



# International Monetary Fund

## **IMF Mission Concludes 2013 Article IV Consultation Discussions with Timor-Leste**

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An International Monetary Fund (IMF) mission led by Mr. Neil Saker visited Dili, Timor-Leste, during June 5 to 17, 2013 to conduct the 2013 Article IV Consultation discussions. The mission met with the Minister of Finance, the Governor of the Banco Central de Timor-Leste, senior officials, and representatives from the private sector and civil society to discuss recent economic developments and the medium-term outlook. At the conclusion of the mission, Mr. Saker issued the following statement:

"Timor-Leste has made substantial progress as it enters its second decade of independence. A number of key milestones have been achieved. The 13-year UN presence was concluded successfully in 2012. Parliamentary and presidential elections were held in mid-2012 with Prime Minister Gusmao reelected, heading a coalition government. A Strategic Development Plan (SDP) to guide Timor-Leste toward upper middle-income status was developed in an inclusive manner and its implementation started in 2011. Timor-Leste has accumulated a highly regarded Petroleum Fund that now stands at around \$13 billion.

"The non-oil economy has grown rapidly in recent years with growth averaging close to 12 percent from 2008 to 2012, allowing the average per capita income to steadily increase. The growth was driven by a rapid increase in government spending (averaging over 30 percent per annum) which boosted the public administration and construction sectors. So far, the contributions from agriculture and manufacturing have been modest, hampering employment opportunities outside of the public sector and constraining widespread growth in living standards.

"Inflation has been high despite full dollarization, rising to over 15 percent in 2011. It moderated in 2012 but is still running at over 10 percent. This reflects strong demand growth and bottlenecks impeding an effective supply response. In addition to hitting the low-income households, high inflation in a dollarized economy hampers Timor-Leste's ability to diversify and generate employment growth.

"Discussions with the authorities focused on the challenges of shifting to a higher quality growth path in which an organic private sector, operating independently from government contracts, increasingly takes the lead. This has become necessary as the government has reached the limits of its capacity to execute productively ever higher levels of public spending. More fundamentally, the economy needs to start generating employment opportunities for a fast growing labor force to ensure that economic growth results in broad based poverty reduction.

"The mission welcomed the government's latest medium-term

budget framework, recently approved by the Council of Ministers, that anticipates a substantial moderation in the growth of public expenditure. This will bring a number of benefits. Firstly, it will reduce inflationary pressures in the economy, helping reduce poverty. Secondly, by largely eliminating excess withdrawals from the Petroleum Fund, the financing of the budget will be placed on a long-term sustainable path. Finally, it will provide an opportunity to improve the overall quality of public expenditure. Overall, provided needed structural reforms are pushed forward, the medium-term budget framework is consistent with strong growth in household consumption, lower inflation and declining poverty over the medium term.

“Realizing the new expenditure path will require policy choices and identifying priorities, with a greater focus on value for money and budgetary planning and execution. On the capital side, funding of key infrastructure (roads, port and airport) should be prioritized over capital-intensive projects with low employment generation potential. On the recurrent side, the challenge will be to generate space for much needed higher spending on operations and maintenance and provision of essential supplies in health and education. This can be done through greater restraint in the growth of the wage bill and in spending on subsidies and transfers.

“Catalyzing an organic private sector will become an increasing priority in order for Timor-Leste to shift the economy from public to private-sector led growth. This will require steps to improve competitiveness and address structural bottlenecks. With regards to labor cost competitiveness, the key priority is to reduce inflation in the economy and bring wage levels in Timor-Leste in line with its peers in the ASEAN region. Capital investments in transport infrastructure remain a high priority.”

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