East Timor

Establishing the Foundations of Sound Macroeconomic Management

Luis M. Valdivieso
Toshihide Endo
Luis V. Mendonça
Shamsuddin Tareq
Alejandro López-Mejía

International Monetary Fund
2000

Preface

This paper has benefited from the comments of a large number of IMF colleagues, in particular Shigemitsu Sugisaki, Yusuke Horiguchi, Anoop Singh, and Anthony Elson. It also reflects comments received from Sérgio Vieira de Mello, Andrew Whitley, and Fernanda Borges (all of the United Nations Transitional Administration in East Timor—UNTAET).

In preparing this report, IMF staff held extensive consultations with UNTAET; leaders and technical representatives of the National Council of the East Timorese Resistance (CNRT); the authorities of the East Timorese church; representatives of the main bilateral donors and NGOs; and representatives of the East Timorese private sector and civil society at large. The paper has also benefited from close cooperation with the Indonesian authorities. The staff has also held numerous meetings with various organizations involved in humanitarian relief operations (initially the UN Office for the Coordination of Humanitarian Affairs (OCHA) and subsequently the Humanitarian module of UNTAET, UN agencies, and various NGOs). IMF staff has coordinated closely with the staff of the World Bank and the Asian Development Bank.

Most of the information used in the background section and the key elements of the strategy were developed by the first IMF mission to East Timor, which consisted of Messrs. Valdivieso (head) and Wade (both Asia and Pacific Department), Messrs. Corfmat and Prakash (both Fiscal Affairs Department), Messrs. Lee and Lonnberg (both Monetary and Exchange Affairs Department), and Mr. Morris (Regional Office for Asia & the Pacific). The strategy was further developed by two technical assistance missions from the Monetary and Exchange Affairs Department and the Fiscal Affairs Department in January–February 2000, while the assessment of implementation and monitoring of developments have been done through a combination of sequential Asia and Pacific Department missions, a full-fledged Asia and Pacific Department mission in June 2000, and two review missions by the Monetary and Exchange Affairs Department (May 2000) and the Fiscal Affairs Department (June 2000).

Acronyms and Abbreviations

AsDB	Asian Development Bank
ASEAN	Association of South East Asian Nations
BI-D	Bank Indonesia Office in Dili
BULOG	National Food Logistics Agency
CAP	Consolidated Appeal Process
CEP	Community Empowerment Project
CFA	Central Fiscal Authority
CNRT	National Council of the Timorese Resistance
CPO	Central Payments Office
DCU	Donor Coordination Unit
EC	Executive Council
EK	Elang Kakatua project
ETA	East Timor Administration
FAD	IMF Fiscal Affairs Department
FAO	Food and Agriculture Organization of the United Nations
GDP	Gross Domestic Product
HAER	Humanitarian Assistance and Emergency Rehabilitation
JAM	Joint Assessment Mission
JICA	Japan International Cooperation Agency
LPG	Liquified Petroleum Gas
MAE	IMF Monetary and Exchange Affairs Department
NCC	National Consultative Council
NGO	nongovernmental organization
Rp	Indonesian Rupiah
SEP	Small Enterprise Project
SRSG	Special Representative of the Secretary General of the United Nations for East Timor
TFET	Trust Fund for East Timor
UNAMET	United Nations Mission to East Timor
UNDP	United Nations Development Programme
UNOCHA	United Nations Office for the Coordination of Humanitarian Affairs
UNTAET	United Nations Transitional Administration in East Timor
USAID	U.S. Agency for International Development
WFP	World Food Programme

East Timor: Basic Social Indicators

Mortality Indicators	
Infant mortality rate per 1,000 live births (1996)	149
Maternal mortality rate per 1,000 live births (1990)	8
Life expectancy (1996)	52
Health Indicators	
Percentage of malnourished children (1998)[1]	38
Percentage of children under five with full immunization coverage (1996)	49
Medical doctors per 100,000 people (1996/97)	15
Education Indicators	
Illiteracy, percentage (1996/97)	50
Percentage of adult population with secondary or higher education (1998)	19
Other Indicators	
Percentage of the population below the poverty line (1998)	50
Number of buses per 100,000 people (1998)	1.5
Percentage of households with access to electricity (1996)	25
Number of phone lines per 1,000 people (1996)	8
Percentage of households with access to running water (1996)	25

Sources: World Bank, *Joint Assessment Mission (JAM) Background Report*, available via the Internet: http://wbln0018.worldbank.org/eap/eap.nsf; M. Arneberg and J. Pedersen, *Social and Economic Conditions in East Timor* (Columbia University and Fafo Institute of Applied Social Science), 1999.

[1]Children in the age group one to six.

I

Introduction and Background

This report provides an overview of the economic and institutional developments in East Timor up to September 1999 and the immediate impact of the violent events that followed the August 30, 1999, referendum to decide the future status of East Timor. It then presents the key elements of the strategy recommended by IMF staff to the United Nations Transitional Administration in East Timor (UNTAET) to rebuild the institutions needed to support economic activity and public administration, including external financing requirements, technical assistance, and training needs in the area of macroeconomic management. Finally, the report assesses the status of implementation of the strategy, and discusses the steps that should be taken to ensure that the strategy will help East Timor to prepare to face future challenges.

East Timor was under Portuguese rule for more than four hundred years through 1975, when it was annexed by Indonesia. Following an agreement among the UN, Indonesia, and Portugal on May 5, 1999, a referendum was held on August 30, 1999, on the future status of East Timor. Four-fifths of the citizens of voting age voted in favor of independence. This outcome triggered widespread violence, which resulted in damage and destruction of property, the displacement of about two-thirds of the population, and the loss of many lives.

On September 21, 1999, a multinational peace-enforcement mission (INTERFET) arrived in East Timor to restore security and facilitate humanitarian relief efforts. The United Nations Mission to East Timor (UNAMET) was entrusted with the task of overseeing the humanitarian relief effort. On September 29, 1999, the World Bank coordinated a donors' conference in Washington, with the participation of the National Council of the Timorese Resistance (CNRT) and representatives of the Indonesian government. At that conference it was decided that there would be a joint mission of all multilateral and bilateral assistance agencies to be led by the World Bank that would assess the economic and social situation in East Timor and help to coordinate more effectively the international effort to assist East Timor. Subsequently, on October 20, 1999, the People's Consultative Assembly of Indonesia revoked the decree of annexation of East Timor, and five days later, the UN Security Council issued a resolution establishing the United Nations Transitional Administration in East Timor (UNTAET) with broad responsibility for the administration of the territory of East Timor during its transition to independence.

On October 22, 1999, in response to a request from the United Nations Secretary General, the Executive Board approved a proposal for IMF staff to field a mission to East Timor, and for the IMF to provide technical services in its areas of expertise. With this mandate, during the October 26–November 21 period, an IMF mission visited Dili to prepare a macroeconomic assessment and provided advice on how to develop a macroeconomic framework for guiding key policy decisions. The mission coordinated its work closely with the World Bank-led Joint Assessment Mission (JAM). A summary of the IMF mission findings was presented to an informal IMF Executive Board meeting on November 22, 1999, and to a donors' meeting held in Tokyo on December 17, 1999. Since then, the IMF staff has had a permanent presence in Dili by means of sequential missions, and there have been four technical assistance missions on fiscal and monetary matters, involving the IMF's Fiscal Affairs Department (FAD) and Monetary and Exchange Affairs Department (MAE). In addition, the IMF has provided technical support and financial assistance (through an administered account) for recruiting qualified staff for top positions in the key economic institutions.[1]

Since mid-November 1999, UNTAET has been led by Mr. Sergio Vieira de Mello, the Special Representative of the Secretary General of the UN for East Timor (SRSG). UNTAET established the National Consultative Council (NCC) to be a forum for reaching consensus on all policy matters and it helped to address a serious power vacuum that had arisen from the destruction of the normal structures and systems of government. The NCC consists of 15 members: four from UNTAET, including the SRSG; and 11 East Timorese, comprised of seven from the pro-independence movement, one from the Catholic Church, and three from the pro-autonomy faction.[2]

[1]A summary of the role of the World Bank and the Asian Development Bank (AsDB) is presented in Appendix I.

[2]One of the seats for the pro-autonomy faction is still vacant. In the remainder of this paper, the East Timorese members of the NCC together with other key figures of the CNRT and the church are referred to as the East Timorese leadership.

II

Economic Developments and Institutional Set-up Prior to the Referendum

East Timor ranked among the poorest provinces in Indonesia, with an income per capita of around $350 in the mid-1990s. The East Timorese economy was structured along the lines of the Indonesian economy, and most East Timorese institutions and procedures were provincial versions of those at the level of the Indonesian central government.

Output, Prices, Employment, and Wages

East Timor real GDP grew at an average annual rate of 10 percent in 1994–96, mainly reflecting heavy spending on roads and construction funded by transfers from the Indonesian Central Budget. At the same time, consumer price inflation in Dili remained below 10 percent and interest rates rose moderately to 15¾ percent. Although the population grew modestly over this period, real GDP per capita still rose by over 23 percent during 1994–96, to reach $430 in 1996 (see Table A1).

In the wake of the Asian crisis, East Timor's real GDP growth slowed down to 4 percent in 1997 and declined by over 2 percent in 1998 (see Figure 1). As the construction projects and the road program were scaled back, construction sector output fell by almost 30 percent in 1998 (see Table A2). This decline was partially offset by continued growth in the financial sector, public administration, defense, public utilities, and hotel services. Agricultural sector output remained virtually unchanged. As total output declined, inflation and interest rates rose in 1998 to 80 percent and 38 percent, respectively (see Figure 2).

Labor market data for 1998 set the labor force at 367,600 people, 6 percent of whom were facing open unemployment[3] and 11 percent were facing underemployment.[4] Agriculture accounted for almost 75 percent of the labor force, whereas the share of the public administration and defense was 13 percent (these two sectors together provided for 45,000 jobs in 1998, of which 12,000 were military and police personnel). In 1999, the minimum monthly wage in East Timor was equivalent to $23,[5] well below the average of $85 paid to civil servants.[6]

Financial Sector

Mainly reflecting the adverse impact of the Asian crisis on real income, money velocity and credit disintermediation increased in East Timor between December 1997 and September 1999. Broad money and credit declined from 41 and 17 percent of GDP in December 1997, respectively, to 30 and 8 percent of GDP in September 1999 (see Table A3). Bank lending amounted to about 30 percent of bank deposit liabilities, and was mainly distributed among

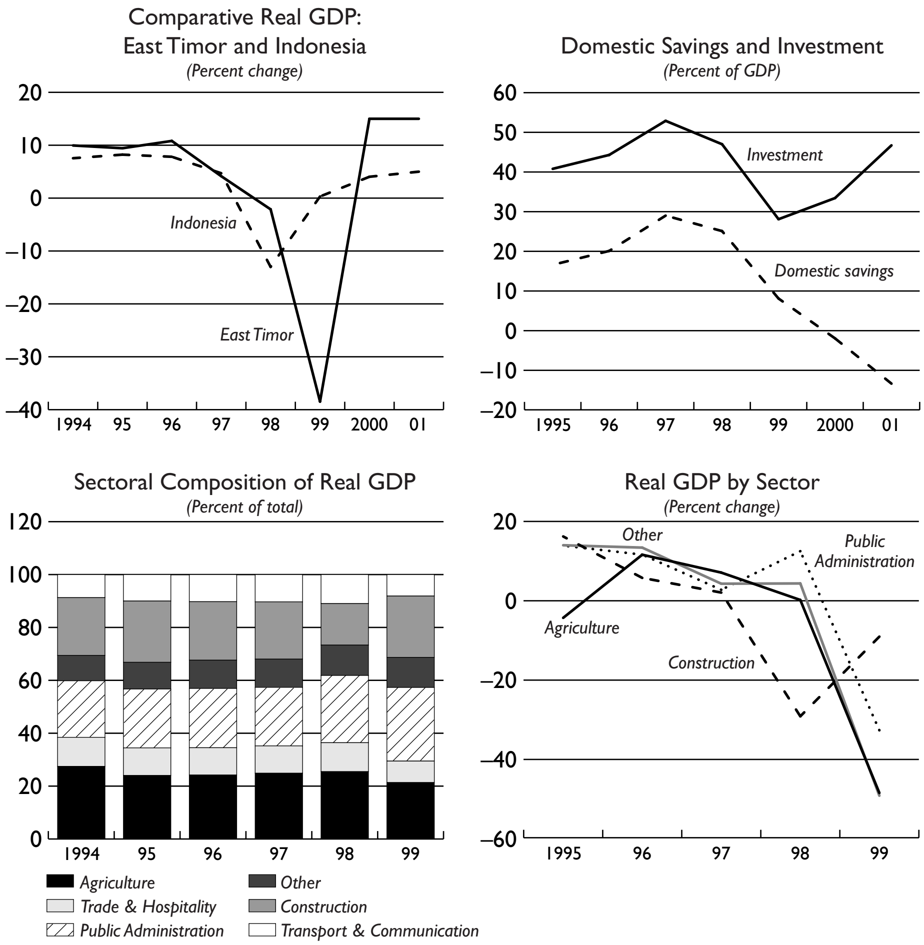
[3]Defined as persons of working age actively looking for a job. For additional details see M. Arneberg and J. Pedersen (1999).

[4]Defined as persons employed but who work less than 40 hours a week and are seeking employment.

[5]The minimum wage remained unchanged since 1997.

[6]Non-Timorese civil servants posted in East Timor were paid a regional allowance.

Figure 1
Aggregate Supply and Demand Indicators



Sources: Data provided by the East Timor and Indonesian authorities; and IMF staff estimates.

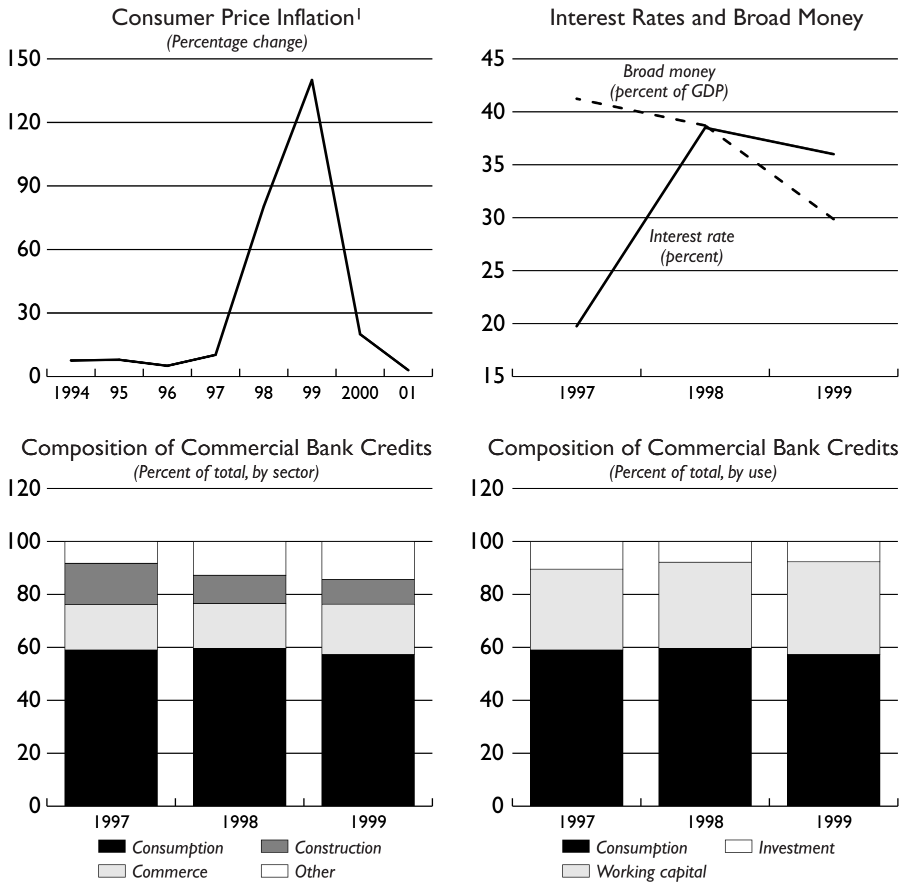
consumer loans and credits to the construction and commerce sectors (see Table A4). In May 1999, nonperforming loans were about 30 percent of outstanding bank credit.

