

**FOR
AGENDA**

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Supplement 1

June 11, 2008

To: Members of the Executive Board

From: The Secretary

Subject: **Democratic Republic of Timor-Leste—Staff Report for the
2008 Article IV Consultation—Informational Annex**

The attached informational annex is being issued as a supplement to the staff report for the 2008 Article IV consultation with the Democratic Republic of Timor-Leste (SM/08/165, 6/11/08), which is tentatively scheduled for discussion on **Wednesday, June 25, 2008**. At the time of circulation of this paper to the Board, the Secretary's Department has not received a communication from the authorities of the Democratic Republic of Timor-Leste indicating whether or not they consent to the Fund's publication of this paper; such communication may be received after the authorities have had an opportunity to read the paper.

Questions may be referred to Ms. Creane (ext. 37294) and Ms. Tumbarello (ext. 34395) in APD.

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the Asian Development Bank, following its consideration by the Executive Board.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities. This supplement is not being distributed in hard copy. It can be accessed in the Institutional Repository. A link to this document can be found in the daily list (<http://www-int.imf.org/depts/sec/services/eb/dailydocumentsfull.htm>) for the issuance date shown above.

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INTERNATIONAL MONETARY FUND

DEMOCRATIC REPUBLIC OF TIMOR-LESTE

Staff Report for the 2008 Article IV Consultation—Informational Annex

Prepared by the Asia and Pacific Department

June 10, 2008

	Contents	Page
I.	Fund Relations	2
II.	Relations with the World Bank Group.....	5
III.	Relations with the Asian Development Bank	7
IV.	Statistical Issues	8

ANNEX I. TIMOR-LESTE: FUND RELATIONS

(As of April 30, 2008)

I. Membership Status: Joined 7/23/2002; Article VIII

II. General Resources Account: SDR Million % Quota

Quota	8.20	100.00
Fund holdings of currency	8.20	100.00
Reserve position in Fund	0.00	0.01

III. SDR Department:

Net cumulative allocation	None
Holdings	None

IV. Outstanding Purchases and Loans: None

V. Financial Arrangements: None

VI. Projected Obligations to Fund: None

VII. Exchange Rate Arrangements

On January 24, 2000, the U.S. dollar was adopted as the official currency of then East Timor by the United Nations Transitional Administration in East Timor (UNTAET). This arrangement has been maintained after Timor-Leste's independence on May 20, 2002. At present, the monetary authority does not undertake foreign exchange transactions; they are handled by commercial banks on the basis of rates quoted in the international markets.

VIII. Article IV Consultations

The 2006 Article IV consultation discussions with the authorities were held during October 9–20, 2006. The last Article IV consultation was concluded on January 29, 2007. The Public Information Note may be found at <http://www.imf.org/external/np/sec/pn/2007/pn0724.htm>.

IX. Technical Assistance

Since late 1999, a significant amount of technical assistance has been provided by the Fund as part of the international community's efforts to reconstruct the Timor-Leste economy. The Fund's technical assistance has

focused on establishing key economic institutions (especially fiscal and monetary authorities) essential for macroeconomic management, as well as on developing local capacity to manage them. It also played a key role in the adoption of a new currency arrangement based on the U.S. dollar. Between late 1999 and end-2007, Timor-Leste has been one of the largest recipients of Fund technical assistance.

FAD: A series of multi-topic FAD missions took place early on to establish and develop the Central Fiscal Authority (CFA, February 2000), which developed into the Ministry of Planning and Finance. Assistance was provided to develop budget preparation, establish tax policy and administration, strengthen treasury and expenditure management, and advise on oil sector fiscal regimes. Long-term resident advisors were assigned to the Ministry of Planning and Finance and the Revenue Service of Timor-Leste to cover a wide range of issues, partly under a cost sharing arrangement with the UN. Over August 2004–July 2005, a FAD resident advisor assisted in the design and establishment of the Petroleum Fund, which started operations in August 2005. A FAD resident advisor to the Treasurer of the ministry finance started work in December 2006 to help strengthen expenditure management, reporting and budget execution—after a short break, a replacement will commence in June 2008 to continue this work. In 2007, an FAD TA mission provided guidance for future reform of the non-oil tax regime.

