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WORLD BANK GROUP

TIMOR-LESTE ECONOMIC REPORT

Leveraging WTO Accession for Economic Transformation

July 2024

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Timor-Leste Economic Report

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Acknowledgment

The Timor-Leste Economic Report (TLER) is a bi-annual World Bank report that assesses recent macroeconomic developments, outlook, and risks, as well as specific development challenges for the Timorese economy. In doing so, the TLER aims to inform the public policy debate and is geared towards a wide audience, including the general public, the government, the private sector, civil society organizations, and other domestic and international stakeholders.

The TLER is a product of the World Bank Jakarta and Timor-Leste office and receives strategic guidance from Carolyn Turk, Country Director for Indonesia and Timor-Leste. The report is prepared by the Macroeconomics, Trade, and Investment (MTI) Global Practice team, under the guidance of Lars Christian Moller (Practice Manager), Rinku Murgai (Practice Manager), Bernard Harborne (Resident Representative), and Habib Rab (Program Leader and Lead Economist). The production of the report's first and second chapters is led by Alief Aulia Rezza and Yus Medina Pakpahan. Cigdem Celik and Bambang Suharnoko Sjahrir authored Section 1.3. The focus chapter was authored by Csilla Lakatos, Mochamad Pasha and Ananda Nathan Narasimhan. Ana de Oliveira provided administrative support and coordinated the organization of the report's launch event. The report also benefited from comments provided by Pierre Sauve, Ruth Nikijuluw, and Amina Coulibaly.

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To receive the TLER and related publications by email, please email adeoliveira1@worldbank.org. For questions and comments, please email acoulibaly4@worldbank.org and ypakpahan@worldbank.org.

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KEY INDICATORS	
Population (million)	1.3
GDP (USD billion)	1.6
GDP per capita (USD)	1,295
Poverty headcount ratio -national poverty line (% population)	41.8
Poverty headcount ratio-USD 1.90 a day (2011 PPP, % population)	22.0
Poverty headcount ratio-USD 3.20 a day (2011 PPP, % population)	65.9
GINI index	28.7

Notes: Population and GDP data are for 2019. Poverty and inequality data are for 2014 (with revised PPPs)

Acronyms

AFT	Aid for Trade initiative
ASEAN	Association of Southeast Asian Nations
BCTL	Central Bank of Timor-Leste
CIT	Corporate Income Tax
CPF	Country Partnership Framework
EAP	Asia and Pacific
ESI	Estimated Sustainable Income
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GSP	Generalized System of Preferences
GVCs	Global Value Chains
ICT	Information and Communications Technology
IF	Infrastructure Fund
IMF	International Monetary Fund
INETL	Institute National Statistics of Timor-Leste
JSI	Joint Statement Initiative
LPI	Logistic Performance Index
MTCI	Ministry of Tourism, Trade, and Industry
NEER	Nominal Effective Exchange Rate
NEET	Not in Employment, Education, or Training
NQI	National Quality Infrastructure
NTFC	National Trade Facilitation Committee
NTMs	Non-Tariff Measures
PF	Petroleum Fund
PIT	Personal Income Tax
REER	Real Effective Exchange Rate
SDP	Strategic Development Plan
SPS	Sanitary and Phytosanitary
TBT	Technical Barriers to Trade
TFA	Trade Facilitation Agreement
TIN	Taxpayer Identification Number
UN	United Nations
VAT	Value added Tax
WTO	World Trade Organization

Summary

1. Recent Developments

Preliminary estimates from INETL, the Timor-Leste National Statistics Office, suggest that the economy grew by 2.3 percent in 2023, following growth of 2.9 percent in 2021 and 4.0 percent in 2022.[1] The subdued economic growth in 2023 reflects the fiscal drag and low budget execution rates resulting from the Parliamentary Election and subsequent change in government. Private consumption increased by 3.2 percent, potentially fueled by substantial remittance inflows.

The reliance on public sector-driven economic activity over the past decades has exerted a substantial influence on Timor-Leste's labor market dynamics. In particular, the decline in non-oil per capita GDP since the political impasse in 2017 has been reflected in a decrease in labor productivity. Accordingly, wage levels have significantly decreased, with those possessing higher levels of education experiencing a steeper decline.

