Timor-Leste

Economic growth remained high in 2011, supported by another large increase in government expenditure. Double-digit growth is forecast for 2012, before a moderation in fiscal expansion sees some easing in economic growth. Inflation climbed sharply, and is expected to remain internationally high in 2012 and 2013. The key economic challenge is to move from an economy driven by public sector activity to one in which the private sector plays a key role.

Economic performance

The economy's strong growth performance continued in 2011, with GDP, excluding the offshore petroleum sector and the United Nations (the measure of GDP used hereafter), expanding by 10.0%. The spending of petroleum revenue continued to drive the economy. Although the full 2011 budget allocation was not spent, government expenditure, including development partner–funded activities, reached $1.4 billion. This was an increase of 36.4% from 2010, and saw the ratio of government expenditure to GDP reach 185.5% in 2011.

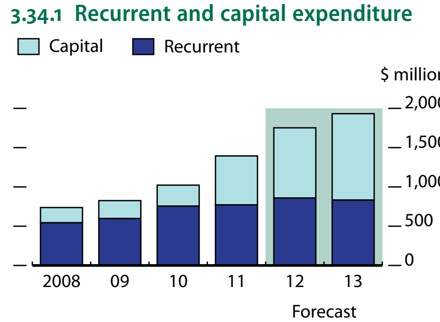
The government's capital spending more than doubled in 2011 (Figure 3.34.1), while recurrent expenditure rose by only 2.2%. Expenditure on wages and salaries rose by 22.6% in 2011 to $112 million, primarily because a large number of temporary civil service positions were converted to permanent positions during the year (Figure 3.34.2). This moved expenditure out of goods and services and this category was therefore below both the budgeted level and the outturn for 2010. Overall, 88.3% of the budget was spent in 2011, a similar ratio to the previous 2 years.

The national electrification program begun in 2008 accounted for most of the capital spending in 2011. Around half the total cost of $0.9 billion was spent during the year. The program will provide two new power stations and a new transmission system, and will greatly extend the distribution system. The first major milestone was met in late 2011, when the first power station entered operation.

A large budget surplus was again recorded. The steep rise in the world oil price boosted petroleum revenue to a new high of $3.5 billion over the year, dwarfing the $0.1 billion raised domestically. The overall budget surplus of $2.5 billion was more than three times GDP. Public savings of $2.5 billion boosted the balance in the Petroleum Fund to $9.3 billion, around 12 times GDP.

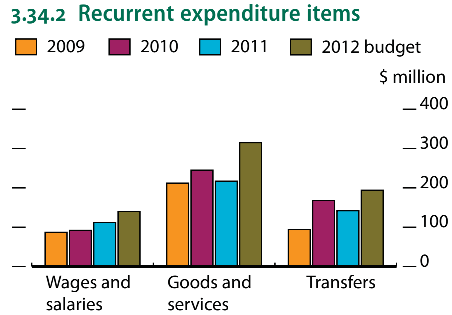
Average annual inflation was 13.1%. Inflation rose rapidly in the first quarter of 2011 as higher world oil and food prices fed through the economy. Other contributing factors to the first quarter rise were a reduction in rice subsidies, and disruption to the harvest cycle because of excessive rain in 2010. There was little additional inflation in the second

3.34.1 Recurrent and capital expenditure



Sources: ADB estimates based on Timor-Leste National Statistics Directorate. Government of Timor-Leste Transparency Portal. http://www.transparency.gov.tl/english.html; Government of Timor-Leste. State Budget: Book 1 and Book 6. Various years.

3.34.2 Recurrent expenditure items



Sources: ADB estimates based on Timor-Leste National Statistics Directorate. Government of Timor-Leste Transparency Portal. http://www.transparency.gov.tl/english.html; Government of Timor-Leste. *State Budget: Book 1 and Book 6*. Various years.

This chapter was written by Craig Sugden, of the Special Office in Timor-Leste, ADB, Dili.

and third quarters, despite strong domestic demand. But in the final quarter, year-on-year inflation reached 15.4%.

Increased demand in the lead-up to end-of-year celebrations and the loss of capacity at the international port in Dili from October as new navy vessels occupied one of three berths were the key contributors to the fourth quarter jump in inflation (Figure 3.34.3). This jump was despite the deflationary effects of some easing in world food prices and an appreciation of the United States dollar (which is used by Timor-Leste as its official currency) against key currencies.