The rupiah was the sole legal tender and virtually the only currency in circulation in East Timor. There are no official data on the outstanding stock of currency in circulation in East Timor but preliminary estimates based on net outflows from the Bank Indonesia office in Dili (BI-D) point to a possible range of Rp 450–900 billion at the end of September 1999.[7]

Since 1975, only Indonesian banks have been allowed to operate in East Timor. By mid-1999, the banking system consisted of the Dili branch of Bank Indonesia (BI-D) and eight commercial banks (a regional development bank owned by the provincial government of East Timor, four branches of Indonesian government owned banks, and three branches of privately owned Indonesian banks). Altogether there were 31 banking outlets in East Timor. Nonbank financial institutions included six insurance companies, a pawnshop, and

[7]From December 1997 to August 1999, net outflows of rupiah from the BI-D (i.e., rupiah notes and coins put in circulation in East Timor minus rupiah notes received for payments and unfit notes exchanged for new notes) are reported to have amounted to Rp 450 billion. If gross outflows of rupiah previous to December 1997 were taken into account (there is no information on gross inflows for this period), the estimated currency in circulation at end-August 1999 could be as high as Rp 900 billion.

Figure 2
Price, Monetary, and Banking Indicators



Sources: Data provided by the East Timor and Indonesian authorities; and IMF staff estimates.
[1]CPI measured in Indonesian rupiah before the year 2000 and in U.S. dollars afterwards.

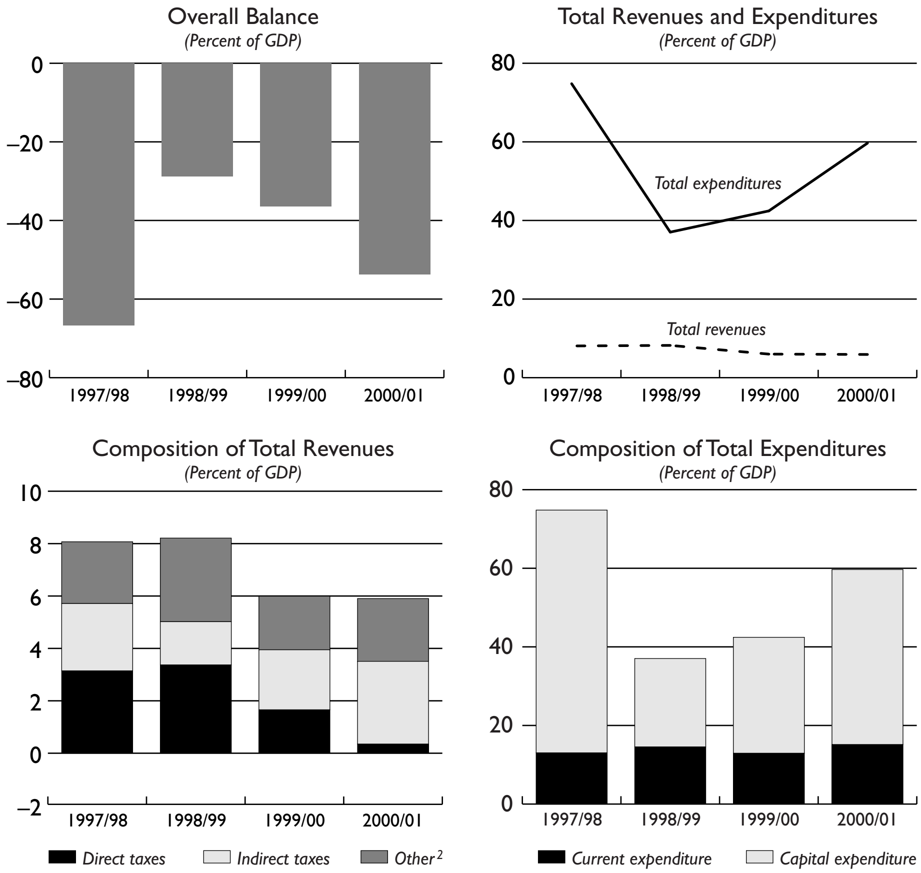
one exchange bureau. Up to September 1999, the payment system in East Timor was similar to regional payment systems in the provinces of Indonesia. The clearing was carried out daily at BI-D and worked well. During 1998, the daily average number and value of cleared items grew by 30 and 40 percent, respectively, and the number of returned items was very low.

Public Finance and Administration

East Timor's overall government deficit (excluding the net operating income of publicly owned corporations) declined sharply from 67 percent of GDP in FY1997/98 to close to 30 percent of GDP in FY1998/99 (see Table A5 and Figure 3),[8] reflecting a corresponding decline in transfers from the Indonesian central government that cut support to its provinces in the aftermath of the Asian crisis. Given a revenue collection of almost 8 percent of GDP in each of these years (which covered about 60 percent of recurrent expenditures and between 10–20 percent of total expenditures), the reduction

[8]To provide a comprehensive view of the consolidated government operations in East Timor, fiscal revenues have been defined as the sum of revenues generated domestically and kept in the territory as well as those transferred to the Indonesian central government. Similarly, expenditures assigned to the central and provincial levels are presented together. Due to data limitations, a number of assumptions were made, and the numbers should be treated as indicative. The Indonesian fiscal year ran from April 1 to March 31.

Figure 3
Fiscal Indicators[1]



Sources: Data provided by the East Timor and Indonesian authorities; and IMF staff estimates.
[1]Figures for 1999/00 are from the budget prepared under Indonesian rule.
[2]For 1997/98–1999/00, data include revenue from land and property taxes, regional revenue, and nontax revenue. Data for 2000/01 include fees for public utilities and Timor Gap revenue.

in transfers translated into a severe compression in capital expenditure.

Almost 90 percent of East Timor's revenues accrued to the Indonesian central government, with direct taxes, namely the income tax and the revenue sharing from land property taxes, accounting for almost two-thirds of total federal revenues, and the rest from value added/sales tax (see Table A6). Revenues accruing to East Timor directly consisted mainly of taxation on vehicles. Recorded collections from customs duties and taxes on external trade were marginal[9] because almost all foreign commodities were imported to the port of Dili (the main port of East Timor) through trans-shipment and were taxed in other regions of Indonesia. In the same way, goods produced in East Timor including sandalwood, garments, and handicrafts were shipped to other ports (Jakarta and Surabaya) before they were exported and taxed.[10] The revenue estimates do not include collections from the exploitation of the oil and gas fields of the Timor Sea, which has been accruing revenue for Indonesia at an annual rate of about $3½–4 million (see Box 1).

[9]In 1997–98, import duties collected in East Timor amounted to only $62,560; $200,000 was collected from value-added tax on imports.

[10]Until 1998, coffee beans produced in East Timor were subject to local (district and provincial) taxes at specific rates. The tax was collected before shipment. Other goods also subject to local export taxes included coconut and palm oil.

Box 1. The Timor Gap Treaty[1]

A Timor Gap Zone of Cooperation Treaty was signed in 1989 by Indonesia and Australia covering issues with regard to petroleum-related activities and economic interests. The treaty set the basis for the creation of two entities—the Ministerial Council, as the highest organ with seats for the two countries' resources ministries, and the East Timor Gap Joint Authority, which is the executive organ taking care of the daily operations in the Zone of Cooperation. Each country had a set of representatives in the Joint Authority. In early February 2000, UNTAET assumed all rights and obligations under the Timor Gap Treaty previously exercised by Indonesia.

Rather than reaching agreement on a single seabed boundary, the treaty established Zones of Cooperation to share the resources. The treaty covers about 65,000 square kilometers and has three areas (Areas A, B, and C). The revenue split with Australia in Zone A is 50/50, whereas in Zone B it is 90/10 in favor of Australia, and in Zone C it is 10/90 in favor of East Timor.

Since 1991, 42 wells have been drilled in Zone A. This Zone has reserves estimated in the range of 300–400 million barrels of condensate and Liquefied Petroleum Gas (LPG), proven natural gas reserves of about 4 trillion cubic feet, and the prospect of another 4 trillion cubic feet in areas to be explored.

Currently, Phillips Petroleum operates the Elang Kakatua (EK) project in Zone A. At the start of 1999, the field was producing 30,000–40,000 barrels of oil per day, but it declined to 18,000 barrels per day by the end of the year and is expected to decline further in 2000. Up to mid-1999, the EK project accrued revenue to Indonesia at an average annual rate of about $3½–4 million. If this revenue had been paid to the East Timorese budget, it would have raised annual revenue by about 1½–2 percent of GDP.

The field with the greatest economic potential in Zone A is the Bayu-Undan gas and gas-condensate field. The preliminary engineering study for an upstream (liquids recovery/lean gas recycle) project was completed in late 1998, but the first phase of development of this field has been approved only recently. The first phase includes drilling, production, and construction of a processing platform. The total investment is estimated at about $1½ billion to be financed by a consortium of international firms. Full output is expected in 2004.

[1]For additional details see M. Arneberg and J. Pedersen (1999).

Total expenditures in FY1997/98 amounted to about 75 percent of GDP, mainly capital expenditures earmarked for construction projects. With the downturn in the Indonesian economy, capital expenditures were scaled down considerably in FY1998/99.[11] In relation to recurrent expenditures, salaries and wages constituted about 75 percent of total expenditures, reflecting the fact that the provincial administration in East Timor was heavily overstaffed.

The budget for East Timor for FY1999/00 anticipated a deficit slightly above the outcome of the preceding year. This reflected only a moderate increase in capital spending and a projected decline in income tax and land revenue-sharing collection due to a continued deterioration in economic activity and increasing social unrest in East Timor. There are no comprehensive data for the execution of the budget for FY1999/00.

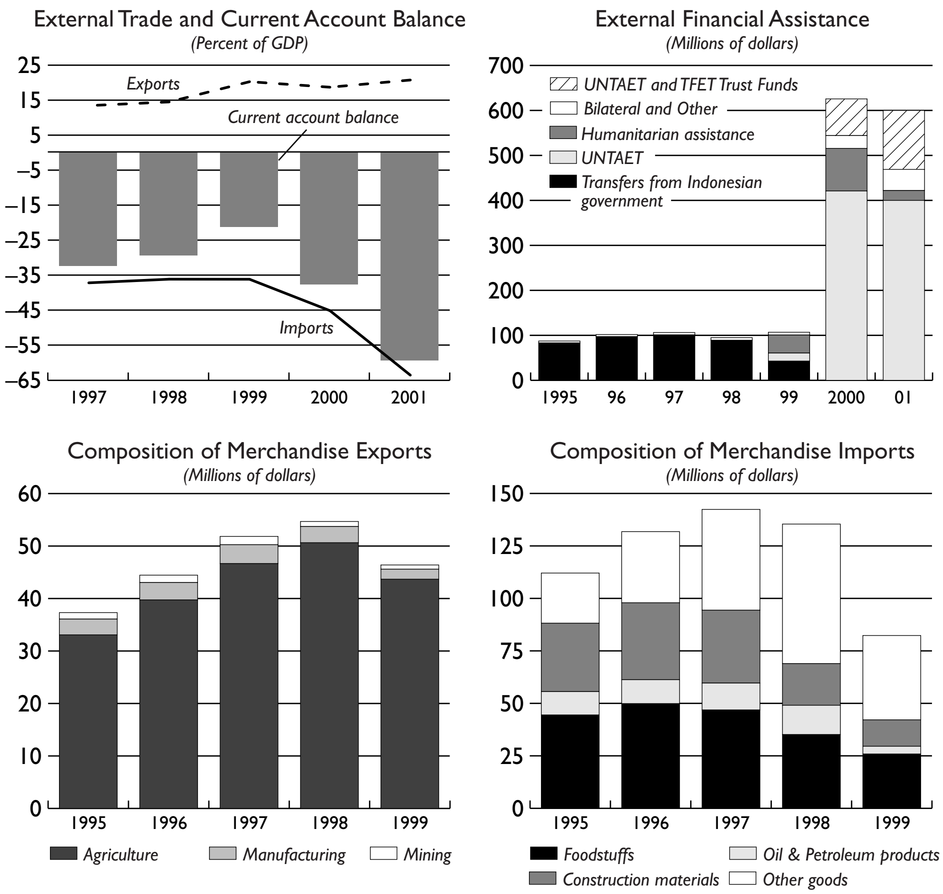
The fiscal management system of Indonesia was highly centralized and, as a result, provincial management capacity was limited. Budget preparation at the provincial and district levels was not guided by macroeconomic parameters. Budgeting for recurrent expenditures was essentially incremental in nature, with a percentage increase (not necessarily related to inflation) allowed each year. The main component of the recurrent budget was for salary and allowances. The development budget was determined by the central planning agency according to the national priorities, and the provincial agencies had a limited role to play. Treasury operations (i.e., payments and revenue collections) were made through the commercial banking system. There was an absence of comprehensive cash management and, as a result, there was a sizable float in the commercial bank accounts of the government.

External Sector

During the period 1995–98, East Timor's external current account deficit, excluding transfers, averaged 32 percent of GDP (see Table A7 and Fig-

[11]Data on capital expenditure must be interpreted with caution, as there are indications that they might have included expenditures that are recurrent in nature, such as, for example, maintenance and in some cases even wages.

Figure 4
External Sector Indicators



Sources: Data provided by the East Timor and Indonesian authorities; and IMF staff estimates.

ure 4).[12] The external account deficit reflected to a large extent the savings-investment gap of the public sector, which was mostly financed by official transfers from the Indonesian central government (net of certain tax revenue collected locally in East Timor and transferred to Jakarta).

Based on limited data for the period 1995–98, merchandise exports are estimated to have averaged 13 percent of GDP, and merchandise imports around 36 percent of GDP. The vast majority of this trade was with, or through, other provinces of Indonesia ("inter-island trade").[13] Overall export growth was driven by a healthy expansion in exports of agricultural products whereas nonagricultural exports stagnated (see Table A8). Agriculture, in particular coffee, accounted for a large part of exports. Imports included foodstuffs, petroleum products, and products used in the construction industry, especially cement, concrete reinforcing bars, and asphalt. The value of imports is likely to be underestimated as the prices of most of the key imports were subsidized, particularly those for rice and petroleum products.

[12]For the purposes of constructing the historical balance of payments, East Timor has been treated as a separate entity from Indonesia. All flows of goods, services, official transfers (including from the Indonesian central government), financial transactions, and external assistance have been treated as external flows analogous to the balance of payments for a country. Due to data limitations, several assumptions needed to be made. Therefore, figures should be treated with caution.

[13]For example, most of the coffee was shipped to Surabaya before being exported to Singapore and beyond. Because Dili was not registered as an international destination, relatively few goods entered East Timor directly from third countries or departed directly to third countries.

III

Immediate Impact of the Post-Referendum Violence

The economy and the institutional structure of East Timor were seriously disrupted by the outbreak of violence and destruction that followed the August 30, 1999, referendum. The destruction cut across all sectors of the economy and throughout the territory.

