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**Statement by Mr. Bevilaqua, Mr. Saraiva, and Mr. Coelho on Democratic Republic of  
Timor-Leste  
Executive Board Meeting  
July 9, 2021**

On behalf of our Timorese authorities, we thank the mission chief and his team for the constructive engagement and policy dialogue during this year's Article IV consultation. Our authorities also thank the IMF for the invaluable technical assistance received through the years.

**As one of the youngest countries in the world, Timor-Leste has made great strides in securing lasting peace, institutional development, and political stability.** Only two decades ago, Timor-Leste rose from decades of civil conflict to become the first sovereign state of the century in May 2002. Since independence, the country has made significant progress in promoting a democratic society, with transparent elections, broad representation, separation of powers, and rule of law. Timor-Leste has also managed to build its public infrastructure from scratch, develop its institutions, promote economic development, and reduce poverty. In this process, the country has greatly benefited from international best practices and from the IMF's expertise on how to strengthen efforts to sustain macroeconomic and financial stability and improve its development trajectory.

**Twin shocks and policy response**

**Forceful policy response last year helped to mitigate the impact of the pandemic.** Preventive measures contained the spread of the novel coronavirus that causes COVID-19. The authorities also implemented an economic response package to support households and businesses, comprising a US\$200 cash transfer to most households and a 60 percent wage subsidy for registered firms. This package was vital to mitigate income losses and sustain economic activity.

**However, twin shocks caused by the COVID-19 pandemic and by floods pose new challenges to the economic outlook.** Timor-Leste registered its first confirmed case of community-transmitted COVID-19 in February 2021. As of end-June 2021, there were a total

of 9,055 cases and 21 deaths. On April 4, 2021, a devastating flood hit the country, leaving most parts of Dili underwater. The number of dead or missing stood above 40 and around 16,000 people were displaced. These shocks create significant challenges for 2021, which promised to deliver strong growth due to improved political stability and last year's policy support following negative growth in 2020. The outlook, however, is gradually improving. Vaccination rollout began last April and, as of end-June 2021, 15.7 percent of the population received at least one dose, while two percent is fully vaccinated. Australia and China have also pledged to support the vaccination campaign with 630,000 and 100,000 doses, respectively. Through COVAX, Timor-Leste has secured additional doses for 20 percent of its population.

**The twin shocks required additional fiscal policy support in 2021.** The 2021 budget was rectified by the National Parliament in April 2021, providing additional spending outlays to respond to the pandemic and floods. The fiscal deficit is now projected to increase from 26 percent of non-oil GDP in 2020 to 46 percent of GDP in 2021, considering the extraordinary expenditures to combat the crisis.

### **Medium-term outlook**

**The medium-term outlook remains positive, with the new government coalition committed to investing in human capital and encouraging private sector development.** After a sequence of fragile government coalitions, political stability will contribute to advance the required reforms to improve business climate, and support economic diversification, especially the agricultural and tourism sectors. Support for the private sector will also come through legal reform and harmonization of laws to encourage private investment and job creation.

**The authorities are implementing Public Financial Management (PFM) reforms and improving budget execution and fiscal outturns.** With the support from the Fund and the World Bank, the authorities have drafted a new PFM Law to simplify and streamline budgeting and procurement processes. The annual budgeting process will take place within a strong multi-year framework, connecting it to the Multiannual Strategic Plan. A Medium-Term Fiscal Framework approved and revised annually by Parliament will increase predictability of the annual budget. The authorities have also recently presented to Parliament a draft of the Budget Framework Law, which will guide future budgeting and planning process, enhancing comparability by adopting a chart of accounts and budget classification based on international standards.

**The authorities are fully committed to preserving the Petroleum Fund and maximizing its developmental impact.** Over the years, the authorities have used oil revenues responsibly. They remain committed to a prudent management of the fiscal accounts that aims at preserving the resources accumulated in the Petroleum Fund, while addressing the development needs of the country and exploring new sources of revenues. In 2018, the Petroleum Fund had a balance of US\$ 15.8 billion. During the last Article IV consultation,

the baseline scenario for 2020-2023 projected a balance of US\$ 14.5 billion. However, at end-May 2021, the Petroleum Fund had a significantly higher balance of US\$ 19.5 billion, or about 11 times last year's GDP, making it one of the largest sovereign wealth funds relative to GDP in the world. Considering that the Petroleum Fund has been fed mainly by taxes and royalties from the Bayu-Undan field, from which production is bound to expire in a few years, the authorities are investing in reducing dependence from the Petroleum Fund and increasing non-oil revenue mobilization. They are also working on a segmentation of the Petroleum Fund into separate liquid and growth portfolios, aimed at reducing investment risk, using the Petroleum Fund's balances more effectively, and encouraging medium-term fiscal planning. This new approach is based on independent advice and is consistent with industry best practices.

**The Greater Sunrise fields could provide additional oil revenues, but the exploration model is still to be developed.** Given its magnitude (6.6 trillion cubic feet of gas and 273 million barrels of oil), exploration of the Greater Sunrise fields has the potential to substantially change the Timorese economy's outlook. The authorities are committed to developing a model of production and using future revenues in a manner that addresses the needs of the population, not only in the short term, but also sustainably over time.

