IMF Mission Concludes 2014 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, from June 3 to 17 to conduct the 2014 Article IV Consultation discussions.[1] The mission met with the Minister of Finance, the Governor of the Banco Central de Timor-Leste, senior officials, development partners, 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:

“Given appropriate policies, Timor-Leste is well placed to sustainably improve living standards in line with the goals of the Strategic Development Plan (SDP). The authorities are committed to a transparent and accountable fiscal framework that has allowed oil revenues to be saved through the Petroleum Fund (PF). This internationally well-regarded institution plays a key role in avoiding the ‘resource-curse’ and has accumulated assets of over US$16 billion (approximately three times GDP).

“New developments suggest that Timor-Leste is entering a transition period. This comes amid a backdrop of declining oil production in the short and medium term that will impact overall GDP growth. The 2012 National Accounts data show that non-oil GDP growth has slowed markedly due to a lower but more sustainable level of government expenditure. The first-cut estimate of non-oil GDP growth in 2012 at 7.7 percent is significantly below 14.7 percent in 2011 and the average of over 12 percent during 2007 to 2011 that was driven by high rates of government spending. Our baseline projection is for non-oil GDP growth of around 5-7 percent in the medium term. Still high by international standards and in line with trends in emerging Asia, this rate of growth will also be of higher quality than before. This is because it would be more private-sector led and inclusive, and consistent with lower inflation. In fact, inflation has already fallen markedly from 18 percent in early 2012 to around 2 percent in 2014.

“In the context of this transition, the key to inclusive and sustainable growth is catalyzing the private sector. This will require fostering job-rich sectors in line with Timor-Leste’s fundamentals, such as agriculture, tourism, and energy. With regard to the first two sectors, Timor-Leste could market ecologically-friendly products. In the energy sector there could be startups in niche areas such as oil industry services and specialized oil-based products. The mission is encouraged by reported foreign direct investment (FDI) in areas such as cement, food processing, and tourism. With significant infrastructure improvements (Tibar Bay Port, Dili airport and new roads), investment in labor-intensive industries such as these will be the engines of future high-quality growth that generates employment.

“As Timor-Leste builds its linkages with global trade and production networks, diversification prospects will arise. Given Timor-Leste’s leadership role in the g7+ grouping, participation in the

Community of Portuguese Language Countries and links with Australia and the EU, Timor-Leste is well-placed to take advantage of global and regional integration trends. To benefit from these opportunities, the private sector must be able to compete and expand into businesses in areas of comparative advantage. Given missing and incomplete markets and large positive externalities, a public sector role in industrial development is warranted, but this needs to be well-targeted and judicious. The business cases for developments including the Tasi Mane development area and Special Economic Zones such as proposed for Oecussi need to be well articulated, with the focus on private sector participation and risk sharing.

"The mission welcomed the authorities' increased focus on fiscal sustainability and considers that a front-loading strategy in line with the SDP objectives should see expenditures stabilized at US$1.3 billion. Capital projects should go ahead only on the basis of realistic cost-benefit analysis, in which, at a minimum, the growth benefits outweigh the opportunity cost of lower Petroleum Fund revenues. To better support growth, expenditure should focus more on priority areas such as health and education, as well as operation and maintenance of new infrastructure, while the social safety net should be better targeted toward the poor. Simultaneously, special efforts need to be made on raising non-oil domestic revenues. A strong asset-liability framework will become critical with potential new liabilities undertaken including via public-private partnerships and large capital intensive projects by public sector firms. Continued efforts are needed to improve communication on the budget, given large deviations between the published budget and budget execution.

"The financial system is slowly developing amid new challenges. The number of banks has increased with new products emerging, and the non-bank financial sector is also developing. The mission endorses the BCTL's Financial Sector Master Plan, which sets out the role of a robust and inclusive financial system, and looks forward to working with the authorities in enhancing the supervisory and regulatory frameworks and governance. It is important that the Anti-Money Laundering / Combating the Financing of Terrorism (AML/CFT) framework is developed, and also that the financial sector entities within the Special Economic Zones remain within the supervisory mandate of the BCTL. While financial markets remain underdeveloped, the current exchange rate regime that uses the US dollar remains appropriate.

"The quality of statistics continues to hamper surveillance. The mission welcomes ongoing efforts to enhance methodologies particularly relating to National Accounts, inflation and poverty data."

[1] The completion of the Article IV Consultation is subject to the discussion by the IMF Executive Board.

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