg would be a nontrivial exercise as long as uncertainty about trade and capital flows is high. Second, in order to produce some stability of the real exchange rate, the parity has to move according to the inflation differential between the anchor and the domestic currency. Domestic inflation, however, is not easy to predict in a transition process. Third, as a consequence of these problems the band around a central parity would have to be rather large if speculative attacks are to be avoided, whereas an exchange rate regime would only provide some guidance for money supply if the band around a parity is rather narrow.

In principle, two further alternatives are available: fixed but adjustable exchange rates and fully flexible exchange rates. Both options cause almost insurmountable credibility and information problems for a newly created central bank. As the recent Asian crisis has shown, fixed exchange rates can easily be misaligned and thereby open the way for speculative attacks even in fairly mature economies such as Thailand. With flexible exchange rates, one main problem is the missing yardstick for money supply as there is no information about the development of money demand. The latter will, of course, become available with experience so that flexible exchange rates could be an option for East Timor in the very long run although even then the country might opt for some kind of exchange rate stabilization because of the strong weight of external transactions.

Altogether, both the evaluation of the pros and cons of a currency board and the problems of defining an intermediate exchange rate regime lead to the conclusion that the introduction of a currency board would serve East Timor best. This holds, at least, for the first phase after the transition to an own government. A historic example for such a rather careful move towards own monetary institutions are the Currency Boards in Malaysia and Singapur which were only abolished after full credibility of domestic policy was established and the currencies came under pressure for appreciation.

2. Sectoral Policies

The discussion in Section II.2 has shown that the urban sector was particularly hard hit by the post-referendum conflict. To provide at least partial emergency relief, diverse employment projects have been initiated in urban areas. These projects use labor-intensive public works to generate temporary jobs and income opportunities for the poor and, at the same time, to get some basic infrastructure repairs done. The most extensive effort of this kind is the Dili Community Employment Project administered by the World Bank. Other significant employment projects in all 13 districts of East Timor have been launched by USAID and the Japanese government.

To help restart economic activities in the private sector, small loans ranging from \$500 to \$50,000 are now made available to East Timorese with viable business plans.⁵ Business ideas from all sectors – manufacturing, construction, transportation, trade, agricultural processing – are eligible for consideration. Among the priority uses of loans are the purchase of trucks or minibuses, the restocking of traders, the establishment of business centers and the rehabilitation of small hotels. All of these activities provide benefits for other private sector investments that may follow. The availability of motorized vehicles, for example, will obviously facilitate the transport of goods. The loans must be repaid in full, at an interest rate of 10 percent per year, and have a repayment period of 3 to 36 months. Overall, providing capital to enable entrepreneurs to restart the economy is likely to have a high payoff. Given that most urban East Timorese worked in the public sector before the ballot and thus do not have business experience, the expected payoff of the loan program could even be higher if it was complemented by a training component.

In the rural sector, where much of the production capacity remained intact during the violence, various specific bottlenecks had to be removed. Virtually throughout East Timor, there was a pressing need for seeds. Another major impediment to the cultivation of staple food crops was the lack of cattle, water buffaloes and tractors to prepare the fields.⁶ In the coffee sector, procurement constituted the main problem with a lack of financial institutions to make payments to farmers, a lack of trucking capacity, and the occupation of the Dili-based dry processing facilities by international agencies. Since most of these problems have by now been solved at least partially, a relatively quick recovery of the agricultural sector, perhaps already in the year 2001, seems possible.

The medium-run objective is to make agriculture more productive than before the referendum. Whether this objective can be reached hinges on a number of factors. First, competitive agricultural input and output markets have to be established. Second, incentives for farmers must be adequate. This does not only mean that agricultural pricing policy should abstain from taxing farmers while subsidizing urban consumers, a practice that had devastating effects in so many low-income countries. For export crops, in particular, it also means that macroeconomic policy has to be appropriate. Both overvalued exchange rates and import protection for industrial goods would discriminate against agricultural exportables. Third, farmers must have access to credit in order to finance investments. During the transitional period, small loans are provided by the Community Empowerment Project administered by the World Bank.⁷ In the longer run, however, a continuous flow of credit to smallholders will only be possible if land can be used as collateral.⁸ Finally, some institutions, such as extension services and a public agricultural research system, are needed to help farmers realize productivity increases.

⁵ Intermediary services for this program are provided by Banco Nacional Ultramarino, one of the two foreign banks that have opened branches in East Timor.

⁶ Large numbers of water buffaloes and cattle were killed or taken across the border to West Timor, while tractors were systematically destroyed in most districts.

⁷ The main task of the Community Empowerment Project is to build equitable, accountable, transparent and participatory local governance structures.

⁸ On the difficulties with formulating a new land policy, see Section IV.1.

3. Trade and Foreign Investment Policy

With its very small domestic market, East Timor has no other choice than integrating into the world economy. Whether the country can become a successful participant in the international division of labor depends to a significant extent on the regulatory framework it formulates for external trade and foreign direct investment. Up to now, such a framework has not been spelled out explicitly.