Output, Prices, Employment, and Wages

Real GDP is estimated to have declined by almost 40 percent in 1999. The supply shock was dramatic, reflecting the combined effect of the disruption of the agricultural cycle, the destruction of local inventories of basic manufactured goods, the closure of the border with West Timor, and limited civilian access to port facilities to permit commercial imports from abroad. Harvesting and replanting of crops were severely hampered as farmers sought refuge in the hills or in West Timor. About 70 percent of the government's administrative buildings and many private buildings were partially or completely burnt and/or looted. While many farmers started to return to their farms in October and November, planting of crops for 2000 began late. The stock of seeds declined sharply due to destruction, but some assistance was quickly put in place. Severe damage was also inflicted on the infrastructure. Some facilities, however, such as the seaport and the airport, were in a state that they could be made partially functional quickly, while others, such as the fuel depot, were virtually unaffected. Most of the electricity network was affected, but some generators and selected sources of water supply were restored quickly by UNAMET with the support of timely bilateral assistance.

Initial acute shortages of goods led to a hike in prices. An ad hoc price survey of the Dili market recorded an increase in the prices of a selected basket of goods of about 200 percent between August and October 1999.[14] Fuel prices also increased sharply as Pertamina (the Indonesian oil company) started selling petroleum and petroleum derivatives in East Timor at international prices in September 1999.

Perhaps the greatest loss concerns human capital. Educated local leaders were particularly targeted during the violence and the majority of key civil servants and commercial bank officials (mostly Indonesian nationals) returned to Indonesia. The widespread displacement of the population created acute labor shortages. As the public administration stopped functioning, the UN and nongovernmental organizations (NGOs) became almost the only source of employment, paying wages well above the levels existing prior to the referendum. Depending on the skill category, the monthly wage paid by the UN to locally hired staff varied between a range of $111 and $335, whereas NGOs paid an average monthly wage for unskilled workers of approximately $92.

Financial Sector

In the aftermath of the disturbances, the banking and payments system in East Timor ceased function-

[14] See World Bank, *Joint Assessment Mission Background Report*, available via the Internet.

ing. Except for the building of the BI-D, which was virtually intact, all bank buildings and equipment were destroyed and their vaults severely damaged. Prior to the outbreak of violence, however, the BI-D and the commercial banks relocated key staff and records to Kupang, West Timor, from where some banking operations, mostly withdrawal of bank deposits, reportedly have continued to take place.[15] A full deposit guarantee extended by the Indonesian government (in the wake of the Indonesian banking crisis) still applies to the commercial banks previously resident in East Timor, but so far there have not been any payouts related to the deposits held by these banks.

With the breakdown of the banking and payments system, all transactions in East Timor shifted to a cash basis of payment, mostly in rupiah, although some foreign currencies—mainly the U.S. and Australian dollars and some currencies of the Association of South East Asian Nations (ASEAN)—started circulating. A firm estimation of the quantity of rupiah taken out of East Timor by former residents is difficult to gauge, but it is believed to have been quite substantial (possibly as much as 50 percent of the estimated amount of currency in circulation prior to the events of September 1999). It is also difficult to estimate the size of the net inflows of rupiah. It is likely that the outflow of rupiah may have continued through limited cross-border trade with West Timor and third countries.[16] The use of multiple currencies in an uncertain situation and with the absence of adequate information channels started to create distortions in relative prices in East Timor. This situation stemmed mainly from distortions in the setting of cross-exchange rates between the currencies in use in East Timor.

[15]No precise information is available on the amount of deposit withdrawals from Indonesian banks since September 1999.

[16]New injections of rupiah have also taken place. For a while, UNAMET/UNTAET expenses for payments to local employees and for purchases of some goods and services were made in rupiah. It is also very likely that part of the cash withdrawal of bank deposits from former East Timor banks operating in West Timor or elsewhere in Indonesia may have found their way into East Timor.

Public Finance and Administration

Government structures and systems stopped functioning. Tax and customs administrations were dismantled. Collection of revenue from all sources came to a halt when the senior level staff departed. Commercial goods imported into East Timor were not subject to a trade tax regime or any control or record. Office equipment and most of the records vital to administration were removed or destroyed. Budgetary transfers from Jakarta ceased in early September 1999, although it has been reported that public servants who relocated to Kupang continued to receive their salaries until March 31, 2000. Other government spending and the provision of public services stopped. The Indonesian National Food Logistics Agency (BULOG) ceased distributing subsidized rice and other foodstuffs. A few rudimentary public services were restored, but no systems existed for paying public servants who remained in East Timor or for retirees. Some UN agencies and NGOs distributed rice and other food staples as soon as it was possible.

External Sector

The disruption in production and transportation caused exports and imports to decline markedly. The trade deficit is estimated to have contracted sharply (from $81 million in 1998 to $36 million in 1999) as imports declined dramatically (Tables A7 and A8). Trade financing by commercial banks dried up and major trading outlets were disrupted. Exports declined, largely because the main export crop, coffee—which had remained fairly well preserved in spite of the general destruction—could not be immediately shipped due to logistical and transportation problems. In the last few months of 1999, foreign aid related imports surged with the establishment of a permanent UN presence in East Timor and the start of major humanitarian aid operations.

IV

Strategy to Establish a Sound Macroeconomic Framework

The need to promote stability and to create an enabling environment for recovery required establishing from the outset sound foundations for macroeconomic management. An early adoption of a framework was viewed as instrumental in helping to provide reasonable assurances to all the parties involved, including donors, that the resources to be made available to East Timor would be effectively used and properly accounted for. The task ahead was particularly difficult because the economic system that had emerged from many years of Indonesian administration had failed to develop an indigenous managerial capacity; promoted a culture of dependence on the government as key provider of employment, direct transfers, and subsidies; and built up an infrastructure that was very costly to maintain. In such an environment, and following consultation with the World Bank, IMF staff focused its technical assistance on helping UNTAET develop a macroeconomic framework to guide economic decision making and establish key financial institutions.

Monetary and Financial Aspects

The most critical initial steps toward reviving the payments system were the choice of the currency that would serve as legal tender and the establishment of a monetary authority. The East Timor leadership indicated their interest in introducing their own currency at the time of independence. While receptive to their views, IMF staff recommended that the introduction of a new currency be considered at a later stage, once a sound and credible financial policy and a well developed institutional and legal framework were fully in place to support the value of the new currency. The most important components of credible financial policy include fiscal sustainability and banking system soundness, as they are essential to help maintain the value of the currency as a medium of exchange and a store of value. In addition, the needed financial resources and administrative and institutional capacity must be available to act on the policy and technical measures required to introduce a new currency. These conditions were deemed not to be present in East Timor for at least the duration of the transitional administration.

IMF staff recommended the adoption of a single currency as it would help eliminate the inefficiencies and distortions already apparent by the use of multiple currencies. Given the uncertainties surrounding the estimate of the amount of rupiah in circulation, however, the substitution of the rupiah for the new legal tender was to be gradual. From all the currencies that were under consideration, the U.S. dollar was the currency that best satisfied for East Timor the desirable characteristics of a legal tender, such as stable value, wide international use, and convertibility. The adoption of the U.S. dollar was also advisable because most of the international trade of East Timor is denominated in U.S. dollars. Several practical considerations were also taken into account, including the relatively low cost of transactions of the U.S. dollar in Asian markets compared to those of other major currencies, and the absence of a requirement to have an arrangement with the United States Federal Reserve System to adopt the U.S. dollar as a legal tender. At the request of UNTAET, IMF staff conducted consultations with the monetary and fiscal authorities of the governments whose currencies were being considered, including with representatives of the European Central Bank. IMF staff also accompanied the Special Representative of the Secretary General (SRSG) of the United Nations for East Timor and other UNTAET officials on a visit to the Central Bank of Indonesia in December 1999 where a working group was proposed for designing, among other issues, an arrangement to facilitate the withdrawal of the rupiah. Subsequent discussions with Indonesia on this issue have been framed within a much broader agenda to normalize relations between Indonesia and East Timor (see Box 2).

The establishment of a monetary authority also featured prominently in the recommendation made by IMF staff. Since East Timor was a purely cash-based economy, however, IMF staff envisaged that during the initial stages the main responsibilities of the monetary authority would be limited to managing, handling, storing, and maintaining an adequate inventory of banknotes and coins of the legal tender chosen for East Timor. Accordingly, the staff recommended the creation of a Central Payment Office (CPO) with the capacity for safekeeping of funds, handling taxes, customs duties, public utility charges and fees, and other UNTAET receipts, as well as undertaking cash payments in accordance with instructions from the UNTAET fiscal administration. Furthermore, it was envisaged that the CPO would not exchange one currency for another; initially, this function would be handled by licensed dealers in foreign exchange and later also by banks, as they resume operations.

Box 2. Steps to Normalize Relations Between East Timor and Indonesia

UNTAET and the East Timorese leadership assign a very high priority to the normalization of relations with Indonesia because such normalization is critical for the success of the reconstruction and development efforts. The Indonesian authorities share this view and, as a result, since October 1999, both UNTAET and Indonesia have taken a number of steps toward enhancing cooperation, including several official visits at the highest levels of representation in both directions.

In late February 2000, after the visit of President Wahid to East Timor, a joint decision[1] was made to initiate structured discussions covering a broad range of issues, including: (i) the repatriation and resettlement of East Timorese refugees currently in West Timor; (ii) the scope for mutual assistance in legal, judicial, and human rights matters; (iii) the delineation of land and maritime borders and regulation of cross-border relations, including a transit corridor between Oecussi, East Timor's enclave in West Timor, and the main territory of East Timor; (iv) the orderly settlement of mutual claims and liabilities, including extending access to East Timorese to their deposits in Indonesian banks; (v) the regularization of the payment of State pensions to retired East Timorese employees of the Indonesian Government as well as the determination of the status of the cumulative contributions of the East Timorese public servants to the Indonesian State Pension System up to August 1999; (vi) the maintenance of educational opportunities and scholarships for East Timorese students in Indonesian educational institutions; (vii) the definition of the trade regime which will affect bilateral commercial relations and the reestablishment of trade relations; (viii) the establishment of agreements to develop aviation, commercial transport, and communications links between Indonesia and East Timor; and (ix) the rebuilding of East Timor's archives and records, such as property titles, taxpayers registry, judicial and police records, census, civil records, etc. Cooperation on military issues, including steps to improve security conditions at the border and refugee camps in West Timor, are being guided by a separate memorandum of understanding between Indonesia and UNTAET.

Following three rounds of discussions, there has been important progress in some areas, although no comprehensive outcome has yet been reached. Discussions have been underpinned by assessments conducted by specialized working groups. For example, an Indonesian Asset Team recently visited East Timor to survey the facilities and equipment which they believe belong to Indonesian companies. Another UNTAET team worked early in the year on assessing the possible East Timorese claims on the Indonesian State Pension System; final discussions are expected soon. There are also joint commissions actively working on cross-border issues, including those aspects which have a direct effect on the issue of refugee repatriation. Discussions are expected to focus increasingly on the settlement of claims and liabilities.

[1]For further reference see the *Joint Communiqué Between the Republic of Indonesia and UNTAET*, dated February 29, 2000, and various press releases available at the United Nations website.

In the medium term, the strategy for the payment system for East Timor would rely on commercial banks. These banks—to be licensed under a new banking law—would provide in addition to other normal banking services, domestic payment services, to be cleared through a local clearing house and settled on the books of the CPO. Accordingly, once banks start operations, the proposed strategy would reduce the role of the CPO in cash and noncash payment services, and a division of the treasury and commercial banking operations would take place. To ensure sound and safe practices in the banking sector, IMF staff recommended that the CPO should also be responsible for bank licensing and supervision. It was proposed that the regulatory framework for the banking system be designed consistent with Basle Core Principles and internationally accepted banking practices.

Public Finance and Public Administration Aspects

To eliminate the vacuum created by the withdrawal of the Indonesian institutions in charge of fiscal management, IMF staff recommended a fiscal strategy that included the establishment of a Central Fiscal Authority (CFA), and the adoption of an interim consolidated budget underpinned by a simple tax system and an expenditure plan that would guarantee the provision of basic public services. The CFA, once operational, would be in charge of designing an overall fiscal strategy, formulating tax policy and administering the collection of revenues, and coordinating the execution of the expenditure program.[17] IMF staff recommended that the CFA should consist of four departments: the budget department, which would plan the budget, develop economic forecasts, and bring together the options for tax and nontax revenues and public spending; the treasury department, which would execute the budget and be responsible for issuing financial authority to spending agencies, within the limits authorized in the overall plan; the tax administration department, which would be responsible for raising revenue through taxes; and a customs department, which would be responsible for raising revenues through customs duties.

The second element of the fiscal strategy was the adoption of a preliminary budget that would be underpinned by a fair, transparent, efficient, and easy to administer tax system. The preliminary budget for 2000[18] was presented to donors in Tokyo (see Box 3) and was consistent with the aim of providing sufficient revenue to finance half of the recurrent expenditures in the initial year and most of the recurrent budget at the end of a three-year period. The recommended tax structure had the following characteristics: a 5 percent import duty, various excise taxes, and a 5 percent sales tax to be collected at the border; a 5 percent service tax on hotel receipts, restaurant receipts, private accommodation rental, government rental, and vehicle rentals; a 5 percent presumptive income tax on coffee sales—considered to be a reasonable proxy for corporate income tax—that could be credited against the corporate income tax liability, once a comprehensive business tax system was in place; a 10 percent wage withholding tax to be introduced from July 1, 2000; and an interim structure of fees, such as an airport departure fee and car registration fee, and user charges based on cost recovery principles, such as airport and port user charges and charges on public utilities.

Defining the minimum level of public sector employment and establishing the wage structure applicable to public servants was key to achieving a sustainable budget. IMF staff proposed to use the employment requirement estimates prepared by the Joint Assessment Mission, which envisaged hiring 3,886 people by the end of the first six months, rising to 7,735 by the end of the year 2000. On wages, IMF staff recommended that initially the wage structure should remain the same as in the recent past (i.e., an annual average wage equivalent to $1,000 a year).

IMF staff also stressed the importance of delineating clearly the spending responsibilities between the humanitarian institutions and agencies funded through the Consolidated Appeal Process (CAP) and the East Timor budget, as well as defining the level of aggregate spending (i.e., including budgetary as well as humanitarian and peace-keeping expenditures) that would be consistent with the absorptive capacity of the economy. In this regard, initial estimates projected that aggregate spending in the first half of 2000

[17]Since the CFA would take at least six months to become operational, IMF staff proposed an interim regime that would allow UNTAET to engage in reasonably transparent and accountable procedures. The regime was based on the continuation of UN procedures that involved a process to plan, prioritize, and monitor spending against the preliminary budget for the first half of 2000.

[18]The fiscal year for the preliminary budget was defined as the same as calendar year 2000.

Box 3. Preliminary Budget for the Year 2000

In December 1999, UNTAET presented to the Donors' Conference in Tokyo a preliminary budget for the year 2000, which supported the recurrent and capital expenditures of the East Timor Administration (ETA) during the transitional period. This interim budget satisfied the early requirement of minimum needs based budget and gave the opportunity for early coordination among the ETA, the UN, and the humanitarian agencies coordinated by the office of Humanitarian Assistance and Emergency Rehabilitation (HAER), helping to avoid budget overlaps.

Budgeted spending amounted to $107 million (comprising $30 million in recurrent, and $77 million in reconstruction and development expenditure in the year 2000). Taking into account projected domestic revenues of $15 million, the total external financing requirements for the East Timorese budget for 2000 amounted to $92 million. The level of spending proposed for the East Timorese budget took into account humanitarian assistance provided through the Consolidated Appeal Process (CAP), which was estimated at $40 million in the last quarter of 1999 and projected at an additional $86 million in 2000.

The assumptions underlying the budget included the early introduction of simple-to-administer tax and fee regimes that could yield total revenues of about $10 million for the year as a whole. In addition, receipts from the rental of public buildings and houses and the sale of public services were expected to yield at least $5 million.

The basic parameters behind the expenditure projections were: an average total compensation of $1000 per annum per staff (similar to the average compensation paid during the Indonesian administration of Rp 606,000 per year); goods and services generally budgeted at 20 percent of the wage cost, although additional provisions were made for special needs, such as medical supplies; and capacity to administer and execute a capital investment program of the proposed magnitude and sustainability of capital expenditures over the medium term.

