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Democratic Republic of Timor-Leste: Selected Issues and Statistical Appendix

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DEMOCRATIC REPUBLIC OF TIMOR-LESTE

Selected Issues and Statistical Appendix

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Approved by the Asia and Pacific Department

May 31, 2005

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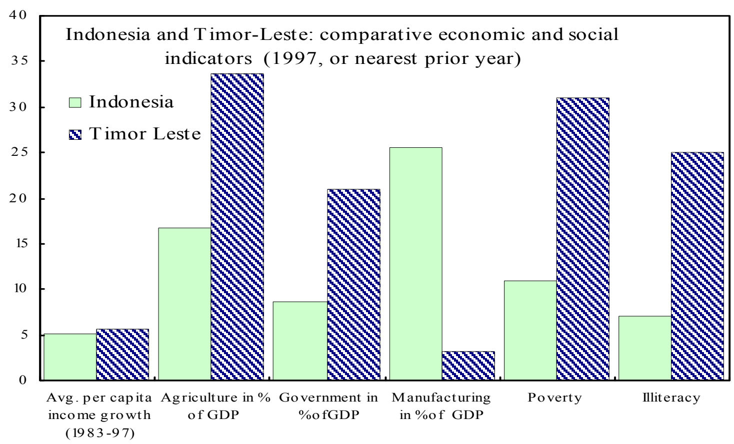
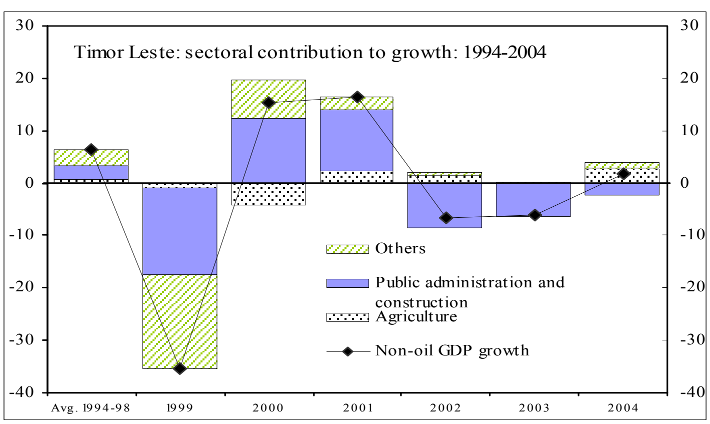
I. Removing Impediments to Growth Through Public Investment and Private Sector Development[1]

This chapter provides an overview of past growth performance and an assessment of the outlook for growth in Timor-Leste. It identifies impediments to growth and discusses policies that would contribute to the accelerated rates of growth needed to reduce poverty and unemployment and the other objectives of the National Development Plan.

A. Growth Performance in Timor-Leste, 2000-04

1. **For more than a decade before the 1999 post-referendum violence, Indonesia-governed Timor-Leste experienced high growth rates. However, per capita income and social indicators lagged well behind those for Indonesia as a whole**. From the early 1980's until the 1997-98 Asian crisis, the Timor-Leste economy grew at an average rate of 5.6 percent.[2] Nonetheless, in 1997 Timor-Leste's per capita income was estimated at 36 percent of that for Indonesia as a whole, while most social indicators also lagged those in Indonesia. The structure of the economy was dominated by activity in the agriculture and government sectors, reflecting the large subsistence-agriculture sector, the dominance of coffee as an export crop, and a large government sector including military. The relative importance of the government sector in the rapid growth during this period suggests that much of the benefits may have fallen to households employed by the administration, generally personnel from outside Timor-Leste. The construction sector was also relatively



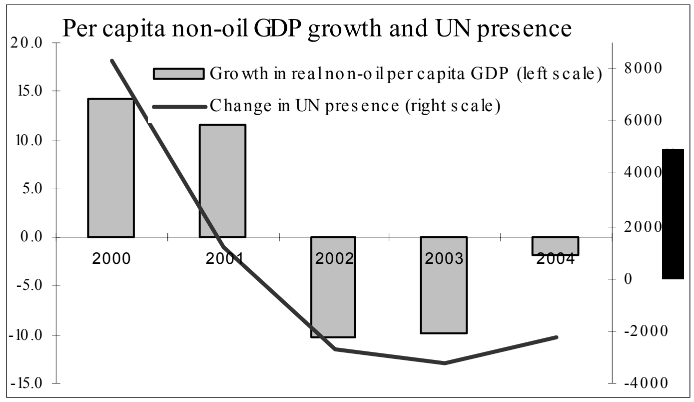


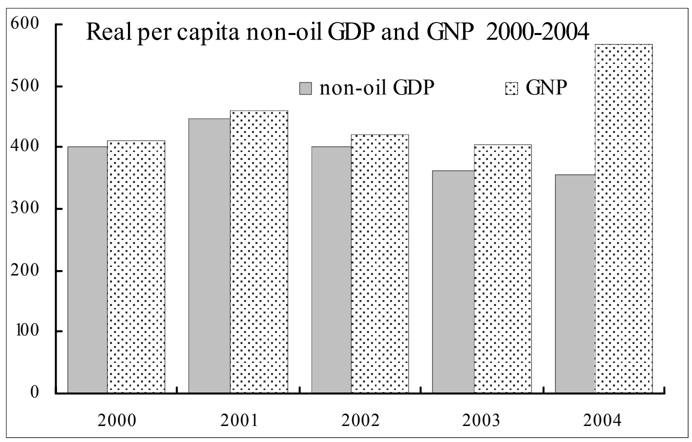
[1] Prepared by Valeria Fichera.

[2] Pre-1999 estimates of economic and social indicators are based on extrapolations from official Indonesian regional statistics by Hill (2001).

dynamic, given significant public investment in infrastructure (although much of it reportedly geared to military and security considerations). This unbalanced economic structure is likely to have amplified the economic downturn from the 1999 conflict, when most administrative activity broke down and Indonesian civil servants and military personnel left Timor-Leste.

2. **During the first four years following the withdrawal of Indonesia, the growth path in post-conflict Timor-Leste was largely driven by the dynamics of the UN presence**. Following a collapse in GDP by about 35 percent in 1999, foreign-financed emergency reconstruction, humanitarian aid, and consumption by expatriates and national staff hired by the UN mission spurred an economic recovery in 2000 and 2001.[3] Since 2002, the numbers of UN military peace-keepers, civilian staff and volunteers in Timor-Leste declined sharply, as did economic activity. Recently revised national accounts estimates indicate an even worse decline than initially assessed (Box 1). A drought in 2003 compounded the negative impact on the economy of the withdrawal of the foreign presence, and, together with continued rapid population growth (reflecting both the return of refugees and a high fertility rate) contributed to a decline in real per capita non-oil GDP by a cumulative 20 percent between 2001 and 2003.





3. **The year 2004 was marked by moderate recovery in non-oil economic activity and the start of oil production**. A post-drought rebound in agriculture and expansion in banking activity offset the impact of some further decline in donor activity. However, the modest non-oil economic recovery was not sufficient to offset continued rapid population growth; as a result, per capita non-oil GDP is estimated to have declined further. At the same time, substantial oil

[3] UN expatriate personnel rose to about 10,000 in 2001, dropped to about 7,500 in 2002 and declined further in 2003 and 2004. The number of Timorese nationals hired by the UN rose to above 1,700 in 2001 and then declined by about 25 percent per year until end 2004. For an analysis of the economic impact of UN operations in Timor-Leste in 2000-2004, see Carnahan, Gilmore, Rahman (2005).

income came on stream from the Bayu-Undan field, resulting in large tax and royalty payments to the government and a 40 percent jump (to US$ 563) in gross national per capita income.[4]

Box I.1. Revisions to the National Accounts, 2001-2003

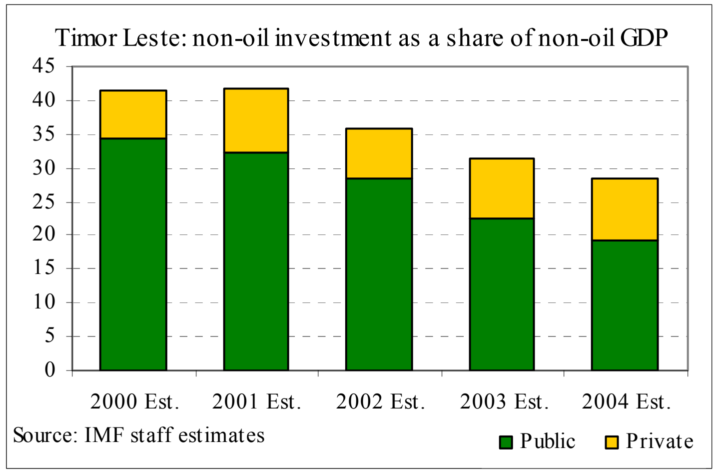
- In October 2004, the Boston Institute for Developing Economies (BIDE), under a World Bank grant, compiled new national accounts estimates for 2000-2003.
- To prepare the new estimates, BIDE conducted interviews and used detailed information, where available, including from the 2001 Timorese Living Standard Measurement Survey and preliminary data from the 2004 population census. The estimates were produced on a methodologically sound basis; nonetheless, significant gaps in data availability and information limit their robustness.
- The broad pattern of a rise and then fall in economic growth rates are seen in both the BIDE and previous Fund staff estimates (published in the Staff Report for the 2004 Article IV Consultation); however, the timing and magnitude of the change in the growth rates are different, as illustrated below. The largest changes relate to the valuation of public administration (including the UN) and agriculture value added. The new estimates imply a much steeper decline in real non-oil GDP than previously assessed.
- National accounts estimates and projections included in the Staff Report for the 2005 Article IV consultation incorporate the BIDE estimates.

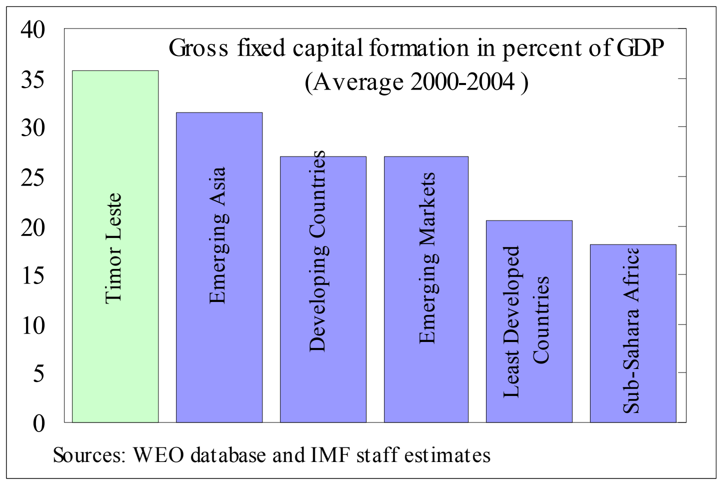
National Account - Data Revisions

	2001		2002		2003	
	IMF	BIDE	IMF	BIDE	IMF	BIDE
Real Non-oil GDP						
Growth Rate	14.6	16.5	3.0	-6.7	-2.7	-6.3
deflator (percentage change)	5.2	-0.2	-4.6	0.0	-7.8	4.3

[4] Gross national income is approximated by the sum of non-oil GDP and oil/gas income accruing to the government (royalties and oil tax revenue).

4. **Investment in 2000-04 was primarily driven by the international donors' focus on rebuilding following the 1999 violence**. Non-oil investment as a share of non-oil GDP is estimated to have declined from 40 percent of GDP in 2000 to just below 30 percent of GDP in 2004, albeit still a high level for low income countries.[5] On the other hand, the large investment activity was mainly directed at reconstructing basic infrastructure for the provision of essential services by the public sector, and residential buildings by the private sector, both largely destroyed in 1999.[6] Construction activity for private residences and basic infrastructure had a significant short term impact on income and employment in 2000-2001, but did not create a sustainable basis for longer-term growth because it was not complemented with the parallel accumulation of more productive capital.





5. **In addition, Timor-Leste's long-term growth prospects are also hindered by the sharp decline in the human capital stock following the 1999 conflict**. The relatively more educated workers in both the government administration and the private sector were in large part from Indonesia and left at the time of the violence or immediately thereafter.

B. The Outlook for Growth

6. **While the near-term prospects are positive, to fully benefit from the "peace dividend" and absorb the fast growing unskilled labor force over the medium-term, new engines for growth are needed**. Under current policies and trends the outlook is for a pick-up in economic activity in 2005 and a doubling in 2006 to 5 percent, mainly reflecting the start of

[5] The quality of estimates of GDP components on the expenditure side is very poor. Neither the government nor donors have yet conducted a households expenditure survey nor business survey. Estimates for private investment are particularly tentative.

[6] One exception was the establishment of private hotels, concentrated in Dili, to meet demand from the large numbers of expatriate visitors to Timor-Leste in the early post-conflict years.

increased public investment spending along with some parallel response from the private sector. However, the authorities' medium-term growth objective of 6 percent set out in the NDP will be difficult to achieve. Moreover, an even more rapid growth rate may be needed to absorb likely new entrants to the labor force.

7. **With respect to other post-conflict economies, Timor-Leste has rapidly established relatively stable social and political conditions, and a solid macroeconomic policy framework—all essential ingredients for growth**. On the other hand, the structure of the economy remains skewed toward government activity (including donor-funded projects) and subsistence agriculture. The still limited stock of physical and human capital assets suggests that well-targeted public investment in infrastructure and education and health, together with accelerated private investment in labor-intensive sectors, could trigger a significant productivity and growth response in the economy.

8. **Currently, the bright spot in Timor-Leste's growth outlook is the new oil and gas production although the experience of other low-income resource-rich countries invites caution**. Generally, the onset of oil and gas activity triggers limited direct spillovers on the non-oil domestic economy of a country—particularly when activity occurs fully off-shore. Moreover, empirical evidence shows that resource wealth often results in highly volatile growth and destabilizing macroeconomic effects with negative long-term consequences, if the policy framework to manage the resource wealth (or its implementation) is inadequate.[7] The contribution of the oil sector to non-oil domestic activity and employment in Timor-Leste will mainly occur through the fiscal channel. In view of the government's decision to establish sound practices for the management of the oil wealth, as described in Chapter II, Timor-Leste has a good chance of escaping the "oil curse". The chosen policy framework for using Timor-Leste's oil/gas wealth should provide a relatively stable and permanent flow of budget resources that would relax some of the constraints faced by most low-income countries for medium-term expenditure planning, particularly for public investment.[8]

C. Policies to Remove Impediments to Growth

9. **Aside from uncertainties in the oil sector, the main risks to the growth outlook for Timor-Leste relate to the pace and strength of further reform**. This section looks at the policies needed to remove impediments to growth through realization of well-targeted public investment and introduction of a legislative, regulatory, and administrative framework to attract private investment.

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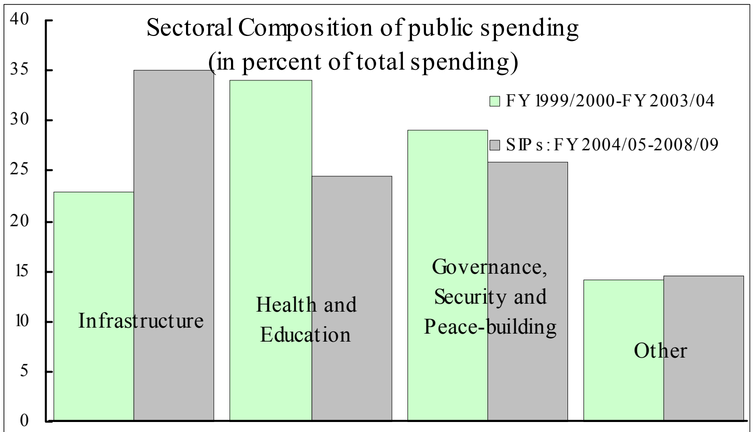
[7] See Sachs and Warner (2001) on the natural resource curse and Richard Auty (2000) on the role of domestic economic policy and governance structure in explaining the impact of natural resource abundance on economic growth.

[8] A successful example of effective long-term natural resource management and public investment set in a sustainable fiscal framework is Botswana.

Well-Targeted Public Investment



Source: Ovrview of Sector Investment Programs, April 2005, Ministry of Planning and Finance.

10. **With the transition from post conflict emergency now ending, public investment should become more growth-oriented**. Through the Sector Investment Programs (SIPs), the government has strengthened its commitment to use fiscal resources in support of non-oil sector growth and poverty reduction. The SIPs appropriately presume the maintenance of stable macroeconomic conditions; and the draft budget for FY 2005/06 and the accompanying medium-term fiscal framework are in line with this assumption.[9] The investment programs have been refocused on infrastructure and the maintenance of still significant allocations to human capital development. The choice is wise and respects the need for complementarities between public and private investment for long term development. However, the slow pace of execution of on-budget public investment must accelerate, particularly to offset any possibility of emerging slack from declining donor funded off-budget projects. The government needs to be ready to further refine public investment priorities to ensure that projects with the highest expected economic and social return are undertaken first, if donors support falls short of desired levels.

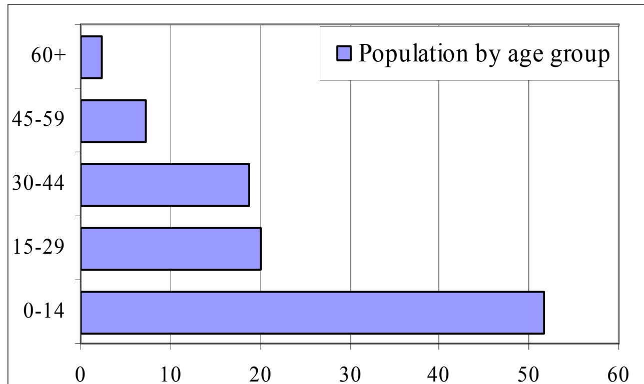
11. **Limited access to electricity and relatively high prices suggests that investment in the power sector could impact growth positively, including in the rural areas**. The SIPs include a large budget allocation to the power sector to increase supply, reduce costs, expand coverage and enhance reliability. In FY 2005/06, the government envisages starting the construction of the first large hydro-power project in the country (Ira Lalaro) and of transmission lines to connect to the Dili system, once the environmental impact assessment has been completed. Studies are also ongoing to gauge the economic feasibility of using onshore oil/gas seeps for power generation, particularly for the use of local communities close to the seeps, some of which are located in very poor areas. Currently, an external management contractor is operating the state electricity agency EDTL. The external contractor started running EDTL in

[9] Despite a large increase in spending (particularly for development expenditure) in the draft FY 2005/06 budget, total spending is programmed below sustainable spending. This choice will limit the risk that demand pressures on the small domestic economy trigger inflation pressures. It also reduces the risks that public funds would be wasted, particularly given still weak domestic administration.

Electricity cost in the Pacific (US$/KWH)										
Australia	Indonesia	Micronesia	Fiji	Marshall Islands	Solomon Islands	Samoa	Timor Leste	Kiribati	Vanuatu	Tonga
~ 0.06	~ 0.07	0.10 - 0.16	0.16	0.16	0.16	0.18	0.16 - 0.20	0.24	0.26	0.31
Source: Holden, et al. (2004); Fund staff estimates.										