LEG: A number of LEG missions have been to Timor Leste to advise the authorities on key fiscal and financial legislation. These included tax legislation, the budget and financial management law, and banking regulations (relating to the monetary authority, the banking system, and the payments system). Jointly with MFD (now MCM), technical assistance has been provided to assist in drafting an AML/CFT Law. LEG has also recently provided assistance, in collaboration with FAD, for the drafting of the Petroleum Fund Act and tax consolidation, and in collaboration with MCM, for the drafting of the Central Bank Law.

MCM: A large number of missions took place early on to establish and develop the Central Payments Office (CPO, January 2000), which was transformed subsequently into the Banking and Payments Authority (BPA) (November 2001). Assistance was provided to establish a payment system, prepare banking legislation, and develop key functions of the monetary authority, including banking supervision, asset management, accounting, and organization and management. Assistance was also provided on the introduction of a dollar-based currency system and to issue domestic coins to supplement the use of U.S. dollar coins. More recently, assistance has been provided to (i) draft the insurance law and develop a framework for insurance supervision, (ii) strengthen banking supervision, (iii) address a broad range of issues relating to money laundering and

financing of terrorism, (iv) establish and train the investment unit responsible for managing petroleum fund assets (funded by Norway, a resident adviser commenced in March 2005 and, after a break due to contract renegotiations, a replacement is expected to commence in 2008), (v) prepare for the establishment of the central bank, (vi) design of a more effective organizational structure at the BPA, and (vii) modernize payment systems, and accounting for the Petroleum Fund. In addition, long-term resident advisors, including on banking supervision, payments, and accounting, have been assigned to the BPA under a cost sharing arrangement with the UN. Since early 2005, a long-term advisor has been assisting the BPA general manager.

STA: A multi-sector statistical mission took place in November 2000 to assess the availability and quality of official macroeconomic data, and help establish the Statistic Division of the Ministry of Planning and Finance. A long term statistical advisors was provided over the period November 2001-October 2005. A peripatetic statistical advisor was appointed in 2007 and is assisting the authorities in improving data compilation and developing local capacity to prepare balance of payments statistics—responsibility for this was transferred to the BPA in 2007. In early 2008 a monetary and financial statistics mission helped introduce the standardized report forms (SRFs) for reporting monetary data to the IMF and an integrated monetary database. Subsequently, Timor-Leste has, for the first time, been able to publish a country page in *IFS*.

X. Resident Representative

A resident representative office was established in Dili in August 2000. The current resident representative, Mr. Tobias Rasmussen assumed the post in February 2006.

ANNEX II. TIMOR-LESTE: RELATIONS WITH THE WORLD BANK GROUP

(As of May 6, 2008)

1. Timor-Leste joined the World Bank Group on July 23, 2002. It became eligible for IDA assistance on October 9, 2002. Thus far, there has been no lending to Timor-Leste, reflecting the authorities' policy to avoid external borrowing, including concessional loans. However, the World Bank has been actively involved in the reconstruction and development of the economy since late 1999, by playing a key catalytic role in mobilizing and coordinating international assistance to Timor-Leste. Timor-Leste also joined IFC in September 2004 and, together with the Pacific Enterprise Development Facility, an office was opened in Dili in 2006.
2. During the transition to independence, the World Bank's involvement centered around its role as trustee and co-manager of the Trust Fund for East Timor (TFET), which was established in December 1999 as a vehicle to provide grant assistance for reconstruction activities and economic development in Timor-Leste. Under the TFET, which is co-managed with the Asian Development Bank (ADB), the World Bank has administered projects relating to social services (especially health and education), agriculture, private sector development, community development and governance, economic capacity building, and petroleum sector development.¹
3. In addition to its involvement through the TFET, the World Bank played a key role in mobilizing budgetary assistance for the post-independence period through an annual multi-donor budget support operation. The Transition Support Program (TSP) from FY 2003 to 2005, was followed by the Consolidation Support Program (CSP) to FY2006/07, to reflect the shift from post-conflict transition to consolidation of gains made thus far. The TSP programs brought about \$30 million in budget support annually with about \$5 million financed by IDA, and the balance financed by 9 bilateral partners. The CSP programs brought around \$10 million in budget support annually, with about \$0.5 million financed by IDA. Both the TSP and the CSP programs focused on three thematic areas: (1) good governance, including developing a legal framework for governance and the judiciary and strengthening public expenditure management; (2) service delivery for poverty reduction, particularly in education and health; and (3) job creation, especially through private sector development, agriculture, and improvements in basic infrastructure.
4. The World Bank has also provided analytical and advisory services, including through a Country Economic Memorandum, a Poverty Assessment, a Public Expenditure Management and Accountability Note, a Public Expenditure Review, an Education Sector Review, and a Paper on Strengthening the Institutions of Governance in Timor-Leste. The