#### **Fiscal consolidation and Debt Sustainability Analysis**

**Given Timor-Leste's very low indebtedness and substantial buffers, the risk of debt distress for the foreseeable future is very low.** Total external debt, all consisting of concessional loans, is only one percent of the existing balance in the Petroleum Fund. Hence, any risk of debt distress would not come from high indebtedness but rather would arise only if the fiscal position substantially deteriorates for an extended period. In this regard, the authorities are disappointed with the change in Timor-Leste's risk of debt distress assessment by staff, from low to moderate. This assessment would only hold in the highly implausible scenario of an unchanged fiscal position for more than a decade. The authorities are fully aware that important adjustments must be made, in a timely manner, to bring the fiscal accounts to a stronger footing and therefore avoid depletion of the Petroleum Fund. In this regard, our Timorese authorities are fully committed to implementing measures to substantially raise the collection of domestic revenues and ensure debt sustainability over time. They also emphasize the expected improvements in macro-fiscal conditions in the coming years, given the government's focus on political stability and fiscal responsibility. They hope therefore that this downgrade will be merely temporary, as staff considers mitigating country-specific circumstances and the forthcoming improvements in the fiscal outlook.

**Timor-Leste's long-term fiscal stability prospects would be enhanced by economic diversification and additional domestic non-oil revenue mobilization.** Although domestic revenue collections suffered from lower economic activity and the implementation of temporary relief measures in 2020, the authorities have implemented a wide-ranging set of actions to increase non-oil revenue mobilization by improving tax administration, promoting

economic diversification, and fostering private-sector job creation. A new Value-Added Tax (VAT) Law is due in Parliament this year. Other fiscal reforms are in the pipeline, such as the new Tax & Duties Act, a revised Tax Procedures Code and the establishment of the Board of Tax and Customs Appeals' Office. In addition, the recent implementation of program-based budgeting will facilitate the prioritization of government spending.

### **Monetary and financial policy**

**The dollarized monetary regime has worked as an important anchor for the economy.** In recent years, inflation has been low and close to trading partners' inflation. Inflation expectations are also well anchored. The authorities continue to carefully assess the merits of maintaining the current monetary system and stress that, while the current regime has served the country well, the central bank will keep on reviewing the merits of the current regime versus alternative ones.

**The financial system continues to develop and has weathered the crisis well.** Timor-Leste's incipient banking system has remained stable throughout the crisis, and the authorities are vigilant regarding risks related to increasing credit costs and nonperforming loans once the credit moratorium expires. In this regard, they have implemented measures to improve the regulatory and supervisory framework, including enhanced reporting standards for the insurance sector, such as solvency margins, good governance practices, licensing, and supervision for issuing life insurances.

**The authorities are committed to furthering the development Timor-Leste's financial system.** Overall, financial inclusion has been improving. The 2020 Financial Inclusion Report, published in June 2021, showed that access to formal credit markets tripled in the last two years and about 68 percent of the adult population now have access to financial services. Recently, the Central Bank (BCTL) launched the "Digital Village Program" to enhance financial inclusion. Lower-income population in rural areas can have access to an e-Wallet account if banking services are absent in their villages. The BCTL is also modernizing the payments system, including via digitalization, while also focusing on financial literacy programs in elementary schools. In March 2021, the BCTL and the Ministry of Finance launched a system that allows taxes to be paid via ATM. Additionally, the BCTL has made substantial efforts to improve the regulatory and supervisory framework of financial institutions as noted above.

### **Structural reforms and engagement with the IMF**

**Timor-Leste is moving forward with a series of structural reforms aimed at improving the business environment and competitiveness and diversifying the economy.** Recent measures include streamlining business registration and licensing, by promoting electronic certification and quickly issue licensing to low risk businesses; developing extrajudicial means of dispute resolution, such as arbitration and mediation; and enhancing internet connectivity by setting up a submarine fiber-cable through Australia's northern territory.

Also, the authorities remain resolute to fight corruption and strengthen the anti-corruption and AML/CFT frameworks. The new Law on Measures to Prevent and Fight Corruption, enacted in August 2020, will strengthen governance and improve procurements processes.

**Timor-Leste remains closely engaged with the Fund and other international organizations in capacity and human capital development.** Investing in human capital is a key priority in Timor-Leste's institutional and capacity development strategy, aiming at providing opportunities to the new generations of Timorese. The authorities have increased their engagement with the World Bank, UNDP, and the Fund on how to drive efficiency in the health and education sectors, improve data collection, and PFM reform. The authorities have also requested technical assistance in the design of the VAT implementation plan and tax administration. With international support, the authorities have also started a program to help assess the outcomes and impacts of policies on citizen's lives. The government also plans to change the General Directorate of Statistics, currently under the Ministry of Finance, into an autonomous institute.

### **Sustainable Development**

**The authorities remain committed to a sustainable development agenda.** Recent floods demonstrate the need to enhance the country's disaster management strategy. The authorities have taken measures to further develop climate-resilient infrastructure, strengthening the contingency fund and improving territorial planning for urban and housing development, especially along riverbanks. Timor-Leste has also achieved substantial progress towards the 2030 Sustainable Development Goals and the authorities remain committed to pursuing a comprehensive agenda to ensure that development follows a sustainable path.

**In conclusion, Timor-Leste is a successful case of building a country under very challenging circumstances in a very short timeframe, but the task is far from complete.** The Timorese authorities and people are fully cognizant of the magnitude of the mission and are committed to it for the good of not only the current, but also future generations.