

**IMMEDIATE
ATTENTION**

SM/12/13
Supplement 1

January 17, 2012

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Democratic Republic of Timor-Leste—Staff Report for the 2011 Article IV Consultation—Informational Annex**

The attached informational annex is being issued as a supplement to the staff report for the 2011 Article IV consultation with the Democratic Republic of Timor-Leste (SM/12/13, 1/17/12), which is being considered on a lapse of time basis. At the time of circulation of this paper to the Board, the authorities of the Democratic Republic of Timor-Leste have indicated that they need more time to consider whether they will consent to the Fund's publication of this paper. Publication will only proceed upon the receipt by the Fund of the member's explicit consent. 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. Jang (ext. 34169) 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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DEMOCRATIC REPUBLIC OF TIMOR-LESTE

STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

January 13, 2012

Prepared By

The Asian and Pacific Department
(In consultation with other departments)

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ANNEX I. TIMOR-LESTE: FUND RELATIONS

(As of December 31, 2011)

I. Membership Status

Joined: July 23, 2002; Article VIII

II. General Resources Account

| | SDR Million | Percent 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 | Percent Allocation |
|---------------------------|-------------|--------------------|
| Net cumulative allocation | 7.73 | 100.00 |
| Holdings | 7.73 | 100.00 |

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. Timor-Leste has accepted the obligations

under Article VIII, Sections 2(a), 3 and 4, and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions.

VIII. Article IV Consultations

The 2010 Article IV consultation discussions with the authorities were held during October 26–November 9, 2010; the consultation was concluded on January 28, 2011. The Public Information Notice may be found at <http://www.imf.org/external/np/sec/pn/2011/pn1131.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, an FAD resident advisor assisted in the design and establishment of the Petroleum Fund, which started operations in August 2005. An 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, an FAD TA mission provided guidance for future reform of the non-oil tax regime. In April 2009 an 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 a follow-up mission on treasury management. Also in 2010 and 2011, FAD TA missions provided advice on the calculation of estimated sustainable income from petroleum and other selected petroleum fiscal issues. In 2011, an FAD TA mission provided advice on non-oil tax policy and administration.

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 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 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, were 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 published a country page in IFS for the first

time. 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. In 2011, STA missions provided advice on external sector statistics and national accounts statistics.

X. Resident Representative

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

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

1. The Bank and Fund country teams for Timor-Leste, led by Mr. L. Constantino (World Bank country manager) and Mr. B. Jang (Fund mission chief), have closely cooperated on macroeconomic issues and macro-critical structural reforms. The Bank team joined the 2011 Article IV consultation mission.

2. The two teams have worked closely on the following:

- 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.
- Public finance management: Bank staff have been following up on the PEFA and ROSC recommendations, including helping the Ministry of Finance (MOF) put together a Strategic Plan. There is regular coordination between Bank staff on the ground and the IMF's Treasury Adviser at the MOF.
- External debt: The teams have engaged very closely on discussions around government plans to borrow. A joint DSA has been conducted in November/December 2011, which is an important building block for the Bank's creditworthiness assessment.

3. 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 to prioritize public expenditure; to strengthen public financial management; and to accelerate reforms to promote productivity and competitiveness. The

effectiveness of scaling up public investment will depend critically on progress in these areas. The government launched the Strategic Development Plan (SDP) 2011–30 in July 2011 to step up development.

4. Based on this shared assessment the following structural reform areas were identified as macro-critical:

- Medium-term development plan (MTDP): The SDP envisages a rapid scaling up of public investment. The MTDP should help prioritize public expenditure and 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. Table below details the specific activities planned by the two country teams over the December 2011/2012 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.