The introduction of import tariffs and export taxes has largely been driven by fiscal considerations. From the rather moderate tariff rates and from the announcement that the current customs regime is to be regarded as provisional, one may conclude that trade taxes were not introduced with the additional objective of creating a protectionist trade regime. In order to demonstrate its commitment to open trade relations more clearly, East Timor should soon take some further concrete steps. One of the most powerful signals would be to phase out the export tax on coffee. This tax constitutes a significant burden for the East Timorese economy as it reduces the international competitiveness of the only major source of foreign exchange earnings. An early preparation for membership in the WTO and ASEAN would be another useful step, signaling East Timor's willingness to comply with international trade rules.

With respect to foreign direct investment, the general observation is that firms from abroad do not face high bureaucratic hurdles when they are willing to establish a business in East Timor. The registration process is fairly simple and transparent, and it does not differ from that for domestic firms. All other relevant investment parameters – such as the form and size of corporate taxes, the terms under which land and property can be bought and the possibilities for repatriating profits – have not yet been codified. These uncertainties, together with the general insecurity prevailing in the transitional period, are likely to deter a number of potential investors. While some of the issues could (and should) be resolved in the near future, the specification of a functioning land and property market apparently is more complex and thus will take longer time (Section IV.1).

In sum, there are indications that East Timor will adopt a liberal trade and investment regime, but intentions should be made more explicit in order to avoid insecurity among economic actors.

4. Infrastructure

The incentives for economic activities outlined in the previous sections can only materialize if they are complemented by an adequate infrastructure which allows the transport of goods in due time and at reasonable costs. East Timor's transport infrastructure (roads, ports, airports) only incurred comparatively light damage after the referendum.⁹ Roads were largely unaffected, with the exception of some causeways. The three ports and the two international airports remained intact, but all equipment was destroyed or rendered inoperable. Urgency measures have ensured a quick resumption of some international traffic. The Australian carrier Air North now operates daily flights between Dili and Darwin, while Merpati operates flights between Dili and Denpasar (Bali) twice a week. Shipping connections exist between Dili and Darwin and between Dili and Surabaya.

In the medium term, the main task will be to make internal transport more reliable. Road conditions in East Timor are insufficient due to long-term neglect of maintenance and lack of compliance with design standards. Roads have narrow carriage ways, steep banks with poor stability, and deteriorated surfaces and drainage. Almost 60 percent of paved roads are estimated to be in poor or damaged condition, and less than 50 percent of the villages are accessed by paved roads at all. Gravel roads are rough and potholed, and most can only be used by four-wheel-drive vehicles. During the rainy season,

⁹ The brunt of the post-ballot violence was borne by all kinds of buildings (schools, hospitals, administrative buildings, residential buildings).

many roads are impassable because of missing bridges and poor drainage. The huge investments necessary to rehabilitate and upgrade the road system will make some kind of cost recovery, e.g. in the form of tolls, inevitable.

In the maritime and aviation sector, there is no rationale for large infrastructure investments in the foreseeable future. Both sectors do not need additional capacities. Two international airports and three ports in a small country such as East Timor rather point towards excess capacities. The main bottleneck is the low quality of port and airport services. In the port of Dili, for example, vessel clearance and cargo handling is the sole responsibility of the shipping line. To bring these services in line with international standards, management contracts should be tendered through an international competitive bidding process. The management should be allowed to collect user charges, such as landing fees and terminal taxes at airports, in order to achieve self-financing and to ensure an efficient use of port and airport facilities. Currently, no fees are charged at ports and airports.

5. Investment in the Social Sector

Given the widespread destruction of social infrastructure and the almost complete breakdown of economic activities caused by the post-ballot violence, the most urgent social needs in East Timor definitely are humanitarian in nature, including the provision of food, shelter, and basic health services. In the area of education and health, however, it is necessary to add a longer-run perspective to the short-run emergency considerations because investments in these two sectors contribute to human capital formation and thereby affect the long-run development prospects. Such a perspective is all the more important considering the poor preconflict education and health indicators (Table 2) which imply that a mere reconstruction of the preexisting education and health systems would be insufficient. In the following, East Timor's options for the education and health sector will be examined in some detail.

a. Education

Both education infrastructure and personnel have been hard hit after the referendum. It is estimated that 75–80 percent of primary and secondary schools, over 60 percent of the University of East Timor, and 80 percent of the Dili Polytechnic have been partially or completely destroyed. Virtually all textbooks and school materials in the public school system have been removed or spoiled. For personnel, the situation varies greatly between the primary and secondary level: it is estimated that at least 75 percent of primary school teachers have remained in the country, while less than 20 percent of secondary and vocational teachers are still available.

In the short term, the first priority is to enable primary and secondary students to return to school. This requires the rehabilitation and repair of classrooms, the supply of basic teaching and learning resources, and the basic training of teachers. A fast track program to fulfill these tasks has been started in February. It is hoped that it will be finished by the beginning of the school year in October. Secondary teachers, which are in short supply, will partly be recruited from domestic graduate students or from other countries in the region provided they speak Bahasa Indonesia. Other priorities include vocational training for unemployed youths in urban areas, the provision of bursaries for tertiary students to complete their studies in Indonesian universities,¹⁰ or to study abroad, and the training of educational administrators who are expected to formulate long-term strategies for the sector.

¹⁰ The Indonesian government has assured that students from East Timor are welcome to continue their studies in Indonesia.