After 5 years of almost no change, lending levels rose by 18.5% in 2011 (Figure 3.34.4), helped by a shift in lending policy at one of the larger commercial banks toward more risk sharing. The July inauguration of the country's fourth commercial bank and the first locally owned bank, the Banco Nacional Comércio de Timor-Leste, also contributed to the rise in lending. Deposits with the banking system increased by 6.0% in 2011, while the broad money measure of money supply expanded by 9.3%.

The data show a large increase in imports during 2011, consistent with the high import content of heavy government expenditure. Merchandise imports were almost double the previous year's. Nonpetroleum merchandise exports, predominately coffee, declined by 18.5% and remained a small fraction of merchandise imports. The surplus on the income account attributable to petroleum revenue continued to outweigh the wide trade deficit in 2011, providing for a large current account surplus of more than three times GDP.

Economic prospects

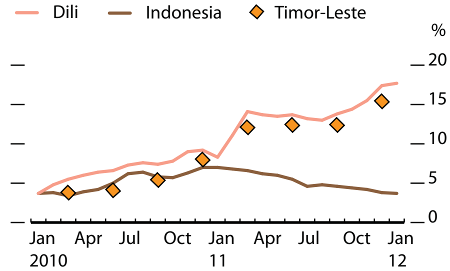
The continuing rise in government spending is projected to see the economy stay strong. But the rate of economic growth is expected to ease, from around 10.0% in 2012 to 8.0% in 2013, as the rate of fiscal expansion begins to moderate (Figure 3.34.5). Government expenditure is projected to expand by 25.7% in 2012, but by only 10.3% in 2013.

Inflation is seen remaining high in the first half of 2012. The temporary loss of capacity at Dili port, and extra demand arising from preparations for the Parliamentary elections due midyear, are expected to maintain upward pressure on prices. Inflationary pressures are expected to decline over the second half of 2012 as these effects pass, and as the departure of the United Nations mission (to be completed by 30 December) helps slow the expansion in aggregate demand. Inflation is projected to average 10.2% in 2012 before declining to 7.4% in 2013.

The budget for 2012 provides for a further large increase in government expenditure to $1.8 billion, of which $1.6 billion will be from the Petroleum Fund and domestic revenue, with the remainder from development partners. The ratio of expenditure to GDP is projected to remain close to 200% in 2012.

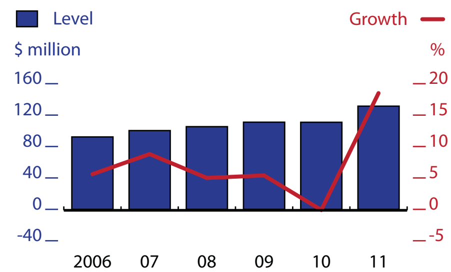
Big-ticket capital expenditure items funded from the multiyear Infrastructure Fund are again prominent in the budget. Capital spending is budgeted to rise to 100% of GDP. Outlays on the national electrification program are tapering off, but will remain high at $280 million. A large allocation is to be made for infrastructure designed to trigger industrial development on the south coast—the Tasi Mane program—and

3.34.3 Inflation



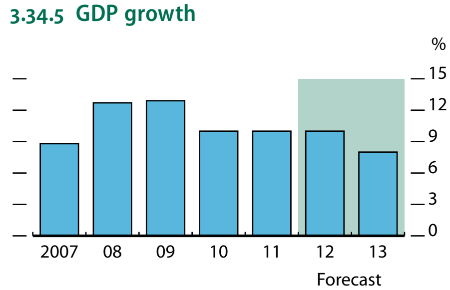
Source: Timor-Leste National Statistics Directorate.

3.34.4 Total loans and advances



Source: Central Bank of Timor-Leste.

3.34.5 GDP growth



Note: Non-petroleum, non-UN GDP, annual growth.

Source: Government of Timor-Leste. 2011. *State Budget 2012: Budget Overview. Book 1*. November.

$170 million is allocated for road projects. Road investments will be partly funded by the government's first loans. A total of $150 million in loans from development partners is proposed to support a multiyear project to begin upgrading the country's major roads.

