Timor-Leste

Economic growth remained high in 2012, buoyed by a large increase in government spending. Growth in double digits is expected to continue in 2013 and 2014 with modest declines due to planned fiscal tightening. Inflation moderated from 2011 but remained above 10%, prompting the government to postpone some infrastructure initiatives. The biggest challenge facing leaders is to effectively channel petroleum revenues into ambitious plans to build infrastructure and human resources while sustaining the Petroleum Fund.

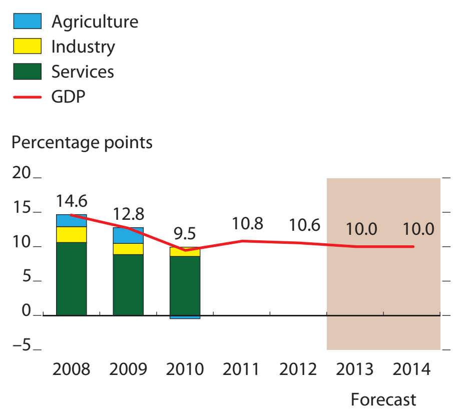
Economic performance

Strong economic growth continued in 2012, with non-oil GDP expanding by 10.6% (Figure 3.35.1). Government spending, particularly on public infrastructure, continued to drive the economy. This spending propelled growth both directly and indirectly through spillover effects on non-oil business investment and demand for the goods and services provided by private businesses. Government expenditure totaled $1.8 billion, up by 64.8% from 2011. The United Nations Mission in Timor-Leste departed at the end of 2012, but this appears to be having little impact on economic activity, as only 1% of GDP was linked to it and government spending has continued to rise.

Inflation in 2012 remained high at an annual average of 10.9% but moderated from 13.1% in 2011 (Figure 3.35.2). This reflected easing world food prices and lower import costs with the strengthening of the US dollar, which Timor-Leste uses as its official currency, against the currencies of some of Timor-Leste's important trade partners. Government spending in the face of persisting bottlenecks and spending linked to the midyear elections countered some of the deflationary impact of these external developments.

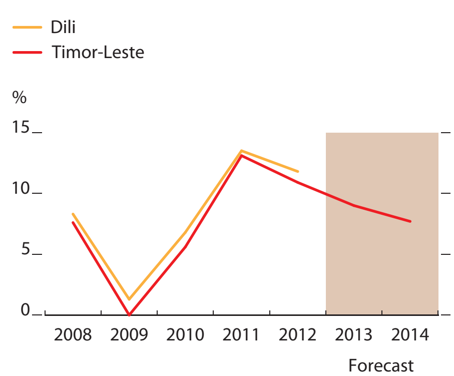
Capacity constraints on carrying out infrastructure development plans caused a significant portion of budgeted 2012 expenditures to be postponed amid implementation delays. Nonetheless, the ratio of government expenditures to non-oil GDP reached 192.7% in 2012, surpassing the previous high set in 2011. The largest increase was in capital expenditures, which grew by 78.4% over 2011. The vast majority of this spending went to national electrification. The system is being built to accommodate future electricity demand but currently has excess generating capacity. Despite rising Petroleum Fund returns and overall balance, the rise in spending has necessitated withdrawals from the fund that exceed what the Ministry of Finance estimates can be sustained over the long run.

3.35.1 Supply-side contributions to growth



Sources: Timor-Leste National Statistics Directorate; ADB estimates.
Click here for figure data

3.35.2 Inflation



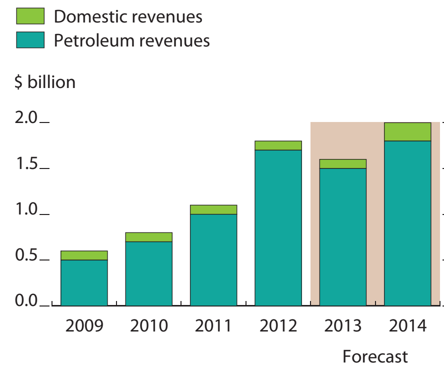
Source: Timor-Leste National Directorate of Statistics.
Click here for figure data

This chapter was written by Christopher Edmonds of the Pacific Department, ADB, Manila.