The reconstruction and development spending estimates were based on the projections made by the World Bank-led Joint Assessment Mission (JAM) teams. These spending projections were adjusted, in percentage terms, to match the size and capacity of the civil service likely to be in place in line with the estimates prepared by the JAM.

There were certain constraints in the preparation of the budget, including: lack of information; lack of adequate data on the actual current operational cost of major public services; and overlaps between the functions of HAER (including the NGOs) and the services to be financed by the East Timorese budget.

	1999	2000			Total
	QIV	1st half	2nd half	Year	QIV 1999-2000
		(In millions of U.S. dollars)			
Domestic revenue mobilization	. . .	4	11	15	15
Expenditures	. . .	39	69	107	107
Recurrent	. . .	10	20	30	30
Reconstruction & Development	. . .	29	49	77	77
Financing Requirement	. . .	34	58	92	92
Memorandum					
CAP budget	40	. . .	. . .	86	126
CAP Financing Requirement	40	. . .	. . .	86	126

Source: UNTAET, *East Timor—A Preliminary Consolidated Budget for 2000* (East Timor, December 15, 1999).

would be in excess of $188 million. This level was well above 50 percent of projected yearly GDP, which was the maximum spending level that IMF staff considered should be executed to avoid imposing too much stress on a seriously disrupted economic system in the early stages of recovery. Preliminary budget spending was kept at $107 million for the year 2000 as a whole; humanitarian expenditures were expected to be close to $86 million. Taking into account that a significant portion of these expenditures was to come in the form of imports, IMF staff viewed the proposed aggregate level of spending as appropriate.

Decision-Making Structure

In addition to the CPO and CFA, IMF staff recommended that a seven-member Executive Council

(EC) be created to facilitate the overall economic decision-making process. It was foreseen that the EC could eventually evolve into a cabinet of ministers. The EC would be headed by the Special Representative of the Secretary General (SRSG) of the United Nations for East Timor, and could include as members: the Chairman of the Central Fiscal Authority; the Chairman of the Central Payments Office; and the officials in charge of Social Services (Community Development, Health, and Education), Agriculture, Infrastructure, and the judicial system and law enforcement.

Technical Assistance Program

The implementation of the financial and fiscal strategy described above required a comprehensive technical assistance program. In the field of competence of the IMF, immediate technical assistance was needed to design and implement a general macroeconomic policy framework; establish a CFA, set up the tax system, organize the customs and tax administration, prepare and execute the budget, and draft tax, customs, and budget and financial management regulations; select the criteria for the choice of a currency to be used as legal tender, including clarifying the logistical arrangements with the authorities of the selected currency, as well as with the Indonesian authorities on the rupiah; introduce an interim payment system, including drafting legislation and regulations underpinning the operation of the CPO; and draft new banking legislation and formulate regulations under which banks would operate, including their licensing, prudential regulatory framework, and supervision.

Similarly, the specialized areas identified in need of medium-term technical assistance included policy advice on achieving the conditions, designing the preparatory steps, formulating the legal framework, defining the technical details, and preparing training programs in currency management for an eventual introduction of an East Timorese currency; development of a more permanent and modern payment system; drafting legislation for the establishment of a monetary authority in East Timor; adoption of modern budgeting, treasury, and spending control techniques; and further development of the tax system and administration and enforcement procedures. The precise design of the various technical assistance programs and the timetable for implementation were left to be undertaken by specialized IMF missions.

Confronted with the massive loss of human capital, it was clear that the staffing and training needs for the CPO and the CFA were also going to be substantial. As a result, an effort would be made to identify experts that would be willing to assist UNTAET temporarily in running these institutions and to undertake the task of identifying, hiring, and providing on the job training to East Timorese who could eventually take over the administration of such entities. It was expected that the World Bank, the Asian Development Bank, the United Nations Development Programme (UNDP), and the IMF would combine their efforts in supporting the staffing and training of these two critical institutions.

V

Developments Since September 1999

The overall economic environment in East Timor has improved visibly since September 1999. This has been facilitated by a number of factors, including noticeable advances in restoring security conditions—except for sporadic, albeit grave, incidents at the border, East Timor could be seen now in a state of peace; the emergence of a basic public administration; various determined steps taken by UNTAET and the East Timorese leadership to promote reconciliation with members of the pro-integration movement; a number of initial steps taken to establish a credible judiciary system; and the efforts taken to facilitate the return of over 160,000 refugees. Despite this progress, much remains to be achieved in each of these areas, particularly as regards the return of over 100,000 refugees, who are still living under very precarious conditions in West Timor.

Output, Prices, Employment, and Wages

During the first half of 2000, overall economic activity started to pick up, led by commerce, basic services, and reconstruction of public and residential buildings. By early June, approximately 35 restaurants, eight hotels, and four car rental firms were operating in Dili. The postal service has begun operating again in Dili and Baucau, and one telecommunications company and several foreign and domestic construction enterprises and shipping companies have expanded their presence in East Timor. The manufacturing sector is taking longer to respond, although a water bottling company is already operating. Furthermore, around 2,300 firms were registered in the first half of 2000, of which approximately 5 percent were foreign firms.

There is evidence that some consumer prices, which rose sharply in the aftermath of the September 1999 events, have returned to the levels that prevailed in mid-1999. In particular, the price of rice, which more than doubled from August to November 1999, has since returned to the pre-crisis level of around Rp 4,500 per kilogram (a decline in prices if measured in U.S. dollar terms). Other prices have also risen sharply, reflecting the removal of subsidies—most prominently petroleum, which has resulted in higher transportation costs. Aside from these discrete price increases, some upward pressures in prices have built up, particularly in Dili. These pressures reflect the impact of growing spending by expatriates and wage increases in certain segments of the labor market, driven by the surge of activities in the services and construction sectors, as well as UN salaries paid to local employees. Furthermore, large regional differentials in prices have also emerged as a result of general market disfunctionality, partly due to the deterioration of the road network and also to lack of market information (particularly about price levels) throughout the country.[19]

[19]UNDP has supported a first effort at measuring consumer prices in Dili, in the context of preparing a study on the cost of living. Estimates for the consumer price index for April and May 2000 have been prepared, using the weights of the consumer price index of Jakarta and rupiah-denominated consumer prices. According to this study, consumer prices rose by 8.4 percent in

The general disruption of economic activity aggravated an already serious unemployment situation. Although there are no official labor statistics, the UN estimates that the rate of unemployment could be as high as 80 percent. High unemployment is particularly visible in urban areas reflecting a substantial migration from the countryside. Agriculture continued to provide most of the employment during the first six months of 2000, although employment is rapidly growing in other sectors, albeit from a very low base. About 11,000 jobs have been created by the ETA, UN agencies, and NGOs (mostly in the education and health sectors). In addition, about 30,000 temporary employment positions have been created through various employment generation programs sponsored by the U.S. Agency for International Development (USAID), Office of Transitional Initiatives, UNTAET, Japan International Cooperation Agency (JICA), and the Community Empowerment project funded by the Trust Fund for East Timor (TFET). Although there is no information on the employment provided by the emerging private sector and other humanitarian institutions and NGOs, indications are that they have created a large number of mostly temporary positions.

Banking and Payment Systems

Following the adoption of the U.S. dollar as the legal tender on January 24, 2000, all domestic budget outlays have been made in dollars. However, the use of the legal tender has not been as widespread as expected, because budgetary spending—the official window for injecting dollars in the economy—has been much lower than anticipated, and tax payments have been made exclusively in dollars, even though such payments are also permissible in rupiah. The use of the dollar also has been affected by the scarcity of low denomination U.S. notes and the absence of coins, reflecting logistical problems in providing secure storage of cash, as well as the continued lack of familiarity of the population with the new legal tender, despite UNTAET's information campaign.

May 2000, or around 2½ percent if adjusted for the depreciation of the rupiah against the U.S. dollar in that month. This finding, however, must be taken with great caution as both the basket of consumption and the coverage of prices is not representative of current conditions in East Timor.

The absence of normal banking operations has imposed a burden on the economy, but its restoration is expected to be only gradual. Two foreign financial institutions currently operate in Dili, mainly providing foreign exchange services, but only one has started to intermediate loans to the private sector under the Small Enterprise Project funded by the Trust Fund for East Timor (TFET). Some large foreign banks have expressed interest in opening branches and there is also some local interest to initiate microfinance institutions. There also has been some progress in restoring payments, particularly payments of budgetary wages and stipends, and to settle official purchases of domestic goods and services. Developments in the Dili foreign exchange market have been characterized by a sizable, albeit stable, spread between the buy/sell rate of the rupiah vis-à-vis the U.S. dollar, and a volatile margin between the mid-point exchange rate in Dili and that in Jakarta (see Figure 5). This partly reflects the lack of competition in the market. However, a growing number of people have begun conducting foreign exchange operations on the street, even though they are not registered to operate formally under the existing regulation. Casual evidence suggests that soon after the appearance of the street vendors, the spread between the buy/sell rates on the street has declined and the mid-point exchange rate on the street has converged somewhat toward the mid-point exchange rate in Jakarta.

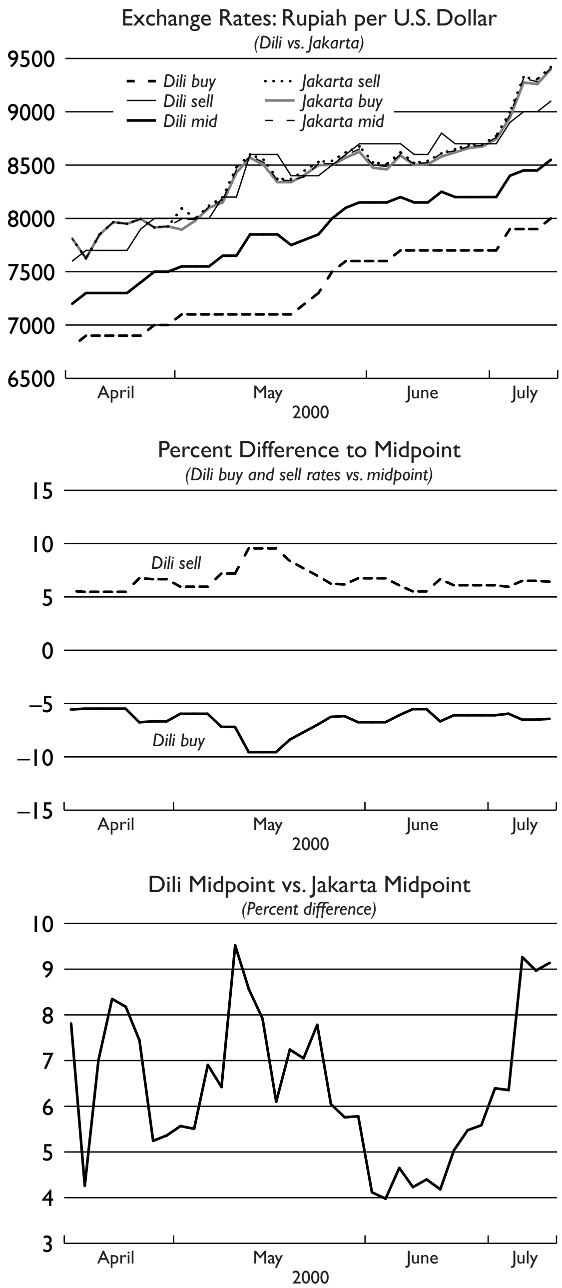
Public Finance

The execution of the East Timorese Administration (ETA) preliminary consolidated budget[20] for 2000 proceeded slowly in the first six months of 2000, reflecting the complex administrative procedures for the use of UN Trust Fund resources, lack of mechanisms to ensure adherence to the expenditure allocations envisaged in the budget, and long, drawn out planning stages of investment projects. The overall cash budget deficit in the first half of 2000 is projected to have reached $14⅓ million, compared to $34⅓ million in the preliminary budget (see Table A9).

Total revenues, excluding receipts associated with the exploration of oil and gas in the Timor Gap, are

[20] For further reference see: UNTAET, East Timor—A Preliminary Consolidated Budget for 2000, December 15, 1999.

Figure 5
Indonesian Rupiah/U.S. Dollar Exchange Rate Developments in Dili



Sources: Banco Nacional Ultramarino; and Bloomberg.

expected to be about one-third of the amount budgeted, mainly because of delays in starting to charge user fees for public utilities. Overall tax collections are likely to be only slightly below target as the shortfall created by a delay of almost three months in the start of border tax collection was offset by an earlier than anticipated introduction of excise taxes. Revenue collections, however, projected to be about $2 million by the end of June 2000, could not be spent until the legislation permitting their use was approved. Such legislation was approved only at the end of June 2000.

Cash expenditure payments in the first half of 2000 (including some quasi-fiscal expenditures financed directly by donors) are expected to reach about $15¾ million, below the $38⅔ million projected in the preliminary budget. The composition of expenditures differed markedly from that envisaged in the preliminary budget, reflecting, in part, a lax enforcement of fiscal discipline upon spending units. This was compounded by the lack of sufficient detail in the expenditure appropriations in the preliminary budget and the difficulties inherent in the UN procedures for authorizing and processing goods. In particular, although recurrent expenditure is likely to be lower than projected, the wage bill will be almost twice as much as originally projected because both the level of public sector employment and the average monthly compensation[21] were markedly different than envisaged in the preliminary budget. In addition, other recurrent expenditures are expected to reach $1¾ million, compared with $7 million in the preliminary budget. Capital expenditures are projected to reach $9 million, compared with $28⅔ million in the perliminary budget, mainly reflecting a lengthy project planning process and some delays in securing external financing.[22]

External Sector

There are indications that foreign trade activity is gradually picking up, although comprehensive data on exports and imports are not yet available. For example, it is estimated that about 4,000 tons of coffee were in stock when the hostilities broke out. Most of

[21]Including stipends paid by UNICEF, WFP, and NGOs to some 7,000 teachers and 900 health workers in the first quarter of 2000.

[22]The Community Empowerment Project and the Dili Employment Project started disbursing in March 2000, followed by the Small Enterprise Project in April 2000. The roads, ports, and power program, led by the Asian Development Bank (AsDB), started disbursing in early June. The health sector program was expected to be effective by late June, with education and agriculture projects starting to disburse in early July.

this has now been exported. Data on port activities also indicate small shipments of other exports to Australia and Surabaya, province of Indonesia. Following the establishment of a UN presence in September 1999, there was a surge in imports related to the operations of the peacekeeping force and humanitarian activities. However, the composition of imports appears to have shifted more toward those related to aid inflows for reconstruction and commercial imports. No significant increase in exports is projected for the year 2000. As a result, the current account deficit is projected to increase in the year 2000, reaching some 38 percent of GDP.

East Timor's endeavor to rehabilitate and reconstruct the economy has been supported by generous external financial assistance from the broad international community. This assistance has taken the form of grants and donations to avoid the creation of external liabilities for the future independent country and is being provided through a number of channels (see Box 4). There are two trust funds—the UN Trust Fund (UNTF) and the Trust Fund for East Timor (TFET)—that are financed by voluntary contributions. Further assistance is provided directly by bilateral donors and indirectly through NGOs. An important part of the bilateral assistance is supporting directly activities that are typical budgetary expenditures (i.e., quasi-fiscal), while the rest has mainly supported the creation of temporary employment and the agricultural sector (e.g., USAID support to the coffee growers cooperative). Assistance is also provided through the UNTAET budget, financed by assessed contributions from the UN member states, and through the humanitarian assistance program Consolidated Appeal Process (CAP). Only a minor part of the UNTAET assessed contributions budget has been used to support the ETA budget so far.