World oil prices are projected to remain around current levels in 2012 and 2013, underpinning high petroleum revenue (Figure 3.34.6) as well as large budget and current account surpluses. These surpluses are projected to remain close to 200% of GDP in 2012, before easing in 2013 (Figure 3.34.7).

Longer-term prospects for private sector development and the economy more broadly have been strengthened by the early 2012 government approval of a framework for public–private partnerships. The framework identifies the type of public infrastructure that may be considered for such partnerships, and how such projects will be evaluated, provisioned, and managed. It is now important to bring forward the best candidate projects to address looming infrastructure bottlenecks. Priorities are operating and maintaining the expanding electricity system, rehabilitating the only international airport, building a new international sea port, and upgrading the degraded water supply system in Dili.

A large step forward was also taken through Parliament's approval in early 2012 of a land law that provides a framework for land ownership and resolution of conflicting claims. Complementary laws that allow the state to acquire land for public purposes were also approved. These new laws extend a legal process established in 2011 for registering land claims and confirming those that are undisputed (so far, 92% of 47,000 registered claims have been undisputed). A Civil Code that came into force in March 2012 also includes a section governing day-to-day decisions such as the sale and lease of land. Such legal reforms are an essential underpinning of private sector development because they provide greater certainty over property rights.

Policy challenge highlights

A key issue facing Timor-Leste is whether the economy should be slowed in an effort to reduce inflation. While some farmers have benefited from the boost to their income provided by higher food prices, many of the urban poor are suffering from the increased cost of living. Other policy responses also warrant consideration. Notably, enhanced targeting of the government's sizable public social safety net, which received another large funding increase in the 2012 budget, could help alleviate pressures on the poor. It is also important to keep infrastructure investment high, as this is needed to alleviate supply bottlenecks and reduce the cost of local production.

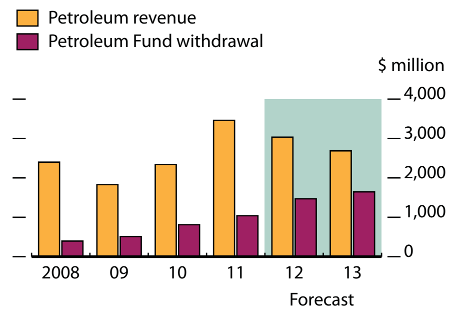
The major economic challenge remains moving from an economy in which growth has been primarily dependent on public sector activity to one in which the private sector plays a key role. The inaugural Business Activity Survey, covering 2010, has provided a reminder of the nascent state of the private sector. The survey confirmed the concentration of the formal business sector in Dili—more than 80% of employment and value-added was earned by Dili-based businesses—and its shallow structure—the retail and wholesale, construction, and accommodation and food services accounted for about 60% of total employment and value added.

3.34.1 Selected economic indicators (%)

	2012	2013
GDP growth	10.0	8.0
Inflation	10.2	7.4
Current account balance (share of GDP)	229.4	153.7

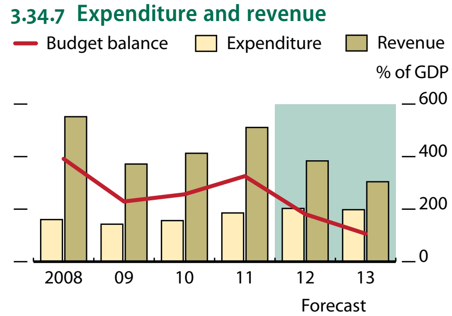
Source: ADB estimates.

3.34.6 Petroleum accounts



Sources: ADB estimates based on Timor-Leste National Statistics Directorate. Government of Timor-Leste Transparency Portal. http://www.transparency.gov.tl/english.html; Government of Timor-Leste. *State Budget: Book 1 and Book 6*. Various years.

3.34.7 Expenditure and revenue



Note: Non-petroleum, non-UN GDP, annual growth.

Sources: ADB estimates based on Timor-Leste National Statistics Directorate. Government of Timor-Leste Transparency Portal. http://www.transparency.gov.tl/english.html; Government of Timor-Leste. *State Budget: Book 1 and Book 6*. Various years.