2004 and the contract is for three years. Despite operational difficulties and the absence of an arms-length relationship with the government, EDTL performance has improved. Faster movement is needed to complete the design of the regulatory framework and transform EDTL into a public corporation run on commercial principles. In 2002, the government had envisaged that, over the long term, electricity provision in Timor-Leste should be provided through a long term concession of the national power system under a built-operate-transfer arrangement with a private investor. However, this option will be evaluated again at the expiration of the current management contract in light of the acquired experience.[10] The main challenge the government will face when moving to the implementation phase of the proposed investment in the power sector is the scarcity of technical and engineering skills available in the administration and in the country. The government is expected to need external support to ensure proper design, implementation and monitoring of what are likely to be technically complex projects. In addition, in view of Timor-Leste's policy of avoiding external borrowing, the government and donors need to find alternative modalities to engage external support for these projects, which are normally undertaken through long-term lending operations.

12. **Investment in education and health will continue to figure prominently in public investment plans and will be driven by the Millennium Development Goals.** With a young and fast growing population, and health and education indicators below the average for low income countries, the government needs to continue to invest strongly in the country's human capital. In view of international evidence showing positive links between improvements in girls' education, better health indicators and long-term growth, the government should strengthen the focus on programs that concretely encourage parents to send girls to school, including in the rural areas. Efforts at strengthening vocational training and orienting it to sectors where productivity is low and potential is high (e.g. agriculture) could also have high returns.



Source: Demographic and Health Survey. (World Bank, 2003)

[10] See Power Sector Development Plan for Timor-Leste (Asian Development Bank, 2004).

13. **Further refocusing of investment programs toward strategic sectors could encourage private activity**. The policy strategy for agriculture established under the SIPs has defined public investment priorities for agriculture, forestry and the fisheries by identifying the most pressing needs for infrastructure and capacity building. The agriculture sector shows good potential both for improving yields in subsistence agriculture, thus improving food production and reducing poverty, and for new opportunities in commercial agriculture, mainly in niche market products, that could be operated by small and medium private enterprises and absorb part of the underemployed rural labor force.[11] In addition, fisheries, which have until now focused on supplying the small domestic market, could be developed as an export sector. Tourism is another promising sector for development, particularly marine tourism given pristine reef conditions. Over the last four years, tourism activity benefited from the large and relatively captive expatriate community. But with the international presence in Timor-Leste declining, the target market must change and the sector must face international competition if it is to expand. Existing private operators are optimistic but point to the need for a clear legal and regulatory framework for business (see below) and the need for sector-specific training of the low-skilled labor force if tourism is to become an engine for growth and job creation.

14. **In the short term, the government plans to use small public work projects to create temporary jobs for the very poor and to develop basic community infrastructure, particularly in rural areas**. The SIPs include programs for the construction of rural roads and small-scale water and sanitation projects in the poorest districts. If properly managed, these projects could provide needed infrastructure in parallel with income support tied to employment. In addition, small public work schemes could temporarily bridge the gap between decreasing job opportunities with the donor community and the still slow emergence of private sector jobs. The government, however, will need to exercise caution in setting appropriately low wages for these work programs to send a clear signal that with the departure of the international community, wages for low-skilled labor are to be kept in check and even decline, if the economy's competitive potential is to be enhanced. In addition, the temporary nature of these projects should be emphasized lest the government evolve into the established employer of last resort—a problem that has emerged in other oil producing economies.

15. **The government is considering the creation of public enterprises, including a national oil company and a fishery management venture**. Though the objective of extracting a larger share of profits from national resources is understandable, international experience with state enterprises, particularly in low income countries, suggests that it should proceed with caution.[12] The government has clarified that if it were created, the national oil company would be fully integrated into the existing petroleum policy framework and comply with the proposed

[11] Agricultural land in Timor-Leste has been mainly used for subsistence agriculture and has not been treated with chemical fertilizers. As a result, bio-agriculture is a promising niche and already has been exploited successfully for exports of certified organic coffee.

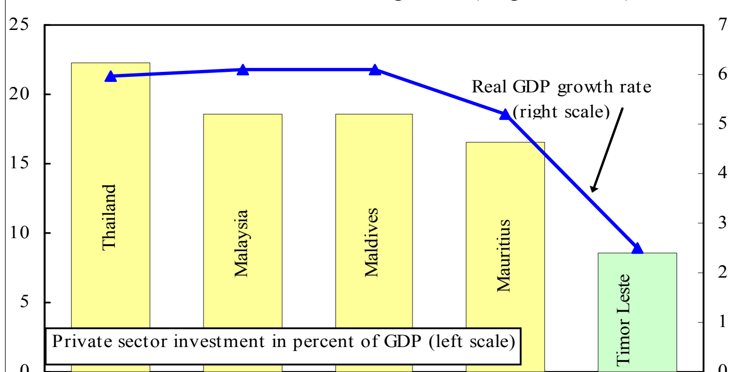
[12] For an overview of the role and impact of national oil companies, see McPherson (2003).

petroleum fund and saving policy requirements. On the other hand, the limited availability of human capital and the persistent scarcity of capacity in government administration suggests the possible diversion of the most skilled workers toward the national oil company could further delay capacity building in the non-oil sector.[13] In the fisheries sector, creation of a public enterprise raises the risk of discouraging the emergence of private commercial enterprises, particularly if the sector regulator is also the owner of a company competing in the sector. In any decision regarding the creation of state-owned enterprises, the government should carefully weigh the risk of crowding out private sector investment. If a decision to establish a state company is taken nonetheless, a transparent regulatory framework that credibly addresses potential conflicts of interest should be established upfront.

Creating the Environment to Stimulate Private Sector Activity

16. **To strengthen long-term growth and employment creation prospects, Timor-Leste needs the emergence of small and medium-sized, labor-intensive private enterprises**. International evidence suggests that countries with high levels of private investment have historically experienced higher levels of growth and lower unemployment. In addition to maintaining stable macroeconomic conditions, fast growing economies, particularly in Asia, have also been characterized by very open trade regimes, relatively flexible labor markets and good legal and regulatory environments for businesses. In Timor-Leste, the trade regime is liberal, but the regulation of the labor market is unclear and the legal and regulatory environment for business is incomplete. At the same time, institutions responsible for the interaction of the administration with the private sector and for enforcing contracts or resolving business disputes are weak or still to be established.

Private sector investment and growth (Avg. 1981-2003) 1/



Sources: WEO database and Fund staff estimates.
1/ For Timor Leste estimated average for 2000-2004 (non-oil GDP).

17. **Creating a coherent legal framework from the existing mix of Portuguese, Indonesian and UNTAET (United Nations) legislation is a difficult endeavor**. But as a new country, Timor-Leste has the opportunity to consider global best practices when deciding on legislation and regulations, particularly on economic matters.[14] The limited capacity of the

[13] Several low-income, oil-rich countries have experienced the drain of the best human resources towards jobs in the national oil companies, which normally pay higher salaries than in the rest of the administration and in the economy in general, and, additionally, provide opportunities to extract high private benefits from the conduct of public business (e.g., Angola and Nigeria).

[14] The opportunity seems to have been captured with the oil sector legislative and regulatory framework, which is considered to be consistent with best practices.

administration and the diverse background of external advisors have occasionally transformed this opportunity into a serious challenge, and raised the risk for inconsistencies in the legal framework that could hinder economic activity. To limit this risk and accelerate the preparation of legislation in support of private sector activity, strengthened legal and economic expertise in business-related legislation is needed. The focus should be on ensuring coherence and identifying at an early stage the by-laws, implementing regulations and administrative responsibilities needed for effective introduction of economic legislation.

18. **The recent adoption by parliament of the investment laws, the insurance laws and the law regulating private lease contracts bodes well for further progress with the lagging agenda on private sector development**. Most of the approved laws indicate deadlines for the issuance of implementing regulations and the government should strive to abide by them.

- The **investment laws** establish a framework for domestic and foreign investment in Timor-Leste and the interaction of investors with the administration. However, tax incentives included in the laws may complicate implementation and entail difficult to assess revenue costs. The implementing regulations for the investment laws should minimize the risks for unwarranted revenue losses and establish clear limits to administrative discretion.

- The creation of an **investment and export promotion agency** to operate as a one-stop-shop for foreign investors is envisaged in the foreign investment law. The agency is scheduled to start operating by end-2005.

- The adoption of the **insurance law** was also a much awaited step by the business community that was confronted with higher costs because of lack of access to insurance against standard risks. The Banking and Payments Authority is designated as the sector regulator. It is important that the licensing of insurance companies starts soon, but also that new entrants in the market are competent and financially solid.

- The **law on leasing between private parties** together with the decree law on the leasing of government property will encourage property rental and increase transparency in how public land and properties are leased.

19. **However, the still pending legislative agenda in support of the economy remains large and calls for enhanced commitment by the government**.

- The completion of **land legislation** will take time because of the need to establish a cadastre before comprehensive land titling can go forward.[15] Progress with land titling is essential for resolving land disputes, to encourage investment in land improvements and allow for the use of land as collateral in financial transactions. The government therefore

[15] Experts estimate that the set up of the cadastre and comprehensive land titling may require 3 to 5 years.

needs to keep a fast pace in progressing with the land legislation agenda, even if the task will require a few years.

- The government also needs to accelerate action towards the finalization of a **bankruptcy law**, for which the first draft has been under preparation for more than a year. Though the small size of the formal private sector might suggest that business solvency crisis would not have widespread effect, the lack of a bankruptcy law creates a regulatory vacuum and adds uncertainty for investors. The recent rapid increase in bank credit to the private sector, including small businesses, strengthen the case for faster progress in establishing a legal framework that defines the rights of different categories of creditors in the case of insolvency.

20. **For the private sector to operate effectively, interactions with the administration should be as limited as possible and strictly rule-based**. Anecdotal evidence suggests that the limited competence of civil servants that deal with businesses and the legacy of corruption in business-public sector interactions create an unfavorable environment for setting up and effectively operate a private enterprise in Timor-Leste. Empirical evidence suggests that reducing the number of administrative procedures required to start a business, shortening the time elapsing between them and limiting the required direct contacts with public administration officials have positive impacts on economic growth.[16] Some steps are underway to address these issues:

- The government and business representatives have agreed to hold the first national level **Business-Government Dialogue forum** in June. The dialogue will focus on the cost of doing business and on reducing the regulatory burden on companies. It is important that both the government and businesses use this opportunity to identify the most burdensome administrative requirements and discuss rapid measures to ease them. Once agreement is reached on some proposals, prompt action by the government would be a concrete sign of its pro-growth orientation.

- The World Bank plans to include Timor-Leste in the **"Doing Business" database**. A team of experts will visit Timor-Leste mid-2005 to collect the necessary data and information to assess the business climate in the country. Findings from this exercise are expected in September and should guide further action in revising the legal and regulatory framework for private sector development.

- Under the Small Enterprises Project II[17], small groups of civil servants involved in dealing with the business community have started receiving specific training to

[16] Doing Business in 2005 (World Bank and IFC, 2005).

[17] The Small Enterprises Project II, funded by the Trust Fund for East Timor (TFET), includes a capacity building component aimed at training working-level civil servants involved with policy making and facilitation of private sector development.

strengthen the capacity of the administration to deal professionally with the private sector. The training will need to be extended and re-tailored once the results of the business-government forum and the “doing business” assessment would have provided indications for priority needs.

21. **Finally, a competent and independent judiciary is essential for contract enforcement and business dispute resolution.** Progress with capacity building in the judiciary has been particularly slow. The courts remain very weak and judicial activity is currently managed by internationally appointed judges, following the failure of all Timorese judges to pass a qualification exam. The national judges are now undergoing training, partly on the job, which is scheduled to last two years. Eventually, the country will also need to establish specialized commercial courts or commercial divisions in regular courts to attend to commercial disputes. In the interim, the government will need to rely on the set-up of alternative out-of-court dispute resolution mechanisms, while starting planning on specific training for the judges and court actors that will be involved in commercial cases.

D. Conclusion

22. **Timor-Leste’s public investment program and plans to set up a legal and regulatory framework supportive of private sector development point in the right direction, but faster implementation is needed**. The main challenges will come from the limited capacity of the administration to design, execute and monitor investment programs of increasing complexity; and from the low capacity of the administration and other public institutions to meet the needs of the business community.

23. **Creative solutions will be needed to proceed at a faster speed with complex public investment projects that are essential for long-term growth.** The government and its development partners will need to design new modalities to ensure that the implementation of complex projects, including major extension to power generation and the distribution network, can proceed despite the limited domestic technical capacity. At the same time, new projects should include substantial training and capacity building components in order to relax over time the binding capacity constraint.

24. **Completing the essential legislative and regulatory framework to enable new non-oil private sector activities remains an immediate priority**. The steps taken with the adoption of the investment laws, the insurance law and the creation of the investment and export promotion agency are promising signs to investors. However, implementation will remain the ultimate test of the government’s commitment to private sector development. Over the longer term, it is important to strengthen the administrative agencies dealing with businesses and to build the necessary institutions for proper contract enforcement and dispute resolution.

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II. MANAGING OIL/GAS WEALTH IN TIMOR-LESTE[1]

A. Introduction

1. **The 2004 onset of oil/gas production in Timor-Leste marks a turning point for the impoverished and newly independent country**. Oil/gas revenue from the existing Bayu Undan field is estimated at $3.2 billion (NPV terms) over 20 years, more than nine times Timor-Leste's 2004 non-oil GDP. These prospects are uncertain: they could be higher if new projects are undertaken or lower if oil prices return to historical norms. To date the new oil revenue has contributed to a sharp improvement in the fiscal situation, with the central government surplus (including grants) moving from 10 percent of non-oil GDP in FY03/04 to 70 percent of non-oil GDP in FY04/05.[2]

2. **Many economies with significant natural resources have suffered from the "resource curse."** Weak institutions, lack of transparency, and political pressures have often resulted in misuse and misallocation of the resources. Boom-burst cycles in oil/gas-producing countries have been at least partially caused by fiscal policies that followed oil/gas price developments. To date, many oil/gas producing countries have had difficulty achieving economic stability and high sustained growth.

3. **Timor-Leste's long-run economic prospects will thus depend on its strategy for use of its oil/gas wealth**. The key challenge for the government will be the effective use of oil/gas wealth for the development of the economy by preserving the right balance between spending and saving for future generations. This chapter is organized as follows: Section B reviews the macroeconomic challenges commonly faced by oil/gas exporters, Section C discusses Timor-Leste's oil/gas revenue outlook, Section D describes Timor-Leste's plans for managing its oil/gas wealth through a natural resource (petroleum) fund and a saving policy, and Section E provides some conclusions.

B. Managing Natural Resources: Challenges Facing Oil/Gas Producing Countries

4. **The past experience of resource-rich economies is often one of poor macroeconomic performance in the absence of good policies for managing the wealth**. Studies show that resource-rich economies generally grow less rapidly than those without natural resource wealth. The challenges that arise include the following:

5. **Fiscal policy in oil/gas countries may be excessively expansionary.** Frequently, government spending exceeds appropriate levels given long-term considerations, without convincing signs that the higher spending has been able to lift the productive potential of the economy. This is related to volatile oil/gas prices, which may translate into pro-cyclical

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[1] Prepared by Yitae Kevin Kim.

[2] The fiscal year runs July to June.

expenditure. In addition, the volatility may cause frequent unexpected fiscal adjustments, which are costly to private sector activity, particularly when making a downward adjustment.

6. **The large inflow of oil/gas revenue may cause an appreciation of the real exchange rate**. This appreciation may lead to loss of competitiveness in the non-oil/gas sector of the economy, including the manufacturing sector, which is regarded as an engine of early development and a potential source of employment and growth. This generally means that economic resources move away from the production of tradable goods to non-tradable sectors and imports would rise. The oil/gas resource inflow also affects the rest of the economy through its impact on macroeconomic aggregates. Income increases as a result of rising oil/gas revenue will likely lead to higher consumption and investment. Without proper management of aggregate demand, this would substantially raise the overall price level and may distort relative prices.

7. **Given that oil/gas is a nonrenewable resource, intergenerational equity should be considered**. This means that oil/gas revenue should be used in a way that will leave future generations as well off as the current one; generally this would involve some level of saving. How much saving should occur before the oil/gas reserves are fully extracted depends on the particulars of the country case. Those countries with significant development needs would arguably best use part of the resources to finance public expenditure with high social and economic returns; however, those countries with limited absorptive capacity would need to save more since the efficiency of public spending may be low.

8. **From these challenges, lessons may be drawn for oil/gas producers in designing a strategy for managing natural resource wealth**:

- **Fiscal policy should be set in a longer-term, comprehensive framework**. This requires analyzing the government's overall net wealth, including estimates of the value of oil/gas in the ground, and ensuring that the wealth is prudently managed and that the government's fiscal policy is sustainable. This typically entails saving a significant share of current oil/gas revenue.

- **Pro-cyclical fiscal policy should be avoided and preparations should be made for downturns**. To prevent having to cut spending sharply when oil/gas prices fall, governments need to ensure sufficient financing capacity. As many oil/gas-producing countries are credit constrained (especially when oil/gas prices are low), liquidity cushions are recommended.

- **Fiscal policy should focus on the non-oil/gas deficit as a percent of non-oil/gas GDP in developing a long-term budgetary framework**. Given that national wealth is expected to derive predominantly from the non-renewable oil/gas resources, the non-oil/gas primary balance is a key variable as it strips out the impact of volatile oil/gas revenues. The non-oil/gas budget balance also reflects, to a large extent, the current and future economic developments in the domestic economy. Focusing on the developments in the non-oil/gas economy can help the government to pursue the objective of diversifying the economy and to create a tax base that does not solely rely on oil/gas revenues.

- **Transparency should be a guidepost in managing the oil/gas wealth and fiscal policy**. At the same time, accumulated assets could be invested overseas to prevent real exchange rate appreciation and minimize risks to the real value of the asset.

Box II.1. Fiscal Environment for the New Oil Exporter

The fiscal sector in Timor-Leste has several unique features that, taken together, differentiate it from other low income oil/gas exporters. These include:

a. Large fiscal surpluses since oil/gas production began in 2004;

b. Administrative capacity shortfalls, which have led to shortfalls in budget execution, particularly for investment spending, notwithstanding significant large development needs;

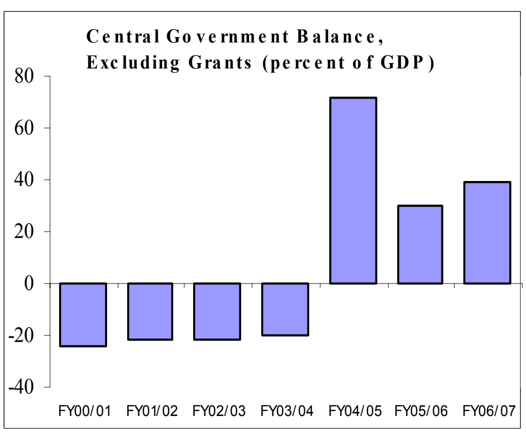
c. A broad medium-term investment strategy, under the Sector Investment Programs, with the objective of achieving the millennium development goals;

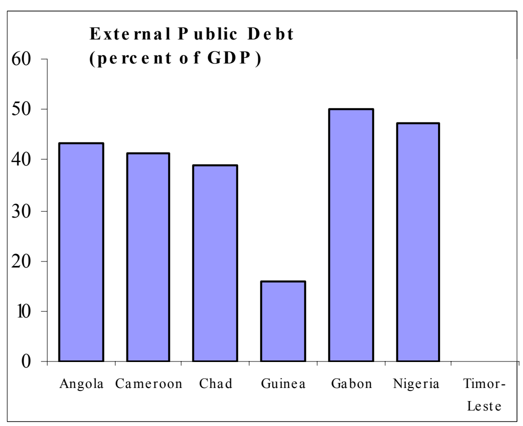
d. A policy of refraining from either domestic and foreign borrowing, resulting in no interest burden;

e. Early establishment of a petroleum fund, expected to be operational from July 1, 2005 to avoid Dutch disease and other resource-related complications;

f. Very low level of non-oil/gas tax revenue; and

g. An officially dollarized economy, highlighting the importance of fiscal policy.