Persistent slow budget execution continues to hinder economic performance. By May 2024, approximately 25 percent of the total Central Government budget and 6 percent of the Capital and Development budget had been expended. These figures align with historical average execution rates of 25 percent and below 11 percent for the respective categories between 2015 and 2024. Substantially higher execution rates are necessary, though not necessarily sufficient, to achieve the desired higher levels of economic growth.

The strengthening of the US dollar has contributed to an easing of price pressures, yet food inflation remains persistently elevated. In the first quarter of 2024, the Nominal Effective Exchange Rates appreciated by 1.0 percentage points due to the global strength of the US dollar. This partly helped ease inflation in tradable goods, which decreased to 4.7 percent in the first four months of this year from an average of 11.9 percent year-on-year during the same period last year. Nevertheless, despite stable or slightly increasing prices in most consumption categories, rice prices have risen substantially, driven by reduced international supply and slower domestic harvests due to unpredictable rainfall.

The balance of the Petroleum Fund (PF) remained relatively stable. As of the end of March 2024, the PF's capital was valued at USD 18.45 billion, representing 11 times of the 2023 GDP, and reflecting a modest increase of 3.4 percent from USD 17.83 billion at the same time last year. This growth was driven by higher-than-expected oil and gas prices in 2023, the payment of petroleum revenues from FY 2022 transferred to the Fund in FY 2023, and reduced withdrawals due to low budget execution amid the political transition.

2. Outlook and Risks

Timor-Leste is forecasted to maintain its recovery trajectory, with growth rate nearing merely 3 percent in 2024, subsequently accelerating to an average of 3.7 percent over the period 2024-2026. Government expenditure remains the primary driver. Efficient investments in capital spending, aimed at addressing infrastructure deficiencies and reducing production costs for the private sector, are expected to be particularly impactful. Additionally, the anticipated influx of visitor arrivals, spurred by efforts to join ASEAN, along with steady remittance inflows, will provide further support for the economy.

[1] *Instituto Nacional de Estatistica Tinor-Leste*, I.P.

The fiscal deficit is projected to remain around 44.8 percent of GDP in the medium term. Without revenue-generating measures, the mildly expansionary fiscal stance adopted by the authorities suggests a gradual increase in the deficit. Non-oil domestic revenues are projected to be around 10 percent of GDP, while spending will average 84 percent of GDP. Further withdrawals from the rapidly depleting Petroleum Fund will be the primary financing source.

The economic outlook faces several downside risks. Going forward, prolonged and escalating geopolitical tensions could sustain or increase oil and food prices, with potential disruptions to gas supply and grain exports further exacerbating food price inflation. The El Niño phenomenon and extreme weather events pose a risk to food availability and prices. Rising energy prices are expected to impact transportation and electricity costs. Lastly, a downturn in international stock markets could affect the PF's investment returns, similar to the experience in 2022.

The year 2024 presents a unique opportunity for reform in Timor-Leste, marked by the confluence of a newly elected government with a strong mandate and a period of relative stability following years of challenges. Structural reform and fiscal consolidation are paramount as these two agendas are intrinsically linked and must be addressed concurrently for lasting and meaningful change. The alignment of political will and economic stability provides a window of opportunity that, if seized, could usher in a new era of sustainable growth and development for Timor-Leste.

Timor-Leste's recent accession to the World Trade Organization (WTO) and ongoing efforts to join ASEAN present a unique opportunity to drive domestic reforms. Aligning domestic policies with international best practices through WTO accession can offer Timor-Leste stable market access and an improved business climate, both of which are crucial for attracting much-needed foreign direct investment, as detailed in Chapter 3.

3. Special Focus: Leveraging WTO Accession for Economic Transformation

Timor-Leste's accession to the World Trade Organization (WTO) presents a pivotal opportunity to broaden its economic base. The country's export profile is narrow, which underscores the urgency for diversification. By joining the WTO, Timor-Leste can enhance its trade relations and leverage opportunities in niche agricultural exports. This move could strengthen ties with key trading partners, while fostering participation in multilateral partnerships such as ASEAN. Policymakers in Timor-Leste are thus tasked with prioritizing policy reforms that will facilitate this transition, ensuring a more diversified and resilient economy.