The government posted another large budget surplus of $1.8 billion, which was about 1.4 times non-oil GDP in 2012. However, the surplus was much smaller than in 2011 when it equaled 2.4 times non-oil GDP. The government received $3.0 billion in income from its oil concessions in 2012, down from $3.5 billion in 2011. As in recent years, these revenues dwarfed the government's domestic revenues of $146 million (Figure 3.35.3). Public savings, defined as the Petroleum Fund plus foreign exchange reserves, are $11.6 billion, which is more than 9 times annual non-oil GDP.

The value of goods and services imported into Timor-Leste in 2012 increased by 15%, but this was much lower than in the previous year, when there were particularly large imports of heavy construction equipment. Nonpetroleum exports, mostly coffee, increased by 10.9% but still covered only 4.4% of the cost of imported goods. The surplus in the income account from petroleum revenue continued to outweigh the wide trade deficit in 2012, providing a current account surplus equivalent to 1.7 times non-oil GDP.

3.35.3 Government revenue



Source: Timor-Leste 2013 state budget.

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Economic prospects

Strong economic growth is expected to continue in 2013 and 2014, driven largely by government expenditures and more modest rises in investment outside the petroleum sector. Total budgeted expenditures of $1.6 billion make the government's 2013 budget 8.8% lower than in 2012. However, economic growth is projected to continue at about the rate observed in 2012, as the budget, if fully executed, would push actual expenditure up 38% from 2012 actual expenditures. Actual government expenditures have been consistently below budgeted levels in recent years.

High inflation is consistent with the economy's high rate of growth. Inflation is projected to remain high at 9.0% in 2013, but this is lower than in 2012, reflecting some success in the government's efforts to stem inflation. These efforts include postponing planned expenditures on the Tasi Mane project and a new national development bank in 2012. Another factor seen to moderate inflation is the dissipation of inflationary pressures from one-time events that raised prices in 2012, including election-related spending and increased congestion at Dili's international port. Inflation is projected to continue to moderate to 7.7% in 2014, despite planned increases in government spending, as more public infrastructure comes online, supply chain bottlenecks are addressed, and the entry of new businesses increases competition in wholesale and retail markets.

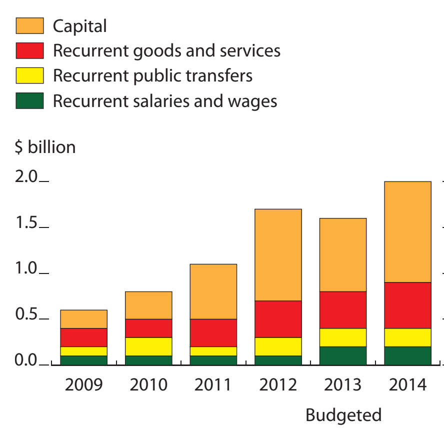
The budget for 2013 has a large increase in government spending to $1.8 billion (Figure 3.35.4), or 200% of non-oil GDP, of which $1.6 billion will come from the Petroleum Fund and other sources of domestic revenue (with the remainder sourced from development partners). Capital expenditure, funded from the multiyear Infrastructure Fund, will remain prominent in the budget, with spending projected to rise to 100% of non-oil GDP. Outlays on the national electrification program are tapering off but will still be $280 million. Expenditure on the Tasi Mane project—intended to trigger development on the south coast—is budgeted at $1.32 billion. The budget also allocates $544 million for road upgrades over the next 5 years. World oil prices are projected to fall slightly in 2013 and 2014, which could reduce Timor-Leste's petroleum revenue and its

3.35.1 Selected economic indicators (%)

	2013	2014
GDP growth	10.0	10.0
Inflation	9.0	7.7
Current account balance (share of GDP)	102.8	66.0

Source: ADB estimates.

3.35.4 Government expenditure



Note: 2009 to 2011 show actual expenditures, 2012 to 2014 show budgeted expenditures.

Source: Timor-Leste 2013 state budget.

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budget and current account surpluses. Budget surpluses are projected to fall to about 100% of non-oil GDP in 2013 and 50% in 2014. The country's current account surplus is forecasted to fall to just over 100% of non-oil GDP in 2013 and 66% in 2014.