¹ Pledges to the TFET were made by 12 donors, including the European Commission and the World Bank, with the total amount of funds reaching \$178 million. This comprises donors' contributions of \$167 million (including \$10 million by the World Bank) and investment income of \$9 million. Of this total, \$167 million was disbursed by end-February 2008 (a new Trustee Report is now under preparation and should be released before end-May). TFET projects are expected to wind down by end-2010.

“Doing Business” report for 2006 featured Timor-Leste for the first time and was updated for 2007.

5. In July 2005 the World Bank adopted a Country Assistance Strategy for FY 2006–08. Currently the World Bank Group, including the International Finance Corporation (IFC), is supporting and planning to support 21 projects covering the development of the power sector; the health care system; developing the education sector; the development of private business and agriculture; transparency in the management of petroleum resources; supporting war veterans; promoting leadership and communication, a national employment program and a comprehensive framework for youth policy. The CAS provided for a total amount of IDA grants of about US\$ 25 million. One of the largest overall programs is a Planning and Financial Management Capacity Building Project, approved in March 2006, that amounts to \$37 million with \$7 million from IDA and \$30 million from development partners.

6. As budget support is no longer required given the increase in petroleum revenue, the CSP program will be replaced by donor support for the Government’s 2008 National Priorities. These include six priority areas where progress could lead to a transformation in the under-performing economy and improve significantly the lives of Timor-Leste’s one million citizens. These six priorities are: i) transparent management of the country’s petroleum resources; ii) budget execution; iii) addressing the youth crisis; iv) creating an environment for private investment; v) improving service delivery; and vi) protecting the most vulnerable

7. The World Bank used to co-chair the Timor-Leste Development Partners Meeting (TLDPM) with the Government of Timor-Leste. The seventh and latest TLDPM took place at the end of March 2008 and it was just chaired by the Government. The World Bank and UNMIT (UN Integrated Mission to Timor-Leste) helped the preparation of the government’s background paper to the TLDPM.

ANNEX III. TIMOR-LESTE: RELATIONS WITH THE ASIAN DEVELOPMENT BANK
(As of May 2, 2008)