C. Oil/Gas Sector Prospects

9. **The prospects for oil/gas production in Timor-Leste are favorable, although still highly uncertain**. Production of oil/gas in the Timor Sea is already providing Timor-Leste with

significant revenues; updated revenue projections show petroleum revenues of around US$ 3.2 billion, more than 9 times 2004 non-oil GDP.[3] Development of other fields and additional exploration for both onshore and off-shore areas are planned. The Phoenix field, adjacent to the current Bayu-Undan production area, has an estimated value of 2.26 trillion cubic feet of gas, and could extend the life of the Bayu-Undan field by around 15 years from 2023. The Greater Sunrise field has 8.3 trillion cubic feet of gas (three times that of Bayu-Undan) and around 200 million barrels of oil/gas. The allocation of revenue from Greater Sunrise will depend on the outcome of current negotiations with Australia.

10. **Major oil/gas fields**. Timor-Leste's oil/gas revenue is generated from the commercial exploitation of oil/gas/ resources mostly in the "Timor Gap" (Box 2). Major oil/gas fields discovered to date include the Elang-Kakatua-North (EKKN), Bayu-Undan, Phoenix, and Great Sunrise fields. The Bayu-Undan field is currently the main source of oil/gas revenue. Resources from the EKKN field were limited and are nearing exhaustion. The timeframe for the Great Sunrise field remains uncertain, pending conclusion of negotiations with Australia regarding an area of disputed sovereignty with some recent reports suggesting these negotiations are nearing conclusion.

11. **Revenue sharing arrangement**. The commercial exploitation of oil/gas in the Timor Gap is governed by the Timor Sea Treaty signed between Timor-Leste and Australia on May 29, 2002. Under the Treaty, the Timor Gap is partitioned into tree areas: (1) the Joint Petroleum Development Area (JPDA) (see JPDA Map below), (2) an area under Australian jurisdiction, and (3) an area under Timor-Leste jurisdiction. Oil/gas revenue in the JPDA are shared between Timor-Leste and Australia with a 90/10 split.[4] The Bayu-Undan field is located entirely in the JPDA, while the Great Sunrise field straddles the boundary of the JPDA to areas that are claimed by both countries.

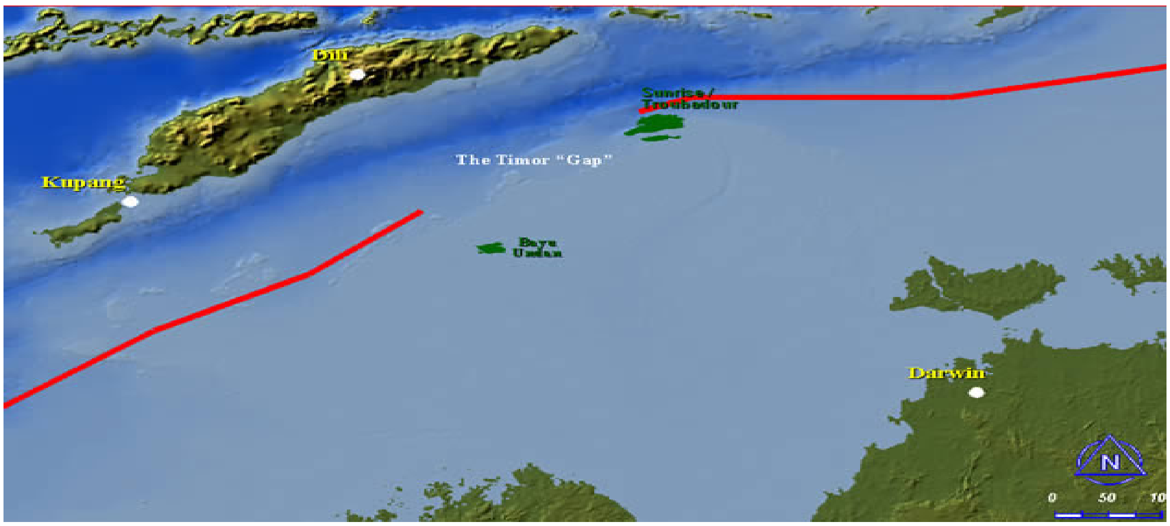
12. **The outlook for oil/gas revenue is highly sensitive to oil/gas prices as well as production**. The sensitivity analysis of the projection for revenue from Bayu-Undan is based on data provided by the authorities and is largely derived from ConocoPhillips, the oil/gas extraction company that is the principal "operator" for Bayu-Undan. Estimating oil/gas revenue is highly difficult mainly due to the non-linearity of price elasticity oil/gas revenue (profit oil/gas revenue is contingent on movements in oil/gas prices) and the volatility of world oil prices. The scenarios taken for the analysis assume prices that are $5 higher and $10 lower than the baseline

[3] Oil/gas revenue is based on the NYMEX forward price minus 5 dollars ($39.6, $38.2, $35.9, $34.5, $33.7, and $33.2 per barrel, 2004/05–2009/10). Future prices after 2010/11 are assumed to grow 2.5 percent a year.

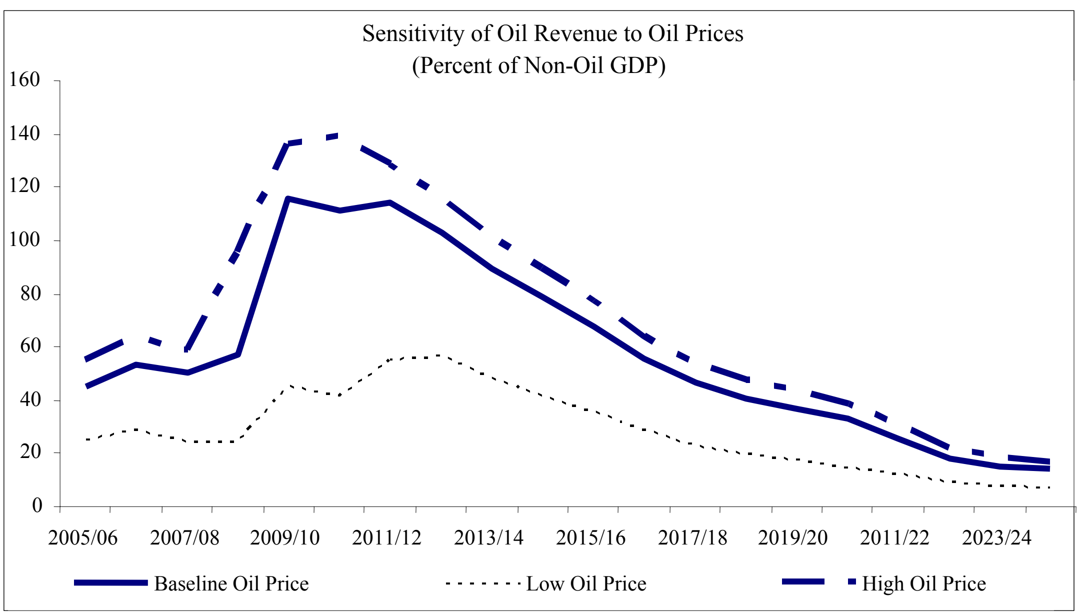
[4] The Timor-Leste Government receives two streams of revenue from the petroleum fields in the JDPA, tax revenue and royalty payments. Tax revenue is gained by levying taxes (including income and withholding taxes and VAT) on companies (e.g., petroleum and construction companies) operating in the JDPA. The Government also gets royalty payments, called first tranche petroleum (FTP), from the Bayu-Undan field when the petroleum companies sell the Government's share of petroleum on the Government's behalf.

Box II.2. Timor Gap

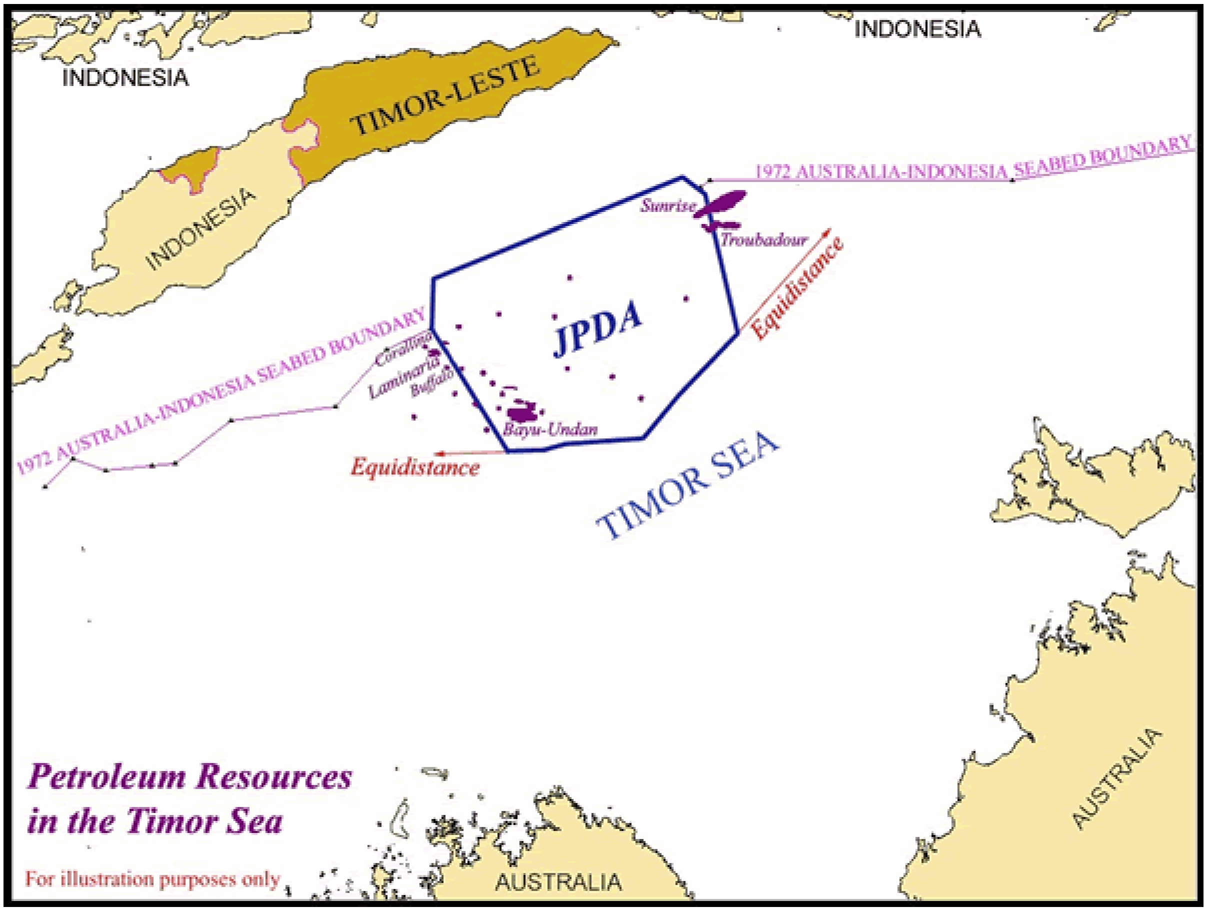
The Timor Gap was created by the 1972 seabed boundary agreement between Australia and Indonesia. It was a legacy of the fact that Australia and Portugal—then the colonial ruler of Timor-Leste—never agreed on a maritime boundary between Portuguese Timor and Australia.



Source: Timor Sea Office.



series from 2005/06 onward (prices are per barrel). The asymmetrical bands were chosen because of the historically high level of current oil/gas prices. The $15 price band is modest compared to historic movements in world oil prices (prices moved within a $24 band in 2004). Figure 1 shows the large fluctuation in government revenue, varying substantially according to oil/gas prices. Operational uncertainties regarding the pace and costs of extracting oil and gas are additional risks, in particular for the period when Bayu-Undan is the only source of revenue.



JPDA Map. Source: Timor Sea Office.

D. A Long-term Strategy for Oil/Gas Wealth Management

Natural Resource Funds

13. **Natural Resource Funds (NRFs) may help in addressing the challenges commonly facing natural resource rich countries**. Resource funds have been established in Norway, Azerbaijan, Chile, Kazakhstan, Kuwait, Oman, and Venezuela with a significant variety in design and purpose. NRFs can be classified as stabilization funds, saving funds and financing funds, based on the envisaged purpose, although in most cases the nature of the fund is mixed.

Stabilization funds are designed to reduce the impact of volatile revenue inflow, saving funds emphasize the accumulation of wealth for future generations, and financing fund primarily focus on effectively financing the overall budget deficit.

14. **Well-designed NRFs may help stabilize aggregate demand and dampen real exchange rate appreciation**. Investing NRF assets abroad reduces the need for domestic sterilization of foreign exchange inflows. NRFs may also enable a build-up of financial savings for future generations on political economy grounds. In their absence, the large inflow of natural resources can prompt considerable political pressure to spend the higher revenues for the current generation by increasing budget expenditure or reducing taxation. Against this backdrop, establishing a NRF with clear and transparent objectives may provide support for governments in building public consensus for saving part of the revenue from natural resources.

15. **The performance of NRFs across countries has been mixed.** If not properly set up or managed, NRFs carry risks, including the fragmentation of the budget account, asset management losses, and lack of transparency. If the fund is abused or mismanaged by the authorities, it can often be more of a problem than a solution. For instance, the oil/gas fund in some countries may be seen as a way to avoid public scrutiny and accountability. The lack of the transparency of operations and the poor quality of management could further aggravate economic performance. An assessment of established oil/gas funds in selected countries (Fasano, 2000) shows that savings funds in Norway, Azerbaijan and Kuwait have contributed to building sizeable assets to meet needs for future generations and some stabilization funds have helped to alleviate the volatility of fiscal expenditure by making fiscal policy less driven by revenue availability. However, the experience of stabilization funds in Oman and Venezuela was less successful because of frequent changes to rules and weak commitment to the intended purpose. Success, therefore, does not hinge on the establishment of NRFs, but rather on prudent fiscal management and fiscal discipline conducted through NRFs. Indeed, some argue (Sala-i-Martin and Subramanian, 2003) that where weak institutions and governance may lead to waste and increase vulnerability to corruption, distributing natural resource wealth directly to the population would be more efficient and conducive to long-term growth on the assumption that the private sector could spend the windfall more efficiently than the public sector.

A Petroleum Fund for Timor-Leste[5]

16. **The Timor-Leste government has announced the intention to establish an oil/gas (petroleum) fund as of July 2005.** Based on the experiences of other countries, a petroleum fund could be a useful tool for Timor-Leste to manage its petroleum wealth wisely—particularly given Timor-Leste's petroleum revenues are large relative to the size of the economy and its limited absorptive capacity. The design of the petroleum fund draws on the Norwegian model, including the emphasis on transparent operations of the fund.

[5] This section draws heavily on the public consultation paper on the establishment of a petroleum fund for Timor-Leste, prepared by the Ministry of Planning and Finance (2004).

Box II.3. Experience with Petroleum Funds in Oil/Gas Producing Countries

Norway. Oil/gas wealth is managed through the State Petroleum Fund (SPF), which was established in 1990. The purpose is to preserve national wealth so that future generations inherit as large an amount of wealth as the present generation. All of the government's net income from oil/gas revenue is fed into the SPF, from which an annual transfer is made to the treasury to meet the non-oil/gas deficit in the budget. The Fund contributes to increasing transparency in the use of oil/gas revenue. The SPF can be considered a successful institutional arrangement. It has served as a tool for managing the resources needed in connection with the increase in pension outlays and helped enhance the effectiveness of fiscal policy by facilitating the adoption of a countercyclical fiscal stance.

Azerbaijan. The State Oil/gas Fund of the Republic of Azerbaijan (SOFAZ) was established in 1999 as an extra-budgetary institution. The main objective is the professional management of oil/gas revenue for the benefit of the country and future generations. The SOFAZ receives all government revenues arising from oil/gas production. The Fund's rules currently prohibit spending in excess of inflows in any given year. A conservative expenditure policy has ensured a steady growth of savings in the fund. The creation of an oil/gas fund in Azerbaijan has had a positive impact on fiscal discipline and contributed to better transparency and accountability of oil/gas revenue management.

Kuwait. In 1976, the Kuwaiti authorities created a saving fund, the Reserve Fund for Future Generations (RFFG), aimed at providing a stream of income for future generations. Transfers to the RFFG—10 percent of total government revenue—are made independently of budget or oil/gas market developments. Nearly all assets are managed offshore and accumulated sizeable assets helped cover government expenditure during the 1990-91 regional crisis when oil/gas facilities were damaged and helped finance a large part of the reconstruction effort.

Oman. While the initial State General Reserve Fund(SGRF) was created in 1980, several revisions including in 1990 and 1993 have adulterated well-established operational guidelines. Notwithstanding the stated objective of building assets for future generations, accumulated assets have been frequently used for budget support in the face of external shocks.

Venezuela. A 1999 revision to the Macroeconomic Stabilization Fund (MSF) may have weakened the stabilization objectives by introducing presidential discretion for withdrawals, changes to the reference values, and earmarking the use of resources for social and investment expenditure and debt repayment.

Source: Fasano (2000).

17. **The Petroleum Fund is to be fully integrated into the budget process**. The Petroleum Fund will operate as a government account rather than a separate institution. Annual budget formulation and reporting will focus on the consolidated presentation, including the Fund, and expenditure of Petroleum Fund assets will be executed—as with other government revenue—by the Treasury Directorate of the Ministry of Planning and Finance. In addition, the return on the Petroleum Fund's investments will be added to the Fund. The outflow from the Petroleum Fund will depend on the government's saving policy (described below).

18. **The Petroleum Fund's assets are to be prudently managed and invested offshore**. The Petroleum Fund's savings are to be invested securely in low risk financial assets abroad, so that they are available when there is a need to draw on them. This strategy also has the benefit of putting less pressure on the domestic economy and contributes to balanced economic development. There is also a concern that investing domestically may increase the risk of corruption and bad governance. The government will have overall responsibility for the management of the Fund and the Minister of Planning and Finance will exercise key functions and competences. The Minister of Planning and Finance will be advised by an Investment Advisory Board that includes experienced financial advisers.