The amounts pledged by donors in Tokyo exceeded the overall requirements for the year 2000. Total pledges amounted to $523 million. Pledges to the UN Trust Fund (mainly covering only the year 2000), used to finance recurrent expenditures and capital expenditures in the areas of civil administration and law and order, amounted to $32 million. Pledges for the 2000–02 period for the TFET, used to finance other reconstruction and development expenditures, amounted to $147 million. An additional $37 million was pledged to the two trust funds, but was left unallocated. Pledges for the CAP amounted to $150 million. Pledges for bilateral programs, and other unallocated pledges, were $157 million.

Contributions to the UN Trust Fund amounted to $28½ million by end-May 2000. These included contributions by six donors who had not originally pledged contributions at the Tokyo meeting, as well as residual amounts transferred from the UN Trust Fund. About $3⅓ million was spent out of the Fund by end-May and an additional $1 million is estimated to have been spent in June. The balance available for FY2000/01 (July 1, 2000–June 30, 2001) is estimated at $17 million because an additional $7 million is estimated to have already been committed for additional spending.[23]

The pace of disbursements from the TFET has also been slow in the first six months of 2000, reflecting problems in procurement and difficulties in setting up implementing institutions. As of end-May, disbursements totaled $1.9 million. About $1 million was disbursed under the Community Empowerment Project (CEP) while the rest was for the Dili employment generation project and the Small Enterprise Project (SEP). Disbursements by end-June were estimated to have reached $6 million,[24] while contributions (cash and promissory notes) were estimated at some $64 million.

During the first half of 2000, bilateral donors provided an estimated $6 million for various development projects and other quasi-fiscal activities. This figure does not include in-kind contributions and spending on other projects directly undertaken by donors through local and international agencies. External assistance has also been provided through more than a hundred NGOs operating in East Timor. Most of this assistance has been humanitarian in nature and has helped to alleviate the immediate humanitarian needs of the population. An estimate of assistance provided by NGOs is not available.

Cash expenditures out of the UNTAET assessed contributions budget amounted to $68 million up to end-April 2000. This amount included $33 million

[23]On a cash basis, the outstanding balance as of end-June 2000 should be $24 million (i.e., excluding the additional $7 million in spending commitments made by UNTAET). However, a balance of $17 million is presented because UNTAET decided to book the $7 million in spending commitments against the budget for the first half of 2000. This treatment was adopted to facilitate the move from a UN accounting framework to a national government accounting framework. In future, a conventional carryover provision will be followed.

[24]In addition to these disbursements, TFET had already committed an amount of $34 million, including $8.6 million for the CEP, $4.8 million for the SEP, $12.7 million for the health sector, and $7 million for infrastructure projects.

Box 4. Main Sources of External Financing

The *UN Trust Fund* was established by the U.N. Secretary General on October 26, 1999, for the purpose of financing operational costs of the East Timor Administration, including the building of basic institutions, the functioning of public services and utilities, and infrastructure maintenance. Recurrent expenditure of all sectors, including salaries of civil servants, plus capital expenditure in the areas of law and order and civil administration, are financed by resources of the UN Trust Fund, which in turn originate from voluntary donor contributions.

The multi-donor *Trust Fund for East Timor* (TFET) was established in late February 2000 by the Board of Executive Directors of the International Development Association (IDA). The Fund is managed by IDA in close cooperation with the Asian Development Bank (AsDB). The AsDB is the leading agency in designing and implementing infrastructure projects while the World Bank has the lead responsibility for all other sectors. The TFET Resolution limits commitments out of the TFET to the amount of cash and promissory notes received from donors.

Substantial external assistance has been provided to East Timor through *bilateral sources*. This assistance has been used to pay salaries for some civil servants, cover operating expenses for electricity generation, rebuild schools and train teachers, build capacity, improve health services, restore infrastructure, and implement quick employment generation projects, among other purposes.

The *UNTAET assessed contributions budget* finances the expenses related to the UN involvement in the territory. It does not include the cost of running the East Timor Administration (except for the secondment of foreign experts to key administrative positions) or the development and reconstruction budget. The UNTAET budget for the seven month period ending June 30, 2000, amounted to $386 million, including $70 million of nonrecurrent expenditures. This includes appropriations to cover expenses related to military and civilian personnel (including East Timorese employed in the UNTAET administration), operational costs of the UNTAET administration, public information programs, and a few other items.

A major portion of the humanitarian assistance was provided through the *Consolidated Appeal Process (CAP)* and coordinated by the office of Humanitarian Assistance and Emergency Rehabilitation (HAER). The CAP provided a common framework for all stakeholders in the humanitarian program to develop priorities and agree on a common strategy, thus facilitating appropriate and effective interventions to address needs.

in personnel costs and $11 million in expenses for freight. In addition to cash expenses, contractual obligations for $62 million are likely to translate into cash spending before the end of June. This could have brought total cash spending to as much as $130 million by June 30, 2000.

In relation to the CAP, implementing agencies reported receiving contributions of $104 million by end-April 2000 and projected to disburse $84 million by end-June. The remaining amount is expected to be disbursed by end-December. Outside the CAP, humanitarian agencies reported total receipts of $54 million in contributions and expected to use almost the entire amount by end-June 2000. The contributions received by end-April allowed humanitarian agencies to distribute over 35,000 tons of food and vaccinate more than 50,000 children. Initial emergency shelter was provided for some quarter of a million people in East Timor, which was subsequently followed by a more structured shelter program through the distribution of shelter kits. Humanitarian agencies also undertook to rebuild schools and provide basic school supplies and some provided salaries to teachers. Other humanitarian activities included emergency rehabilitation of infrastructure, repair of water and sanitation facilities, and provision of medical care and immunization.[25]

The magnitude of the external assistance—and the multiplicity of projects and funding sources—called for effective donor coordination. This was recognized at the onset, as it was felt that a comprehensive and coordinated development effort, rather than a string of unconnected bilateral projects and programs, offered the best hope for speedy recovery and rehabilitation. To this end, UNTAET established a Donor Coordination Unit (DCU) to facilitate the coordination of bilateral and multilateral assistance programs. The establishment of the TFET was also set with this objective in mind. Several constraints have inhibited a more effective donor

[25]A recent review of the humanitarian program's consolidated appeal process (which included an agency self-assessment, a beneficiary evaluation, and an external review) identified some shortcomings in reporting and consultation, but concluded that the overall performance and achievements of the humanitarian program in East Timor have been very positive and timely.

coordination including the low bilateral participation in sector programming missions, lack of continuity of key personnel, and the fact that many donors still do not have a permanent presence in Dili.[26]

Economic Legislation and Institution Building: The Role of Technical Assistance

As originally envisaged, IMF assistance to East Timor has focused on developing a macroeconomic framework to guide economic decision making and establishing key economic institutions. Relying on sequential visits since January 2000, IMF Asia and Pacific Department (APD) staff has played an active role in several NCC meetings providing advice and helping create a consensus that was instrumental in the approval of several regulations.[27] This advice is expected to be enhanced with the presence of a Senior Fund Representative starting in August 2000 and was consistent with recommendations of four IMF Monetary and Exchange Affairs Department (MAE) and Fiscal Affairs Department (FAD) technical assistance missions, and with technical support provided by the IMF Legal Department (LEG).

In the monetary area, two MAE technical assistance missions took place in the first half of 2000. In addition, MAE arranged for six visits by experts to advise on the development of the payments system. Among the types of technical advice provided are recommendations to introduce and implement an interim cash payment system; a proposal for the organization structure of the CPO, focusing on the immediate staffing requirements and the operating budget for FY2000/01; draft regulations, instructions, and procedures for licensing and supervision of banks and currency exchange bureaus based on international best practices; a new legal framework for nonbank financial institutions; recommendations on accounting policies and procedures consistent with accepted international accounting standards; assistance on the procurement of low denomination U.S. dollar banknotes and coins; and an offer to help in reaching agreements concerning the settlement of bank claims and liabilities, as well as the exchange of unfit notes and detection of counterfeit, if such a role is acceptable to Indonesia.[28]

Following the approval of enabling regulations, the Central Payments Office (CPO) started to provide basic depository and payments services to the government, including the safekeeping of funds, tax, and duties collections, as well as treasury functions related to the payments of stipends for civil service workers. However, two difficulties in making the CPO operational delayed the implementation of some of MAE's recommendations. First, the CPO lacked secure premises to store small denomination notes and coins. This problem is expected to be eased with the renovation of a building and a vault allocated to the CPO, expected to be completed in August 2000. The second difficulty faced by the CPO was a delay in hiring its executive staff, mainly because of inappropriate remuneration. The IMF (with funding support from Japan) recently completed a cost-sharing arrangement with the UN that supplements UN salaries for four long-term experts to take executive positions with the CPO. The head of the CPO and the two deputy heads for payments and for supervision arrived in June and they have assigned a very high priority to the implementation of the recommendations and draft regulations and instructions provided by MAE.

In the fiscal area, technical assistance from the IMF's FAD and LEG has been instrumental in making the CFA operational.[29] The IMF has not only extended its assistance to supplement UN salaries to attract seasoned professionals, but it has also coordinated technical and financial assistance with the World Bank, Australia, and Japan to provide additional long- and short-term experts for the CFA. In

[26]For more details, please see UNTAET and World Bank, *Background Paper for Donors, Meeting on East Timor, June 2000*.

[27]These included regulations on: the establishment of the Central Fiscal Authority (Regulation # 2000–01); the use of currencies in East Timor (Reg. # 2000–02); licensing of currency exchange bureaus (Reg. # 2000–05); the establishment of the Central Payments Office (Reg. # 2000–06); the adoption of the U.S. dollar as legal tender (Reg. # 2000–07); bank licensing and bank supervision (Reg. # 2000–08); and a tax and customs regime for East Timor (Reg. # 2000–12).

[28]For details, on the tasks ahead, including a proposed timetable for implementation, see: IMF, *East Timor: Initial Steps in Restoring and Transforming the Payment and Banking Systems*, June 2000, and IMF, *Further Steps in Restoring and Transforming the Payment and Banking Systems*, July 2000.

[29]For details on the technical assistance provided in the fiscal area, see IMF, *East Timor: A Strategy for Rebuilding Fiscal Management*, February 2000, and IMF, *East Timor—Establishing Fiscal Management: A Progress Report*, June 2000. In addition, IMF LEG has also helped to draft the necessary fiscal legislation: an organic budget law, an appropriation law for FY2000/01, and legislation establishing taxes and tax procedures.

addition, the AsDB is assisting UNTAET in identifying local staff to be trained as tax inspectors. As a result of these efforts, there is now a minimalist staff of foreign experts and local staff in place to perform the functions of the CFA. In particular, the position of the head of the CFA was filled in March 2000; the Acting Head of the Tax Administration Department, who has been under contract with the IMF since April, was appointed in early July; a Budget Department started operations by mid-April; and a Treasury has recently been set up. Contrary to IMF FAD recommendations, however, a Border Control Service Department, responsible for collecting taxes at the border, was created as an independent agency. Nonetheless, customs policy remains a responsibility of the CFA.

The CFA has made significant progress in a very short time. The budget department prepared the budget for FY2000/01, the first budget for East Timor.[30] In the preparation of the budget, several East Timorese technical groups participated actively, although the participation was not equally active across sectors. The NCC was also involved at different stages of the process. With the recent passage of the budget and financial management regulation, the treasury department is now positioned to undertake basic treasury activities starting early in the new fiscal year. The problems experienced during the first half of 2000, which rendered actual expenditures inconsistent with the preliminary budget, should be avoided, since internationally accepted treasury procedures will now replace the UN procedures that were adopted out of necessity. In relation to tax policy and tax administration, a survey of restaurants, hotel, and other services suppliers was completed to gauge the size of the services tax base. This information was instrumental in the approval of the service tax, which was a chapter of a more general tax code approved recently. Finally, the collection of taxes at the border began in March 2000. In this regard, the experience with the implementation of the customs duties has disclosed that there is a need for a less discretionary definition of the goods that are to be exempted from such duty. Despite this progress, it is worth noting that some of the elements originally envisaged in the fiscal strategy have been adopted with significant delays. In particular, the service tax and several fees and user charges have only been approved recently and collections are not expected to start until August 2000, whereas the decision on the rate and timing of a wage withholding tax has been postponed to the end of the year.

[30]Following the establishment of the CFA, the fiscal year for East Timor runs from July 1 to June 30.

VI

Macroeconomic Outlook for the Near Term

The comprehensive reconstruction plan to be executed in the next three years, together with continued humanitarian assistance and the expected reemergence of the private sector, are likely to impart a near-term boost to East Timor's overall economic activity while helping to support consumption levels comparable to those prevailing prior to September 1999. Traditional quantitative macroeconomic indicators for East Timor are likely to record sizable changes, especially in the near term. However, these changes must be interpreted with caution because economic boosts are typical near-term responses in most post-conflict situations that have been supported with substantial external resources. In these circumstances, policymakers should focus on ensuring that the policy strategy adopted to address immediate needs, the expected near-term evolution of the key macroeconomic variables, and the institutional framework being established, are consistent with setting a strong foundation for sustained growth and poverty reduction over the medium to long term.

With this in mind, the following sections attempt to provide some insights on selected sustainability issues that arise in connection with the strategy adopted by UNTAET and the East Timorese. The sections also try to identify the scope to improve the basic institutional framework already established for decision making, in general and, fiscal and financial management, in particular. Wherever appropriate, policy challenges that require immediate attention to prevent adverse consequences in the medium term are highlighted. However, no attempt is made to define East Timor's path for sustained development as the reconstruction effort starts to fold down. Defining such a path would require, among other things, a comprehensive analysis of the country's resource potential and constraints to future development. It also would need to reflect policy options that should be designed by an independent East Timorese government, preferably with technical and policy advice of the World Bank and other development organizations, and decided by the East Timorese civil society at large.

Output and Prices

The observed recovery of economic activity in the first part of 2000 is expected to continue in the next few years. Real GDP growth is expected to average at least 15 percent per annum in 2000 and 2001, led by agriculture, commerce, basic services, and reconstruction of public and residential buildings.[31] Investment is expected to increase to about 47 percent of GDP in the year 2001 from an estimated 28 percent of GDP in 1999 as the process of reconstruction picks up. As a result, merchandise imports are also projected to increase sharply to about 64 percent of GDP in the year 2001, from

[31]Agriculture is projected to grow strongly. According to a report prepared by the Food and Agriculture Organization of the United Nations (FAO) and the World Food Program (WFP), conditions for coffee growing are expected to be as favorable in 2000/01 as in the current season, while rice and maize production in 2000/01 could reach as much as 70 percent and 75 percent of the 1996/97 bumper levels, respectively. Road repairs and the general rehabilitation of infrastructure are expected to be instrumental in facilitating other sectors' recovery.

36 percent in 1999, and the current account deficit would reach almost 60 percent of GDP. As real income grows in the medium term, East Timor's national savings is expected to be less negative and should progressively start becoming positive, converging toward the average level of 20 percent of GDP that prevailed in 1995–98. Meanwhile, continued, albeit declining, reliance on foreign savings should be expected (Table A1 and Figure 1).

Upward pressures on prices are expected to decline as supply constraints are relaxed by the comprehensive rehabilitation and reconstruction efforts and the cost of transport stabilizes (Table A1 and Figure 2). Similarly, price volatility is expected to decline as the functioning of markets improves and the rehabilitation of the infrastructure continues, in particular communications and the road network. Moreover, as the U.S. dollar becomes more widely used, inflation in East Timor should start converging to that of its major trading partners. There is a risk, however, that wage pressures may partially counter some of the beneficial effects of the removal of supply constraints and improvements in the infrastructure.