Despite facing structural challenges, Timor-Leste's path toward economic resilience is rich with opportunities for growth and diversification. The nation's small domestic market and geographical position present unique challenges but also the potential for innovative trade solutions. Timor-Leste is actively working to overcome high trade costs and improve infrastructure resilience against natural disasters. Policy reforms aimed at tariff liberalization, harmonization of non-tariff measures, and attracting foreign direct investment are underway to strengthen integration into global value chains. Institutional quality and customs reforms are also in focus to ensure robust trade facilitation.

Timor-Leste's path to leveraging its WTO membership can be anchored by three keywords: compliance, modernization, and inclusiveness. The economic trajectory hinges on domestic reforms and adherence to WTO standards, a commitment that promises long-term growth but are essential for unlocking the full potential of the membership. The country must undertake strategic policy reforms and institutional modernization. These include adjusting trade barriers to align with its WTO commitments and facilitate economic diversification. Recognizing the potential disruptions from economic reforms and to encourage inclusive growth, Timor-Leste could consider providing support to sectors and communities that may be adversely affected. This can be done through targeted assistance, such as retraining programs and financial aid.

1. Recent Developments

1.1. Global growth moderates as inflation eases but risks remain.

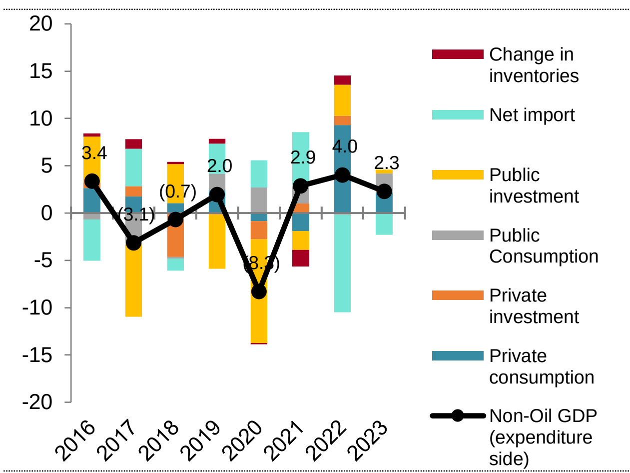
Despite modest improvements in recent months, global growth remains sluggish. Economic growth in advanced economies slowed to 1.5 percent in 2023. In early 2024, China saw a slight uptick in growth, driven by a positive contribution from net exports, which offset weakening domestic demand. Elsewhere in the East Asia and Pacific region, growth strengthened as exports began to recover from the downturn in 2023. Goods exports have since gained momentum in several major export-oriented economies, and manufacturing activity has shown signs of improvement, with purchasing managers' indexes rising in most larger economies. Private consumption growth remained robust across the region. Investment, however, remained subdued, partly due to the delayed impact of monetary policy tightening and increased global and domestic uncertainty.

Global inflation exhibits signs of abating. Following a steep decline from mid-2022 to mid-2023, variations in commodity prices were less marked in the latter half of the previous year. Although enhanced supply conditions have helped maintain commodity prices at relatively lower levels, these prices persist at rates significantly exceeding those observed before the pandemic. Agricultural commodity prices have largely stabilized. Despite these positive developments, however, global food insecurity is estimated to have further deteriorated.