1. Timor-Leste joined the Asian Development Bank (AsDB) on July 24, 2002. To date, there has been no lending to the country. However, like other international financial institutions and bilateral donors, the AsDB has been actively involved in the reconstruction and development of the economy since late 1999.
2. The AsDB's involvement has centered around co-managing with the World Bank the Trust Fund for East Timor (TFET), which was established in December 1999 as a vehicle to provide grant assistance for reconstruction activities and economic development in Timor-Leste.² Under the TFET, the AsDB has managed six projects with total funding of \$51.7 million,³ which aimed at the rehabilitation of physical infrastructure (urban and rural power, national roads, ports, and water and sanitation) and the development of microfinance.
3. In the wake of the post-referendum destruction, the focus of the projects was on providing emergency assistance, but subsequently shifted to meeting the country's long-term development needs. The AsDB's Country Operations Business Plan 2008 to 2010 identifies infrastructure development and management as the primary focus of ADB support to Timor-Leste. An ongoing road rehabilitation project (\$10 million grant) and Dili water supply project (\$6 million grant) are funded through the 9th Asian Development Fund (ADF IX). The recently negotiated ADF X allocates approximately \$20 million for the first biennial period 2009-2010, entirely on a grant basis. Most of this money will support road maintenance, rehabilitation, and improvement. Additional ADB technical assistance will average approximately \$2 million per annum. Allocations will be confirmed in a new Country Partnership Strategy for 2009-2013. Timor-Leste is the recipient of AsDB's largest ever technical assistance (TA) grant, the Infrastructure Project Management TA. This \$15 million 4 year package finances international and domestic project engineers, procurement specialists, and others to work within the Ministry of Infrastructure to help plan, prepare, and execute the Government's capital development program.
4. AsDB is currently preparing a private sector development support program, with a likely focus on access to finance (secured transactions) and public-private-partnerships in infrastructure development. AsDB has also intensified efforts to strengthen and divest the Microfinance Institute of Timor-Leste (IMfTL).

² See footnote 1 in Relations with the World Bank Group.

³ These projects comprise the Emergency Infrastructure Rehabilitation Project (\$29.8 million); the Emergency Infrastructure Rehabilitation Project 2 (\$9 million); the Water Supply and Sanitation Rehabilitation Project (\$4.5 million); the Water Supply and Sanitation Rehabilitation Project 2 (\$4.5 million); the Hera Fisheries Port Facilities Rehabilitation Project (\$1 million); and the Microfinance Development Project (originally \$4 million, but reduced to \$2.7 million)

ANNEX IV. TIMOR-LESTE: STATISTICAL ISSUES

Data provision to the Fund has serious shortcomings that significantly hamper surveillance. Weaknesses remain in the macroeconomic data, especially in the balance of payments and the national accounts. Prior to 1999, macroeconomic data were compiled by the Indonesian Central Bureau of Statistics (Badan Pusat Statistik, BPS) and the Central Board of Statistics of the East Timor Province. Balance of payments statistics were almost nonexistent as Timor-Leste was treated as one of the Indonesian provinces. Data compilation was seriously disrupted in 1999, as the post-referendum turmoil destroyed databases, and institutional capacity collapsed after most Indonesian statistical officers left.

During reconstruction, international financial institutions and bilateral donors provided technical assistance. A multi-sector Fund statistics mission visited Dili in November 2000 and assisted the authorities in establishing objectives for restoring economic statistics and in setting up a Statistical Division in the Ministry of Planning and Finance in 2001. A long-term resident statistical advisor assisted the Statistical Division during November 2001–February 2004, and was succeeded by a new resident advisor until September 2005.

National accounts

Under a World Bank-financed project, national accounts data for 2000 (both sector and expenditure basis) were estimated by the Boston Institute for Developing Economies (BIDE). In late 2004, BIDE, under a follow-up World Bank project, produced GDP estimates for 2001-03 that suffer from limited source data and substantial extrapolation. The Division of Statistics has not been able to replicate the BIDE estimation exercise. Consequently, estimates of GDP (including for the oil sector) have been prepared by Fund staff. To improve national accounts data, appropriate staff and substantial efforts in data collection and compilation are needed. The authorities have secured a commitment from the World Bank for further support on national accounts.

Prices, employment, and wages

A consumer price index has been compiled monthly for Dili and for the whole country. To address quality weaknesses, in particular inappropriate and outdated weights, the commodity basket and the weighting scheme were revised in mid-2003 under a donor-supported project, and a new monthly index for Dili has been compiled, with December 2001 as the base period. A further update of CPI weights based on detailed consumption patterns is not expected before 2009 as the authorities are focusing on the conduct of a World Bank living standards measurement survey.

Annual data on public sector employment and wages are available through fiscal records. No official data are compiled regularly on private sector employment and wages, except for partial data from household surveys conducted jointly by UNDP, ADB, and the World Bank.