Budgetary Outlook

The draft budget for FY2000/01 and fiscal projections for FY2001/02 and FY2002/03 were endorsed by the NCC in early June 2000. The fiscal deficit projected for FY2000/01 is about $155 million, or 54 percent of GDP (Table A9 and Figure 3). Revenues are projected at $17 million (6 percent of GDP), including the impact of additional revenue measures, which could yield some $7 million. These measures include the recently approved 10 percent tax on the delivery of a range of services, including hotels and restaurants, and the expected introduction of users' fees on airports,[32] ports, and electricity. The users' fees will be set at a level consistent with cost recovery, although in the case of electricity, they will apply initially only to the largest institutional and commercial users.[33]

Total spending projected for the next fiscal year is about $172 million (60 percent of GDP), of which 25 percent represents current spending. The projected wage bill ($14⅔ million) represents about one-third of total current expenditures. The number of civil servants in FY2000/01 is projected at about 9,000. Nonwage current expenditures are projected to reach $29 million in FY2000/01. The significant level of nonwage current expenditures reflects some initial high costs of setting up a new administration (initial stock of medicines, uniforms, supplies), as well as the operational cost of running utilities, in particular power production. Capital expenditures are projected to reach almost $130 million (44 percent of GDP) in FY2000/01, including $43½ million of quasi-fiscal expenditures financed directly by donors. Most expenditures would be concentrated in infrastructure ($55 million), health ($13 million), education ($12 million), and agriculture ($11 million). More than half of the expenditures are expected to be financed through TFET, with the remaining financed by the UNTF, and donors (including $2½ million to repair roads damaged by the peacekeeping forces which is expected to be financed from the assessed contributions budget).

For FY2001/02 and FY2002/03, the fiscal deficit is projected to remain above $100 million, with fiscal revenue more than doubling in the outer year so as to cover about 80 percent of current spending. Capital spending is projected to come down as a percent of GDP as the reconstruction effort winds down.

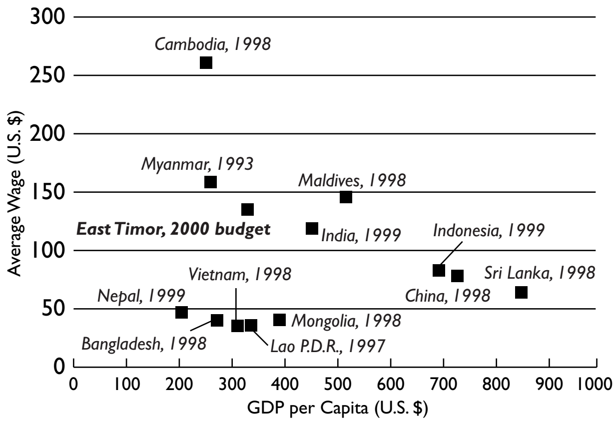
Some of the policies underlying the budgetary projections give rise to serious concerns about sustainability. First, on wage policy, the budgetary projections for FY2000/01 have been made using a weighted average monthly wage for civil servants of about $135, which is much higher than wages prevailing in Indonesia[34] and other countries with comparable GDP per capita (see Figure 6). In addi-

[32]The gross revenue from users' fees for the airports is likely to be smaller than anticipated because the UN will be "exempted" from the user fees, so as to off-set the cost of managing the airports that is expected to be financed from the UNTAET assessed contributions budget.

[33]User fees for all the public services noted above and water were approved on July 26, 2000. The expected collection from the large electricity consumers would cover only one-third of the cost of producing electricity; the rest will be paid for by the budget.

[34]The proposed average wage for FY2000/01 is three percent higher than the average labor cost estimated by the Joint Assessment Mission (JAM), which was calculated taking the average wage paid by the Indonesian administration in 1999, including allowances, benefits, and subsidies. Although the average wage used in the budget projections for FY2000/01 represents all direct labor costs to the government, it is not strictly comparable to the JAM estimate of labor costs because East Timorese civil servants will continue to receive some subsidies (e.g., electricity, water, and other public utilities), as well as other forms of income support through humanitarian assistance. There is no quantification of the value of the implicit additional income support to be provided.

Figure 6
Average Wages vs. GDP per Capita[1]



[1]Data indicates year of most recently available observation.

tion, it has been decided that all civil servants within the same skill category will be hired at the same initial wage, regardless of their previous experience. It is likely that the government will have to accommodate pressures to introduce wage differentials within the same skill category sooner rather than later. Otherwise, the government will not be able to retain the most experienced personnel, especially taking into account that the UN and some international organizations are already paying average wages that exceed such levels. Setting an appropriate wage scale for each skill category in the years to come will therefore be a critical policy challenge.

Second, on taxation, the projected increase in revenues in FY2001/02 and FY2002/03 could not be achieved on the basis of tax policy currently in place and the additional tax and user fees expected to be approved with the budget for next fiscal year. Hence, there will be a need for a more comprehensive tax system and user fees, including both a higher tax burden and a broadening of the tax base. The design of a comprehensive tax system should take into account efficiency and equity considerations as well as tax administration capacity. In this regard, striking the right balance between these three factors presents another important challenge for policy makers.

The IMF staff has had extensive discussions with both the UNTAET administration and the East Timorese leadership on these policy issues and believes that they are aware of the risks inherent in the policy strategy chosen. The IMF staff is encouraged by the decisions taken to postpone for a year the adoption of wage scales for each skill category; keep the size of the civil service under control; and set up a sub-committee to look into the issue of tax policy and provide recommendations for the possible introduction of a wage withholding tax in 2001. The decision regarding the size of the civil service is particularly important given the concerns raised about wage policy. On current projections, in FY2000/01 there will be about 9,000 employees, including civil police and security, rising to 10,500 by the end of FY2002/03.[35] This compares favorably to the 12,200 positions recommended by the Joint Assessment Mission for FY2002/03, which excluded civil police and security, and should help keep the total wage bill within reasonable boundaries.

External Financing Requirements

The external financing requirement for FY2000/01 reflects almost entirely the public sector deficit of $155 million. It is estimated that about $77 million would be available for budget financing from the two trust funds and from unused tax collections, leaving a gap of $78 million (Table A9). This includes a gap of $23½ million in the UN Trust Fund to finance recurrent expenditures and capital expenditures related to public administration,[36] and a gap of $54⅔ million to finance the reconstruction program to be executed through TFET and bilateral sources. The financing gap for the TFET was estimated at $11 million while the remaining $44 million would need to be mobilized from bilateral sources.

Representatives of some 45 institutions including bilateral donors, international agencies, and NGOs engaged in East Timor met in Lisbon on June 22–23, 2000 to review developments in East

[35]These employment figures do not include positions that would need to be created if an East Timorese army was established. The feasibility of establishing an army is currently under study by UNTAET, with the assistance of a team from the King's College Centre for Defense Studies of London University.

[36]The UN Trust Fund was expected to receive additional contributions of about $10 million from pledges made in Tokyo, leaving a residual financing gap of $13 million. The actual request made at the Lisbon conference was for $16 million, including $3 million for a cash reserve.

Timor and consider the request for additional funding to close the financing gap. The meeting provided concrete pledges for the UN Trust Fund and reconfirmed the financial commitments made in Tokyo to support reconstruction and development activities. As regards the financing gap for the UN Trust Fund, concrete pledges of $5 million were received. However, several countries indicated that they would consider additional contributions for an amount that could be as high as $8 million. This would leave an uncovered residual gap of $3 million, but this should not affect the implementation of the budget because the financing request had incorporated a $3 million cash reserve. In any event, some other countries also indicated that additional support for closing the budgetary financing gap could be forthcoming, but they could not be precise until their respective foreign assistance budgets for the next fiscal year were approved. As for the TFET, if previously planned contributions were to be realized on time, they would be sufficient to cover the gap for FY2000/01. Donors received favorably the World Bank's request that some of the disbursements for subsequent years be made as early as possible in 2001 so as to permit the signing of grant agreements under the TFET for FY2001/02 and beyond. With respect to bilateral financing (i.e., outside the TFET), several donors pledged additional resources, including in-kind contributions. The amount of these pledges that would be available to close the $44 million gap identified for the coming fiscal year is not clear at this time, however.

Scope for Deepening Dollarization and Developing the Banking and Payments System

Key to the dollarization of the economy will be a more timely and effective execution of the budgetary spending (with an expected yearly net injection of dollars to the local economy of at least $25–30 million), additional efforts at educating the population in the use of the legal tender, and improved availability of low denomination U.S. notes and the introduction of coins. However, rupiah are likely to continue to be used for some time for undertaking small value transactions in the market. At the request of UNTAET, the IMF staff will explore with Indonesia's central bank the possibility of arrangements for exchanging new rupiah notes and detecting counterfeit.

Because a sound banking sector is a precondition for a well functioning payments system, the CPO's strategy to strengthen the development of the banking system relies on the adoption of a coherent operational and regulatory framework and adequate banking supervision. Consistent with this goal, the new management of the CPO has undertaken to adopt a prudential regulatory framework based on Basel Core Principles, including instructions on bank licensing, capital requirements, and liquidity—all of which are already drafted. Instructions on large exposures, connected lending, accounting and reporting requirements, and asset classification are expected to be adopted by end of August 2000, and an additional set of 30–40 instructions aimed at ensuring sound banking practices is expected to be prioritized and issued as needed by the Department of Supervision. Furthermore, the instruction on licensing of foreign exchange bureaus and the regulation on nonbank financial institutions are expected to be approved by end-July 2000. These approvals should speed the process for private sector operators to secure licenses to undertake foreign exchange services, and should help meet the needs of the rural and agricultural sectors for financial services.

Scope for Strengthening Fiscal Management

In order to improve the decision-making process in the budget area, a Budget Committee has been established with responsibility for oversight of budget preparation and implementation. The next fiscal cycle should therefore start with a consultation between UNTAET and the NCC on the budget strategy, priorities, and overall resources envelope. In addition, there are a number of specific steps that could be taken in the next six to 12 months, especially to improve tax policy, where the tax subcommittee should be appointed as soon as possible to begin technical work on the wage withholding tax as well as the corporate income tax, including a tax on small businesses; tax and customs administration, where there is an urgent need for staffing and training as well as for defining clearly the criteria for granting exemptions from customs duty; and budget execution, where the appointment and training of treasury accounting officers in each of the major spending agencies should be expedited, and the computerization of basic treasury functions be put in place as soon as possible.

Scope for Improving the Decision-Making Structure

In an effort to enhance the participation of the East Timorese in the decision-making process, UNTAET has recently agreed with the East Timorese leadership to a shift from a transitional administration to a transitional government. In the new structure, the Transitional Administrator would keep the rights and responsibilities as defined in UN Security Council Resolution 1272. However, the representativeness of civil society will increase as the NCC membership expands from 15 to 33 members to constitute a National Council. In addition, the new structure includes a cabinet of eight portfolios;[37] and six independent bodies reporting directly to the SRSG, including the CPO, a human rights office, a gender affairs unit, an inspector general office, an ombudsman office, and a National Planning and Environment Unit.[38] It is also envisaged that all district manager positions will be assumed by East Timorese, wherever possible.

The changes in the administrative structure are only a preamble to the forthcoming changes at the political level. In a recent meeting of the UN Security Council, the SRSG indicated that elections for a constitutional assembly could be held in the second half of 2001. That assembly would consider—and hopefully approve—a constitution for an independent state. Upon independence, East Timor would be eligible to become an IMF member.

[37]In line with UN Security Council resolution 1272, UNTAET has retained executive authority for Police and Emergency Services, Political Affairs, Justice, and Finance. East Timorese have taken over executive authority for Internal Administration, Social Affairs (including Education, Health, and Gender Issues), Economic Affairs, and Infrastructure.

[38]UNTAET is to maintain the leadership of the CPO, Human Rights, and Gender Affairs, whereas the Office of the Inspector General will be assumed by an East Timorese. The National Planning and Environment Unit is expected to be managed jointly.

VII

Immediate Challenges and Concluding Remarks

The severe economic disruption created by the violence and destruction that followed the August 30, 1999, referendum aggravated further the general economic decline observed since the onset of the Asian crisis in the region. Emergency relief was provided rapidly by various UN agencies and nongovernmental humanitarian institutions. As this unprecedented relief effort unfolded with generous international financial support, it became clear that the reconstruction task would require the restoration of law and order, the reestablishment of government structures and systems, and the rebuilding of all basic institutions needed to ensure the functioning of a market economy. The task ahead is further complicated because of the weak economic system inherited from many years of Indonesian administration.

The rapid deployment of international forces in mid-September 1999 helped to reduce security concerns relatively quickly. It was evident from the outset, however, that addressing the administrative and institutional vacuum in East Timor would take time as it would need the development and swift implementation of a comprehensive reconstruction framework. At the request of the Secretary General of the United Nations, several official multilateral and bilateral agencies joined efforts with the UN agencies and the East Timorese in assessing requirements for reconstruction, including external financing and technical assistance and training. The World Bank took the lead in assessing the reconstruction needs and designing the reconstruction program in close coordination with the East Timorese, UN agencies, and other official institutions. The IMF focused on helping UNTAET and the East Timorese to develop a basic macroeconomic and institutional framework, with special emphasis on the immediate steps needed to ensure stability and create an enabling environment for economic recovery, including an intense program of technical assistance. From the outset, efforts were made at ensuring close coordination with the East Timorese, the World Bank, the Asian Development Bank, the UNDP, and other specialized organizations.

Most of the key elements of the strategy proposed by the IMF have been fully or partially implemented, and there are some positive signs of economic revival and a gradual stabilization of prices. However, prices remain volatile across regions and unemployment remains high. It is therefore very important that the rehabilitation effort be expedited so as to ease supply constraints and enhance the functioning of markets. Equally important will be continued humanitarian assistance to provide temporary income support for the most needy segments of the population.

One of the most important foundations for sound macroeconomic management was the development of a decision-making structure, which includes the initial establishment of the National Consultative Council (NCC), and, more recently, the approved shift from a transitional administration to a transitional government. Under this transitional government, East Timorese have started to assume executive positions in an administration structured along the lines of a traditional government, including departments that could evolve into ministries and autonomous government entities.

The adoption of a preliminary budget for 2000 and the subsequent development and adoption of the budget for FY2000/01 signal clearly the intention of UNTAET and the East Timorese leadership to adhere to a framework of transparency and accountability that makes explicit their budgetary constraints and revenue and expenditure priorities. Although the implementation of the preliminary budget for the first half of 2000 was not without problems, the experience gained so far has helped to ensure the development of a sound budget for FY2000/01. IMF staff welcomes the steps taken so far to address the risks posed to the budget by the underlying wage and tax policies. However, UNTAET and the East Timorese would be well advised to take all necessary steps to meet the immediate challenges posed by the choice of the wage scale for civil servants and the design of a more comprehensive tax system. It would also be advisable to intensify monitoring of fiscal developments and ensure that decision makers stand ready to take remedial actions, if needed. It is also encouraging to note that steps are being taken to reduce the budgetary financing problems encountered earlier in the year and improve donor coordination by enhancing the role of UNTAET's donor coordination unit.

The decision endorsed by the NCC to adopt the U.S. dollar as the legal tender replacing the Indonesian rupiah was a step in the right direction. This has helped to address the problems that were arising in connection with the use of multiple currencies in the absence of efficient financial markets. The limited use of the U.S. dollar, however, underscores the importance of making additional efforts to improve the execution of the budget (the official channel for injecting dollars in the economy); resolve the logistical problems that prevented adequate availability of low denomination U.S. notes and absence of coins; and strengthen UNTAET's information campaign. It will be equally important that the revival of the banking system remains a priority. In this connection, an enabling regulatory framework should soon be put in place. The development of a financial market and the establishment of an appropriate financial policy and institutional framework are essential prerequisites for achieving the stated objective of the East Timorese leadership to introduce their own currency after independence.

On the institutional front, it is encouraging to note that the two key economic institutions—the Central Payment Office and the Central Fiscal Authority—are close to becoming operational. As noted earlier, IMF staff have worked closely in coordination with other national and multilateral agencies to provide policy advice and technical assistance in institution building and the formulation of macroeconomic policies, and will continue to do so in the period ahead. As part of this process, the IMF's Monetary and Exchange Affairs Department and Fiscal Affairs Department have assisted in identifying key technical/managerial staff for the two key institutions. As noted above, however, there is still significant scope for improvement in the development of the key institutions for economic management.

