

2.2. Problem Analysis

Timor-Leste is a fragile, small island developing country and its institutions are still in a process of construction and consolidation following the country's independence in 2002. Service delivery is still frail in the country, in particular in rural areas, affecting people's access to food, clean water and health services⁵. This has a heavier impact on specific groups such as women, children, people living in poverty, and persons living with disabilities

This document is based on several diagnostic studies and assessments carried out over the last years, namely: i) PEFA 2018, which provides a thorough assessment of the status of the PFM system over the years 2015-2017; ii) Public Investment Management Assessment 2016, elaborated by the IMF (not published); iii) Public Expenditure Review (PER) 2021, elaborated by the WB; iv) Climate Public Expenditure and Institutional Review, elaborated by UNDP in January 2022; v) Tax Administration Diagnostic Assessment Tool (TADAT), still ongoing; vi) Methodology for the Assessment of Procurement Systems (MAPS), still ongoing; vii) and the EU annual Public Finance assessments.

Timor-Leste has also undergone a continuous process of PFM reform, which has been affected by political instability, as well as by the limited capacity of its human resources and more recently by the Covid pandemic. Consequently, the country struggles to move forward with the institutional reforms in general and the PFM reform in particular.

PFM reform seems however to be gaining momentum with the intention manifested by the administration to review and update the draft PFM Reform Policy and related Action Plan, covering the period 2021-2025. The draft PFM Reform Policy document sets out the key goals of the reforms and identifies the priority reform actions, whereas the PFM Action Plan provides an implementation roadmap while identifying the institutional responsibilities. PEFA 2018 assessment found that although PFM reform has gradually progressed since the previous PEFA 2013, the overall performance had stalled and even deteriorated in specific areas. The PEFA assessment shows that 9 of the 31 indicators had deteriorated, 7 have improved and 10 remained unchanged. PFM reforms in some areas are advancing but at a very slow pace. Significant human resources constraints like high staff turnover, low technical capacity, low motivation, and lack of management experience, compounded by weak political consensus, have been the main causes of the reform's poor performance.

Programme budgeting was adopted in March 2017 through Government Resolution 17/2017. A Budget Governance Roadmap was prepared by the OECD with the support of the Australian Government with a focus on the transition to programme budgeting, but also including elements related to the development of medium-term planning and budgeting, M&E systems, and transition to accrual accounting. Although programme budgeting has been adopted by the whole government with the 2022 budget, there is still a long way to go before reaching a fully developed and consolidated system. Medium-term budgeting gave some steps but a coherent system linking the overall Medium-Term Fiscal Framework (MTFF) to the Medium-Term Expenditure Frameworks (MTEF) at the sector level, still has to be developed. The M&E system, which is a key pillar of the programme budget, has also made notable progress with the development of the *Dalan ba Futuru* system⁶ (The Road to the Future), a tool designed to assist the elaboration of annual plans, monitoring and tracking its implementation and to evaluate its results, but the link between planning (medium-term) and budgeting (short term) still needs to be developed.

Although "Collecting more" is an integral component of the Strategic Development Plan 2011-2030, the revenue composition remains very unbalanced and is unsustainable over the longer term. The government's total revenue depends on 84% of the withdrawals from the petroleum fund, 6% on taxes on commodities (excise, import duties, sales), 4% on income, and 4% of non-tax revenue. Diversification of the domestic

⁵ <https://documents-dds-ny.un.org/doc/UNDOC/GEN/G21/313/39/PDF/G2131339.pdf?OpenElement>

⁶ DBFTL is a "web-based application" developed using an "Open Source" platform and hosted in Government Datacentre TIC- Timor