1.2. Domestic economic expansion slowed due to the political transition.

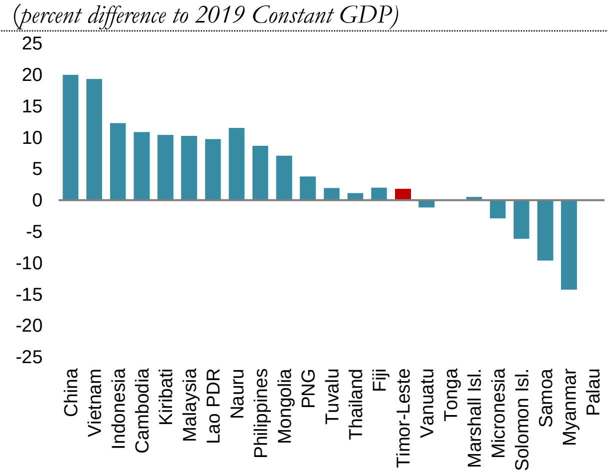
Timor-Leste, with its limited integration into the global economy, continues its gradual path to recovery. Between 2017 and 2021, the country faced a series of challenges including political instability, the COVID-19 pandemic, Tropical Cyclone Seroja, and global price increases exacerbated by the conflict in Ukraine. Preliminary estimates from INETL, the Timor-Leste National Statistics Office, suggest that the economy slowed to 2.3 percent in 2023, following growth of 2.9 percent in 2021 and 4.0 percent in 2022 (Figure 1.1). Sustained growth over the past three years has enabled Timor-Leste to regain its pre-pandemic level of economic output. The recovery rate lags the average for both East Asia and Pacific (EAP) countries, although it surpasses the rate for Pacific Island countries (Figure 1.2).

Figure 1.1:The economy slowed down in 2023…
(real growth, percent)



Source: INETL and World Bank Staff calculation.

Figure 1.2: … though sustained growth has helped Timor-Leste to recover output to its pre-pandemic level
(percent difference to 2019 Constant GDP)



Source: World Development Indicators, EAP Update April 2024 and World Bank Staff calculation.

The subdued economic growth in 2023 reflects the fiscal drag and low budget execution rates resulting from Parliamentary Elections and the subsequent change in government. The IX Constitutional Government, inaugurated in July 2023, amended the 2023 budget to align it with the new administration's objectives.[2] This rectification aimed to address slow budget execution, facilitate the government reorganization, initiate a review and planning process, and prioritize the new administration's policy goals. The challenge of slow budget execution was particularly acute, with less than 30 percent of the budget expended by mid-2023. Moreover, the extensive government restructuring, involving significant changes in at least ten ministries or government offices, disrupted government spending.

Despite delays in implementation, economic expansion in 2023 was driven by domestic consumption and investment. Private consumption increased by 3.2 percent, potentially fuelled by substantial remittance inflows. Public consumption and investment increased by 1.9 percent and 0.4 percent respectively. While exports, particularly in the services sector, experienced growth due to a significant influx of visitors during and after the election period, the overall trade balance remained negative. Constraints in domestic production capacity necessitate imports to meet domestic demand for both consumption and investment goods.

Weak public and private investment raise concerns for the long-term prospects of growth. Over the last decade, significant government expenditure, often exceeding the fiscal rule on Estimated Sustainable Income (ESI), was defended as necessary to meet investment needs. The peak in budget allocations for capital spending occurred in 2016, but has since sharply declined, even as the overall budget continued to grow. Worryingly, this decrease in government investment has coincided with ongoing challenges in executing the allocated budget, resulting in less efficient and effective public spending. Further exacerbating the situation, private investment has been on the decline since 2017. Low levels of investment are likely to impair output potential and productivity, which in turn could hinder job creation for the country's young and dynamic workforce.

Timor-Leste has been stuck in a low-growth equilibrium. The country, which once enjoyed growth averaging 4.9 percent annually in the decade following independence (2003-2012), has faced a pronounced slowdown in the subsequent period (2013-2022), with growth averaging a mere 1.1 percent. Factors contributing to this subdued growth are multifaceted. Political instability coupled with the global economic disruptions caused by the COVID-19 pandemic, have collectively undermined the progress achieved in earlier years. The persistent underperformance of the economy has raised concerns about the feasibility of achieving the ambitious growth targets set out in national development plans and government programs. The Strategic Development Plan's target of 11.3 percent average annual growth for 2011-2020 proved to be exceedingly optimistic. A continuation of current policies and practices will not suffice to achieve the 5 percent average growth target for 2023-2028 set by the IX Constitutional Government.

