

**IMMEDIATE
ATTENTION**

SM/10/308
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December 3, 2010

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Democratic Republic of Timor-Leste—Staff Report for the 2010 Article IV Consultation—Informational Annex**

The attached informational annex is being issued as a supplement to the staff report for the 2010 Article IV consultation with the Democratic Republic of Timor-Leste (SM/10/308, 12/3/10), which is being considered on a lapse of time basis. Unless an objection from the authorities of the Democratic Republic of Timor-Leste is received prior to the conclusion of the Board's consideration, the document will be published. Any requests for modifications for publication are expected to be received two days before the Board concludes its consideration.

Questions may be referred to Mr. Schule (ext. 34563), Ms. Sun (ext. 35371), and Mr. Ochirkhuu (ext. 37662) 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 2010 Article IV Consultation—Informational Annex

Prepared by the Staff Representatives for the 2010 Consultation with Timor-Leste

(In Consultation with Other Departments)

December 3, 2010

	Contents	Page
I.	Fund Relations.....	2
II.	World Bank-IMF Collaboration.....	5
III.	Relations with the Asian Development Bank.....	8
IV.	Statistical Issues	9

ANNEX I. TIMOR-LESTE: FUND RELATIONS

(As of November 01, 2010)

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:	SDR Million	% Allocation
Net cumulative allocation	7.73	100
Holdings	7.73	100
IV. Outstanding Purchases and Loans:	None	
V. Latest 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 2009 Article IV consultation discussions with the authorities were held during June 4–15, 2009; the consultation was concluded on June 15, 2009. The Public Information Notice may be found at <http://www.imf.org/external/np/sec/pn/2009/pn0988.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. Since late 1999, 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 has continued this work since July 2008. In 2007, a FAD TA mission provided guidance for future reform of the non-oil tax regime. In April 2009 a FAD technical assistance mission provided advice on implementation of the fiscal regimes for petroleum. In addition to PEFA and fiscal ROSC, in 2010, FAD sent follow-up mission on treasury management. Also in 2010, FAD TA mission provided advice on the calculation of estimated sustainable income and other selected petroleum fiscal issues.

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 Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) Law. LEG has also 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 payments 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 related to AML/CFT; (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 continued this work from November 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, up until 2006 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. A long-term resident advisor assisted the BPA General Manager from February 2005 until February 2008, with that support subsequently provided on a peripatetic basis and funded by a Japanese grant.

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. Assistance was provided by long term statistical advisors during November 2001-October 2005. Since 2007, a peripatetic statistical advisor has provided assistance for improving data compilation and developing local capacity to prepare balance of payments statistics—responsibility for this was transferred to the BPA in 2007. Provisional annual balance of payments statements for 2006 and 2007 were published in December 2008. In early 2008 a monetary and financial statistics (MFS) 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*. A March 2009 follow-up MFS mission assisted in expanding the institutional coverage of depository corporations to include microfinance institutions and in revising the call report form that will be used to collect balance sheet data. In 2010, STA sent a follow-up mission on balance of payments statistics and a mission providing assistance on updating the CPI basket to Dili.

X. Resident Representative

The resident representative office closed at end-June 2009, which was established in Dili in August 2000.