Despite the progress achieved so far, the tasks ahead remain monumental and there will be a continued, albeit declining, need for external financial assistance as well as for further technical assistance and training for a number of years. The development and adoption of sound macroeconomic management is important to provide assurances that resources will be used efficiently while East Timor develops its own resource base. The IMF stands ready to work in close coordination with other national and multilateral agencies to provide policy advice and technical assistance in institution building and the formulation of macroeconomic policies in the period ahead.

In the final analysis, however, it is clear that the success of the reconstruction effort, in general, and of the strategy to establish the foundations of sound macroeconomic management, in particular, depends most critically on the extent to which the East Timorese leadership and the civil society at large identify themselves with the objectives and associated strategy. This can only be achieved through a very active participation of the East Timorese at all stages of the process—including design, implementation, monitoring and, if required, reformulation of the objectives and policy priorities. It would also require continuous dialogue among the East Timorese, and between the East Timorese and the international community, as well as an extensive information campaign. Although developments up to June 2000 have been at times frustrating despite genuine efforts on the part of UNTAET and the international community to address the difficulties encountered, it is encouraging to see that a careful and responsible assessment of the situation has led to several modifications to the structure of the government and the policy making process that will enhance the participation of the East Timorese in the transition to self-rule.

Appendix: East Timor—The Role of the World Bank and the Asian Development Bank[39]

The World Bank and the Asian Development Bank (AsDB) are actively engaged in the reconstruction and development work in East Timor. The World Bank led a joint assessment mission in October 1999 to evaluate the economic and social conditions in East Timor and estimate its reconstruction needs. The conclusions of the mission formed the basis for the financing request to donors at a conference jointly chaired by the World Bank and the UNTAET in Tokyo in December 1999. A second donor's conference was held in Lisbon in June 2000, also jointly chaired by the World Bank and the UNTAET.

A major part of the reconstruction and development effort in East Timor is funded through the Trust Fund for East Timor established at the Tokyo meeting. The World Bank and the AsDB signed a Memorandum of Understanding defining their cooperation and division of responsibilities regarding the trust fund. Under this memorandum, the World Bank will prepare projects in the areas of health, education, agriculture, irrigation, support to small and medium enterprises, and economic capacity building. The AsDB will take the lead in the rehabilitation of roads, ports, power, water, telecommunications, and microfinance development. The two institutions will work together on community development projects. As of end-June 2000, seven grant agreements totaling $52.749 million had been signed under the trust fund.

[39]This section is based on information provided by the World Bank and the Asian Development Bank

- **Community Empowerment Project:** The Community Empowerment and Local Governance Project provides block grants to local communities, supporting the creation of elected village councils who then plan and manage these grants according to priorities identified by the community. By mid-June 2000, the project had supported the formation of 341 village development councils across the country. Approximately 20 percent of the 214 projects approved have been for feeder roads, 15 percent for water repair, 8 percent for schools and clinics, and 57 percent for meeting halls and other communal buildings in villages. Thirteen Timorese district accountants have been trained and deployed across the country, together with 79 Timorese facilitators.

- **Dili Community Employment Generation Project:** The project was designed as a short-term safety net project to bridge the employment gap before private sector activities revive and larger public sector projects are launched. Implemented by UNDP, the project helps communities organize to remove debris from Dili neighborhoods and manage solid household waste. It currently operates in ten communities, employing 480 people. The possible extension of the project from September to December 2000 is under consideration.

- **Small Enterprise Project:** The small enterprise project provides lines of credit and training to Timorese entrepreneurs and cooperatives, to put in place capacity early on for

Timorese businesses to participate in the reconstruction programs and "kick-start" provision of local goods and services. As of mid-June 2000, the project had received $30 million in applications. About two thirds of the applications have been for financing transport (freight or passenger) and small shops. The first 20 loans have been awarded in Dili.

- **Roads, Ports, and Power:** The project provides for emergency repairs to key infrastructure within a two-year sector framework. Under the project, work has already started on the repair of high-traffic road sections, the rehabilitation of key bridges, the maintenance of priority road sections and the completion of the wharf deck and the landing-craft slipway at the Dili port. The project encourages the build up of local capacity among East Timorese in the public sector infrastructure agencies and in the contracting/construction industry.

- **Health Sector Rehabilitation and Development Program:** The first tranche of the project, which will be active in the next six months, has five components: agreements with service providers at district levels on a standard package of services and coverage to be provided in each district; accelerated implementation of selected high priority activities, in particular the immunization campaign; the establishment of a pharmaceutical logistic system; reconstruction and re-equipment of clinics; and a baseline statistical survey and workshops on health policy for capacity-building and policy development.

- **Emergency School Readiness Project:** The first phase of the TFET education project aims primarily at physical rehabilitation of the education sector. In coordination with UNICEF, which is providing roofing for primary schools, the project aims to ensure that 2,100 primary and junior secondary classrooms are roofed and have furniture, basic textbooks, and teaching-learning materials by the time schools reopen in October 2000. Other rehabilitation works will be carried out between September and December. In addition, the project will complete the design of four prototype schools to replace those that have been demolished.

- **Agriculture rehabilitation and development project:** Asset restoration is a priority of the project. During the period July–December 2000, the project aims to distribute livestock and hand tools, repair designated irrigation systems, and will carry out a vaccination campaign. In addition, Pilot Agricultural Service Centers will be established in each district to supply farm input, services, and training. The Community Empowerment Project will deliver components on rural roads, and the Small Enterprise Project will provide agricultural credit.

Two other projects are being appraised under TFET:

- **Water and sanitation (WSS):** The AsDB water and sanitation mission is expected to complete appraisal and grant agreement for a $4.5 million project by the end of July 2000. The project aims to develop a WSS sector management program, capacity building, and institutional development, and to provide a WSS quick response facility and repair and rehabilitation of water supply systems in Dili.

- **Microfinance:** The AsDB is appraising a project to strengthen credit unions for savings and loans in poor communities. The project will assist community level credit unions with training and information, together with the creation of a central liquidity fund. In addition, the AsDB project will appraise the feasibility of setting up a microfinance bank to provide commercial banking services to micro-entrepreneurs, also expected to be implemented in the same period.

The World Bank is also providing funding for a technical capacity building/human resource survey project through the IDA Post-Conflict Fund. This project provides equipment to Timorese technical groups and finances a human resource survey in each district.

The AsDB is also providing technical assistance for the Community Empowerment Project; a Transport Sector Study to identify management and cost recovery options; development options in the power, telecommunications, and water supply/sanitation sectors; capacity building in governance and public sector management; development of a microfinance program; and statistical assessments and needs analysis for East Timor.

East Timor: TFET Grant Agreements Under the First Work Program

Activity/Project/Grant	Date of Agreement	First Tranche Agreement (In millions of U.S. dollars)	Estimated Total Value of TFET Funded Projects
Community Empowerment	February 21, 2000	7.0[1]	21.5
Dili Community Employment Generation	April 3, 2000	0.5	0.5
Roads, Ports, and Power	April 5, 2000	7.0	10.0
Small Enterprise Project	April 13, 2000	4.9	29.5
Health	June 7, 2000	12.7	28.0
Education	June 21, 2000	13.9	40.0
Agriculture	June 21, 2000	6.8	20.7
Total		52.7	150.2

Source: The World Bank.
[1]Excludes $2.0 million which was provided by the World Bank-IDA Post-Conflict Funds.

Appendix Tables

TABLE A1
East Timor: Key Economic Indicators

	1995	1996	1997	1998	Est. 1999	Proj. 2000	Proj. 2001
GDP (in billions of rupiah)	708	862	996	1,272	1,878	. . .	. . .
GDP (in millions of U.S. dollars)[1]	315	368	383	375	228	263	303
GDP per capita (in U.S. dollars)[1]	374	429	442	424	304	. . .	. . .
Population (in thousands)	843	857	868	884	750	. . .	. . .
Of which: Displaced persons (thousands)	. . .	. . .	. . .	. . .	120	. . .	. . .
				(Percent change)			
Real GDP growth	9	11	4	–2	–38	15	15
Inflation rate (CPI, Dili, based on rupiah prices)	8	5	10	80	140	20	. . .
Inflation rate (CPI, Dili, based on U.S. dollar prices)	. . .	. . .	. . .	. . .	. . .	. . .	3
				(In percent of GDP)			
Consumption	83.4	79.9	71.0	74.6	91.9	104.2	112.7
Nongovernment	59.6	57.8	60.7	59.9	82.4	93.4	98.0
Government (excluding transfers and subsidies)	23.8	22.1	10.2	14.8	9.5	10.8	14.7
Investment	40.8	44.3	52.9	47.0	28.1	33.4	46.7
Nongovernment	. . .	. . .	10.0	10.0	8.0	5.7	7.3
Government	. . .	. . .	42.9	37.0	20.1	27.7	39.5
Domestic Saving	16.6	20.1	29.0	25.4	8.1	–4.2	–12.7
Nongovernment	. . .	. . .	32.8	31.5	12.9	2.8	–5.7
Government	. . .	. . .	–3.8	–6.2	–4.8	–7.0	–6.9
External saving	24.2	24.2	23.9	21.6	20.1	37.6	59.4
				(In percent of GDP)			
Money and credit							
Broad money[2]	. . .	. . .	41.2	38.7	29.9	. . .	. . .
Currency[2]	. . .	. . .	6.1	4.5	5.9	. . .	. . .
Demand deposits[2]	. . .	. . .	8.6	6.4	6.7	. . .	. . .
Quasi money[2]	. . .	. . .	26.5	27.8	17.3	. . .	. . .
Domestic assets (net)[2]	. . .	. . .	37.1	36.8	26.1	. . .	. . .
Interest rates (percent)[2]	13.5	15.8	19.8	38.5	36.0	. . .	. . .
				(In millions of U.S. dollars)			
Merchandise exports	37	44	52	55	46	49	63
Merchandise imports[3]	112	132	142	135	82	118	192

TABLE A1 (CONCLUDED)

Fiscal Year[4]	1995/96	1996/97	1997/98	1998/99	Budget[5] 1999/00	Jan.–Jun. 2000 Prel. Budget	Jan.–Jun. 2000 Est.	2000/01
					(In percent of GDP)			
Fiscal balances								
Revenues	. . .	. . .	8.1	8.2	6.0	3.2	1.2	5.9
Recurrent expenditures	. . .	. . .	13.0	14.6	12.9	7.4	5.1	15.1
Capital expenditures	. . .	. . .	61.8	22.5	29.5	21.0	6.9	44.6
Overall balance (deficit)	. . .	. . .	–66.7	–28.8	–36.4	–25.2	–10.8	–53.8

Sources: Data provided by the Indonesian authorities; and IMF staff estimates.
[1]GDP in U.S. dollars was calculated using 1996 as the base year and assuming purchasing power parity.
[2]Estimated figures for 1999 are for end-September.
[3]Includes imports through foreign aid and excludes projected UNTAET and OCHA imports in 1999, 2000, and 2001.
[4]The fiscal year under Indonesia was from April 1 to March 31. There is no data on the actual execution of the 1999/2000 budget. The preliminary budget of UNTAET was prepared for calendar year 2000. The fiscal year 2000/01 is from July 1 to June 30.
[5]Original Indonesian provincial budget for East Timor.

TABLE A2
East Timor: Real GDP by Sector

	1994	1995	1996	1997	1998	Est. 1999
			(In percent of total)			
Agriculture	27.5	24.0	24.2	24.9	25.5	21.3
Mining and quarrying	0.9	1.0	1.0	1.2	1.0	1.4
Manufacturing industry	3.0	3.3	3.3	3.5	3.4	3.5
Electricity, gas, and water	0.6	0.7	0.8	0.8	0.9	0.7
Construction	21.8	23.2	22.1	21.7	15.7	23.2
Trade, hotels, and restaurants	11.0	10.4	10.3	10.3	10.9	8.1
Transportation and communications	8.7	10.0	10.3	10.3	11.0	8.1
Finance, rents, and business services	3.9	3.9	4.5	4.0	5.2	4.6
Public administration and defence	21.4	22.3	22.4	22.1	25.4	27.8
Private services	1.2	1.2	1.1	1.2	1.1	1.2
Total	100.0	100.0	100.0	100.0	100.0	100.0
			(Annual change, in percent)			
Agriculture	1.3	–4.3	11.6	7.1	0.2	–48.4
Mining and quarrying	4.5	14.8	14.2	22.2	–8.6	–13.8
Manufacturing industry	16.0	21.4	7.9	11.7	–4.2	–37.4
Electricity, gas, and water	6.0	18.1	35.1	4.8	4.2	–49.9
Construction	14.5	16.2	5.8	2.1	–9.1	–9.0
Trade, hotels, and restaurants	29.3	4.1	9.6	4.3	3.6	–54.3
Transportation and communications	12.2	25.3	13.7	4.6	4.3	–54.5
Finance, rents, and business services	2.3	11.0	25.7	–6.7	26.2	–44.6
Public administration and defence	9.2	13.9	11.6	2.8	12.5	–32.6
Private services	10.6	10.8	6.6	7.5	–3.2	–32.0
Total	10.0	9.4	10.8	4.1	–2.1	–38.5

Sources: Data provided by the Indonesian authorities; and IMF staff estimates.

Table A3
East Timor: Monetary Survey
(In billions of rupiah)

	1996	1997		1998			1999
	December	March	December	March	September	December	September
Net foreign assets	...	...	–20	...	–30	–34	–40
Assets	...	...	0	...	9	7	9
Liabilities	...	...	–20	...	–39	–41	–49
Net domestic assets	...	...	370	...	421	468	490
Cash holdings	...	...	9	...	118	71	54
Net banking system float	...	...	12	...	0	0	–13
Reserve assets	...	...	...	...	...	...	...
Other assets	...	...	...	...	...	...	...
Liabilities	...	...	...	...	...	...	...
Credit	116	113	165	162	167	166	141
Interbank credit (net)	...	...	44	...	23	4	35
Loans	...	...	...	...	...	...	...
Borrowings	...	...	...	...	...	...	...
Capital and reserves	...	...	–17	...	–25	–18	–17
Interoffice credit (net)	...	...	157	...	233	311	324
Net unclassified assets	...	...	–1	...	–95	–66	–33
Assets	...	...	8	...	12	11	1
Liabilities	...	...	–9	...	–107	–77	–34
Deposit liabilities	...	...	350	...	391	435	450
Current deposits	...	...	86	...	69	82	126
Savings deposits	133	152	155	161	127	150	207
Time deposits	...	...	109	...	195	203	118
Stock of currency in circulation (estimated)	...	...	61	...	49	58	111
Deposit liability/GDP (in percent)	...	...	35	...	31	34	24
Cash holdings/Deposit liability (in percent)	...	...	3	...	30	16	12
Credit/GDP (in percent)	...	...	17	...	13	13	8

Sources: Data provided by the Indonesian authorities; and IMF staff estimates.