Timor-Leste: Bank and Fund Planned Activities in Macro-Critical Areas

November 2011–December 2012

| Title | Products | Provisional Timing | Expected Delivery of Output |
|-----------------------|---|--|------------------------------------|
| 1. Bank Work Program | Ministry of Finance Strategic Plan | Nov / Dec 2011 | Feb 2012 |
| | Ministry of Finance PFM Program | Ongoing | Nov 2012 (program closes) |
| | Ministry of Finance design for external support post-2012 | Mar/Apr 2012 | Sep 2012 |
| | Parliamentary seminars on lending, social transfers | Nov 2011, Feb 2012 | Jun 2012 |
| | Support on Public Investment Mgmt | Jan 2012 | Jun 2012 |
| | Civil Service wage and salary bill | Mar 2012 | Sep 2012 |
| 2. Fund Work Program | Article IV Consultations | Missions in November 2011 and September 2012 | January 2012 and November 2012 |
| | TA Tax Mobilization | Mission in November 2011 | December 2011 |
| | TA Government Finance Statistics | Mission in March 2012 | May 2012 |
| | TA Monetary and Financial Statistics | Mission in Spring 2012 | Spring 2012 |
| | TA GDDS | Mission in March 2012 | Spring 2012 |
| | TA PF investment management | Mission in Spring 2012 | Spring 2012 |
| | TA Resident Treasury Advisor | Ongoing | |
| | TA ESI and fiscal regime for petroleum | Ongoing | |
| | | | |
| 3. Joint Work Program | DSA update | Joint mission in November 2011 | January 2012 |

ANNEX III. TIMOR-LESTE: RELATIONS WITH THE ASIAN DEVELOPMENT BANK

(As of December 2011)

1. Timor-Leste joined the Asian Development Bank (AsDB) on July 24, 2002. The AsDB has been actively involved in the reconstruction and development of the economy since late 1999. To date, there has been no lending to the country.

2. AsDB assistance to Timor-Leste over 1999–2005 had concentrated on emergency infrastructure works. The ADB country strategy for 2006–2010 continued the focus on infrastructure, while completing a transition to rehabilitation works. Over the 2011–15 period AsDB will help the government begin to upgrade infrastructure.

3. The Timor-Leste country partnership strategy (CPS) 2011–15 aligns AsDB support with Timor-Leste’s Strategic Development Plan 2011–2030. It outlines a five-year strategic partnership with the government in support of infrastructure, financial services, and the skills training to meet the needs of a growing economy. It will support the private sector to help Timor-Leste make the transition from a public sector-led economy.

4. AsDB resources for infrastructure over the 2011–2015 period are expected to be concentrated in road and urban water supply and sanitation. Support will be private sector-oriented, with AsDB playing an “honest broker” role in facilitating private sector engagement in infrastructure.

5. Timor-Leste first accessed the Asian Development Fund (ADF) in 2005. ADF supported activities include an ongoing road

rehabilitation project (\$46 million grant), a Dili water supply project (\$6 million grant), a district capital water supply project (\$11 million grant), and a technical and vocational education and training project (\$11.5 million grant). Timor-Leste is the recipient of one of AsDB’s largest ever technical assistance (TA) grant, the Infrastructure Project Management TA. This \$15 million six-year package, co-financed with AusAID, helps plan, prepare, and execute the Government’s capital development program. Other AsDB activities include support for regional economic integration, the finance sector, small-scale infrastructure, and the strengthening of statistics and macroeconomic management, the civil service, and environmental management.

6. To date AsDB has provided a total of 11 grants (5 from the ADF and 6 from the Trust Fund for East Timor) for total amount of \$137.8 million, and TA projects for a total of \$32.1 million. Four ADF grants (\$75.0 million) and 8 TA projects (\$19.0 million) are active.

7. Timor-Leste became eligible to borrow from the ADF in 2011. The \$27.7 million in ADF resources available for 2011–12 are a mix of grants and loans: \$18.5 million as grants, and \$9.2 million as concessional loans. From 2013–14, all ADF resources will be available on a loan basis. In October 2011, the ADB Board approved the reclassification of Timor-Leste as a ‘B’ member country. This provides access to ADB’s Ordinary Capital Resources (OCR), while retaining access to ADF.

ANNEX IV. TIMOR-LESTE: STATISTICAL ISSUES

(As of December 2011)

I. Assessment of Data Adequacy for Surveillance

General: Data provision to the Fund has shortcomings that significantly hamper surveillance. Weaknesses remain in the macroeconomic data, especially the national accounts and trade statistics.