Once the basic levels of educational services are reestablished, attention must turn to the quality and financial sustainability of the public education system. There are indications that prior to the ballot low quality rather than a lack of services was the main weakness of East Timor's education system. Net primary school enrollment, for example, was far from universal even though tuition-free elementary education was available in all towns and most villages of East Timor. Among the efforts to raise the quality of primary and secondary education must be the development of a new curriculum that responds to the demands of the labor market. Furthermore, teaching quality needs to be improved. This includes better training of and better incentives for teachers, who were generally regarded as inadequately qualified and poorly motivated in the preexisting system,¹¹ and the removal of shortages in the supply of textbooks and other school materials. Quality improvements may also be realized if competition is increased by encouraging a stronger role of the private sector and nongovernmental organizations (NGOs) in the provision of educational services. Prior to the ballot, 85 percent of primary and secondary schools were run by the state and the remaining 15 percent by the Catholic Church. The impact of all these measures on educational outcome should be evaluated regularly.

If East Timor will be able to achieve broad-based access to basic education of reasonable quality, it can expect high economic returns and a significant reduction of poverty from this investment as the experience of various other East Asian countries has shown. Large state investments in tertiary education facilities, by contrast, are much less justified because they have low economic returns in poor countries such as East Timor, and they also have a low poverty incidence due to a lack of access by poorer families. At least during the transitional period, the strategy for East Timor should be to send students abroad. Students can be prepared for this, for example, by offering courses in English and languages of the region. If tertiary education facilities are eventually reestablished in East Timor over the longer term, an involvement of the private sector is called for.

The public financing of education should also prioritize basic services. Primary schooling should be free in order to reach the objective of universal enrollment. More or less full cost recovery for tertiary education and partial cost recovery for secondary education is likely to be necessary in order to finance services of high quality and to free resources for primary schools. Access of students from poorer families to higher education levels can be ensured by means of scholarships and loans.

b. Health

The situation in the health sector mirrors the situation in the education sector. Extensive destruction of the health infrastructure during the post-referendum violence has caused a total breakdown of the health system, made worse by a complete loss of all equipment and drugs, and the departure of most of the senior health staff, including 130 of 160 doctors. The majority of the mid-level health workforce, such as nurses and midwives, is still in East Timor.

The most immediate need in the health sector was to avoid an outbreak of major diseases which was feared as a result of risk factors such as population displacement and a deteriorated water and sanitation situation. Immunization campaigns as well as malaria and tuberculosis control programs organized by UN agencies and NGOs ensured that so far the fears have not materialized. Projects aiming at the improvement of water supply and sanitation have also begun. Among the other priority interventions were the restoration of primary health care services and inpatient care, including the rehabilitation of community health centers and hospitals; the development of a distribution network for drugs; the reestablishment of a health administration; and the development of a program for the training of health workers. Activities in all these areas are under way. A number of medical facilities

¹¹ The poor motivation of most teachers was at least partly due to low wages and a low reputation of the teacher's profession in society. Wages were often so low that teachers needed a second job.

have, for example, been reopened covering all 13 districts of East Timor, and an Interim Health Authority, which is composed of 16 East Timorese and 9 international staff, has been established.

A strategy for the long-term development of health policies and a health system that will contribute to the overall development process in East Timor can build upon the preexisting health system. This system laid emphasis on primary health care close to the people. Primary health services were provided at community health centers in each of the 67 subdistricts of East Timor and through 309 fixed satellite subcenters, supported by mobile services and village midwives. Eight small district hospitals and a central referral hospital in Dili provided inpatient care and essential specialist care.

In principle, health systems focusing on primary services should deliver positive results for low-income countries like East Timor, having a high impact on poor people's health, thereby enabling them to learn better at school and be more productive at work. Why, then, were East Timor's main health indicators so disappointing? One reason is that the multiline administration (provincial and national) with consequent overlap and overstaffing made the health sector inefficient. This problem is hoped to be solved with a lean administration under the new Interim Health Authority. Moreover, as in the education sector, improved incentives and training for health workers and administrators as well as better equipment for medical facilities may raise the quality of health services. These input measures should, again as in education, be combined with a close monitoring of health outcomes.

If more public resources are made available for primary health care, this must be offset by lower expenses for higher levels of health care. The medium-term financing of inpatient and specialist care should rely on fees for services or private co-payments varying with income levels. For large health risks, one may think of the introduction of an insurance scheme, although such a scheme is likely to encounter problems inherent to low-income countries, e.g. the high share of informal workers that limits overall coverage. The private provision of health services may also be an option. This option can, however, easily lead to rapid cost escalation unless rigid controls or very high co-payments are in place.

IV. Institution Building

1. Legal and Regulatory Framework

In order to create an institutional framework conducive for sustained economic development, a number of legal and regulatory measures are required. Among these are the specification and enforcement of property rights, the establishment of economic institutions such as central banks and customs offices, and certain regulations pertaining to the establishment and conduct of businesses. Currently, UNTAET carries overall responsibility in the area of institution building. UNTAET is empowered to exercise all legislative and executive authority, including the administration of the judiciary. So far, it has already taken important steps towards providing East Timor's economy with the essential institutions:¹²

- i) With two regulations, UNTAET has facilitated financial transactions. One regulation allows the establishment of currency exchange bureaus. These agencies are permitted to sell and purchase currencies in the spot market, but not to deal in the forward market or to provide banking services such as money lending. The latter activities are confined to banks. The terms under which banks are allowed to operate are subject to another regulation. This regulation specifies all services banks may provide, and a number of provisions they have to comply with, such as a minimum capital requirement of \$2 million and the application of international accounting standards.