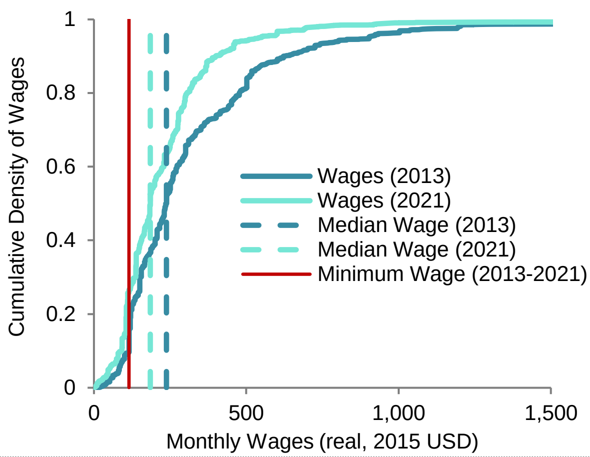
This calls for a reevaluation and renewal of the nation's economic strategy. The economy has been heavily reliant on public expenditure, which accounted for approximately 81.7 percent of total gross domestic production between 2013 and 2022. Conversely, the private sector remains nascent, with private investment levels stagnating at approximately 5.9 percent during this period. While private consumption constituted a significant portion of domestic expenditure at 63.8 percent, it is important to note that this figure is supported by government payments such as civil service wages and social transfers. The decade-long escalation of public spending has not translated into robust economic growth, indicating a lack of dynamism within the economy, which has hindered job creation and contributed to driving external imbalances.

[2] The amendment to the 2023 budget reduced the initial allocation from USD 1.9 billion to USD 1.7 billion. By the end of 2023, approximately USD 1.5 billion of the revised budget had been executed. This represents an execution rate of 87 percent, indicating that the new government was able to achieve a higher execution rate compared to the previous year, where the execution rate was 79 percent. However, in nominal terms, the executed budget in 2023 is lower than in 2022, when the budget amounted to USD 2.2 billion.

1.3. Timor-Leste's heavy reliance on the public sector has led to a stagnant labor market.

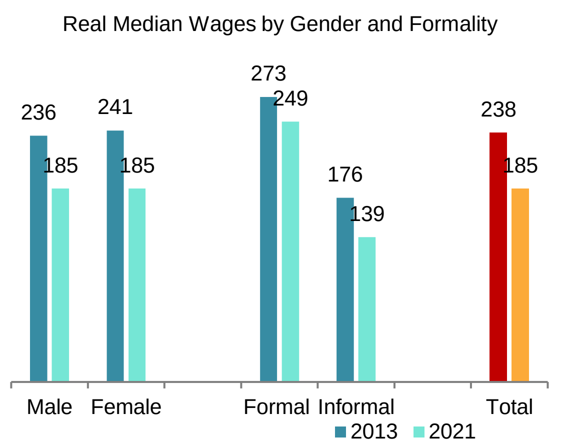
The reliance on public sector-driven economic activity over the past decades has exerted a substantial influence on Timor-Leste's labor market dynamics. Between the two Labor Force Surveys in 2013 and 2021, there has been no discernible improvement in the labor force participation rate, which remains the lowest among the nation's peers. Furthermore, as persistent obstacles to private sector development remain unaddressed, the majority of job creation over the past decade has been concentrated within the public sector. Outside of government employment, the majority of new jobs have been predominantly unskilled and informal in nature, while labor productivity has experienced a notable decline. The services and industry sectors have both witnessed a decrease in labor productivity, as the increase in value added has not kept pace with the rising levels of employment in these sectors. A concerning development is that, as of 2021, sectors characterized by lower-than-average labor productivity levels employed two-thirds of the workforce in Timor-Leste.

Figure 1.3: Median monthly real wages in Timor-Leste fell from USD 204 USD 185 in 8 years



Source: World Bank staff calculations using INETL 2021 and 2013 TL-LFS microdata

Figure 1.4: The wage gap between the workers in the formal and informal sectors increased over time