19. **The guidelines and operations of the Petroleum Fund are to be transparent with stringent mechanisms to ensure accountability and prevent misuse**. Regular and frequent disclosure and reporting are among the key principles governing the Fund, its inflows and outflows, and its investment strategy and return on assets. The Petroleum Fund's activities will be audited by an independent external agency, and investment performance will be periodically evaluated. These policies are consistent with the principles in the Extractive Industries Transparency Initiative.

Timor-Leste Oil/Gas Saving Policy

20. **A key element of Timor-Leste strategy for managing its oil/gas wealth is the adoption of a saving policy to guide the use of its resources**. From the range of strategies for managing oil/gas resources, the Timor-Leste authorities chose to follow one that draws on Friedman's Permanent Income Hypothesis (PIH) of consumption. The oil/gas saving policy adopted by the authorities envisages the use of only the permanent income from the oil/gas wealth to finance the non-oil fiscal deficit. Accordingly, annual budget "sustainable" spending is set equal to the sum of annual domestic non-oil revenue and the estimated permanent income from the total oil/gas wealth. Under this option, the government preserves oil/gas wealth constant in real terms, which can be calculated by discounting the future value of oil/gas revenue inflows. Based on conservative projections of oil/gas revenue over the life of Bayu-Undan, permanent income from oil/gas wealth of about $100 million, together with projected domestic revenue of about $30 million, would allow "sustainable" spending of about $130 million. Central government expenditure during the period of oil/gas extraction could be maintained at around 30 percent of non-oil GDP, on average.

Box II.4. A Petroleum Fund for Timor-Leste—Key Principles

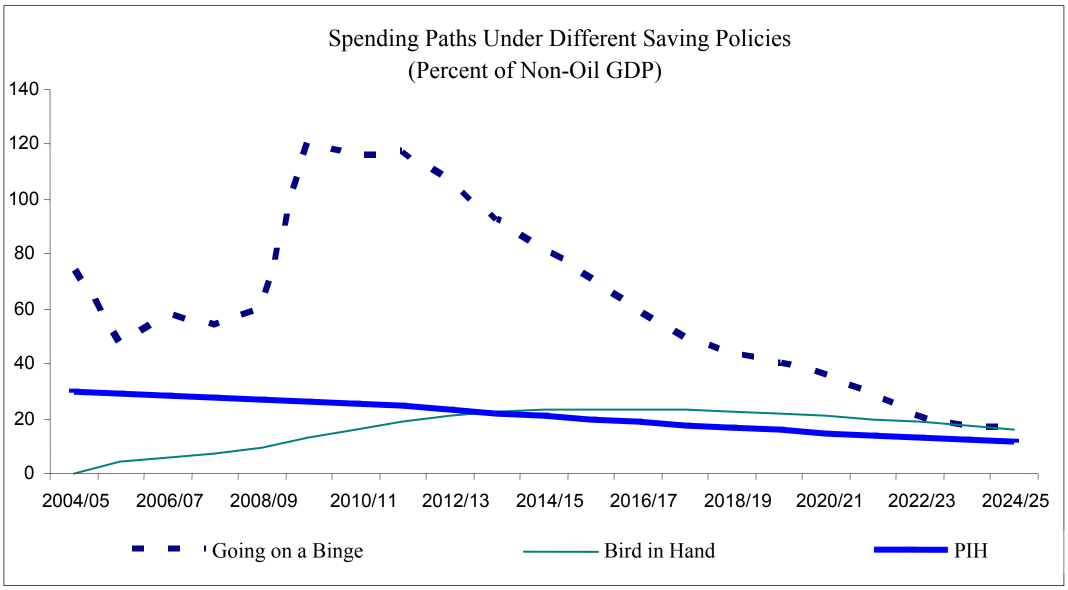
1. The fund will receive all revenue accruing to the Government of Timor-Leste from its ownership of petroleum resources.
2. The fund has strong inter-generational equity objectives.
3. A process, or mechanism, for drawing on the fund which will enable it to support fiscally responsible levels of budget expenditure over the long term.
4. The design of the fund aims to strengthen the role of the budgetary process and existing institutions, with clear lines of responsibility and maintaining democratic accountability.
5. The fund is designed to have a high degree of legislative protection from governments of the day for the objectives of the fund, including its major institutional arrangements for custody and management.
6. The investment of fund resources is to be exercised according to written and approved guidelines which emphasize a conservative, low risk, approach to the placement and management of fund assets.
7. Implementation of the investment guidelines is to be assigned to a carefully selected group of professionals, drawing on appropriate experience, advice and quality information.
8. There will be maximum transparency of fund operations to parliament and the public through frequent, easily accessible and simple reporting.
9. Institutional arrangements will incorporate a role for eminent persons who are widely trusted within the Timorese community.

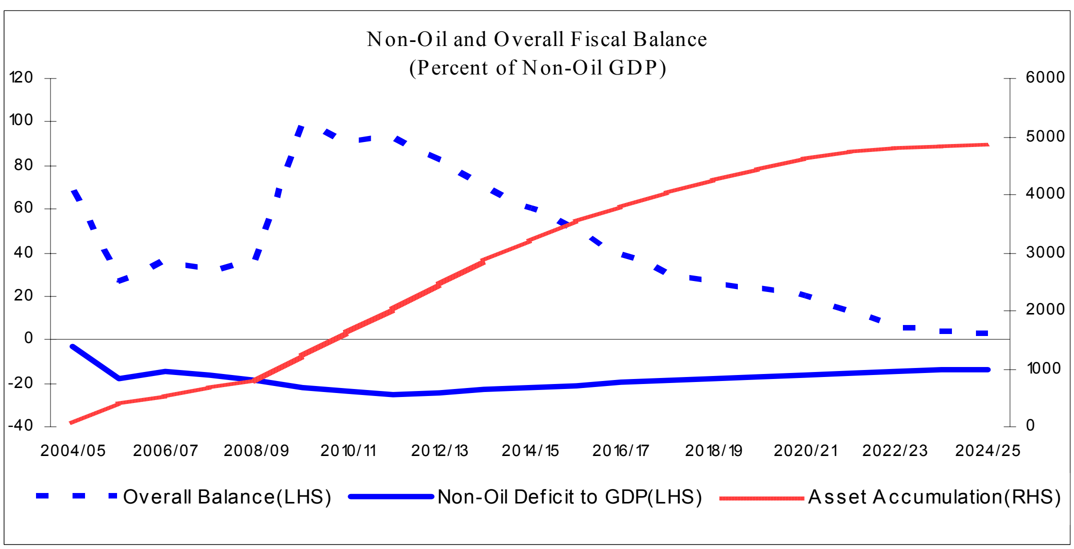
Source: Public consultation paper "Establishing a Petroleum Fund for Timor-Leste" and Timor-Leste Petroleum Fund Draft Act.

21. **Different oil/gas management strategies have considerably different implications for spending paths over the long term**. Under one extreme of the resource management strategies, "going on a binge," the budget is designed to spend all of the oil/gas revenue available. No saving from natural resource revenue is envisaged and budget expenditure depends on production and world oil/gas prices. Under the other extreme, the Bird-in-Hand (BIH) rule, a country saves all current oil/gas revenues in the form of income generating assets, and spends only the real projected income from the available stock of assets. One drawback of the second approach is a lower level of income generation in the initial stage of the fund primarily due to the slow initial accumulation of oil/gas wealth.

22. **The non-oil/gas deficit in Timor-Leste is expected to be very large over the long term, while the overall fiscal balance should run significant surpluses during the period of oil/gas extraction**. This result is driven by the dominance of oil/gas revenue and the relatively weaker production from the non-oil/gas sector. Studies indicate that higher reliance on transfers

from natural resources may be harmful to fiscal sustainability over the long term. Instead, stronger non-oil revenue allows a permanently higher level of expenditure. Thus, the long-term fiscal strategy should include measures to strengthen non-oil revenue and avoid excessive reliance on oil/gas revenue.





23. **The saving policy adopted allows some flexibility on the level of sustainable spending**. Under a strict PIH saving rule, the level of sustainable expenditure is established. In contrast, the procedural guidelines for Timor-Leste's petroleum fund allow expenditure to exceed the sustainable level if authorized by Parliament under a highly transparent process. Revisions are made in connection with budget preparations and the legal requirements under the Petroleum Fund law to recalculate annually the sustainable income. Parliament can authorize other deviations from the estimated sustainable level of expenditure; for example, limited capacity could suggest spending less than the expenditure guidelines, while urgent needs for infrastructure could suggest exceeding the guidelines. In sum, there is no "ceiling" on withdrawals in Timor-Leste, only a procedural threshold; in other words, the fund follows fiscal guidelines but not strict fiscal rules.

24. **In theory, the difference in the rate of social return between current physical investment and savings in financial assets would be a key to determining the appropriate level of government spending**. Accordingly, if the social return on physical investment is higher than that of saving, the authorities could increase the level of government spending, which otherwise the authorities would save in the form of financial assets. Recent studies suggest that economic returns on infrastructure investment are especially high in early stages of development, given the links between investment in infrastructure and improvement of social indicators such as child mortality, educational achievement, and health indicators.[6] However, in practice there are many examples of countries that have invested in physical investments with low or negative rates of return. A particular problem is to estimate accurately the assets' rate of return, particularly if institutional capacity is limited.[7]

25. **However, capacity constraints and budget execution problems are expected to keep actual spending below the level identified under the new saving policy for the near term**. Generally, given pressing needs for investing in infrastructure, human capital, and basic service delivery, quick movement toward sustainable spending would be desirable, in line with improvements in administrative and absorptive capacity. However, given existing capacity constraints which have prevented the full execution of smaller budgets in Timor- Leste, a sharp and large increase in government spending could risk a less efficient use of resources with investments directed to less productive projects and increasing inflationary pressures. Improved expenditure capacity would allow the authorities to more quickly meet worthwhile development needs by increasing expenditure to the estimated sustainable level. According to staff projections,

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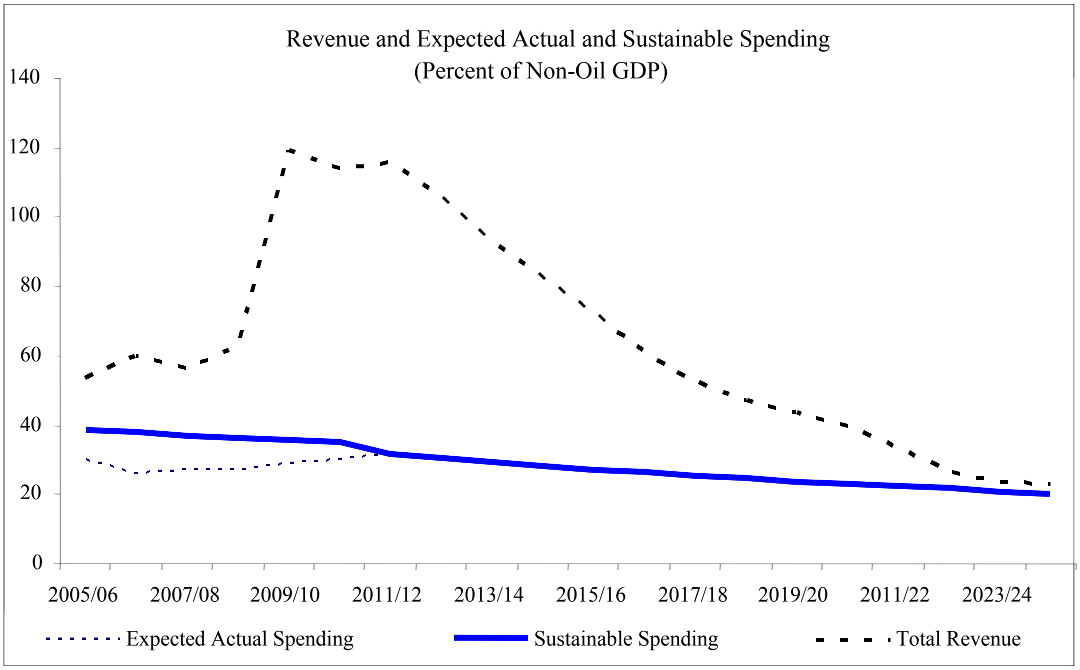
[6] Calderon, Easterly, and Serven (2003) estimate that infrastructure compression in the 1990s reduced longer-term growth by about 3 percentage points a year in Argentina, Bolivia, and Brazil, and by 1.5-2 percentage points a year in Chile, Mexico, and Peru.

[7] For example, during its post-independence development Nigeria over-invested in physical capital and subsequently suffered from poor productivity, mainly due to poor institutions and political pressures for excessive public investment (Sala-i-Martin and Subramanian, 2003).

with steady improvement in capacity building, spending could reach the sustainable spending level around FY 2011/12.



E. Conclusions

26. **Timor-Leste's long-run economic prospects will depend on its strategy for the use of its oil/gas wealth**. The government has made a promising start in meeting the challenge of ensuring effective use of oil/gas wealth for the development of the economy through the establishment of a petroleum fund and a cautious saving policy. The key for the future will be preserving the right balance between spending and saving for future generations. Given that non-oil/gas sector development will be vital to economic growth over the long term, the appropriate use of oil/gas revenue should assist by building an enabling environment for business through wisely spending on infrastructure, human capital and basic services. In addition, the authorities need to build adequate institutional capacity to manage the oil/gas wealth carefully. Overall, the authorities are to be encouraged in their policy to spend, but to spend wisely.

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III. Dollarization in Timor-Leste: The Early Years[1]

A. Introduction

1. **Timor-Leste has been officially dollarized since January 2000**.[2] As part of the transition to full independence, the initial decision to adopt the U.S. dollar was taken by the United Nations Transitional Administration in East Timor (UNTAET). The decision was made in consultation with the National Consultative Council of Timor-Leste (NCC), and drew on the expert advice of the International Monetary Fund. Following the move to full independence in May 2002, the government of Timor-Leste decided to maintain the U.S. dollar as the official currency.

2. **As Timor-Leste moves beyond the post-conflict phase to consolidation focusing on strengthening national institutions and implementing reforms that promote growth and alleviate poverty**, **it is timely to review the early experience with official dollarization**. This chapter also looks ahead and discusses the costs and benefits of continuing with dollarization, while taking into account that the still low level of institutional capacity severely constrains how soon Timor-Leste can move successfully to an alternative exchange rate regime. In this regard, the main objective should be to ensure that the monetary and exchange regime continues to support macroeconomic stability and growth, including by delivering low inflation.

B. A Brief History of Dollarization in Timor-Leste

What motivated the decision to dollarize?

3. **The decision to dollarize was both a political and economic decision that also reflected the reality of weak institutional capacity in the new nation**. At a political level the decision to remove the Indonesian rupiah from circulation and replace it with the U.S. dollar was a symbolic break from Indonesian rule that helped to reinforce the sense of an independent Timorese national identity, which culminated in the introduction of Timorese coins in November 2003. Institutions were emerging slowly after the conflict in 1999 and were already faced with significant challenges such as setting up a basic economic infrastructure, including an adequate payments system.[3] Therefore it was important that the new currency regime could be

[1] Prepared by Ashok Bhundia.

[2] This is in contrast to a de facto dollarized economy in which, alongside a domestic currency, residents to a lesser or greater degree hold foreign currency and foreign-currency denominated deposits at domestic banks. A high degree of de facto dollarization is usually evident in countries that have high inflation and other forms of macroeconomic instability, because residents try to hedge against the loss in purchasing power of the domestic currency.

[3] The more general point is that an inappropriate sequencing of reforms can lead to macroeconomic instability especially in the face of economic shocks as institutions are insufficiently developed to adapt and deal with such shocks.

implemented successfully within these constraints if it was to be credible and provide an effective nominal anchor.

4. **The introduction of the U.S. dollar was also meant to deal with the distortions caused by having multiple currencies in circulation**. After the UNTAET took on the responsibility in 1999 to manage the transition to full independence, several currencies began circulating in Timor-Leste which created inefficiencies and problems in the payments system. The Indonesian rupiah was familiar to the Timorese, but other currencies such as the Australian dollar, and Portuguese escudo also began circulating due to the international presence. Introducing a single currency was intended to eliminate problems such as exchange risk from exchange rate fluctuations, and introduce more transparency in the pricing of goods and services.

The implications of weak institutional capacity

5. **The menu of options open to Timor-Leste for reforming its currency regime was constrained by the weak institutional capacity**. This meant that the new currency regime had to be simple to administer, and minimize the burden on the newly created Central Payments Office (CPO) whose immediate priority was to set up a functioning payments system for the country.[4]

6. **During Indonesian rule, the civil service and administration was dominated by native Indonesians with the Timorese population filling low level responsibilities with relatively little training**. Once conflict broke out in 1999, and it became clear that the referendum vote would be strongly in favor of independence, the administration effectively collapsed as Indonesian staff returned home. After the return of relative peace, institutions had to be built up from scratch as almost all institutional memory was lost (it was not simply a matter of reviving already existing capacity).[5] This was in contrast to some other post conflict countries, including Bosnia, where institutional capacity was already well developed before the period of conflict and so could be revived as peace took hold.

7. **Dollarization was seen as a suitable option for Timor-Leste because it was simple to administer and would anchor the economy to the low inflation monetary policy of the United States**.[6] Introducing a national currency, including a relatively simple arrangement such as a currency board was much more difficult. Had a more ambitious monetary framework been planned, the chances of even limited success were not promising. For example, targeting the

[4] The CPO was established in January 2000 and was the precursor to the Banking and Payments Authority (BPA) which was established in November 2001.

[5] Aaron (2002) argues that institutional capacity is probably easier to resuscitate than build from scratch.

[6] Notwithstanding the significant (initial) technical challenges of replacing notes and coins in circulation with U.S. dollars and educating the public on the benefits of the new currency system.

money supply either through market-based instruments or direct quantitative measures was constrained by the lack of even a rudimentary functioning payments system and financial system, and a limited capacity at the new CPO to analyze the link between money, economic activity and inflation.

Early progress with dollarization

8. **Progress with dollarization was initially disappointing.** Between 2000 and 2002, there were four currencies in circulation—the Indonesian rupiah, Australian dollar, Portuguese escudo and U.S. dollar. For historical reasons, the Indonesian rupiah was the most familiar and widely used currency. Moreover, NGOs and international agencies continued to pay their local staff in rupiah. The Portuguese escudo, Australian dollar and U.S. dollar were in circulation in a limited sphere of the economy such as shops, restaurants and hotels in the Dili area that were frequented by expatriate personnel. The dollarization process began to accelerate once regulations were amended to make it illegal to settle payments in currencies other than the U.S. dollar (supported by stronger enforcement including against transgressions by large businesses), and with the introduction of Timorese coins. By 2003, the initial problems with promoting the dollar as the legal tender had been addressed, the U.S. dollar was fully entrenched, and other currencies were out of circulation.

9. **The initial lack of progress with dollarization was explained by several challenges faced by the Transitional Administration**, including:

- a lack of resources for the publicity campaign needed to familiarize the population with the use of U.S. dollars;
- an insufficient supply of small denomination notes and coins since the average value of transactions was less than US$1. This constraint eased considerably with the introduction of Timorese coins (centavos) in November 2003. Supported by an extensive education campaign, these coins helped improve the popularity of the new currency regime by being seen as a symbol of national identity and by facilitating small transactions;
- the continued use by international donors (including U.N. agencies and NGOs) of currencies other than the U.S. dollar, since initially regulations did not make it illegal to settle transactions in other currencies.