TABLE A4

East Timor: Distribution of Commercial Bank Credits

	1995 December	1996 December	1997 December	1998 December	1999 June
			(In millions of rupiah)		
By sectors					
Agriculture	533	906	1,005	8,135	9,505
Industry	522	794	2,806	5,015	4,902
Construction	13,917	19,239	25,878	17,762	13,481
Commerce	22,145	23,954	28,155	28,081	27,729
Transport	1,912	2,126	9,382	7,688	6,325
Environmental projects	. . .	7	169	141	143
Social projects	221	366	292	197	70
Other consumption	49,094	68,463	97,514	98,767	83,233
Total	88,344	115,855	165,201	165,786	145,388
			(In percent of total)		
Agriculture	0.6	0.8	0.6	4.9	6.5
Industry	0.6	0.7	1.7	3.0	3.4
Construction	15.8	16.6	15.7	10.7	9.3
Commerce	25.1	20.7	17.0	16.9	19.1
Transport	2.2	1.8	5.7	4.6	4.4
Environmental projects	0.0	0.0	0.1	0.1	0.1
Social projects	0.3	0.3	0.2	0.1	0.0
Other consumption	55.6	59.1	59.0	59.6	57.2
			(In millions of rupiah)		
By use					
Investments	3,879	6,639	17,264	12,992	11,225
Working capital	35,371	40,753	50,423	54,027	50,930
Consumption	49,094	68,463	97,514	98,767	83,233
Total	88,344	115,855	165,201	165,786	145,388
			(In percent of total)		
Investments	4.4	5.7	10.5	7.8	7.7
Working capital	40.0	35.2	30.5	32.6	35.0
Consumption	55.6	59.1	59.0	59.6	57.2

Source: Data provided by the Indonesian authorities.

TABLE A5

East Timor: Consolidated Budgetary Operations

(Provincial and central expenditure)

	1997/98	1998/99	1999/2000 Budget[1]
		(In millions of rupiah)	
Total revenue	85,953	116,874	98,898
Tax revenue	83,767	113,862	95,248
Income tax	33,496	47,964	27,351
VAT/sales tax	27,355	23,485	37,790
Other	22,916	42,413	30,107
Nontax revenue	2,186	3,012	3,650
Total expenditure	796,642	527,088	700,168
Current expenditures	138,889	207,132	213,316
Salaries and wages	95,427	146,529	166,980
Goods	22,590	36,474	29,658
Services and maintenance	7,026	8,522	7,233
Travel	4,002	4,492	4,448
Transfers and subsidies	2,952	2,321	920
Contingent		0	0
Other	6,892	8,794	4,076
Capital expenditure	657,753	319,956	486,853
Overall balance (deficit –)	–710,689	–410,214	–601,270
		(In percent of GDP)	
Total revenue	8.1	8.2	6.0
Tax revenue	7.9	8.0	5.8
Nontax revenue	0.2	0.2	0.2
Total expenditures	74.8	37.0	42.4
Current expenditure	13.0	14.6	12.9
Capital expenditure	61.8	22.5	29.5
Overall balance (deficit –)	–66.7	–28.8	–36.4
Memorandum item			
(In millions of rupiah)			
GDP (outturn prices fiscal year)[2]	1,065,025	1,423,382	1,650,105

Sources: Data provided by the Indonesian authorities; and IMF staff estimates.

[1]Budget under Indonesian rule.

[2]No specific estimates for the provincial GDP for FY 1999/2000 have been found. The figure shown assumes that the East Timorese GDP would have grown in FY 1999/2000 at the same rate of growth of the Indonesian overall GDP, as presented in the Indonesian budget.

TABLE A6
East Timor: Consolidated Revenue

	1997/98	1998/99	1999/2000[1]
		(In millions of rupiah)	
Total revenue (I + II + III)	85,953	116,874	98,898
I. Tax revenue total (federal)[2]	76,786	106,225	87,348
Income tax[1]			
(PAJAK PENGHASILAN)	–33,496	–47,964	–27,351
Value added tax/sales tax[2]			
(PPN DAN PPN BM)	–27,355	–23,485	–37,790
Other tax revenue	–812	–668	–590
Revenue sharing scheme			
(Land and property, taxes, forestry,			
and leasing of lands)	–15,123	–34,108	–21,617
II. Tax regional revenue (provincial)[3]			
(PENDAPAPAKAN ASLI DAERAH)	6,981	7,637	7,900
Vehicle taxes	–4,019	–5,105	–5,450
Fee of vehicle ownership	–2,075	–2,399	–2,200
Leges money (uang peges)	–116		
Licensing (sand, stone, etc.)	–441		
Others[4]	–330	–133	–250
III. Nontax revenue (provincial)	2,186	3,012	3,650
Dividends on regional development banks	–944	–985	–1,100
Dividends on forestry and other			
agriculture exploitations	–695	–1,237	–1,450
Other dividends	–547	–790	–1,100
		(In percent)	
Total revenue (I + II + III)	100.0	100.0	100.0
I. Tax revenue total (federal)[2]	89.3	90.9	88.3
Income tax[1]			
(PAJAK PENGHASILAN)	39.0	41.0	27.7
Value-added tax/sales tax[2]			
(PPN DAN PPN BM)	31.8	20.1	38.2
Other tax revenue	0.9	0.6	0.6
Revenue sharing scheme			
(Land and property, taxes,			
forestry, and leasing of lands)	17.6	29.2	21.9
II. Tax regional revenue (provincial)[3]			
(PENDAPAPAKAN ASLI DAERAH)	8.1	6.5	8.0
Vehicle taxes	4.7	4.4	5.5
Fee of vehicle ownership	2.4	2.1	2.2
Leges money (uang peges)	0.1	0.0	0.0
Licensing (sand, stone, etc.)	0.5	0.0	0.0
Others[4]	0.4	0.1	0.3
III. Nontax revenue (provincial)	2.5	2.6	3.7
Dividends on regional development banks	1.1	0.8	1.1
Dividends on forestry and other			
agriculture exploitations	0.8	1.1	1.5
Other dividends	0.6	0.7	1.1

Sources: Data provided by the Indonesian authorities; and IMF staff estimates.
[1]Year 1999/2000 revenue as budgeted.
[2]Source of information: Directorate General of Taxation, Regional Office for XIV– Realisations–Annex I.
[3]APBD (Budget 1999/2000–Regional).
[4]Taxes on petroleum include sales tax and motor vehicle tax on gasoline and diesel (source of information: Pertamina; Customs Directorate).

Table A7
East Timor: Balance of Payments

	1995	1996	1997	1998	Estimated 1999	Projected 2000	Projected 2001
				(In millions of U.S. dollars)			
Current account including official transfers	–16	–18	–18	–15	1	–99	–180
Current account excluding official transfers	–103	–120	–124	–110	–48	–99	–180
Net exports of goods and services	–103	–120	–124	–110	–48	–99	–180
Exports of goods and services	37	44	52	56	50	53	66
Imports of goods and services	140	164	176	166	98	152	246
Foreign aid related[1]	70	82	86	77	40	105	173
East Timor budget	67	78	81	71	34	104	173
Other foreign aid	4	4	5	5	6	1	0
Other imports of goods and services[2]	70	83	90	89	58	47	74
Trade Balance	–75	–87	–91	–81	–36	–69	–129
Exports of goods	37	44	52	55	46	49	63
Imports of goods	112	132	142	135	82	118	192
Foreign aid related	44	51	53	47	24	72	119
Other imports	68	81	89	88	58	46	73
Services (net)	–28	–33	–33	–29	–20	–49	–55
Of which: Aid related services payments	–27	–31	–32	–29	–23	–52	–58
Private transfers	0	0	0	0	0	0	0
Official transfers	87	102	106	95	49	0	0
Of which: East Timor budget	83	97	101	89	43	0	0
Capital account	16	18	18	16	0	126	191
Official transfers (net inflow from UNTAET and humanitarian aid)	0	0	0	0	3	37	31
Trust Fund for East Timor	. . .	. . .	. . .	. . .	. . .	40	74
UN Trust Fund	. . .	. . .	. . .	. . .	. . .	41	57
Bilateral sources	. . .	. . .	. . .	. . .	. . .	28	47
Other capital flows and errors and omissions	16	18	18	16	–4	–20	–18
Commercial banks[3]	0	0	0	10	–3	–10	–9
Other short term[4]	0	0	0	0	0	–10	–9
Errors and omissions	16	18	18	6	–1	0	0
Overall balance	0	0	0	1	0	–22	–96
Financing gap	0	0	0	0	0	22	96
				(In percent of GDP, unless otherwise noted)			
Memorandum							
GDP current prices (in billions of rupiah)	708	862	996	1,272	1,878	. . .	. . .
GDP current prices, US$ millions, CPP adjusted	315	368	383	375	228	263	302
Current account balance excluding official transfers	–32.7	–32.6	–32.3	–29.4	–21.2	–37.7	–59.4
Current account balance including official transfers	–4.9	–4.9	–4.6	–4.0	0.2	–37.7	–59.4
Merchandise exports	11.8	12.1	13.5	14.6	20.4	18.8	20.8
Merchandise imports	35.6	35.8	37.1	36.1	36.1	45.1	63.5
Of which: Foreign-aid related	. . .	. . .	. . .	. . .	. . .	27.5	39.4

Sources: Data provided by UNTAET, Indonesian authorities; and IMF staff estimates.
[1]Assumes that 5 percent of the OCHA–led humanitarian aid and 6 percent of the UNTAET budget is spent locally.
[2]Assumes that half of the net foreign exchange gain from foreign aid transfers is spent by the private sector on imports.
[3]Assumes that one–quarter of the net foreign exchange gain from local spending of foreign aid is saved as bank deposits held by the private sector.
[4]Assumes that one–quarter of the net foreign exchange gain from local spending of foreign aid is hoarded as cash by the private sector.

TABLE A8
East Timor: Balance of Trade
(In millions of U.S. dollars)

	1995	1996	1997	1998	Projected 1999
Exports of goods	37	44	52	55	46
Agricultural goods	33	40	47	51	44
Farm food crops	5	7	8	8	3
Farm nonfood crops	20	25	31	28	33
Livestock	6	6	6	12	7
Forestry	1	1	1	1	1
Fishery	1	1	1	1	1
Mining and quarrying	1	1	2	1	1
Manufacturing industry	3	3	4	3	2
Imports of goods[1]	112	132	142	135	82
Foodstuffs	44	50	47	35	26
Rice	16	18	17	13	14
Nonrice	28	32	30	22	12
Petroleum products	11	11	13	14	4
Construction materials	33	37	35	20	13
Other imports	24	34	48	66	40
Trade balance	–75	–87	–91	–81	–36
Memorandum items					
Inter-island exports	37	44	52	53	39
Exports to third countries	0	0	0	1	7
Inter-island imports	100	120	129	135	105
Imports from third countries	12	12	14	0	19

Sources: Indonesian authorities; and IMF staff estimates.
[1]Excludes imports related to humanitarian assistance and those related to the UNTAET budget.

TABLE A9
Fiscal Accounts for the East Timorese Administration

	2000					
	2000 Budget (Tokyo)	January–June Budget (Tokyo)	January–June Estimate	2000/01 Projection	2001/02 Projection	2002/03 Projection
			(In millions of U.S. dollars)			
Revenues	15.3	4.3	1.5	17.1	30.0	40.0
Direct taxes	1.0	0.5	0.1	1.0	. . .	. . .
Indirect taxes	9.3	1.8	1.4	9.1	. . .	. . .
Nontax	5.0	2.0	0.0	4.9	. . .	. . .
Timor Gap	. . .	. . .	0.0	2.0	. . .	. . .
Expenditures	107.4	38.6	15.8	171.9	184.1	148.0
Recurrent expenditures	30.0	10.0	6.6	43.6	45.6	47.6
Wages[1]	6.9	2.7	4.9	14.6	16.7	18.2
Goods and services	1.0	0.3	0.0	14.1	. . .	. . .
Others[2]	22.1	7.0	1.7	14.9	. . .	. . .
Of which: Infrastructure operational costs	8.8	4.4	0.9	11.9	. . .	. . .
Capital expenditures	77.4	28.6	9.1	128.3	138.6	100.4
Financed by TFET	64.4	. . .	5.9	69.1	78.3	38.3
Financed by UN Trust Fund	13.0	. . .	0.4	15.6	9.8	9.3
Other sources	. . .	. . .	2.8	43.5	50.5	52.9
Balance	–92.1	–34.3	–14.3	–154.8	–154.1	–108.0
Financing requirements	92.1	34.3	14.3	154.8	154.1	108.0
UNTF	. . .	. . .	4.3	40.6	25.3	16.8
TFET	. . .	. . .	5.9	69.1	78.3	38.3
Deposits (– increase)	. . .	. . .	–1.5	1.5	0.0	0.0
Escrow account (Timor Gap)	. . .	. . .	0.0	0.0	0.0	0.0
Other[1, 2]	. . .	. . .	5.5	43.5	50.5	52.9
External financing available	. . .	. . .	15.7	75.2	0.0	0.0
UNTF	. . .	. . .	4.3	17.1	0.0	0.0
TFET	. . .	. . .	5.9	58.1	0.0	0.0
Other	. . .	. . .	5.5	0.0	0.0	0.0
Financing gap	. . .	. . .	0.0	78.1	154.1	108.0
UNTF	. . .	. . .	0.0	23.5	25.3	16.8
TFET	. . .	. . .	0.0	11.1	78.3	38.3
Other			0.0	43.5	50.5	52.9
Memorandum items						
Cumulative Disbursements to the Trust Funds						
UNTF	. . .	. . .	28.5	28.5	. . .	. . .
Of which: Committed[3]	. . .	. . .	7.1	. . .	. . .	. . .
TFET[4]	. . .	. . .	64.0	64.0	. . .	. . .
Number of public servants (FTE)	4,916	1,672	. . .	9,035	. . .	. . .
Monthly average wage (dollars)	83	83	. . .	135	. . .	. . .
			(In percentage of GDP)			
Revenue	5.6	3.2	1.2	5.9	8.9	10.1
Of which: Timor Gap	. . .	. . .	0.0	0.7	. . .	. . .
Expenditure	39.4	28.3	12.0	59.7	54.5	37.4
Recurrent	11.0	7.4	5.1	15.1	13.5	12.0
Capital	28.4	21.0	6.9	44.6	41.0	25.3
Balance	–33.8	–25.2	–10.8	–53.8	–45.6	–27.3
Nominal GDP (in millions of US$)	273	. . .	. . .	288	338	396

Source: UNTAET; World Bank; and IMF staff estimates.
[1]Includes in the first half of 2000 stipends for primary teachers paid by UNICEF and WFP, and for health workers paid by some NGOs.
[2]Includes in the first quarter of 2000 power operation costs paid by the United Kingdom.
[3]Committed from the UNTF before May 15, 2000, but not disbursed in the first half of 2000. The cash payments would be expected to occur in FY 2000/01, but are not included in the budget presentation prepared by UNTAET.
[4]Excludes $2.4 million from World Bank and Japanese post-conflict funds.

References

Arneberg, M., and J. Pedersen, 1999, "Social and Economic Conditions in East Timor" (New York: Columbia University; Oslo, Norway: Fafo Institute of Applied Social Science).

International Monetary Fund, February 2000, *East Timor: A Strategy for Rebuilding Fiscal Management*, Fiscal Affairs Department (Washington).

International Monetary Fund, June 2000, *East Timor—Establishing Fiscal Management: A Progress Report*, Fiscal Affairs Department (Washington).

International Monetary Fund, June 2000, *East Timor: Initial Steps in Restoring and Transforming the Payment and Banking Systems*, Monetary and Exchange Affairs Department (Washington).

International Monetary Fund, July 2000, *East Timor: Further Steps in Restoring and Transforming the Payment and Banking Systems*, Monetary and Exchange Affairs Department (Washington).

United Nations, Food and Agriculture Organization and World Food Programme, April 19, 2000, *Special Report: East Timor* (Rome).

United Nations, Transitional Administration in East Timor, and Indonesia, February 20, 2000, *Joint Communiqué Between the Republic of Indonesia and UNTAET* (East Timor).

United Nations, Transitional Administration in East Timor, December 15, 1999, *East Timor—A Preliminary Consolidated Budget for 2000* (East Timor).

United Nations, Transitional Administration in East Timor, and The World Bank, June 21–23, 2000, *Background Paper for Donors, Meeting on East Timor, June 2000* (East Timor).

World Bank, *Joint Assessment Mission (JAM) Background Report,* available via the Internet: http: //wbln0018.worldbank.org/eap/eap.nsf