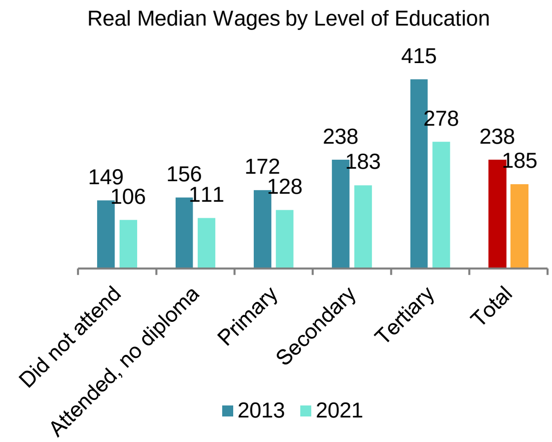


Source: World Bank staff calculations using INETL 2021 and 2013 TL-LFS microdata

In line with declining labor productivity, wage levels have significantly decreased, with those possessing higher levels of education experiencing a steeper decline. Median wages, after adjusting for inflation and spatial price differences, have declined by 22 percent between 2013 and 2021.[3] The median monthly wage fell from USD 238 in 2013 to USD 185 in 2021 (Figure 1.3). Median wages in the formal sector were significantly higher than those in the informal sector and have fallen at a slower rate, thereby increasing the wage gap between formal and informal sector employees (Figure 1.4). Although overall wage levels were higher for employees with higher levels of education, over time, they have declined at a faster rate for those with higher educational attainment. For instance, for the workforce with no educational attainment, median real wages fell from USD 149 to USD 106 per month, corresponding to a 29 percent decrease. In contrast, those with tertiary education have seen their median wages decline by 33 percent, from USD 415 to USD 278 per month (Figure 1.5).

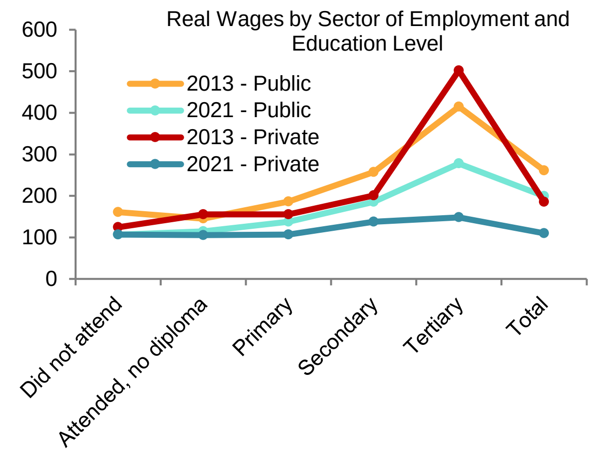
[3] The wages presented in this report are in real terms, in 2015 US Dollars, in line with the base year used in the national accounts data. Median wages are used in the analysis due to measure the central tendency that is less influnced by extreme values.

Figure 1.5: Median wages declined faster for workers with higher levels of education



Source: World Bank staff calculations using INETL 2021 and 2013 TL-LFS microdata

Figure 1.6: Private sector employees with a tertiary level of education suffered the largest amount of wage losses



Source: World Bank staff calculations using INETL 2021 and 2013 TL-LFS microdata

Real wages were higher for public sector employees across all levels of education in 2021, while the private sector offered higher wages in 2013. In 2013, private sector employees with a tertiary level of education earned more than their counterparts in the public sector. However, by 2021, this group had experienced the largest decline in both relative and absolute terms in their wage levels. Specifically, this group saw a 70 percent decline in their median wages, compared to a 33 percent decline for workers with tertiary education in the public sector (Figure 1.6). Additionally, the decline in wages for private sector employees was greater than for public sector employees across all education levels, except for those who did not attend school.

The decline in non-oil per capita GDP since the political impasse in 2017 has been reflected in both a decrease in labor productivity and a reduction in real wages across all sectors.[4] Between 2013 and 2021, economy-wide labor productivity fell by an average of 15.5 percent, while median wages declined by 22.4 percent. The industry sector, including construction, experienced even greater declines, with labor productivity falling by 50.3 percent and wages decreasing by 30.8 percent (Figure 1.7 and Figure 1.8).