ANNEX II. TIMOR-LESTE: WORLD BANK-IMF COLLABORATION

1. **The Bank and the Fund country teams for Timor-Leste, led by Mr. H. Rab (acting country manager) and Mr. W. Schule (IMF mission chief for Timor-Leste), maintain a close working relationship and have an active dialogue on a range of macroeconomic and structural issues.**
2. **There has been close cooperation on a range of issues including:**
 - (i) **Macroeconomic developments and economic updates:** There has been close dialogue throughout the year on macro policies and economic developments. There is regular sharing of information, including Fund comments on the Bank's semi-annual economic updates.
 - (ii) **Public Finance Management:** The World Bank participated in the IMF led PEFA and ROSC missions. Bank staff have been following up on the recommendations, including helping MOF put together a Strategic Plan. There is regular coordination between Bank staff on the ground and the IMF's Treasury Adviser at the Ministry of Finance.
 - (iii) **External debt:** The teams have engaged very closely on discussions around government plans to borrow. A first joint DSA was carried out during the Article IV mission in October/November 2010.
 - (iv) **Export competitiveness study:** The Bank recently completed a trade diagnostic study for which the Fund provided the analysis of external competitiveness and sustainability.
3. **Based on the above, the teams agreed that Timor-Leste's main macroeconomic challenge is to manage the country's petroleum wealth effectively and sustainably to develop a stronger non-oil economy and reduce poverty.** To meet this challenge Timor-Leste needs a Strategic Development Plan to help prioritize public expenditure; to strengthen public financial management; and to accelerate reforms to promote productivity and competitiveness. The effectiveness of scaling up public investment depends critically on progress in these areas.
4. **Based on this shared assessment the following structural reform areas were identified as macro-critical:**
 - **Strategic Development Plan:** Timor-Leste envisages a rapid scaling up of public investment. The SDP should help prioritize public expenditure, promote sustainable growth and fiscal sustainability.
 - **Public financial management reform:** The recent fiscal ROSC and PEFA missions and the Bank's review of the Planning and Financial Management Capacity Building Program found solid progress but also highlighted pressing issues around medium-term budgeting, expenditure (in particular public investment) management and procurement, and auditing. These areas are critical for the quality of expenditure.

- **Promoting productivity and competitiveness:** Timor-Leste faces a number of challenges to promoting productivity, competitiveness and diversification in the non-oil economy. Three key priorities include addressing skills deficit; improving access to land; and strengthening the business environment, in particular access to finance and contract enforcement.
5. **The teams agreed to continue the close cooperation going forward.** Appendix I details the specific activities planned by the two country teams over the September 2010/2011 period. In summary, the Fund will continue to lead on macro issues, and the Bank will continue to lead PFM and macro critical structural reform issues.

Appendix I. Timor-Leste: Bank and Fund Planned Activities in Macro-critical Areas September 2010–August 2011

Title	Products	Provisional/Actual Timing	Expected/Actual delivery date
1. Bank Work Program	Creditworthiness assessment	December 2010	April/May 2011
	Export competitiveness study	October 2010	January 2011
	PFM Capacity Building Program	Ongoing	July 2011 (Program close)
	Support on Public Investment Management	December 2010	February/March 2011
	Support on MTFF	January/February 2011	Spring 2011
	Civil Service Review	December 2010	Spring 2011
2. Fund Work Program	Article IV Consultations	October/November 2010	December 2010
	TA Balance of Payments Statistics	Missions in September, November, December 2010.	December 2010
	TA Government Finance Statistics	Mission February 2011	February 2011
	TA Consumer Price Index	Mission November 2011September 2010—September 2011	Spring 2011
	TA Resident Treasury Advisor	Ongoing, Res. Treasury Advisor in coop. with World Bank's PFM CBP	
	TA Strategic Development Treasury		
3. Joint Work Program	First DSA	Joint mission in October/November 2010	DSA write up November 2010

ANNEX III. TIMOR-LESTE: RELATIONS WITH THE ASIAN DEVELOPMENT BANK
(As of October 30, 2010)

Asian Development Bank (AsDB) assistance to Timor-Leste commenced in 1999. Assistance was initially conveyed through the United Nations Transitional Authority in East Timor. Timor-Leste joined the AsDB on July 24, 2002.

From 1999 to 2007, AsDB focused on the emergency rehabilitation of infrastructure, funded through the multidonor Trust Fund for East Timor (TFET). AsDB implemented about \$49 million in TFET projects covering urban and rural power, national roads, ports, and water and sanitation. \$4 million in TFET funds were used to establish and capitalize a microfinance institute.

AsDB's recent operations have been guided by the Country Program and Strategy Update 2006-2008 and the Country Operations Business Plans 2008-2011.¹ AsDB support has been closely aligned with the Government's National Development Plan and its goals to improve physical infrastructure and build capacity to manage and deliver quality basic social services.