Government financial statistics

Official data on central government revenue and expenditure are published semi-annually. Audited annual financial statements of the executed budget are made available to APD as soon as they are released, normally three months after the end of the fiscal year. In addition, monthly data are available on request through the budget, treasury, and revenue services. The compilation of revenue and expenditure follows the classification of the *Manual on Government Finance Statistics (GFSM 1986)* (including expenditure based on both functional and economic classification). Data on the execution of expenditure carried over from past fiscal years are not yet compiled and reported regularly. Only partial data are available on fiscal and quasi-fiscal activities undertaken by bilateral donors outside the central government budget. Currently, there are four non-financial public enterprises, which are treated as government agencies and data on their operations are available in the audited annual financial statements. No data are currently reported for the *GFS Yearbook* and the *International Financial Statistics*.

Monetary accounts

Monetary statistics are compiled by the Banking and Payments Authority (BPA), generally following the methodology of the *Monetary and Financial Statistics Manual*. However, data are incomplete because of the absence of official data on public currency holdings—which are difficult to compile under the current currency regime—and of bank's positions with public nonfinancial corporations. The BPA publishes a quarterly bulletin and an annual report with key monetary aggregates.

Detailed monthly monetary data are now available from July 2002 onward following the introduction of the standardized report forms (SRFs). Beginning in February 2008, monetary data are reported to the IMF for publication in the *International Financial Statistics* and *IFS Supplement on Monetary and Financial Statistics*. SRF-based data will be used for the Fund's operational and publication purposes. The BPA is planning to introduce a new call report form in 2008 to obtain balance sheet information from other depository corporations. A follow-up mission has been tentatively scheduled during FY09 to assist the authorities in this endeavor.

Balance of payments

No official data are available, except on merchandise exports and imports (starting March 2000), but no reports are available since July 2007. There are significant gaps in these series, which are based on customs reports with a breakdown for major commodity categories. However, data do not include oil and gas exports. Trade data do not include any estimate of large unrecorded border trade. In the Fund staff estimates, data on oil/gas revenue are currently recorded as current income based on fiscal data. All other major items in the balance of payments are estimated by Fund staff on the basis of limited information obtained from various sources, including bilateral donors and banks. To address institutional weaknesses in the compilation of the balance of payments, the Ministry of Finance transferred responsibility for the compilation of the balance of payments to the BPA in 2007. An STA peripatetic advisor is currently assisting the BPA to develop balance of payments statistics.

Timor-Leste: Table of Common Indicators Required for Surveillance
(As of May 27, 2008)

	Date of latest observation	Date received	Frequency of Data ⁶	Frequency of Reporting ⁶	Frequency of publication ⁶
Exchange Rates	5/2008	5/2008	M	M	M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	2/2008	3/2008	M	M	Q
Reserve/Base Money (<i>excludes currency in circulation</i>)	4/2008	5/2008	M	M	Q
Broad Money (<i>excludes currency in circulation</i>)	4/2008	5/2008	M	M	Q
Central Bank Balance Sheet	4/2008	5/2008	M	M	Q
Consolidated Balance Sheet of the Banking System	4/2008	5/2008	M	M	Q
Interest Rates ²	4/2008	5/2008	Q	Q	A
Consumer Price Index	4/2008	5/2008	M	M	M
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴
Revenue, Expenditure, Balance and Composition of Financing ³ – Central Government	12/2007	2/2008	Q	Q	A
Stocks of Central Government and Central Government-Guaranteed Debt	No debt contracted				
External Current Account Balance	Data not available				
Exports and Imports of Goods and Services ⁵	07/2007	09/2007	M	M	M
GDP/GNP	2003	10/2004
Gross External Debt	Not applicable				
International Investment Position ⁷					

¹Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

²Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

³Foreign, domestic bank, and domestic nonbank financing.

⁴The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments. For Timor-Leste it includes public spending from donors, on which data on execution are not available.

⁵Includes only goods. There are significant gaps in the series. No information on services is available.

⁶Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); NA: Not Available.

⁷Includes external gross financial asset and liability positions vis à vis nonresidents.