¹² A complete listing of the regulations promulgated by UNTAET is provided in Appendix 1.

- ii) As a precursor to a future central bank, a Central Payments Office has been established. This office already has several central bank functions, e.g. to ensure an adequate supply of banknotes and coins of the legal tender for the settlement of cash transactions and to hold foreign exchange reserves. It also is solely responsible for the issuance and withdrawal of licenses to banks and currency exchange bureaus and for the supervision of these financial institutions.
- iii) In a first step to provide a legal base for private business activities, UNTAET has prescribed the registration of all businesses operating in East Timor, with the exception of street vendors and market hawkers. Applicants for registration have to reveal a number of details about their companies, e.g. the identity of major shareholders, in order to enhance the transparency of the business sector. As a next step, the codification of a labor law is currently under way. Other laws, such as an investment code and a commercial law, are likely to follow soon so that a basic legal framework for private business activities could be completed within a year or so. Legislations are, however, only a necessary condition for a reliable business environment. The laws must also be enforced by the judiciary. UNTAET has already established eight District Courts and one Court of Appeal, but it is not yet clear when they will function properly. One serious problem is that almost all court documentation has been destroyed.
- iv) A Central Fiscal Authority has been created which, under the authority of the transitional administration, is responsible for the management of East Timor's budget. It has to formulate an overall fiscal strategy comprising policies for the raising and collection of revenues from different sources (domestic taxes and fees, import duties, export taxes, external transfers) as well as policies for the overall level and the allocation of public expenditures. The Central Fiscal Authority will eventually turn into a Ministry of Finance.
- v) A Border Service has been established to control the movement of persons and goods to and from the borders of East Timor. The Border Service has, inter alia, to provide for the collection of import duties and export taxes, to establish and administer tariff schedules for the purpose of revenue collection, and to regulate the entry and exit of people without endangering international commerce and tourism.
- vi) Finally, public procurement of the civil administration in East Timor has been regulated. In order to obtain best value for public expenditures, to promote competition between suppliers and to guarantee bidders fair and equal treatment, the procuring entity is obliged to procure goods, works and services by open tendering. This rule is subject to some exceptions, e.g. when the procurement does not exceed \$10,000 for goods, \$15,000 for works or \$6,000 for services.

While overall UNTAET's institution building efforts have been remarkably successful in a relatively short period of time, land and property legislation stands out as one significant omission. The UN/World Bank mission rightly regarded the establishment of a land and property commission as one of the top priorities. The commission would be empowered to consider evidence, decide disputes regarding the ownership of land and property, authorize the registration of land and property according to the available evidence, and suggest a plan for land usage (e.g. agricultural, forestry, and residential use) to the transitional administration. Up to now, UNTAET has postponed land and property legislation because of political resistance resulting from the complex and intransparent system of existing property rights. Under Indonesian rule, Indonesian, Portuguese and traditional tenure systems coexisted and partially overlapped. This is now frequently leading to conflicting claims on land and property. UNTAET is so far only legitimized to administer privately owned property abandoned after the referendum until the lawful owners are determined. Since the prevailing uncertainty of property rights is likely to deter (domestic and foreign) investment and to prevent farmers from using land as collateral, UNTAET should make an attempt to settle the land and property issue in the near future despite the undeniable political problems.

2. Civil Service

To ensure the functioning of institutions and the establishment of the rule of law, a capable civil service staff is required. Currently, East Timor's civil service is hardly functioning at all. Beside the destruction of most office equipment and administrative buildings, it is estimated that at least 20–25 percent of all civil servants – those of Indonesian origin – have left East Timor after the ballot and the subsequent violence. Since Indonesian civil servants were concentrated in the higher grades and skilled technical positions, this creates a serious skill deficit for the civil service. The UN/World Bank mission to East Timor in November 1999 found out, for example, that there were no judges and only five lawyers who were licensed to practice law and had passed the qualifying examination administered by the High Court. There is thus a massive need for training and skills development.¹³ While some of the training may be undertaken abroad, the bulk of it has to be done in East Timor. This requires the elaboration of a civil service training program as well as the establishment of new and/or the reconstruction of existing civil service training centers. Efforts to upgrade the qualifications of East Timorese civil servants have only just begun. Australian and New Zealand customs officers, for example, help with the training of East Timorese staff in the Border Service, and international judges serve as mentors to the East Timorese judges and prosecutors at the District Courts. It is very likely that similar efforts have to continue for a considerable time to come in order to remove one critical bottleneck for long-run development.

While there is no doubt that the decimation of the civil service represents a severe loss of skilled manpower, it also provides a welcome opportunity for reform. Under Indonesian rule, the civil service was characterized by

- overstaffing, with over 28,000 civil servants, amounting to 3.5 percent of the population compared to an Asian average of 2.6 percent;
- exceptionally low pay levels, encouraging the acceptance of bribes;
- too many layers of bureaucracy for a small country, fostering inefficient decisionmaking;
- duplication of functions between line ministries and decentralized departments;
- a top-down organizational culture, with little community participation.