C. The Benefits and Costs of Dollarization

10. **Choosing an exchange rate regime involves a trade off**. On the one hand dollarization means giving up an independent monetary policy. Nevertheless, it is likely wise to adopt an international anchor currency if policy credibility or institutional capacity is weak, since under these circumstances the benefits of an independent monetary policy cannot be realized in any case. In the case of Timor-Leste, another important consideration for policymakers is the role that dollarization can play in facilitating the economy's adjustment to large inflows of oil revenue. The experience of other countries is that large inflows of oil revenue (in relation to

economic size) can result in pressure for a real exchange rate appreciation and make it more difficult to diversify the economy, including its export base.[7] In a dollarized economy, the real exchange rate appreciation would have to come through higher relative prices for nontraded goods and services (versus traded goods and services) and higher wages, so that the relative price adjustment would probably take longer than if the nominal exchange rate were flexible.

11. **While the experience of other countries may also shed some light on the costs and benefits of dollarization there are some issues to bear in mind**. First, most dollarized economies have tended to be island economies with very small populations and strong colonial links (see Appendix Table 1). The few larger economies that have dollarized officially have tended to do so in reaction to prolonged economic instability—Ecuador dollarized after a history of economic crisis which made it difficult for the government to credibly commit to low inflation without "tying its own hands" and eliminating the option of printing its domestic currency to finance government spending. [8] Second, Timor-Leste's oil and gas production could have implications for its choice of exchange rate regime. Thus, drawing on the experience of other oil exporters may provide a guide as to whether a hard currency peg as opposed to a more flexible exchange rate regime is appropriate (Appendix Table 2). Third, Timor-Leste is a new nation with a short history, but many of the benefits of dollarization are necessarily long-term, and so may not yet be evident in the data (Berg et al., 2000).

Benefits of dollarization

12. **The experience during the first few years of dollarization has been favorable and has supported the broader objective of nation building after the conflict of 1999**. Given still deepening institutional capacity, Timor-Leste would have faced significant challenges in introducing its own currency and an independent monetary policy framework aimed at delivering similarly low inflation and exchange rate stability. First, the requisite analytical and organizational skills needed to conduct an independent monetary policy has yet to be developed. Second, the temptation to use monetary policy as a means of monetary financing for the government budget deficits may have proved difficult to resist in face of large budget financing gaps in the first few years after the referendum vote.[9] Overall, the most important benefits of dollarization for Timor-Leste include;

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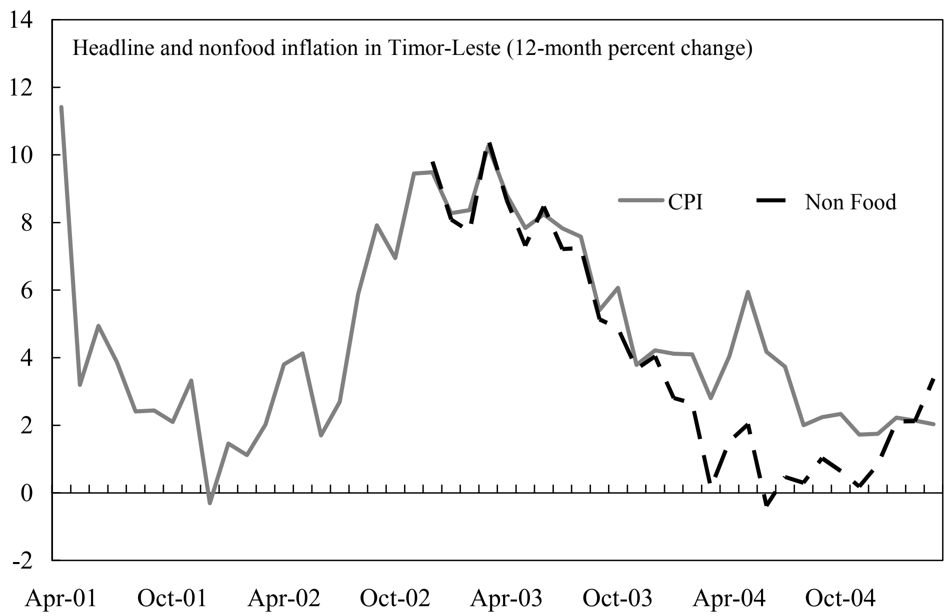
[7] The full extent of the real exchange appreciation would depend on how the oil resources are spent. Other things equal, there would be less pressure for an appreciation if expenditures were more import intensive, or if a significant proportion of the oil resource flow was saved by accumulating assets abroad.

[8] See Zarmeno, Mayra and Mariano Cortes, "Dollarization," Ecuador, Selected Issues and Statistical Annex, IMF Staff Country Report no. 00/125, International Monetary Fund, for a discussion of the pros and cons of dollarization in Ecuador.

[9] These financing gaps were closed through budget support from donors.

- Anchoring inflation at a low level in the face of significant shocks to food prices and the pressure on domestic demand from the international presence. After declining in the first few years following the introduction of the U.S. dollar, inflation has been generally in single digits with any pickup being temporary, reflecting increased pressure on domestic resources from the international presence, or a temporary increase in food inflation such as in 2003 when drought conditions adversely affected the harvest.



- The decision to dollarize has provided an important constraint on fiscal policy, although it likely reflects a broader government commitment to fiscal discipline. In the first few years during the transition to full independence, and before major oil production began, the fiscal budget had large financing gaps. Nevertheless, the government decided to maintain a zero borrowing rule, choosing instead to live within the budget envelope financed by donor grants. In this context, dollarization can be seen as an important signal from the government to help buttress its credibility for budgetary discipline by removing the option of printing money to finance future budget deficits.

- Adopting the U.S. dollar has also eliminated exchange rate fluctuations as a source of volatility for oil revenues, since international oil prices are quoted in U.S. dollars. Very few oil producers have a free floating exchange rate suggesting that oil exporters value exchange rate stability and are prepared to give up some flexibility in monetary policy. Even in Norway, which is a more diversified and industrialized economy, the exchange rate was allowed to float only recently (Appendix Table 1).

- Adopting the U.S. dollar has eliminated the risk of speculative attack, which recent experience has shown can be disruptive to the economy. However, in the case of Timor-

Leste this risk is somewhat limited by its lack of financial integration with the rest of the world.

- Eliminating the risk of an exchange rate devaluation might be expected to reduce domestic interest rates in response to a decline in the risk premia on Timor-Leste assets. However, given the short time lapsed since commercial banks began to lend in Timor-Leste, it is difficult to assess whether interest rates are converging onto U.S. levels after taking into account differences in other country specific risk factors.

Costs

13. **As with any currency regime there is a trade off between having a flexible versus more rigid exchange rate regime**. However, in the context of Timor-Leste, it is important to recognize that many of the costs of dollarization when compared with regimes that allow for more policy flexibility are only "real" if the alternative, more flexible currency regime, is a credible option. Otherwise the benefits of a flexible regime will not be realized and a country may be saddled with higher inflation, exchange rate and macro instability. With this in mind, the most important costs of dollarization for Timor-Leste include;[10]

- The need for the economy to adjust to asymmetric shocks through the goods and labor markets instead of via a change in the nominal exchange rate and an appropriate monetary policy response. While trying to quantify these costs is difficult, and data is lacking, it is clear that the structure of Timor-Leste's economy is very different to that of the United States. Timor-Leste relies on oil for a greater share of government revenue, and its economy is less diversified than the United States, relying more heavily on agriculture. Therefore, the economy is likely to be subject to asymmetric shocks and, in the absence of an independent monetary policy, greater variation in output.

- Foregoing seigniorage revenue. However, this revenue loss, especially in relation to oil revenue, is very small.

- Loss of lender of last resort capabilities. Dollarized economies may be subject to less moral hazard risks which may explain why research finds that dollarized economies have experienced fewer systemic banking crises, at lower cost to the taxpayer when compared to countries with their own central banks (Frydl, 1999). Dollarized economies have tended to rely on self-insurance mechanisms to deal with temporary liquidity problems in the banking system while also putting a premium on effective supervision. In Ecuador, banks, in cooperation with the monetary authority, help finance a liquidity fund which can be accessed periodically (using appropriate collateral) by banks that have a temporary need for liquidity. Although, in the case of Timor-Leste, no such mechanism is in place.

[10] While a comprehensive empirical examination of the various costs and benefits is constrained by a lack of data, some initial observations are possible.

D. Conclusion: The Balance of Benefits and Costs for Timor-Leste

14. **While it is too early for a thorough assessment of the impact of dollarization in Timor-Leste some initial observations are possible**. The economic rationale for adopting the U.S. dollar in Timor-Leste clearly reflects the country's constrained initial conditions, and the early experience with dollarization has been positive. Timor-Leste has never operated under a different exchange rate regime, and so unlike for other dollarized economies such as Ecuador, it is not possible to compare the period of dollarization with economic performance under a previous regime. What is clear is that dollarization has made significant contributions to a number of achievements in Timor-Leste either directly or indirectly, although quantifying them is difficult. These include:

- Evidence of measured inflation converging to U.S. levels while the Banking and Payment Authority has been able to concentrate on core functions such as banking supervision and the payments system;

- Indirectly supporting budget discipline by eliminating the option of printing money to finance the budget during the first few years following the independence vote when budgetary financing gaps were very large;

- Budgetary discipline has also helped to maintain price competitiveness as measured by the real effective exchange rate through restraint in public sector wage growth. While the real effective exchange rate has appreciated more recently as the Indonesian rupiah has depreciated against the U.S. dollar, over the period as a whole, the real exchange rate has been broadly stable (chart).[11]

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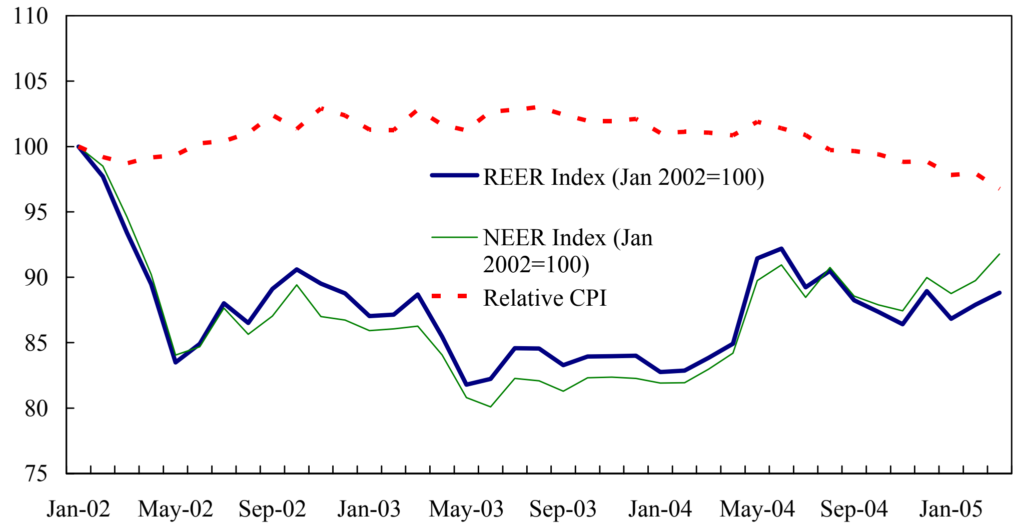
[11] In the absence of disaggregated trade data by country or commodities, the real effective exchange rate is calculated by assuming a 70 percent weight for Indonesia and 30 percent for Australia.

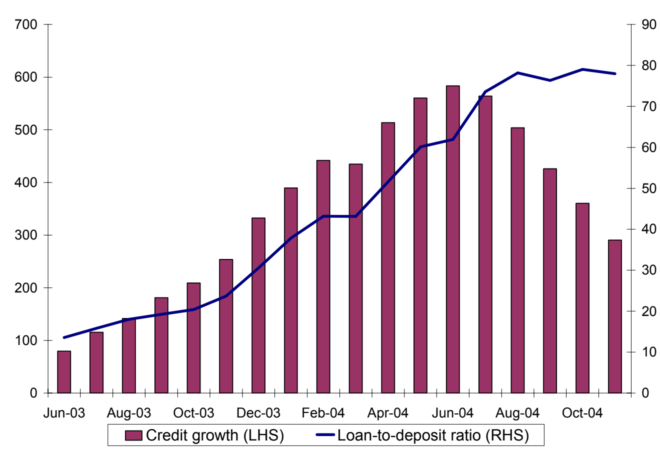
Timor Leste: Nominal and Real Effective Exchange Rate Developments 1/
(Jan 2002=100)



1/ Includes Indonesia and Australia, Timor-Leste's main trade partners. In absence of a trade weighted series, the NEER and REER are based on weights of 70 percent for Indonesia and 30 percent for Australia.

- A recent pickup in credit growth. As the banking system has remained stable and confidence in the dollarization process has grown, credit growth accelerated sharply in the second half of 2003 (see chart).

Credit growth and bank intermediation in Timor-Leste



15. **Looking ahead, there are several areas in which the BPA, together with the government, can make efforts to lay the necessary preconditions for a more flexible exchange rate regime should that be deemed appropriate in the future**. Further strengthening of institutional capacity remains a priority in this regard, including steps to strengthen capacity at the Banking and Payments Authority that would make it a fully functioning central bank at an operational level. Other steps include:

- Enhancing the depth and sophistication of the financial system, including by setting up of a foreign exchange market and domestic money market. These elements would ensure that indirect instruments could be used to set monetary policy, and that a freely traded domestic currency reflects economic fundamentals;

- Strengthening fiscal institutions. The sound management of petroleum resources will be key, and in this regard the passing of the new Petroleum Fund act is an important step in setting up a transparent framework that has public support. In addition, it will be important that fiscal policy continues to support macroeconomic stability as well as providing for the much-needed investment in human and physical capital.

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Appendix Table 1. Officially Dollarized Economies, 2002

Economy	Population	GDP ($bn)	Political status	Currency
American Samoa	67,000	0.5	U.S. territory	U.S. dollar
Andorra	68,000	1.2	independent	euro (formerly French franc, Spanish peseta)
British Virgin Islands	21,000	0.3	British dependency	U.S. dollar
Cocos (Keeling) Islands	600	0	Australian external territory	Australian dollar
Cook Islands	21,000	0.1	New Zealand self-governing territory	New Zealand dollar
Cyprus, Northern	140,000	0.8	de facto independent	Turkish lira
Ecuador	13,200,000	37.2	Independent	U.S. dollar
El Salvador	6,200,000	24	Independent	U.S. dollar
Greenland	56,000	1.1	Danish self-governing region	Danish krone
Guam	160,000	3.2	U.S. territory	U.S. dollar
Kiribati	94,000	0.1	independent	Australian dollar, own coins
Kosovo	1,600,000	?	U.N. administration	euro
Liechtenstein	33,000	0.7	independent	Swiss franc
Marshall Islands	71,000	0.1	independent	U.S. dollar
Micronesia	135,000	0.3	independent	U.S. dollar
Montenegro	700,000	1.6	semi-independent	euro (partly "DM-ized" since 1999)
Monaco	32,000	0.9	independent	euro (formerly French franc)
Nauru	12,000	0.1	independent	Australian dollar
Niue	2,000	0	New Zealand self-governing territory	New Zealand dollar
Norfolk Island	2,000	0	Australian external territory	Australian dollar
Northern Mariana Islands	75,000	0.9	U.S. commonwealth	U.S. dollar
Palau	19,000	0.1	independent	U.S. dollar
Panama	2,800,000	16.6	independent	U.S. dollar, own balboa coins
Pitcairn Island	42	0	British dependency	New Zealand, U.S. dollars
Puerto Rico	3,900,000	39	U.S. commonwealth	U.S. dollar
San Marino	27,000	0.9	independent	euro (formerly Italian lira), own coins
Timor-Leste 1/	857,000	0.2	independent	U.S. dollar, own coins
Tokelau	1,500	0	New Zealand territory	New Zealand dollar
Turks and Caicos Isands	18,000	0.1	British colony	U.S. dollar
Tuvalu	11,000	0	independent	Australian dollar, own coins
U.S. Virgin Islands	120,000	1.8	U.S. territory	U.S. dollar
Vatican City	1,000	0	independent	euro (formerly Italian lira), own coins

1/ For Timor-Leste, the currency regime is for 2004.

Sources: Kurt Schuler, "Encouraging Official Dollarization in Emerging Markets," staff report, Office of the Chairman, Joint Economic Committee, U.S. Congress, April 1999; CIA World Factbook 2001; press reports.

Notes: Data for some countries here are latest available from the CIA World Factbook; not all data are 2001. Some other countries issue domestic notes and coins but grant a foreign currency status as a parallel legal tender. GDP is in terms of purchasing power parity.

Appendix Table 2. Exchange Arrangements in Selected Oil-Producing Economies
(1991 - 2004)

Country	Oil Exports (in percent of) GDP (percent)	Oil Exports (in percent of) Total Exports (percent)	Exchange Arrangement in 2004
Algeria	28.8	91.4	Managed floating with no preannounced path for the exchange rate
Angola	61.0	88.0	Managed floating with no preannounced path for the exchange rate
Azerbaijan	19.6	60.2	Managed floating with no preannounced path for the exchange rate
Cameroon	8.0	32.6	Exchange arrangement with no separate legal tender
Chad	8.3	36.6	Exchange arrangement with no separate legal tender
Congo, Rep	55.9	81.3	Exchange arrangement with no separate legal tender
Cote d'Ivore	4.5	11.3	Exchange arrangement with no separate legal tender
Ecuador	9.2	34.1	Exchange arrangement with no separate legal tender
Equatorial Guinea	96.8	94.1	Exchange arrangement with no separate legal tender
Gabon	41.5	72.9	Exchange arrangement with no separate legal tender
Indonesia	3.5	11.8	Managed floating with no preannounced path for the exchange rate
Iran	17.9	75.3	Managed floating with no preannounced path for the exchange rate
Kuwait	42.1	83.0	Conventional pegged arrangement
Libya	33.5	92.5	Conventional pegged arrangement
Malaysia	5.2	4.9	Conventional pegged arrangement
Nigeria	40.0	88.7	Managed floating with no preannounced path for the exchange rate
Norway	15.8	38.3	Independently floating
Qatar	27.6	47.4	Conventional pegged arrangement
Russia	8.1	27.6	Managed floating with no preannounced path for the exchange rate
Sao Tome	0.2	0.8	Managed floating with no preannounced path for the exchange rate
Saudi Arabia	34.6	83.2	Conventional pegged arrangement
Timor Leste	...	...	Exchange arrangement with no separate legal tender
UAE	29.0	37.9	Conventional pegged arrangement
Venezuela	21.3	74.4	Conventional pegged arrangement

Sources: WEO, *Annual Report on Exchange Arrangements and Exchange Restriction* (2004)

Table 1. Timor-Leste: Selected Social Indicators 1/

	Timor-Leste		East Asia and Pacific island countries		Low income countries	
Gross national per capita income (U.S. dollars)	417		1,080		450	
Area (in thousands of square kilometers)	15		...		...	
Demography						
Total population (in millions)	0.925	2/	1,855		2,310	
Population growth (in percent) 3/	4.0		1.2		2.0	
Life expectancy and mortality						
Life expectancy at birth (years)	62		70		58	
Male	60		68		57	
Female	64		71		59	
Infant mortality (per thousand live births)	89		32		80	
Under 5 mortality rate (per thousand live births)	107		41		123	
Education						
Illiteracy rate (in percent) 4/	51		10	5/	49	5/
Male	46		...		...	
Female	55		...		...	
Net primary school enrollment rate (in percent)	75		93	5/	77	5/
Health						
Immunization rate						
(in percent of children aged 12 to 23 months)						
Measles	60		82		65	
DPT	70		82		67	
Other indicators 6/						
The population below the poverty line	40	5/	…		...	
Households with access to electricity	26		…		...	
Households with access to safe water	52	7/	78	7/	75	7/

Sources: UNDP Human Development Report 2004, World Bank, and Fund staff estimates.