Figure 1.7: Economy wide labor productivity fell by 15.5 percent between 2013 and 2021…

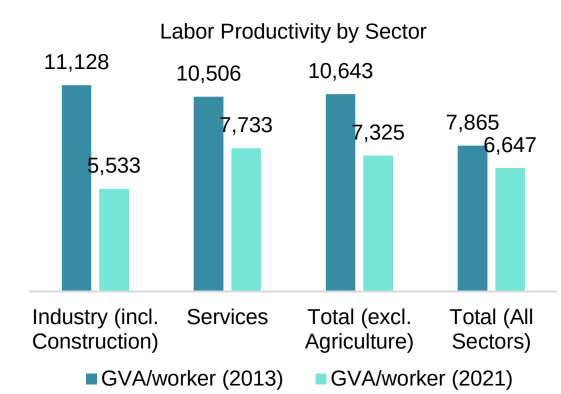
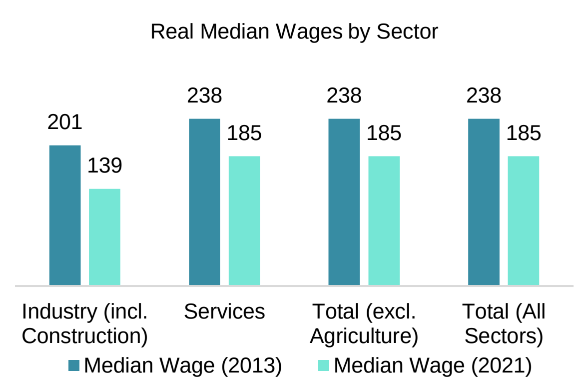


Figure 1.8: …while average real median wages declined by 22.4 percent during the same period



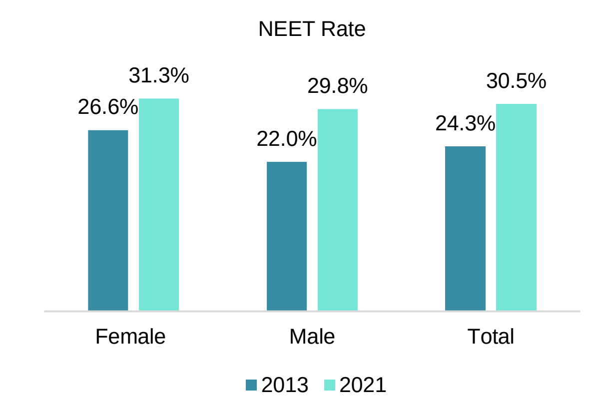
[4] Agriculture sector was excluded from the analysis as it had a very small share of salaried employees within the total workforce and thus did not include enough observations to conduct a wage analysis. Similarly, mean wages are provided for a disaggregation on the main sectors (industry, services and total economy) due to a low number of observations on the wage data at the lower sub-sectoral levels.

Source: World Bank staff calculations using INETL 2021 and 2013 TL-LFS microdata and INETL National Accounts data in constant prices.

Source: World Bank staff calculations using INETL 2021 and 2013 TL-LFS microdata

The creation of jobs in more insecure informal sectors, falling wage levels, and diminishing returns to education discourage workers, particularly the youth, from joining the workforce. While labor force participation fell over time, especially among younger cohorts, this did not necessarily result in youth spending more time in education. The share of youth (aged 15-24) not in employment, education, or training (NEET) increased by nearly 6 percentage points between 2013 and 2021, from 24.3 percent to 30.5 percent. NEET rates were higher for young women than men in 2021 but have risen at a higher pace for young men during the period of study (Figure 1.9). When asked what kind of activity best describes their current engagement, half of the people out of the labor force responded that they were engaged in household or family responsibilities, followed by 15 percent who stated that they were farming or fishing to produce food for family consumption. Only 2 percent stated that they were retired or pensioners, and interestingly, about 21 percent of those out of the labor force stated that they were in "other" activities or did not respond to the question (Table 1.1)[5].