The UN/World Bank mission to East Timor rightly recommended to focus reforms during the transitional period on civil servant numbers and pay levels rather than on the more complicated issues concerning the organization of the state. Specifically, the mission recommended to

- limit the aggregate number of civil servants to about 12,200 in the first three years, with just under 90 percent of these constituting teachers and health workers (Table 7);
- to give a blanket pay increase of 50 percent to all civil servants;
- to increase wage differentials, with senior staff receiving higher increases.

Table 7: Recommended Number of Civil Servants, 2000–2002

| Function | 2000 | 2001 | 2002 |
|----------------------------------|-------|--------|--------|
| Foreign Affairs | 6 | 15 | 29 |
| Internal Affairs | 268 | 379 | 474 |
| Finance and Economic Development | 129 | 259 | 354 |
| Social Development | 6,440 | 8,631 | 10,788 |
| Reconstruction | 959 | 807 | 557 |
| Total | 7,802 | 10,091 | 12,202 |

Source: UN and World Bank (1999).

¹³ For the situation in the education and health sector, see Section III.5.

While it is impossible from an outside position to comment on the exact numbers proposed, the overall direction of the recommendations seems to be appropriate. Perhaps it should be evaluated whether there is a potential to reduce the burden of the civil service even further by encouraging a stronger role of the private sector and NGOs in the provision of health and educational services (see also Section III.5).

To ensure an objective recruitment of civil service staff based on merit and competence, two commissions have been set up: a Public Service Commission with 7 members and a Transitional Judicial Service Commission with 5 members. Both commissions are composed of East Timorese and international experts. They are responsible for the whole selection process, but selected candidates have to be approved by UNTAET. The recruitment of civil servants has already made some progress. At the district courts, for instance, a number of judges and prosecutors have been appointed.

V. The Role of External Support

After the vote for independence and the subsequent violence against its population, East Timor received considerable sympathy from the outside world. Hence, it did not come as a surprise that at the donor's meeting in Tokyo on December 17, 1999, the international community pledged as much as around \$520 million in grant funding over the years 2000–2002 to rebuild East Timor. Some \$370 million was designated for the recurrent budget and for development and reconstruction efforts over the three-year period; the remaining \$150 million were pledged for a humanitarian assistance program providing immediate relief until June 30, 2000. Out of the \$370 million, \$155 million were pledged as bilateral aid, while \$215 million were allocated to two trust funds: a United Nations Trust Fund and a World Bank-administered Trust Fund. The UN Trust Fund administers the recurrent budget of the East Timorese civil service and selected project-based capacity-building initiatives such as the training of judges and other civil servants. The World Bank-administered Trust Fund is managed in close collaboration with the Asian Development Bank (ADB). The ADB takes the lead in rehabilitating roads, ports, transportation, telecommunications, and power; the World Bank prepares projects in the areas of health, education, agriculture, support to small and medium enterprises, and economic capacity building.

In order to coordinate the implementation of projects initiated by various bilateral and multilateral donors, a donor coordination committee was established in Dili which has to approve all suggested projects and programs including those by the two trust funds. The allocation of funds is based on the UN/World Bank assessment mission in November 1999 which came up with a detailed sectoral breakdown of the short- and medium-run external financing requirements for East Timor's successful transition to independence (Appendix 2). Among the short-run humanitarian assistance needs, the repatriation of refugees and the provision of emergency food relief stand out. These two tasks absorb almost 90 percent of the humanitarian budget. The external financing requirements for reconstruction and development in different sectors are summarized in Table 8. Given the destruction caused by the militia attacks after the referendum, the rebuilding of the social, economic and administrative infrastructure necessarily takes the lion's share of investment, at about 65 percent. Other priority areas for external support are smallholder coffee development, the provision of credit to small and medium-size enterprises, and the training of teachers, health personnel and other civil servants. Overall, 56 percent of the reconstruction and development budget is earmarked for social services (education, health, water and sanitation etc.), 26 percent for productive sectors (agriculture, roads and ports, economic management, etc.), and 16 percent for administration and judiciary.

Table 8: Summary of External Financing Requirements for Reconstruction and Development, 2000–2002 (in millions of dollars)

| | 2000 | 2001 | 2002 | Total | Thereof: infrastructure |
|-----------------------------|------|-------|------|-------|----------------------------|
| Community empowerment | 9.2 | 10.9 | 9.8 | 30.0 | — |
| Education | 14.8 | 25.6 | 17.4 | 57.8 | 43.2 |
| Health | 7.5 | 17.0 | 15.7 | 40.2 | 32.2 |
| Agriculture | 7.1 | 14.3 | 3.0 | 24.4 | — |
| Infrastructure ^a | 21.1 | 49.3 | 22.7 | 93.1 | 93.1 |
| Economic management | 4.3 | 6.5 | 5.4 | 16.2 | — |
| Civil service | 16.6 | 16.6 | 9.3 | 42.5 | 28.8 |
| Judiciary | 1.1 | 1.6 | 0.2 | 2.9 | 2.5 |
| Total | 81.8 | 141.9 | 83.5 | 307.2 | 198.8 |

^aDoes not include health, education, public administration and judiciary infrastructure, which are covered in their individual sectors.

Source: UN and World Bank (1999).