1/ Data are for 2003, unless otherwise indicated.
2/ Data for 2004. Provisional population count from 2004 census.
3/ For Timor Leste, average growth over 2000-2004, including returning refugees. For comparators average for 1990-2003.
4/ For ages 15 and above.
5/ Figures are for 2001.
6/ In percentage share of the total.
7/ Figures are for 2002.

Table 2. Timor-Leste: Selected Economic Indicators, 2000-2005

	2000	2001	2002	2003	2004 Est.	2005 Proj.
Output and prices 1/						
Non-oil GDP	316	368	343	336	339	349
Real non-oil GDP growth (percentage change)	15.4	16.6	-6.7	-6.2	1.8	2.5
Inflation (percentage change, end-period) 2/	3.0	-0.3	9.5	4.2	1.8	2.5
	(In percent of non-oil GDP)					
Investment-saving balance						
Gross investment 3/	41	42	36	31	28	32
Non-government	7	9	7	9	9	9
Government	34	32	28	23	19	23
Gross national savings	-46	-44	-48	-34	6	27
Non-government	-51	-50	-54	-44	-36	-26
Government	5	6	6	10	42	53
External savings	87	86	84	65	23	5
Central government budget 4/						
Revenues	17	15	24	31	90	57
Domestic revenues	4	6	6	9	10	9
Oil/gas revenues	4	3	9	12	71	45
Grants	9	6	10	10	9	3
Expenditure	15	15	21	21	22	30
Recurrent expenditure	9	12	17	19	19	20
Capital expenditure	6	3	4	3	2	10
Overall balance	2	0	3	10	68	27
Public debt	0	0	0	0	0	0
Combined sources fiscal operations 4/ 5/						
Revenues	18	16	25	33	92	15
Expenditure	69	70	73	66	62	70
Recurrent expenditure	35	38	44	44	45	41
Capital expenditure	34	32	30	22	18	29
Overall balance	-52	-53	-48	-33	29	-55
Money and credit						
Broad money (end-period) 6/	6	14	16	22	25	28
Net domestic assets (end-period)	-4	-4	-10	-11	-30	-84
	(In millions of U.S. dollars)					
External sector						
Current account excl. international assistance	-275	-316	-288	-218	-77	-18
Current account incl. international assistance	37	46	26	17	119	149
Trade balance	-237	-280	-260	-213	-194	-204
Merchandise exports 7/	5	4	6	7	8	10
Merchandise imports 8/	-242	-284	-266	-221	-202	-214
Overall balance	16	8	20	18	122	216
	(In percent of non-oil GDP)					
Current account excl. international assistance	-87	-86	-84	-65	-23	-5
Current account incl. international assistance	12	13	8	5	35	43
Trade balance	-75	-76	-76	-64	-57	-58
Merchandise exports 7/	2	1	2	2	2	3
Merchandise imports 8/	-77	-77	-78	-66	-60	-61
Overall balance	5	2	6	5	36	62

Sources: Data provided by the Timor-Leste authorities; and Fund staff estimates.

1/ Non-oil GDP and national accounts data for 2000-2003 are based on estimates prepared by BIDE consultants in October 2004.
2/ CPI for Dili.
3/ Excludes oil/gas sector investment.
4/ Fiscal year basis (July-June); for example, 2000 refers to FY2000/01.
5/ Includes fiscal and quasi-fiscal expenditure programs undertaken by bilateral donors and international financial institutions, outside the central government budget. The sharp revenue decline in FY 2005/06 reflects the adoption of the new savings and petroleum fund policy according to which only the sustainable income from the oil wealth is transferred to the budget.
6/ Exclude currency holdings by the public, for which no data are available.
7/ Excludes oil/gas revenue, which are recorded under the income account (royalties) and transfers (tax revenues).
8/ In 2005 includes the transfer of assets from UNMISET, valued at approximately US$ 12 million.

Table 3. Timor-Leste: Non-oil Gross Domestic Product by Sectoral Origin, 1999–2004 1/

	1999	2000	2001	2002	2003	2004
	(At current market prices)					
Agriculture, forestry, and fishery	116.6	81.5	84.7	91.2	97.4	107.1
Mining and quarrying	2.7	3.7	4	3.3	2.7	2.8
Manufacturing	7.5	8.719	11.3	11.4	12.1	12.5
Electricity, gas, water	2.1	2.648	1.4	2.7	3.3	3.3
Construction	33.0	43.3	45.6	37.9	31	31.9
Trade, hotels, and restaurants	15.1	24.7	26.3	24.5	25.1	25.4
Transport and communications	14.6	22.9	26.3	28.3	31.2	31.8
Finance, rents, and business services	10.8	20.5	25	25.6	26.7	29.4
Public admin. and defense 2/	66.2	106.3	141.4	116.3	104.1	92.7
Private services	1.6	1.9	1.9	2	2.1	2.1
Total	270.1	316.2	367.9	343.2	335.7	339.0
	(At constant 2000 market prices)					
Agriculture, forestry, and fishery	95.1	81.5	88.6	93.9	93.5	102.9
Mining and quarrying	3.1	3.7	3.8	3.2	2.5	2.6
Manufacturing	7.9	8.7	10.9	11.0	11.0	11.2
Electricity, gas, water	2.3	2.6	1.4	2.7	3.3	3.3
Construction	34.4	43.3	44.1	36.9	28.8	29.4
Trade, hotels, and restaurants	17.4	24.7	25.6	23.9	23.3	23.5
Transport and communications	15.9	22.9	25.4	27.4	29.3	29.9
Finance, rents, and business services	16.9	20.5	24.1	24.8	24.5	27.0
Public admin. and defense 2/	83.5	106.3	142.7	118.0	104.5	97.0
Private services	1.7	1.9	1.9	2.0	1.9	1.9
Total	278.2	316.2	368.5	343.8	322.6	328.5

Sources: Data provided by the Timor Leste authorities; and Fund staff estimates.

1/ Data on oil and gas value added are not yet available. Figures for 1999 are Fund Staff estimates. Figures for 2000–2003 are estimates made by BIDE consultants under a World Bank-supported technical assistance project.

2/ Includes the value-added of services provided by UNTAET/UNMISET and donor-supported agencies acting on behalf of the Timor-Leste government.

Table 4. Timor-Leste: Non-oil Gross Domestic Product by Expenditure, 1999–2004 1/

	1999	2000	2001	2002	2003	2004
	Estimates					
	(In millions of U.S. dollars)					
Non-oil GDP at current prices	270.1	316.2	367.8	343.3	335.7	339.0
Consumption	305.3	376.0	438.2	403.0	393.0	381.4
Private	264.8	206.0	213.0	203.8	200.0	207.9
Public 2/3/	40.5	170.0	225.2	199.2	193.0	173.5
Gross investment 4/	56.7	130.7	153.6	122.5	105.0	96.3
Private	13.5	22.5	34.9	25.4	29.2	30.7
Public 2/	43.2	108.2	118.7	97.1	75.8	65.6
Net exports of goods/non-factor services	-91.9	-190.5	-224.0	-182.2	-162.3	-138.7
GNP at current prices	270.1	322.7	379.7	363.4	371.1	481.7
non-oil GDP	270.1	316.2	367.8	343.3	335.7	339.0
Oil income	0.0	6.5	11.9	20.1	35.4	142.7
Gross national savings	19.8	-144.6	-161.9	-165.1	-112.7	19.5
Private	22.5	98.3	118.0	67.1	23.0	18.7
Public 2/	-2.7	-242.9	-280.0	-232.1	-135.8	0.7
External savings	37.0	275.3	315.5	287.6	217.7	76.8
	(In percent of non-oil GDP)					
GDP at current prices	100.0	101.0	102.0	103.0	104.0	105.0
Consumption	113.0	118.9	119.1	117.4	117.1	112.5
Private	98.0	65.1	57.9	59.4	59.6	61.3
Public 2/3/	15.0	53.8	61.2	58.0	57.5	51.2
Gross investment	21.0	41.3	41.8	35.7	31.3	28.4
Private	5.0	7.1	9.5	7.4	8.7	9.0
Public 2/	16.0	34.2	32.3	28.3	22.6	19.4
Net exports of goods/non-factor services	-34.0	-60.2	-60.9	-53.1	-48.3	-40.9
GNP at current prices	100.0	102.1	103.2	105.9	110.6	142.1
non-oil GDP	100.0	100.0	100.0	100.0	100.0	100.0
Oil income	0.0	2.1	3.2	5.9	10.6	42.1
Gross national savings	7.3	-45.7	-44.0	-48.1	-33.6	5.7
Private	8.3	31.1	32.1	19.5	6.9	5.5
Public 2/	-1.0	-76.8	-76.1	-67.6	-40.4	0.2
External savings	13.7	87.1	85.8	83.8	64.9	22.7

Sources: Data provided by the Timor-Leste authorities; and Fund staff estimates.

1/ For 2000–2003 the estimates are partially based on provisional national account data prepared by BIDE under a World Bank grant. Data for 1999 and 2004 are Fund staff estimates.

2/ Includes fiscal and quasi-fiscal activities undertaken by multinational institutions and bilateral donors.

3/ Does not necessarily correspond to recurrent expenditures shown in Table 16 due to differences in the coverage of data (particularly those relating to technical assistance).

Table 5. Timor-Leste: Consumer Price Index, 2000–2004 1/

(April 2000 = 100.0)

	Jan.	Feb.	March	April	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Annual average
2000													
Index	…	…	…	100.0	108.4	110.4	111.3	110.4	110.2	111.1	110.3	114.6	109.6
Month-to-month percentage change	…	…	…	…	8.4	1.8	0.8	-0.8	-0.2	0.8	-0.7	3.9	
Year-on-year percentage change	…	…	…	…	…	…	…	…	…	…	…	…	…
2001													
Index	113.6	114.1	112.7	111.4	111.9	115.8	115.6	113.0	112.9	113.4	113.9	114.2	113.5
Month-to-month percentage change	-0.8	0.4	-1.2	-1.2	0.4	3.6	-0.2	-2.2	-0.2	0.5	0.5	0.3	
Year-on-year percentage change	…	…	…	11.4	3.2	4.9	3.9	2.4	2.4	2.1	3.3	-0.3	3.6
2002													
Index	115.3	115.3	115.0	115.6	116.5	117.8	118.7	119.7	121.8	121.3	124.7	125.1	118.9
Month-to-month percentage change	0.9	0.0	-0.3	0.6	0.7	1.2	0.7	0.8	1.8	-0.4	2.8	0.3	
Year-on-year percentage change	1.5	1.1	2.0	3.8	4.1	1.7	2.7	5.9	7.9	6.9	9.4	9.5	4.7
2003													
Index	124.9	125.0	126.8	125.8	125.6	127.5	128.0	128.8	128.4	128.6	129.4	130.3	127.4
Month-to-month percentage change	-0.2	0.1	1.4	-0.7	-0.2	1.5	0.4	0.6	-0.3	0.2	0.6	0.7	
Year-on-year percentage change	8.3	8.4	10.3	8.8	7.8	8.2	7.8	7.6	5.4	6.1	3.8	4.2	7.2
2004													
Index	130.0	130.1	130.3	130.9	133.1	132.8	132.8	131.3	131.2	131.6	131.7	132.6	131.5
Month-to-month percentage change	-0.3	0.1	0.2	0.5	1.6	-0.2	-0.1	-1.1	-0.1	0.3	0.0	0.7	
Year-on-year percentage change	4.1	4.1	2.8	4.0	5.9	4.2	3.7	2.0	2.2	2.3	1.7	1.7	3.2
2005													
Index	132.9	132.9	133.0										
Month-to-month percentage change	0.2	0.0	0.1										
Year-on-year percentage change	2.2	2.1	2.0										

Source: Data provided by the Timor-Leste authorities.

1/ The price index relates to Dili.

Table 6. Timor-Leste: Monetary Survey, 2000–05 1/

	2000	2001	2002	2003	2004				2005
	Dec.	Dec.	Dec.	Dec.	Mar.	June	Sept.	Dec.	Mar.
	(In millions of U.S. dollars; end of period)								
Net foreign assets	33.8	65.4	89.9	108.3	127.7	122	141.2	186.6	283.7
Assets	33.8	72.9	93.3	141.6	184.1	154	179.7	228.2	326.1
Cash holdings	6.3	11.7	18.1	19.0	28.6	17.8	27.8	28.4	24.5
Claims on foreign banks	27.5	61.2	75.3	122.6	155.6	136.1	86.9	65.8	65.5
Treasury bills	0.0	0.0	0.0	0.0	0.0	0.0	65.0	134.0	236.1
Other	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Liabilities	0.0	7.5	3.5	33.3	56.4	32	38.5	41.6	42.4
Net domestic assets	-13.8	-14.3	-35.3	-36.0	-52.7	-35.7	-54.4	-102.6	-197.0
Claims on government (net)	-19.0	-21.1	-33.7	-49.7	-74.3	-78.7	-104.3	-168.4	-269.0
Loans and advances to private sector	0.3	3.0	5.1	22.1	32.4	53.4	66.3	70.5	75.6
Other items (net)	4.9	3.8	-6.7	-8.4	-10.8	-10.4	-16.4	-4.7	-3.6
Broad money 2/	20.0	51.1	54.6	72.3	75.0	84.4	86.8	84.0	86.7
Demand deposits	19.3	36.9	39.1	40.1	43.9	49.7	53.6	49.4	52.4
Saving deposits	0.0	8.2	10.2	22.6	25.2	28.5	27.3	27.8	26.7
Time deposits	0.7	6.0	5.3	9.6	5.9	6.2	5.9	6.8	7.5
	(In percent of non-oil GDP)								
Net foreign assets	10.7	17.8	26.2	32.3	37.7	36.0	41.7	55.0	81.2
Net domestic assets	-4.4	-3.9	-10.3	-10.7	-15.5	-10.5	-16.0	-30.3	-56.4
Broad money 2/	6.3	13.9	15.9	21.5	22.1	24.9	25.6	24.8	24.8
Demand deposits	6.1	10.0	11.4	11.9	13.0	14.7	15.8	14.6	15.0
Saving deposits	0.0	2.2	3.0	6.7	7.4	8.4	8.1	8.2	7.7
Time deposits	0.2	1.6	1.6	2.9	1.7	1.8	1.7	2.0	2.1
Memorandum item:									
Bank loan/broad money ratio (in percent)	1.5	5.9	9.4	30.6	43.1	63.3	76.4	83.9	87.2

Source: Data provided by the Banking and Payments Authority.

1/ The banking system consists of the Banking and Payments Authority (BPA), four commercial banks, and one microfinance institution.

2/ Excludes currency in circulation, for which no data is available due to dollarization of the financial system.

Table 7. Timor-Leste: Balance Sheet of the Banking and Payments Authority, 2000–05
(In millions of U.S. dollars; end of period)

	2000	2001	2002	2003	2004				2005
	Dec.	Dec.	Dec.	Dec.	Mar.	June	Sept.	Dec.	Mar.
Net foreign assets	16.0	23.7	43.5	61.3	86.8	91.9	119.4	183.1	284.5
Assets	16.0	23.7	43.5	61.3	86.8	91.9	119.4	183.1	284.5
Cash in vault	1.3	4.9	13.0	6.9	20.4	8.7	21.8	21.1	18.4
Claims on central banks	14.7	18.8	30.5	54.4	66.4	83.2	32.6	28.0	29.9
Reserve Bank of Australia	14.7	18.7	30.5	54.4	66.4	83.2	32.6	28.0	29.9
o/w Timor Sea account 1/	3.1	7.4	7.5	10.6	13.9	13.9	13.9	14.0	...
Other foreign banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other 2/	0.0	0.1	0.0	0.0	0.0	0.0	65.0	134.0	236.1
Liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net domestic assets	-16.0	-22.7	-39.1	-55.0	-80.9	-86.2	-112.6	-177.6	-279.0
Government (net position)	-19.0	-21.1	-33.7	-49.7	-74.3	-78.7	-104.3	-168.4	-269.0
Budget	-16.0	-13.8	-26.2	-39.1	-60.4	-64.8	-90.4	-154.4	-214.6
Timor Sea account 1/	-3.1	7.4	-7.5	-10.6	-13.9	-13.9	-13.9	-14.0	-54.4
Claims on financial institutions	3.0	3.5	2.4	3.4	2.5	1.3	1.3	0.7	0.2
Commercial banks	3.0	3.5	2.4	3.0	2.1	0.9	1.5	1.3	1.9
Microfinance institution	0.0	0.0	0.0	0.4	0.4	0.4	-0.3	-0.6	-1.7
Other items (net)	0.0	-5.0	-7.8	-8.8	-9.2	-8.8	-9.5	-9.9	-10.3
O/w: capital and reserves	-0.7	-5.0	-6.9	-7.7	-7.7	8.4	8.6	9.0	9.5
Liabilities	0.0	0.0	4.5	6.3	5.9	5.8	6.9	5.5	5.4
Financial institutions	0.0	0.0	4.5	6.3	5.9	5.8	6.9	5.5	5.4
Commercial banks	0.0	0.0	2.3	4.5	4.1	3.9	5.0	3.6	3.6
Microfinance institution	0.0	0.0	2.2	1.8	1.8	1.9	1.8	1.9	1.9
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: Data provided by the Banking and Payments Authority.

1/ Cumulative oil/gas revenue savings (First Tranche Petroleum and interest thereon). After 2004, funds invested in US treasury bills.

2/ Investment in US treasury bills of FTP and part of the government cash-balances.