The Asian Development Fund (ADF) program commenced in 2005. \$62 million in ADF grant funding has been approved, focused on essential infrastructure. A national roads rehabilitation project (\$10.0 million ADF) concluded in 2009 and has been succeeded by a new Road Network Development Sector Project (\$46.0 million ADF). AsDB administers a complementary \$3 million project in support of road side communities, funded by the Japan Fund for Poverty Reduction. AsDB also supports the Dili water supply and sanitation project (\$6.0 million ADF).

Timor-Leste is the recipient of AsDB's largest ever technical assistance (TA) grant, the Infrastructure Project Management TA. This \$15 million package, funded with AusAID co-financing, commenced in 2007 and helps plan, prepare, and execute the Government's capital development program. Other AsDB activities include the strengthening of microfinance, statistics and macroeconomic management, and a civil service training institute.

To-date ADB has approved 9 grants (6 from the TFET and 3 from the ADF) for a total amount of \$114.8 million, and 30 technical assistance (TA) projects for a total of \$28.3 million. Three grant funded projects (\$52.0 million) and 4 TA projects (\$17.1 million) are active.

There has been no lending to Timor-Leste, with all ADF resources provided as grants. ADF resources are set to move from 100% grant in 2010 to 67% grant and 33% loan in 2011-2012 and then to 33% grant and 67% loan in 2013-2014. Timor-Leste's ADF Allocation for 2011-2012 is \$30.2 million.

¹ AsDB. 2005. *Country Strategy and Program Update 2006-2008: Democratic Republic of Timor-Leste*, and ADB, 2007. *Country Operations Business Plan for Timor-Leste 2008-2010*.

ANNEX IV. TIMOR-LESTE: STATISTICAL ISSUES

As of October 27, 2010

I. Assessment of Data Adequacy for Surveillance

General: Data provision to the Fund has serious shortcomings that significantly hamper surveillance. Weaknesses remain in the macroeconomic data, especially the national accounts. 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. Technical assistance in balance of payments (peripatetic) and monetary statistics to the Banking and Payments Authority (BPA) began in mid 2007 and January 2008, respectively, and will continue through at least FY 2010.

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 Statistics Directorate has not been able to replicate the BIDE estimation exercise. Since April 2009, the authorities have been employing a World Bank funded consultant to develop annual estimates of GDP. For the first time in 2010, estimates of GDP (including for the oil sector) have been prepared by the Macroeconomic Unit in the Ministry of Finance in cooperation with Fund staff. To improve national accounts data, appropriate staff and substantial efforts in data collection and compilation are needed.

Price statistics: A consumer price index (CPI) has been compiled for Dili since December 2001 and for the whole country since June 2003. Prices for all items in the basket are collected on a monthly basis in the Dili region. Elsewhere, prices are collected at quarterly intervals for a representative selection of other regions throughout Timor-Leste. The measure of the interim monthly price movements for each item outside the Dili region is then estimated using the corresponding Dili region item price movement as an indicator series. 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. A technical assistance mission during November 8-19, 2010 will assist in rebasing the CPI using data derived from the Timor-Leste Living Standards Survey that was conducted in 2006-7. Shortcomings in data collection need to be addressed and products and outlets updated.

Labor market statistics: Annual data on public sector employment and wages are available in official budget documentation. No official data are compiled regularly on private sector employment and wages, except for partial data from various household surveys conducted by UNDP, ILO, ADB, and the World Bank. In 2010, the Macroeconomic Unit in the Ministry of Finance has started to conduct wage surveys.

Government finance statistics: Official data on central government revenue and expenditure are published quarterly. 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). 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*. A technical assistance mission is tentatively scheduled to the last quarter of FY 2011. This mission will aim to analyze the public sector's composition and accounting information as well as to set up a system to regularly report GFSM2001 data to users, including the IMF.