National Accounts: Since April 2009, the authorities have been employing a World Bank funded advisor to develop annual estimates of GDP. The national accounts advisor, with assistance of Fund technical assistance, is finalizing compilation of the national accounts statistics for 2004–10 for the first time. The responsibility of compiling the national accounts data will be handed over to the National Statistical Directorate from the MOF's Macroeconomic Directorate in early 2012. To improve national accounts data further, appropriate staff and substantial efforts in data collection and compilation are needed.

Price statistics: A technical assistance mission during November 8–19, 2010 assisted in rebasing the CPI using data derived from the Timor-Leste Living Standards Survey that was conducted in 2006–7. The CPI basket weights, however, have not been updated yet. Shortcomings in data collection also 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: 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). These data are bridged to the GFSM 2001 classifications for the compilation of Table 2 of the Staff Report. Only partial data are available on fiscal and quasi-fiscal activities undertaken by bilateral donors outside the central government budget. A technical assistance mission is tentatively scheduled for early 2012.

Monetary statistics: Monetary statistics are compiled by the Central Bank of Timor-Leste (CBTL), 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.

Detailed monthly monetary data are available from July 2002 onward, following the introduction of the standardized report forms (SRFs). A mission in March 2010 assisted the authorities in finalizing the design of the call report form (CRF) and derived the SRF for the other depository corporations (ODCs) based

on this revised CRF. A follow-up mission is scheduled for early 2012 to assist the authorities in introducing the SRFs for the central bank based on the new chart of accounts of the CBTL and for the ODCs based on the revised CRF and to include the credit unions in the institutional coverage of the ODCs.

Balance of payments: A major data gap in the monthly data on merchandise exports and imports 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 are now available for 2006–10.

II. Data Standards and Quality

Not a General Data Dissemination System participant.

While methodology for the production of basic annual estimates of the balance of payments statistics are in place, further development work is needed to address limitations of existing data sources, in particular, 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, and the annual international investment position statements should be finalized. Development of quarterly balance of payments statistics should also be pursued.

No Data ROSC is available.

III. Reporting to STA

No data on government finance statistics are currently reported for the *GFS Yearbook* and the *International Financial Statistics (IFS)*. Beginning in February 2008, monetary data have been reported to the IMF for publication in the *IFS*.

Timor-Leste: Table of Common Indicators Required for Surveillance
(As of December 23, 2011)

| | Date of latest observation | Date received | Frequency of Data ⁶ | Frequency of Reporting ⁶ | Frequency of publication ⁶ |
|---|----------------------------|---------------|--------------------------------|-------------------------------------|---------------------------------------|
| Exchange Rates | 12/23/2011 | 12/23/2011 | D | D | D |
| International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹ | 10/2011 | 11/2011 | M | M | M |
| Reserve/Base Money (<i>excludes currency in circulation</i>) | 10/2011 | 11/2011 | M | M | M |
| Broad Money (<i>excludes currency in circulation</i>) | 10/2011 | 11/2011 | M | M | M |
| Central Bank Balance Sheet | 10/2011 | 11/2011 | M | M | M |
| Consolidated Balance Sheet of the Banking System | 10/2011 | 11/2011 | M | M | M |
| Interest Rates ² | 10/2011 | 11/2011 | M | M | M |
| Consumer Price Index | 10/2011 | 11/2011 | M | M | M |
| Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴ | ... | ... | ... | ... | ... |
| Revenue, Expenditure, Balance and Composition of Financing ³ – Central Government | 12/2010 | 09/2011 | A | A | A |
| Stocks of Central Government and Central Government-Guaranteed Debt | No debt contracted | | | | |
| External Current Account Balance | 2010 | 8/2011 | A | A | A |
| Exports and Imports of Goods and Services ⁵ | 8/2011 | 11/2011 | M | M | M |
| GDP/GNI | 2010 | 11/2011 | ... | ... | ... |
| Gross External Debt | Not applicable | | | | |
| International Investment Position ⁷ | Not available | | | | |

¹ Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

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

³ Foreign, domestic bank, and domestic nonbank financing.

⁴ The 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.

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

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

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