Table 8. Timor-Leste: Consolidated Balance Sheet of Financial Institutions, 2000–05 1/
(In millions of U.S. dollars; end of period)

	2000	2001	2002	2003	2004				2005	Memorandum Items
	Dec.	Dec.	Dec.	Dec.	Mar.	June	Sept.	Dec.	Mar.	Interest rates 2/
Net foreign assets	17.8	41.7	46.4	47.0	40.9	30.1	21.8	3.5	-0.8	
Assets	17.8	49.2	49.8	80.3	97.4	62.1	60.3	45.1	41.7	
Cash holdings	5.0	6.8	5.0	12.1	8.2	9.1	6.0	7.4	6.1	
Claims on foreign banks	12.8	42.4	44.8	68.2	89.2	53.0	54.3	37.8	35.6	
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Liabilities	0.0	7.5	3.5	33.3	56.4	32.0	38.5	41.6	42.4	
Net domestic assets	5.2	12.9	10.7	28.8	36.6	57.5	66.3	81.2	87.7	
Deposits with BPA	0.0	1.0	4.5	6.3	5.9	5.8	6.9	6.0	5.5	
Claims on government (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Loans and advances to private sector	0.3	3.0	5.1	22.1	32.4	53.4	66.3	70.5	75.6	
Other items (net)	4.9	8.9	1.1	0.4	10.5	10.5	4.2	17.6	-16.5	
Deposit liabilities	20.0	51.1	54.6	72.3	75.0	86.3	86.8	84.0	86.7	
Demand deposits	19.3	36.9	39.1	40.1	44.0	50.0	53.6	49.4	52.4	0.4
Saving deposits	0.0	8.2	10.2	22.6	25.1	30.1	27.4	27.8	26.7	0.3
Time deposits	0.7	6.0	5.3	9.6	6.0	6.2	5.9	6.8	7.5	0.4-0.8
Liabilities to BPA	3.0	3.5	2.4	3.4	2.5	1.3	1.3	0.7	0.2	

Source: Data provided by the Banking and Payments Authority.

1/ Comprise four commercial banks and the microfinance institution.
2/ Refers to weighted average interest rates at end-2004.

Table 9. Timor-Leste: Central Government Budget Operations (CFET), FY2000/01–FY2004/05 1/

	FY2000/01	FY2001/02	FY2002/03	FY2003/04	FY2004/05	
					Budget	Revised 2/
	(In millions of U.S. dollars)					
Revenue	58.7	54.0	81.3	105.4	97.9	192.2
Domestic revenues	14.1	20.5	19.3	29.2	23.0	31.6
Direct taxes	0.6	5.4	5.3	6.7	5.4	7.5
Indirect taxes	11.6	12.7	11.7	18.1	13.6	19.5
Nontax revenues and other	1.9	2.4	2.3	4.4	4.0	4.6
Oil/gas revenues	13.1	10.8	29.5	41.4	44.1	129.8
Tax revenues	9.9	6.5	26.4	38.0	18.3	93.9
Royalties and interest	3.1	4.3	3.1	3.4	25.8	35.9
Royalties	3.0	4.2	3.0	3.3	25.5	35.5
Interest	0.1	0.1	0.1	0.1	0.3	0.4
Grants	31.6	22.7	32.5	34.8	30.8	30.8
Expenditure	51.3	52.6	70.8	72.2	75.1	78.7
Recurrent expenditure	29.6	41.1	56.2	62.5	64.9	67.8
Wages and salaries	13.9	18.8	21.9	24.0	28.2	28.2
Goods and services	15.7	22.2	34.3	38.5	36.7	39.6
Capital expenditure	21.7	11.5	14.5	9.7	10.2	10.9
Overall balance	7.4	1.4	10.5	33.2	22.8	113.5
Financing	-7.4	-1.4	-10.5	-33.2	-22.8	-113.5
Changes in CFET cash balances (increase -)	-4.2	2.7	-8.6	-29.8	3.0	-77.6
Oil/gas revenue savings (increase -) 3/	-3.1	-4.3	-3.1	-3.4	-25.8	-35.9
Other	-0.1	0.2	1.1	0.0	0.0	0.0
	(In percent of non-oil GDP)					
Revenue	17.2	15.2	23.9	31.2	28.5	55.9
Domestic revenues	4.1	5.8	5.7	8.7	6.7	9.2
Direct taxes	0.2	1.5	1.6	2.0	1.6	2.2
Indirect taxes	3.4	3.6	3.5	5.4	4.0	5.7
Nontax revenues and other	0.5	0.7	0.7	1.3	1.2	1.3
Oil/gas revenues	3.8	3.0	8.7	12.3	12.8	37.7
Of which : Tax revenues	2.9	1.8	7.8	11.3	5.3	27.3
Expenditure	15.0	14.8	20.8	21.4	21.8	22.9
Recurrent expenditure	8.7	11.6	16.6	18.5	18.9	19.7
Wages and salaries	4.0	5.3	6.5	7.1	8.2	8.2
Goods and services	4.6	6.3	10.1	11.4	10.7	11.5
Capital expenditure	6.4	3.2	4.3	2.9	3.0	3.2
Overall balance	2.2	0.4	3.1	9.8	6.6	33.0
Financing	-2.2	-0.4	-3.1	-9.8	-6.6	-33.0
	(In millions of U.S. dollars unless otherwise indicated)					
Memorandum items:						
Cumulative oil/gas savings (end-period)	3.1	7.4	10.5	13.9	41.0	49.8
(In percent of GDP)	0.9	2.1	3.1	4.1	11.9	14.5
(In percent of recurrent expenditure)	10.6	18.1	18.7	22.2	63.2	73.5
Non-oil overall fiscal balance	-5.7	-9.3	-18.9	-8.2	-21.3	-16.3
(In percent of non-oil GDP)	-1.7	-2.6	-5.6	-2.4	-6.2	-4.7

Sources: Data provided by the Timor-Leste authorities; and Fund staff estimates.
1/ Fiscal year: July-June.
2/ Supplementary budget adopted in February 2005.
3/ Under the current oil/gas saving policy, royalties and interest income are automatically saved and only tax revenues are available for budget financing.

Table 10. Timor-Leste: Central Government Domestic Revenues, FY2000/01–FY2004/05 1/

	FY2000/01	FY2001/02	FY2002/03	FY2003/04	FY2004/05	
					Budget	Revised 2/
	(In millions of U.S. dollars)					
Total domestic revenue	14.1	20.5	19.3	29.2	23.0	31.6
Tax revenue	12.2	18.1	17.0	24.8	19.0	27.0
Direct tax	0.6	5.4	5.3	6.7	5.4	7.5
Wage tax	0.5	2.5	2.7	2.9	2.6	3.6
Government	0.5	0.5	0.5	0.6	0.3	0.4
Other	0.0	1.9	2.2	2.3	2.3	3.2
Corporate income tax	0.2	1.7	1.7	1.9	2.0	2.8
Special withholding tax	0.0	1.3	0.9	1.9	0.8	1.1
Indirect tax	11.6	12.7	11.7	18.1	13.6	19.5
Tax on goods and services	8.8	9.6	8.7	14.2	10.4	14.9
Sales tax 3/	3.0	3.3	3.4	4.4	3.3	4.7
Excise duty 3/	4.1	4.3	3.4	7.2	5.0	7.2
Service tax 4/	1.7	2.0	1.9	2.6	2.1	3.0
Tax on international trade	2.8	3.1	3.0	3.9	3.2	4.6
Import duty	2.6	3.1	3.0	3.9	3.2	4.6
Export duty 5/	0.2	0.0	0.0	0.0	0.0	0.0
Non-tax revenue	1.9	2.4	2.3	4.4	4.0	4.6
Fees and charges	1.2	1.8	2.1	4.3	3.7	4.3
O/w: Property rental	1.1	1.1	1.1	1.3	1.2	1.4
Interest receipts and other	0.6	0.6	0.2	0.1	0.3	0.3
	(In percent of non-oil GDP)					
Total domestic revenue	4.1	5.8	5.7	8.7	6.7	9.2
Tax revenue	3.6	5.1	5.0	7.4	5.5	7.8
Direct tax	0.2	1.5	1.6	2.0	1.6	2.2
Wage tax	0.1	0.7	0.8	0.9	0.8	1.0
Corporate income tax	0.0	0.5	0.5	0.6	0.6	0.8
Special withholding tax	0.0	0.4	0.3	0.6	0.2	0.3
Indirect tax	3.4	3.6	3.5	5.4	4.0	5.7
Tax on goods and services	2.6	2.7	2.6	4.2	3.0	4.3
Sales tax 3/	0.9	0.9	1.0	1.3	1.0	1.4
Excise duty 3/	1.2	1.2	1.0	2.1	1.5	2.1
Service tax 4/	0.5	0.6	0.6	0.8	0.6	0.9
Tax on international trade	0.8	0.9	0.9	1.2	0.9	1.3
Non-tax revenue	0.5	0.7	0.7	1.3	1.2	1.3
Memorandum item:						
Taxes collected at the border	9.9	10.7	9.8	15.5	11.5	16.5
(In percent of non-oil GDP)	2.9	3.0	2.9	4.6	3.3	4.8

Sources: Data provided by the Timor-Leste authorities and Fund staff calculations.

1/ Fiscal year: July-June.
2/ Supplementary budget adopted in February 2005.
3/ Currently collected only at the border.
4/ Turnover tax on hotel, restaurant, and transportation rental services.
5/ Abolished in July 2001.

Table 11. Timor-Leste: Oil/gas Revenues, FY2000/01–FY2004/05 1/

	FY2000/01	FY2001/02	FY2002/03	FY2003/04	FY2004/05	
					Budget	Revised 2/
			(In millions of U.S. dollars)			
Total oil/gas revenues	13.1	10.8	29.5	41.4	44.1	129.8
Tax revenues	9.9	6.5	26.4	38.0	18.3	93.9
Income tax	6.8	4.7	15.5	25.9	11.0	56.3
VAT	3.1	1.7	10.9	12.1	7.3	37.6
Royalties and interest	3.1	4.3	3.1	3.4	25.8	35.9
Royalties	3.0	4.2	3.0	3.3	25.5	35.5
Interest income	0.1	0.1	0.1	0.1	0.3	0.4
			(In percent of non-oil GDP)			
Total oil/gas revenues	3.8	3.0	8.7	12.3	12.8	37.7
Tax revenues	2.9	1.8	7.8	11.3	5.3	27.3
Income tax	2.0	1.3	4.6	7.7	3.2	16.4
VAT	0.9	0.5	3.2	3.6	2.1	10.9
Royalties and interest	0.9	1.2	0.9	1.0	7.5	10.4
Royalties	0.9	1.2	0.9	1.0	7.4	10.3
Interest income	0.0	0.0	0.0	0.0	0.1	0.1
Memorandum items:						
Cumulative oil/gas savings (end-period)	3.1	7.4	10.5	13.9	41.0	49.8
(In percent of GDP)	0.9	2.1	3.1	4.1	11.9	14.5

Sources: Data provided by the Timor-Leste authorities; and Fund staff estimates and calculations.

1/ Fiscal year: July -June.
2/ Supplementary budget adopted in February 2005.

Table 12. Timor-Leste: Central Government Expenditure Composition, FY2001/02-FY2004/05 1/

	FY2001/02	FY2002/03	FY2003/04	FY2004/05	
				Budget	Revised 2/
	(In millions of U.S. dollars)				
Total expenditure	52.6	70.8	72.2	75.1	78.7
Wages and salaries	18.8	21.9	24.0	28.2	28.2
Salaries	18.8	21.9	24.0	28.1	28.1
Overtime/allowances	0.0	0.0	0.0	0.1	0.1
Goods and services	22.2	34.3	38.5	36.7	39.6
Travel	1.0	1.7	1.7	2.0	2
Vehicle	1.6	4.6	5.0	8.1	4.4
Utilities	0.4	1.5	1.8	2.5	2.4
Fuel for generators	0.0	6.2	8.1	4.5	4.5
Materials and supplies	6.5	8.4	6.9	7.5	7.4
Other operational expenses	10.4	3.6	1.2	2.3	2.4
Training/workshops	0.3	0.7	0.6	1.0	1
Others	2.1	7.6	13.2	8.8	14
Refund of Revenue	0.0	0.0	0.0	0.0	1.5
Capital expenditure	11.5	14.5	9.7	10.2	10.9
Infrastructure	1.7	5.1	6.2	8.4	8.7
Purchase of equipment	6.0	4.7	3.2	1.2	1.9
Other	3.8	4.7	0.3	0.6	0.3
	(In percent of non-oil GDP)				
Total expenditure	14.8	20.8	21.4	21.8	22.9
Wages and salaries	5.3	6.5	7.1	8.2	8.2
Goods and services	6.3	10.1	11.4	10.7	11.5
Capital expenditure	3.2	4.3	2.9	3.0	3.2

Sources: Data provided by the Timor-Leste Authorities.

1/ Fiscal year: July - June.
2/ Supplementary budget adopted in February 2005.

Table 13. Timor-Leste: Public Sector Employment and Wages, FY2000/01–FY2004/05
(In number of employees unless otherwise specified)

	FY2000/01		FY2001/02		FY2002/03		FY2003/04		FY2004/05	Monthly
	Budget	Act.	Budget	Act.	Budget	Act.	Budget	Act.	Budget	wage 1/2/
Total government employees	11,164	10,012	14,817	12,569	16,387	13,170	17,150	14,300	17,175	
L1	2,263	1,995	3,013	2,594	3,440	2,601	2,696	1,385	1,518	85
L2	789	557	1,283	1,362	2,024	2,018	3,228	3,472	4,180	110
L3	4,958	4,713	6,402	5,395	6,793	5,187	6,698	5,862	6,825	123
L4	2,599	2,360	3,119	2,678	3,357	2,920	3,658	2,972	3,741	155
L5	359	255	693	392	549	320	622	454	666	201
L6	162	104	261	121	201	112	225	128	223	266
L7	34	28	46	27	23	12	23	27	22	361
Total non-police/defense	9,648	8,499	11,894	9,839	12,139	9,474	12,442	10,087	12,489	
L1	763	495	892	825	839	562	669	304	667	85
L2	779	548	885	662	970	688	1,074	794	1,105	110
L3	4,952	4,709	6,153	5,344	6,380	5,164	6,516	5,680	6,483	123
L4	2,599	2,360	3,003	2,479	3,222	2,630	3,367	2,739	3,384	155
L5	359	255	661	383	513	309	584	418	611	201
L6	162	104	256	119	194	110	213	126	219	266
L7	34	28	44	27	21	11	19	26	20	361
Police (PNTL)	916	913	2,050	1,864	2,855	2,581	3,362	3,033	3,251	
L1	900	900	1,435	1,083	1,400	1,126	1,082	267	221	85
L2	10	9	347	649	1,000	1,207	1,887	2,549	2,665	110
L3	6	4	205	7	370	2	100	5	90	123
L4	0	0	39	124	55	245	250	189	240	155
L5	0	0	20	0	24	0	30	22	31	201
L6	0	0	3	1	5	1	10	1	3	266
L7	0	0	1	0	1	0	3	0	1	361
Defense (FDTL)	600	600	873	866	1,393	1,115	1,346	1,180	1,435	
L1 Recruit/ DEF01-02	600	600	686	686	1,201	913	945	814	630	85
L2 DEF03-05	0	0	51	51	54	123	267	129	410	110
L3 DEF06-08	0	0	44	44	43	21	82	177	252	123
L4 DEF09-10	0	0	77	75	80	45	41	44	117	155
L5 DEF11-12	0	0	12	9	12	11	8	14	24	201
L6 DEF13	0	0	2	1	2	1	2	1	1	266
L7 DEF14	0	0	1	0	1	1	1	1	1	361
Memorandum item:										
Average monthly wage (in US$)										
Total employee	127	126	128	125	125	139	131	149	137	...
Total non-police/defense	134	134	136	132	134	133	135	...	...	...
Police	86	85	96	99	101	103	107	...	...	...
Defense	85	85	97	96	93	93	96	...	...	...

Sources: Data provided by the Timor-Leste authorities and Fund staff estimates and calculations.

1/ Figures relate to the average wage for each grade in U.S. dollars.
2/ The public sector pay-scale has not been changed since FY2000/01.

Table 14. Timor-Leste: Autonomous Agencies Operations, FY2000/01–FY2004/05 1/

	FY2000/01	FY2001/02	FY2002/03	FY2003/04	FY2004/05 Budget
	(In millions of U.S. dollars)				
Total retained revenues	1.4	4.4	4.9	5.5	8.4
Aviation	0.4	1.1	1.0	1.0	1.0
Port	0.7	1.3	1.1	1.0	0.9
Power	0.3	2.0	2.9	3.5	6.5
Total expenditures	8.6	9.2	12.6	10.6	13.9
Aviation	0.1	0.2	0.8	0.6	0.9
Port	0.1	0.2	0.5	0.3	0.9
Power	8.4	8.9	11.2	9.7	12.1
Wages and salaries	0.4	0.4	0.5	0.4	0.7
Aviation	0.0	0.0	0.1	0.1	0.2
Port	0.0	0.0	0.1	0.1	0.1
Power	0.4	0.3	0.3	0.3	0.4
Goods and services	7.6	8.0	9.5	10.0	12.2
Aviation	0.0	0.1	0.5	0.5	0.6
Port	0.0	0.1	0.2	0.2	0.3
Power	7.5	7.7	8.8	9.3	11.3
Capital	0.6	0.9	2.5	0.2	1.1
Aviation	0.1	0.0	0.2	0.0	0.2
Port	0.0	0.0	0.3	0.0	0.5
Power	0.5	0.8	2.0	0.1	0.4
Overall balance	-7.2	-4.8	-7.7	-5.1	-5.6
Aviation	0.3	0.9	0.2	0.4	0.1
Port	0.6	1.1	0.5	0.7	0.0
Power	-8.1	-6.9	-8.3	-6.2	-5.7
Financing	7.2	4.8	7.7	5.1	5.6
Transfers from the budget	8.4	6.8	8.4	6.6	5.7
Aviation	0.0	0.0	0.0	0.0	0.0
Port	0.0	0.0	0.0	0.0	0.0
Power	8.4	6.8	8.4	6.6	5.7
Other (Increase -)	-1.2	-1.9	-0.8	-1.5	-0.1
Aviation	-0.3	-0.9	-0.2	-0.4	-0.1
Port	-0.6	-1.1	-0.5	-0.7	0.0
Power	-0.3	0.1	-0.1	-0.4	0.0
	(In percent of non-oil GDP)				
Total retained revenues	0.4	1.2	1.5	1.6	2.4
Aviation	0.1	0.3	0.3	0.3	0.3
Port	0.2	0.4	0.3	0.3	0.3
Power	0.1	0.6	0.8	1.0	1.9
Total expenditures	2.5	2.6	3.7	3.1	4.0
Aviation	0.0	0.1	0.2	0.2	0.3
Port	0.0	0.0	0.2	0.1	0.3
Power	2.5	2.5	3.3	2.9	3.5

Sources: Data provided by the Timor-Leste authorities, and Fund staff estimates and calculations.

1/ Fiscal year: July-June.