The total amount and the sectoral allocation of external support is revised biannually during donor's meetings. The first of these meetings took place in Lisbon in June 2000. It was prepared by an IMF/World Bank mission to East Timor that looked into the implementation progress of the reconstruction program and also reviewed the budget and external financing needs. The mission identified considerable delay in the implementation of a number of projects and estimated that capital requirements for road and school reconstruction would be somewhat higher than assumed initially. While there seems to be no obvious reason to quarrel with the suggested allocation of funds, the overall amount of transfers should be a cause for concern in the forthcoming meetings. Assuming an annual GDP of about \$275 million, East Timor's average aid-to-GDP ratio over the period 2000–2002 will approach 65 percent, a share that is only matched by the most notorious aid recipients in Sub-Saharan Africa. Within Southeast Asia, for comparison, Indonesia receives only 0.5 percent of its GDP as aid, and the Lao PDR, the most aid-dependent country of the region, less than 20 percent.

High aid inflows are likely to cause at least four major problems: first, they may overstretch the absorptive capacity of the recipient country when institutions are weak. In East Timor, this problem is somewhat cushioned by the existence of UNTAET which provides all administrative services. Second, the large injection of purchasing power has macroeconomic repercussions. It tends to raise prices for nontradables, thereby causing a real appreciation of the domestic currency which lowers the competitiveness of exportables such as coffee and oil. This Dutch disease effect is partially avoided in East Timor because a large proportion of the humanitarian and development budgets is spent on imported goods. Nevertheless, the presence of the staff of the international organizations alone generates a strong demand for urban services. Third, food aid on a large scale provides a disincentive for domestic food production by depressing local prices. Fourth, in the longer run, high and steady transfers may create a culture of aid dependency which has been diagnosed for many Sub-Saharan African countries.

Given the exceptional circumstances prevailing in East Timor, a very high amount of aid inflows may be inevitable in a short transitional period. To avoid the above-mentioned problems, it should, however, be ensured from the very beginning that the financial support is cut back once the domestic revenue base starts to recover, and that general food aid only serves as emergency relief. By contrast, technical support that increases the knowledge of the local population is likely to be needed for a much longer time.

VI. Concluding Remarks

In face of the extensive destruction caused by the post-ballot violence, the reconstruction of East Timor alone represents a formidable task. On top of that, the newly independent country also has to formulate a long-term strategy for economic and social development. So far, achievements in terms of emergency relief, infrastructure repair and institution building have been quite remarkable. All steps have been taken in close cooperation between international organizations and local experts, thereby strengthening the ownership of reforms and the expertise among East Timorese people. Provided that political stability prevails and that the future government keeps on track, e.g. by managing oil revenues wisely, the outlook for sustained progress seems better than in many other low-income countries where much stronger vested interests block reform efforts. On balance, it might be a blessing rather than a curse for East Timor to start from scratch given the distorted policy framework it would have inherited from Indonesia.

The most significant danger for long-term development in East Timor, at the moment, arises from the uncertainty of property rights which is likely to hamper (domestic and foreign) investment and agricultural development. Moreover, it has to be kept in mind that various important measures, such as investments in the education sector and the training of the new civil service staff, will take considerable time to materialize fully, thus demanding a high staying power from the East Timorese which cannot be taken for granted.

Appendix

Table A1: List of Regulations Promulgated by UNTAET

| Regulation No. | |
|----------------|--|
| 1999/1 | On the Authority of the Transnational Administration in East Timor |
| 1999/2 | On the Establishment of a National Consultative Council |
| 1999/3 | On the Establishment of a Transnational Judicial Service Commission |
| 1999/4 | On the Establishment of the Official Gazette of East Timor |
| 2000/1 | On the Establishment of the Central Fiscal Authority of East Timor |
| 2000/2 | On the Use of Currencies in East Timor |
| 2000/3 | On the Establishment of a Public Service Commission |
| 2000/4 | On the Registration of Businesses |
| 2000/5 | On the Licensing of Currency Exchange Bureaus |
| 2000/6 | On the Establishment of a Central Payments Office of East Timor |
| 2000/7 | On the Establishment of a Legal Tender for East Timor |
| 2000/8 | On Bank Licensing and Supervision |
| 2000/9 | On the Establishment of a Border Regime for East Timor |
| 2000/10 | On Public Procurement for Civil Administration in East Timor |
| 2000/11 | On the Organization of Courts in East Timor |
| 2000/12 | On a Provisional Tax and Customs Regime for East Timor |
| 2000/13 | On the Establishment of Village and Sub-District Development Councils for the Disbursement of Funds for Development Activities |

Source: UNTAET (2000).