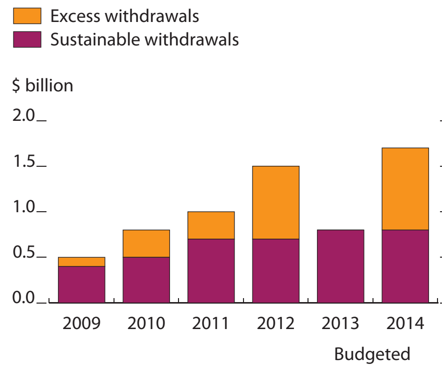
Policy challenge—spreading the benefits of energy exports

Balancing the policy objectives of achieving high economic growth and controlling inflation is an important policy challenge facing Timor-Leste's leaders. Although 2012 saw progress in bringing down inflation, high growth and persistent supply constraints mean inflation remains a concern. Inflation will likely decline in 2013 as some events that drove it in 2012 are unlikely to reoccur. If the US dollar continues to strengthen, that would lower import prices and reduce inflation. However, planned increases in government expenditure in 2014 and beyond are likely to renew price pressure. Measures to address supply constraints, such as developing public infrastructure to address bottlenecks in supply chains and encouraging new businesses to operate in Timor-Leste, offer the most promising avenues for stemming inflation in the long run.

Disagreement between the government and oil companies over tax payments raises concern about the prospects for developing the Greater Sunrise field. How this disagreement is resolved could have important implications for the country's long-term fiscal position. Projected balances in the Petroleum Fund—and the amounts that can be taken out of it to finance development without sacrificing the fund's long-term sustainability—take into account projected petroleum revenues only from areas currently being exploited (Figure 3.35.5). However, the finite nature of the country's petroleum reserves, the sensitivity of revenues to global price fluctuations, and events like the tax payment dispute highlight the need for the government to ensure that fiscal balances are kept in check and that scarce government resources are used efficiently.

The longer-term challenge facing Timor-Leste's leaders is steering the economy away from growth that depends primarily on oil revenues and public sector stimulus, and toward growth in which the private sector plays the lead role. The inaugural Business Activity Survey, covering 2010, illustrates the nascent state of the private sector. The survey confirmed the high concentration of formal sector businesses in Dili, which provide more than 80% of national employment and value added. It showed that retail and wholesale, construction, and accommodation and food service accounted for more than half of national employment and value added (Figure 3.35.6). The long-term prospects for the economy and private sector development are encouraging, as spillover from government spending should create business opportunities and successful past investments should encourage further investment. Economic diversification and private sector development would be fostered by further progress in improving the business environment. The government's One-Stop Shop initiative to simplify procedures for starting a new business, the passage of a public–private partnership framework, and progress toward developing a new law to govern land titles are promising steps.

3.35.5 Withdrawals from the Petroleum Fund

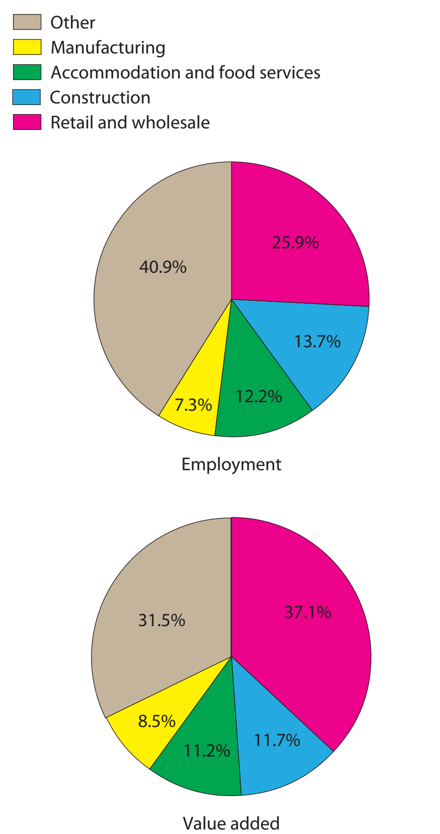


Note: Sustainable withdrawals are defined as the maximum amount that can be appropriated from the Petroleum Fund in a fiscal year and leave sufficient resources in the Petroleum Fund for an amount of equal real value to be appropriated in all later years. It is set at 3.0% of the petroleum wealth. The government can withdraw an amount from the Petroleum Fund in excess of this amount if a justification based on the long-term interest of Timor-Leste is provided to and approved by the National Parliament.

Source: Timor-Leste 2013 state budget.

Click here for figure data

3.35.6 The formal private sector in 2010



Sources: National Directorate of Statistics. 2012. *Business Activity Survey of Timor-Leste 2010.* Dili (January); Government of Timor-Leste. 2011. *2012 Budget Book No. 1.* Dili (November); National Statistics Directorate and United Nations Population Fund. 2011. Population and Housing Census 2010. *Suco Report*. Volume 4. Dili (July).

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