Table 15. Timor-Leste: Operations of the Power Authority, FY2000/01–FY2004/05 1/

	FY2000/01	FY2001/02	FY2002/03	FY2003/04	FY2004/05 Budget
	(In thousands of U.S. dollars)				
Revenue collection	258	1,997	2,871	3,526	6,450
Expenditure	8,639	8,749	11,201	9,717	12,016
Wages and salaries	364	309	309	269	416
Goods and services	7,782	7,618	8,843	9,306	11,280
Fuel	7,523	5,596	7,950	7,732	8,150
Maintenance	...	...	386	756	1,785
Other	...	...	508	819	1,345
Capital expenditure	493	822	2,049	142	320
Of which : Prepayment meter project 2/	0	0	1,900	0	0
Operating balance	-7,887	-5,929	-6,281	-6,049	-5,246
Overall balance	-8,380	-6,751	-8,330	-6,191	-5,566
Financing	8,380	6,751	8,330	6,191	5,566
Budgetary transfers	8,380	6,751	8,442	6,557	5,652
External assistance	0	0	0	0	0
Other	0	0	-112	-366	-86
	(In percent of GDP)				
Revenue collection	0.1	0.5	0.8	1.1	2.0
Expenditure	2.4	2.3	3.1	2.9	3.6
Wages and salaries	0.1	0.1	0.1	0.1	0.1
Goods and services	2.2	2.0	2.4	2.8	3.4
Capital expenditure	0.1	0.2	0.6	0.0	0.1
Budgetary transfers	2.4	1.8	2.3	2.0	1.7
	(In percent of total central government expenditure)				
Budgetary transfers	16.3	12.8	11.9	8.3	7.5
	(In thousands of U.S. dollars)				
Memorandum item:					
Average monthly revenue collection	29	166	239	294	538

Sources: Data provided by the Timor-Leste authorities, and Fund staff estimates and calculations.

1/ Fiscal year: July-June.

2/ The total cost of prepayment meter project was $2.7 million, of which $1.9 million was provided from the budget, with the remainder financed by Norad and TFET.

Table 16. Timor-Leste: Combined Sources Fiscal Operations, FY2000/01–FY2004/05 1/

	FY2000/01	FY2001/02	FY2002/03	FY2003/04	FY2004/05
			Estimates 2/		
			(In millions of U.S. dollars)		
Revenue	60.1	58.4	86.2	111.1	315.7
Domestic revenue	14.1	20.5	19.3	29.2	33.2
Autonomous agencies own revenue	1.4	4.4	4.9	5.7	8.2
Oil/gas revenue 2/	13.1	10.8	29.5	41.4	243.5
Grant financing (budget support)	31.6	22.7	32.5	34.8	30.8
Expenditure	236.6	247.9	248.7	221.4	214.4
Recurrent expenditure	121.0	135.4	147.8	147.0	153.8
Central government budget (incl. autonomous agencies)	30.5	44.0	59.5	66.3	71.6
Donor projects	90.5	91.4	88.3	80.8	82.2
Capital expenditure	115.6	112.5	100.9	74.3	60.6
Central government budget (incl. autonomous agencies)	22.2	12.9	16.2	11.6	10.9
Donor projects	93.4	99.5	84.7	62.7	49.7
Overall balance	-176.5	-189.5	-162.4	-110.3	101.3
Financing	176.5	189.5	162.4	110.3	-101.3
Oil fund financing of non-oil central government fiscal deficit	...	...	...	...	...
Oil/gas revenue savings (increase -)	-3.1	-4.3	-3.1	-3.4	-49.2
Committed project financing by donors	183.9	190.9	173.0	143.5	132.4
Changes in treasury cash-balances (increase -)	-4.3	2.9	-7.5	-29.8	-184.5
			(In percent of non-oil GDP)		
Revenue	17.6	16.4	25.4	32.9	91.7
Domestic revenue	4.1	5.8	5.7	8.7	9.6
Autonomous agencies own revenue	0.4	1.2	1.5	1.7	2.4
Oil/gas revenue (accruing to the budget)	3.8	3.0	8.7	12.3	70.8
Grant financing (budget support)	9.2	6.4	9.6	10.3	8.9
Expenditure	69.2	69.7	73.3	65.6	62.3
Recurrent expenditure	35.4	38.1	43.5	43.6	44.7
Capital expenditure	33.8	31.6	29.7	22.0	17.6
Overall Balance	-51.6	-53.3	-47.9	-32.7	29.4
Financing	51.6	53.3	47.9	32.7	-29.4
Oil fund financing of non-oil central government fiscal deficit	...	...	...	...	...
Oil/gas revenue savings (increase -)	-0.9	-1.2	-0.9	-1.0	-14.3
Committed project financing by donors	53.8	53.7	51.0	42.5	38.5
Changes in treasury cash-balances (increase -)	-1.3	0.8	-2.2	-8.8	-53.6
Memorandum items:			(In millions of U.S. dollars unless otherwise specified)		
Non-oil fiscal balance	-5.7	-9.3	-18.9	-8.2	-10.3
Cumulative oil Savings (end-period)	3.1	7.4	10.5	13.9	63.1
Cumulative oil savings (in percent of non-oil GDP)	0.9	2.1	3.1	4.1	18.4
Total Donor Financing	183.9	190.9	173.0	143.5	132.4

Source: Data provided by the Timor-Leste authorities; and Fund staff estimates.

1/ Include central government budget expenditure and expenditure programs undertaken by bilateral donors, UNTAET/UNMISET, and international financial institutions outside the central government budget, but excludes externally funded military expenditures (e.g. UN military peacekeeping).
2/ On the basis of data collected in the register for external assistance of the Ministry of Plannig and Finance as reported in the April 2005 Sectoral Investment Programs (SIPs) overview paper.

Table 17. Timor-Leste: Balance of Payments, 2000–2004

	2000	2001	2002	2003	2004
			Estimates		
			(In millions of U.S. dollars)		
Current account excl. international assistance	-275	-316	-288	-218	-77
Current account incl. international assistance	37	46	26	17	119
Trade balance	-237	-280	-260	-213	-194
Exports of goods 1/	5	4	6	7	8
O/w: coffee	4	3	5	6	7
Imports of goods	-242	-284	-266	-221	-202
O/w: international assistance-related	-148	-163	-141	-109	-100
Services (net)	-52	-56	-56	-48	-34
Income (net)	2	5	6	5	30
O/w: oil/gas royalty and interest	2	4	4	3	26
Current transfers (net)	325	377	337	273	317
O/w: oil/gas tax revenue	5	8	16	32	116
international assistance	313	362	314	235	195
Capital and financial accounts	-29	-40	-11	16	7
Official capital transfers	80	86	71	53	47
Financial account	-109	-127	-82	-37	-40
Errors and omissions (net)	7	2	5	-15	-4
Overall balance	16	8	20	18	122
Changes in foreign assets (increase -)	-16	-8	-20	-18	-122
Oil/gas revenue savings (increase -)	-19	-2	-13	-16	-119
Other	3	-6	-7	-2	-3
			(In percent of non-oil GDP)		
Current account excl. international assistance	-87	-86	-84	-65	-23
Current account incl. international assistance	12	13	8	5	35
Trade balance	-75	-76	-76	-64	-57
			(In millions of U.S. dollars)		
Memorandum items:					
Oil/gas revenue	7	12	20	35	143
Gross foreign assets (end-period)	16	24	44	61	183

Source: Data provided by the Timor-Leste authorities, and Fund staff estimates.

1/ Exclude oil/gas revenues, which are recorded under the income (royalties) and transfers (tax revenues) because of lack of detailed data on the oil/gas sector (including production, exports, service payments, and profit remittances).

Table 18. Timor-Leste: Banking Indicators (in percent)

	2003				2004			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Capital adequacy ratio	9.1	9.1	33.8	19.4	13.1	12.6	13.6	14.2
Loan growth (q/q)	18.6	29.3	61.2	75.2	46.6	65.1	24.1	6.3
Equity/assets	2.6	2.7	10.6	7.2	5.6	7.2	8.2	9.8
Core earnings/ average assets	...	...	...	...	...	...	...	...
NPLs/total loans	20.8	15.8	10.4	6.3	3.9	2.4	3.2	5.4
Total provisions/NPLs	0.9	1.2	2.1	2.2	5.6	9.5	7.9	5.8
Liquid assets/total assets	86.2	84.6	81.6	74.3	69.3	50.4	47.6	36.0

Sources: Data provided by the Timor-Leste authorities, and Fund staff estimates.

Table 19. Timor-Leste: Summary of Tax System (as of March 2005) 1/ 2/

Tax	Nature of Tax	Exemptions and Deductions	Rates
1. Direct Taxes			
1.1. Income tax	Timor-Leste has inherited the Indonesian income tax system with some modifications. The income tax applies to all taxable income other than that subject to withholding taxes (1.3) or wage income tax (1.4), and is supplemented by the minimum income tax (1.2). In the case of a legal person, income from dividends, interest, royalties and rent is included in the taxable income, with a credit for withholding tax. Progressive rates with three brackets are applicable in the case of a natural person, and a flat rate is applicable in the case of a legal person.	*<u>Depreciation</u>* Business building - Straight line depreciation - 20 years useful life at 5 percent - 10 years useful life at 10 percent Depreciable assets Individual depreciation - 1-4 years useful life at 25 percent - 5-8 years useful life at 12.5 percent - 9+ years useful life at 6.25 percent Pooling depreciation - 1-4 years useful life at 50 percent - 5-8 years useful life at 25 percent - 9+ years useful life at 12.5 percent *<u>Amortisation of intangibles</u>* - 1-4 years useful life at 25 percent - 5-8 years useful life at 12.5 percent - 9+ years useful life at 6.25 percent *<u>Deductible expenses</u> include:* bad debt, interest, foreign exchange losses, salary and wages, contractor expenses, R&D expenses, and losses from sale/ transfer of property.	[Natural person] Income brackets and tax rates: 0 - $3,368 10 % $3,368 - $6,737 15 % $6,737 - 30 % [Legal person] Income tax rate: 30%
1.2. Minimum income tax	Minimum income tax is levied on the taxpayer's total turnover for the year. The ordinary income tax payable is credited against the minimum tax payable for the year.	The taxpayer's total turnover does not include any amount derived by the taxpayer that is subject to the withholding taxes.	1 % of the total turnover

Table 19. Timor-Leste: Summary of Tax System (as of March 2005) 1/ 2/

Tax	Nature of Tax	Exemptions and Deductions	Rates
1.3. Withholding taxes	Income earned from designated sources (including dividend, interest, royalty, and rent) is subject to withholding tax at a variety of rates. The tax is withheld by a person making payments to the recipient of the income. The withholding taxes are final, except for dividends, interest, royalties and rent paid to a legal person.		Tax rates vary according to the source of income: *Payable to residents and non-residents with permanent establishment:* Type of income — Tax rate dividend/ interest/ royalty 15 % rent from land/ building 10 % income from : prizes and lotteries 15 % construction activities 2 % construction consulting 4 % provision of transportation 2.64 % petroleum drilling/ mining 4.5 % provision of selected services 0 % *Payable to non-resident without permanent establishment:* all income 20 %
1.4. Wage income tax	The wage income tax is withheld by the employer.	Each employee is allowed a monthly tax credit of $10 against the wage income tax payable for the month. Excess credit is neither refunded nor carried forward. Exempt wages include: (a) wages received for official duties by diplomatic staff of a foreign government's representative office (b) wages of a public servant of a foreign government (c) wages of an employee of the UN or its agencies	*Resident with Tax Identification Number (TIN)* Monthly wage income — Tax rate $0 to $550 10 percent above $550 30 percent *Non-resident* 20 percent *Resident without TIN* 30 percent
1.5. Presumptive income tax on coffee exports	Imposed on exports of coffee beans, whether processed or unprocessed, at the time of export. Not applicable for coffee export after 05/31/01	Up to 5 kilograms of coffee beans exported in accompanied baggage by a person departing from Timor-Leste are exempt.	5 percent of the value of coffee beans. The value of the coffee beans is the arm's length free on board value of the beans.

Table 19. Timor-Leste: Summary of Tax System (as of March 2005) 1/ 2/

Tax	Nature of Tax	Exemptions and Deductions	Rates
2. Indirect Taxes			
2.1 Border Taxes	All taxes in this category are levied at the border.		
2.1.1. Import duty	Applicable to all imports at an ad-valorem rate except for selected import items.	Imported goods that are exempt include: (a) when accompanying an arriving person - 200 cigarettes and 2.5 liters of excisable beverages - non-commercial goods for personal use up to $300 - household effects (returning former residents) (b) imports by diplomats, UN and specialized agencies. (c) re-imported goods (d) goods for which import duty is less than $10.	6 percent of the customs value. The customs value is the transaction value of the goods, including cost, insurance and freight.
2.1.2. Excise tax	Excise tax is levied on designated goods at specific or ad-valorem rates. Excise taxes on imported goods are levied on the excise value, or the customs value plus the import duty payable. Excise tax is also applicable to designated goods produced domestically, but is not collected currently because of the absence of domestic production. Some of the excises (e.g., those on private yachts and aircrafts) bear characteristics of a luxury goods tax.	Exemption is given to: (a) Goods exported from Timor-Leste within 28 days of importation. (b) Goods that are exempt from import duty.	Rates for major excisable goods: *Specific rates on quantity* Soft drinks $ 0.65 per liter Beer $ 1.90 per liter Wine $ 2.50 per liter Alcoholic beverages $ 8.90 per liter Tobacco $ 19.00 per kg Gasoline, diesel fuel $ 0.06 per liter *Ad-valorem rates of the excise value* Fruit juices/ ice cream 12 % cigarette lighter, smoking pipe 12 % Audio electronic goods 12 % Mobile phones, TV, videos 12 % Perfumes 18 % Fireworks, arms/ ammunition 120% Motor cars: the greater of 36 % excise value, or $500 + 36% over $20,000 private yachts / aircrafts 12 % in excess of US $20,000 36 %

Table 19. Timor-Leste: Summary of Tax System (as of March 2005) 1/ 2/

Tax	Nature of Tax	Exemptions and Deductions	Rates
2.1.3. Sales tax	Sales tax is applicable to imported goods, and goods sold and services provided domestically. For imported goods, the tax base consists of customs value, and the import duty and excise tax payable.	Sales tax does not apply to imported goods exempt from import duty.	6 percent of the sum of : the customs value of the goods; the import duty payable; and the excise tax payable.
	Sales tax applicable to goods sold and services provided domestically is not collected currently.		
2.2. Service tax	The service tax applies to designated services, which comprise: (a) hotel services (b) restaurant and bar services (c) telecommunications services (d) rental services of: (i) cars, trucks, omnibuses, etc (ii) helicopters and airplanes (iii) seagoing vessels	Service tax is payable by providers of services, with monthly turnover of $500 or more.	A uniform 12 percent.

Source: Information provided by the Timor-Leste authorities.

1/ The tax system of Timor-Leste was established by UNTAET Regulation (No. 2000/18 June 30, 2000), modifying then applicable Indonesian Law on Income Tax. After independence, the tax system was amended by the Revenue System Amendment Act (applicable on July 1, 2002).
2/ These taxes are not applicable to oil/gas activities in the Timor Gap.

TABLE 20. TIMOR-LESTE: SUMMARY OF THE EXCHANGE AND PAYMENTS SYSTEM

(Position as of April 30, 2005)

I. Status Under IMF Articles of Agreement

1. Date of membership	Yes	July 23, 2002.
Article VIII	Yes	Date of acceptance: July 23, 2002

II. Exchange Arrangement

1. Currency		The currency of the Democratic Republic of Timor Leste is the U.S. dollar.
a. Other legal tender	Yes	On November 10, 2003, Timorese coins were introduced to serve as fractional currency to the U.S. dollar.
2. Exchange rate structure		
a. Unitary	Yes	
3. Classification		
a. Exchange arrangement with no separate legal tender	Yes	The dollar is legal tender and circulates freely. Foreign exchange transactions are effected through three (foreign-owned) commercial banks and one licenced currency exchange bureau.
4. Exchange tax	No	
5. Exchange subsidy	No	
6. Forward exchange market		
a. Official cover of forward operations	No	

III. Arrangements for Payments and Receipts

1. Prescription of currency requirements		
a. Controls on the use of domestic currency		All domestic transactions and settlements must be in the domestic currency (U.S. dollar).
b. Use of foreign exchange among residents		No restriction
2. Payments arrangements	None	
3. Administration of control		Overall responsibility for the administration of exchange controls rests with the BPA, which has the power to regulate payment and settlement systems in domestic and foreign currency.
4. International security restrictions	No	
5. Payments arrears	No	
6. Controls on trade in gold (coins and/or bullion)	No	

7. Controls on exports and imports of banknotes		
a. On exports	No	
b. On imports		
1. Domestic currency	No	
2. Foreign currency	No	

IV. Resident Accounts

1. Foreign exchange accounts permitted		
a. Held domestically	No restriction	There are no restrictions on the holding of foreign exchange accounts,
Approval required	No	
b. Held abroad	No restrictions	
Approval required	No	
2. Accounts in domestic currency held abroad	No restricitons	
3. Accounts in domestic currency convertible into foreign currency	No restriction	

V. Nonresident Accounts

1. Foreign exchange accounts permitted	No restrictions	
a. Approval required	No	
2. Domestic currency accounts	No restrictions	
a. Convertible into foreign currency	Yes	
b. Approval required	No	
3. Blocked accounts	No	

VI. Imports and Import Payments

1. Foreign exchange budget	No	
2. Financing requirements for imports	No	
3. Documentation requirements for release of foreign exchange for imports	No	

4. Import licenses and other nontariff measures	No	
5. Import taxes and/or tariffs		
a. Taxes collected through the exchange system		There are no quantitative restrictions on imports. With the exception of selected items (e.g., cigarettes and alcohol with certain limits, household effects of returning former residents), a uniform ad-valorem tariff (6 percent) is levied on all imports. Also, excise taxes are levied on imports of selected goods at specific or ad-valorem rates (10-170 percent) depending on types of goods. In addition, the sale tax (6 percent) is levied on the sum of customs value, import duty, and excise payable.
6. State import monopoly	No	

VII. Exports and Export Proceeds

1. Repatriation requirements	No	
2. Financing requirements	No	
3. Documentation requirements	No	
4. Export licenses	No	
5. Export taxes	No	

VIII. Payments for Invisible Transactions and Current Transfers

Controls on transfers	No	

IX. Proceeds from Invisible Transactions and Current Transfers

1. Repatriation requirements	No	
2. Restrictions on use of funds	No	

X. Capital Transactions

A. Controls on capital transactions		
1. Controls on capital and money market instruments	No	No domestic capital and money markets have developed yet.
2. Controls on derivatives and other instruments	No	
3. Controls on credit operations	No	
4. Controls on direct investment	No	

5. Controls on liquidation of direct investment	No	
6. Controls on real estate transactions		
a. Purchase abroad by residents	No	
b. Purchase locally by nonresidents	Yes	The constitution prohibits ownership of land by foreigners.
c. Sale locally by nonresidents	Yes	The constitution prohibits ownership of land by foreigners.
7. Controls on personal capital transactions	No	
8. Provisions specific to commercial banks and other credit institutions		
a. Borrowing abroad	No	
b. Maintenance of accounts abroad	No	
c. Lending to nonresidents (financial or commercial credits)	No	
d. Lending locally in foreign exchange	Yes	All domestic transactions must be made in the domestic currency.
e. Purchase of locally issued securities denominated in foreign exchange	Yes	All domestic transactions must be denominated in the domestic currency.
f. Differential treatment of deposit accounts in foreign exchange	No	
g. Differential treatment of deposit accounts held by nonresidents	No	
h. Investment regulations	No	
i. Open foreign exchange position limits	No	
9. Provisions specific to institutional investors	No	
10. Other controls imposed by securities laws	No	

Changes During 2004

None