Table A2: External Financing Requirements for East Timor: Humanitarian, Recurrent and Development Budgets

| Project | Agency | Emergency phase (humanitarian) | Extending into medium term ^a |
|---|--------------------|-----------------------------------|--|
| Return and Migration (including shelter) | | | |
| E/N01 Protection, Multi-sector Relief, Care and Maintenance, Repatriation and Reintegration Assistance and Other Durable Solutions for Refugees and Displaced Persons | ANCHOR | 45,350,000 | |
| E/N02 Return of Displaced People | IOM | 23,250,000 | |
| E/N03 Emergency Shelter Reconstruction | World Vision | 2,131,000 | |
| E/N04 Return of Qualified Nationals | IOM | 600,000 | |
| E/N05 Reintegration of Demobilized Combatants | IOM | 126,321 | |
| E/N06 Mobile Information and Referral Service | IOM | 1,192,535 | |
| Subtotal | | 72,649,856 | |
| Food Aid and Food Security | | | |
| E/N07 Emergency Food Assistance to Victims of Civil Strife in East Timor | WFP | 21,600,000 | |
| E/N08 Vegetable Seed Distribution | FAO | 310,000 | |
| E/N09 Support the Return and Resettlement of Displaced Farm Families Currently in West Timor | FAO | 600,000 | |
| E/N10 Emergency Support to Maize and Rice Production | FAO | 860,000 | |
| E/N11 Rice Seed Multiplication | FAO | | 128,000 |
| E/N12 Emergency Assistance to the Artisanal Fisheries Sector | FAO | | 317,000 |
| E/N13 Food Security Monitoring and Coordination in East Timor | FAO | | 635,000 |
| E/N14 Support of Rice Production | German Agro Action | 667,600 | |
| E/N15 Resumption of Agriculture | OIKOS | 72,300 | |
| Subtotal | | 24,109,900 | 1,080,000 |
| Health | | | |
| E/N16 Roll Back Malaria | WHO | 1,450,000 | |
| E/N17 Tuberculosis Control | WHO | | 600,000 |
| E/N18 Integrated Management of Childhood Illness (IMCI) | WHO | | 140,000 |
| E/N19 Prevention of STDs and HIV/AIDS | WHO | | 200,000 |
| E/N20 Human Resource Development in the Health Sector | WHO | | 2,010,000 |
| E/N21 Health Surveillance System and Epidemic Preparedness and Response | WHO | | 900,000 |
| E/N22 Drug Storage and Distribution System | WHO | | 1,022,500 |
| E/N23 Public Health Laboratories | WHO | | 600,000 |
| E/N24 Health Sector Coordination | WHO | | 640,000 |
| E/N25 Basic Health Care | UNICEF | 2,500,000 | 10,549,925 |
| E/N26 Technical and Material Assistance for Reproductive Health and Sexual Violence | IRC | | 460,000 |
| E/N27 Reproductive Health Program for East Timor | UNFPA | | 1,283,000 |
| Subtotal | | 3,950,000 | 18,405,425 |

Table A2 continued

| Project | Agency | Emergency phase (humanitarian) | Extending into medium term ^a |
|---|--------------------|-----------------------------------|--|
| Water and Sanitation | | | |
| E/N28 Water and Sanitation | UNICEF | 3,760,000 | |
| E/N29 Emergency Environmental Health Program | OXFAM | | 4,107,000 |
| Subtotal | | 3,760,000 | 4,107,000 |
| Infrastructure and Economic Recovery | | | |
| E/N30 Rehabilitation of Public Utilities and Physical Infrastructure | UNDP | 6,440,000 | |
| E/N31 Joint Program for Community Rehabilitation, Reintegration and Development | UNDP/IOM/ UNHCR | 6,190,000 | |
| E/N32 Employment Registration and Services Centers | UNDP/ILO | 1,700,000 | |
| E/N33 Local Economic Development Agencies (LEDA) for Micro-enterprises and Micro-credit | UNDP/ILO | 2,100,000 | |
| E/N34 Comprehensive Vocational Education and Training (VET) for East Timorese | UNDP/ILO | 3,890,000 | |
| Subtotal | | | 20,320,000 |
| Education and Community Action | | | |
| E/N35 Education and Community Action Project | UNICEF | 7,000,400 | |
| E/N36 Psycosocial Support and Empowerment for Vulnerable | UNFPA | 470,000 | |
| and Traumatized Women and for Adolescents | | | |
| E/N37 Mental Health and Trauma Service | UNDP/WHO | 300,000 | |
| E/N38 East Timor Emergency Care, Protection, and Tracing for Unaccompanied Children | IRC | 150,000 | |
| E/N39 Child Protection through Child and Family Centers | CCF | 900,000 | |
| Subtotal | | 150,000 | 8,670,400 |
| Humanitarian Principles | | | |
| E/N40 Humanitarian Principles Project | UNICEF | 483,000 | |
| E/N41 Institutional Capacity Building | UNICEF | | 777,000 |
| E/N42 Support to Governance and Sectoral Capacity Building | UNDP | | 3,200,000 |
| E/N43 Strengthening the Peace Building Capacity of Local NGOs | CRS | 200,000 | |
| Subtotal | | 483,000 | 4,177,000 |
| Coordination and Logistics | | | |
| E/N44 OCHA Coordination | OCHA | 3,300,000 | |
| E/N45 East Timor Information and Mapping Unit (ETIMU) | OCHA | 412,700 | |
| E/N46 NGO Resource Center | OCHA | | 335,000 |
| E/N47 WFP Special Operations for the East Timor Crisis | WFP | 16,655,018 | |
| E/N48 Radio Kmanek | CARITAS | 500,000 | |
| Subtotal | | 20,867,718 | 335,000 |
| Total | | 125,970,474 | 57,094,825 |