Monetary statistics: Monetary statistics are compiled by the 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 banks' positions with public nonfinancial corporations. The BPA publishes current monetary data on its website on a regular monthly basis, as well as a quarterly bulletin and an annual report with key monetary aggregates.

Detailed monthly monetary data are available from July 2002 onward following the introduction of the standardized report forms (SRFs). Beginning in February 2008, monetary data have been reported to the IMF for publication in the *International Financial Statistics*. The BPA is planning to introduce a new chart of accounts for the BPA in the coming months and a revised call report form (CRF) in late 2010 to obtain balance sheet information from other depository corporations (ODCs). A March 2010 mission assisted the authorities in finalizing the design of the CRF and derived the SRF for the ODCs based on this revised CRF. A follow-up mission could be scheduled for FY 2012 to assist the authorities in introducing the SRFs for the central bank based on the new chart of accounts of the BPA and for the ODCs based on the revised CRF and including the credit unions in the institutional coverage of the ODCs. Additionally, a new CRF could be designed to collect balance sheet data from insurance companies, and surveys compiled for financial corporations.

Balance of payments: Monthly data on merchandise exports and imports have been produced starting March 2000, based on customs reports with a breakdown for major commodity categories. A major data gap is the significant underestimation of imports of goods. Also not included are oil and gas exports; an estimate of the large, unrecorded border trade; and some goods exempt from customs duties. Further, customs data may underestimate imports because of undervaluation of declared goods. Monthly merchandise trade data are now published regularly but there are significant gaps in the series for 2006 and 2007. In the Fund staff estimates, data on oil/gas revenue are currently recorded as current income based on fiscal data.

With technical assistance provided by the IMF's Statistics Department, annual balance of payments data for 2006 and 2007 were published by the BPA in December 2008. Data are now available for 2006-2009.

While methodology for the production of basic annual estimates of the balance of payments statistics are in place, further development work is anticipated to address limitations of existing data sources, in

particular grants, merchandise trade statistics, and travel exports. The coverage of the survey of foreign direct investment enterprises needs to be expanded, and the exploration and extraction activities, in the Joint Petroleum Development Area and in the exclusive territory, require ongoing monitoring. As the economy grows, it will be important to monitor new activities such as new direct investment. Currently, there is limited information on remittances from Timorese working abroad and improvement in the estimation/compilation procedures of such remittances should be pursued.

Some data on stocks of financial assets and liabilities have been collected as the balance of payments development has taken place, and the annual international investment position statements should be finalized. Development of quarterly statistics should also be pursued.

The next balance of payments technical assistance mission will be conducted in November 2010.

II. Data Standards and Quality

Not a General Data Dissemination System participant.

No data ROSC is available.

Timor-Leste: Table of Common Indicators Required for Surveillance
(As of November 01, 2010)

	Date of latest observation	Date received	Frequency of Data ⁶	Frequency of Reporting ⁶	Frequency of publication ⁶
Exchange Rates	11/2010	11/2010	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	9/2010	10/2010	M	M	M
Reserve/Base Money (<i>excludes currency in circulation</i>)	9/2010	10/2010	M	M	M
Broad Money (<i>excludes currency in circulation</i>)	9/2010	10/2010	M	M	M
Central Bank Balance Sheet	9/2010	10/2010	M	M	M
Consolidated Balance Sheet of the Banking System	9/2010	10/2010	M	M	M
Interest Rates ²	9/2010	10/2010	M	M	M
Consumer Price Index	6/2010	7/2010	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴
Revenue, Expenditure, Balance and Composition of Financing ³ – Central Government	12/2009	9/2010	A	A	A
Stocks of Central Government and Central Government-Guaranteed Debt	No debt contracted				
External Current Account Balance	2009	8/2010	A	A	A
Exports and Imports of Goods and Services ⁵	8/2010	9/2010	M	M	M
GDP/GNI	2009	9/2010
Gross External Debt	Not applicable				
International Investment Position ⁷	Not available				

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 regular 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.