

SUR/13/100

November 4, 2013

**The Acting Chair's Summing Up
Democratic Republic of Timor-Leste—2013 Article IV Consultation
Executive Board Meeting 13/98
October 23, 2013**

Executive Directors agreed with the thrust of the staff appraisal. They welcomed Timor-Leste's substantial progress as it enters its second decade as a sovereign nation. The end of the 13-year UN presence, the successful elections in 2012, and the accumulation of substantial assets in the well regarded Petroleum Fund are important indicators that Timor-Leste is overcoming the fragilities inherent in a post-conflict nation.

Directors recognized that substantial development challenges remain given still high levels of poverty. The overriding challenge now is to successfully use oil revenues to foster economic and social development and the diversification of the economy. Directors supported the goals of the authorities' Strategic Development Plan that aims for upper-middle income status and a substantial reduction in poverty by 2030.

Directors noted that, after six years of strong non-oil GDP growth driven by large increases in public expenditure, the next step is to generate a shift to higher-quality growth in which an organic private sector, operating independently from government contracts, increasingly takes the lead. This would support economic diversification, increase employment opportunities, and ensure that economic growth results in broad based poverty reduction.

As part of this approach, Directors welcomed the revised budgetary framework that anticipates a stabilization of government expenditures and revenue diversification. Given the dollarized economy, a restrained fiscal stance that contributes to lower inflation will also have benefits for external competitiveness. Directors also welcomed the on-going reprioritization of expenditures with a renewed focus on growth-enhancing investments in basic infrastructure and a shift away from transfers and subsidies. Directors stressed that although the revised framework limits the buildup of public sector debt, contingent and off-balance sheet liabilities will need to be avoided. In addition, it will be important to ensure that withdrawals from the Petroleum Fund are in line with fiscal sustainability and absorptive capacities, while also carefully monitoring their asset allocation strategy.

Directors emphasized that catalyzing the private sector will require steps to improve the business climate and address structural bottlenecks through improvements in infrastructure and the implementation of productivity-enhancing structural reforms. Directors

noted that the priorities include implementation of the Land Law, streamlining the Investment Law, and improving contract enforcement.

Directors observed that the official dollarization of the economy has played a positive role, especially in light of underdeveloped or missing financial and money markets. In this regard, Directors encouraged the authorities to enhance their capacity to support a potential transition over the long term to a monetary and exchange rate framework that provides more autonomy and flexibility.

Directors noted that financial deepening and improving access to credit will become increasingly important as the economy develops. At the same time, safeguarding the soundness of the banking system will require strengthening central bank prudential supervision, developing a crisis management framework, and addressing weaknesses in the anti-money laundering framework.

Directors welcomed the closer dialogue between the Fund and the authorities. They noted the important role that Fund technical assistance can play in a number of areas to help the authorities achieve their development goals.

It is expected that the next Article IV consultation with Timor-Leste will be held on the standard 12-month cycle.