Table A2 continued

| Project | 2000 | 2001 | 2002 | 2000–2002 |
|---|--------|--------|--------|-----------|
| Community Empowerment | | | | |
| Grant for community recovery | 4,950 | 4,520 | 4,020 | 13,490 |
| Community capacity development | 3,495 | 4,520 | 4,420 | 12,435 |
| Micro-enterprise credit startup funds | 0 | 500 | 500 | 1,000 |
| Community centers for subdistricts/villages | 500 | 1,250 | 750 | 2,500 |
| Local government capacity development | 250 | 150 | 150 | 550 |
| Sector subtotal | 9,195 | 10,940 | 9,840 | 29,975 |
| Education | | | | |
| Textbooks | 1,608 | 3,212 | 824 | 5,644 |
| TA/monitoring system | 80 | 95 | 95 | 270 |
| Early childhood education | 50 | 150 | 150 | 350 |
| Teacher training | 704 | 364 | 356 | 1,424 |
| Youth and adult education | 130 | 290 | 290 | 710 |
| Distance learning: tertiary/technical education | 0 | 355 | 145 | 500 |
| Substitution of secondary school teachers | 5,720 | 0 | 0 | 5,720 |
| Rehabilitation of infrastructure | 6,529 | 21,132 | 15,503 | 43,164 |
| Sector subtotal | 14,821 | 25,598 | 17,363 | 57,782 |
| Health | | | | |
| Training of physicians/health personnel abroad | 500 | 3,500 | 3,000 | 7,000 |
| Public health management capacity | 300 | 150 | 150 | 600 |
| Health system review, including financing | 300 | 150 | 0 | 450 |
| Rehabilitation/requipment of infrastructure | 6,441 | 13,183 | 12,529 | 32,154 |
| Sector subtotal | 7,541 | 16,983 | 15,679 | 40,204 |
| Agriculture | | | | |
| Land capacity/agricultural systems mapping | 75 | 152 | 78 | 305 |
| Reestablishment of rural livelihood database | 0 | 72 | 62 | 134 |
| Restoration of meteorological stations | 0 | 38 | 259 | 297 |
| Local seed resources/production stations | 228 | 299 | 164 | 691 |
| Smallholder farm mechanization program | 0 | 1,525 | 1,075 | 2,600 |
| Pasture improvement and weed eradication | 0 | 160 | 92 | 252 |
| Poultry restoration program | 215 | 200 | 0 | 415 |
| Smallholder cattle/buffalo restoration program | 2,600 | 2,600 | 0 | 5,200 |
| Smallholder coffee development initiatives | 3,990 | 8,750 | 750 | 13,490 |
| Agroforestry/land management development | 0 | 540 | 260 | 800 |
| Agricultural innovation schemes | 0 | 0 | 250 | 250 |
| Sector subtotal | 7,108 | 14,336 | 2,990 | 24,434 |
| Infrastructure | | | | |
| Road network repair | 4,386 | 13,683 | 13,464 | 31,532 |
| Port and maritime recovery | 315 | 1,000 | 0 | 1,315 |
| Airport and air traffic recovery | 1,756 | 3,900 | 500 | 6,155 |
| Housing rehabilitation for the poor | 8,306 | 16,306 | 0 | 24,610 |
| Water systems and utilities | 3,510 | 8,180 | 6,180 | 17,870 |
| Power systems and utilities | 1,921 | 4,287 | 1,073 | 7,281 |
| Drainage and sanitation system | 898 | 1,950 | 1,500 | 4,348 |
| Sector subtotal | 21,090 | 49,306 | 22,717 | 93,111 |

Table A2 continued

| Project | 2000 | 2001 | 2002 | 2000–2002 |
|---|--------|---------|--------|-----------|
| Economic Management | | | | |
| Setting up key economic institutions | 460 | 460 | 0 | 920 |
| Economic policymaking capacity | 440 | 440 | 0 | 880 |
| International agreements | 500 | 0 | 500 | 1,000 |
| Economic framework for investors | 200 | 200 | 0 | 400 |
| Revolving credit for SMEs | 2,000 | 4,000 | 4,000 | 10,000 |
| Statistical office – census and surveys | 700 | 1,400 | 900 | 3,000 |
| Sector subtotal | 4,300 | 6,500 | 5,400 | 16,200 |
| Civil Service | | | | |
| Capacity building/training of the civil service | 1,426 | 1,579 | 1,437 | 4,442 |
| Subcontracting of recruitment | 400 | | | 400 |
| Training | 365 | 356 | 287 | 1,009 |
| Technical assistance | 1,061 | 1,264 | 1,150 | 3,474 |
| Administrative records systems | 0 | 50 | | 50 |
| Rehabilitation of infrastructure/reequipment | 8,928 | 13,373 | 6,445 | 28,746 |
| Reserve | 4,400 | 0 | 0 | 0 |
| Sector subtotal | 16,580 | 16,622 | 9,319 | 42,521 |
| Judiciary and Law Enforcement | | | | |
| Technical assistance to the judiciary | 225 | 75 | 0 | 300 |
| Technical assistance to the land commission | 90 | 30 | 0 | 120 |
| Recovery of courts and judiciary buildings | 830 | 1,509 | 176 | 2,515 |
| Sector subtotal | 1,145 | 1,614 | 176 | 2,935 |
| Total | 81,781 | 141,898 | 83,483 | 307,160 |

^aReconstruction and development.

Source: UN and World Bank (1999).

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