Figure 1.9: NEET rate in Timor-Leste increased by 6 percentage points in 8 years



Source: World Bank staff calculations using INETL 2021 and 2013 TL-LFS microdata

Table 1.1: The majority of the population out of labor force is engaged in household responsibilities or agricultural production for household use

Out of labor force (15+, excl. those in education, training and apprenticeship) Which of the following best describes what you are doing?	Total	Total %
Studying or training	27,756	7%
Engaged in household or family responsibilities	189,998	50%
Farming or fishing to produce food for the family	57,100	15%
Retired or pensioner	7,757	2%
With a long-term illness, injury or disability	16,778	4%
Doing volunteering, community or charity work	608	0.2%
Engaged in cultural or leisure activities	415	0.1%
Other	44,964	12%
Unspecified	34,072	9%
Total	**379,450**	**100%**

Source: World Bank staff calculations using INETL 2021 TL-LFS microdata

The majority of those out of the labor force are not able to start work immediately or could not have started working if they had the choice. Excluding those that are engaged in education, training, or apprenticeship, 319 thousand people out of the labor force stated that they would not be able to start working within the next two weeks. This corresponds to approximately 57 percent of the total population out of labor force, and 84 percent of the population out of labor force, excluding those in education/training. When the people engaged in education and training were excluded, the primary reasons for not being able to start working were being engaged in family or household responsibilities (49 percent), waiting for the agricultural season to start (14 percent), and being engaged in agriculture for personal consumption (13 percent). Only 3 percent of those out of the labor force stated that they were retired, pensioners, or had other sources of income. Females were likelier to have family/household responsibilities and those living in rural regions were likelier to be engaged in agriculture for personal use. (Table 1.2).

[5] An additional 7 percent stated that they were studying or training even though they responded no to the questions on current attendence in school, training or apprenticeship activities.

Table 1.2: 318 thousand people, or 57percent of the population out of the labor force, are not able to start work immediately

If it depended on you, could you have started working last week? = No & Could you start working within the next two weeks? = No Why is that?	Total %	Male %	Female %	Urban %	Rural %
Awaiting recall from a previous job	1%	1%	0%	1%	1%
Waiting for the season to start	14%	18%	11%	8%	18%
In studies, training	8%	10%	6%	11%	5%
Family / household responsibilities	49%	36%	59%	45%	53%
In agriculture / fishing for family use	13%	17%	11%	4%	20%
Own disability, injury, illness	6%	7%	5%	3%	8%
Retired, pensioner, other sources of income	3%	4%	2%	3%	2%
Covid Restriction	4%	5%	4%	6%	3%
Unspecified	2%	2%	2%	1%	3%
Total (%)	**100%**	**100%**	**100%**	**100%**	**100%**
Total (# of people)	**318,678**	**133,240**	**185,447**	**108,619**	**210,067**

Notes: Excluding people engaged in education/training/apprenticeship. In the table above, the row "in studies, training" refers to people that are not formally attending education/training courses but still have declared to involved with studies/training at some capacity as a response to this question. Source: World Bank staff calculations using INETL 2021 data

1.4. Persistent challenges in budget execution, coupled with low efficiency in spending, result in sustained supply challenges.

Despite efforts to improve budget execution, persistent sluggishness in this area continues to hinder Timor-Leste's economic performance, particularly given its heavy reliance on government spending. The 2024 Budget Book acknowledges this issue and outlines the government's ambitious goal of exceeding 90 percent budget execution, particularly in the Capital and Development category. By April 2024, approximately 20 percent of the total budget (Figure 1.10) and 4 percent of the Capital and Development budget (Figure 1.11) had been expended. While the total budget execution was only marginally higher than the historical average of 19 percent, the capital budget execution was below the historical average of 7 percent between 2015 and 2024. Although total budget execution exceeded the historical average, substantially higher rates are necessary, though not necessarily sufficient, to achieve the desired higher levels of economic growth.

Figure 1.10: Budget execution until end of April 2024 was on par with the historical average

(percent)

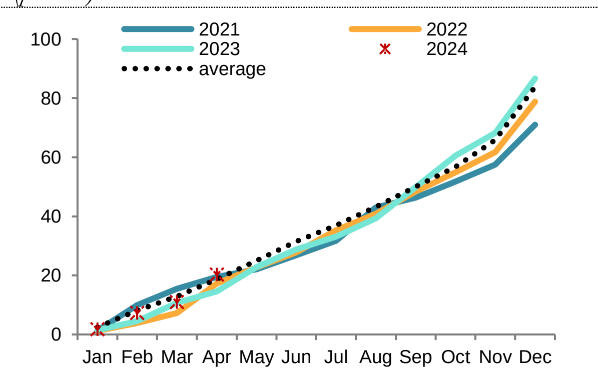
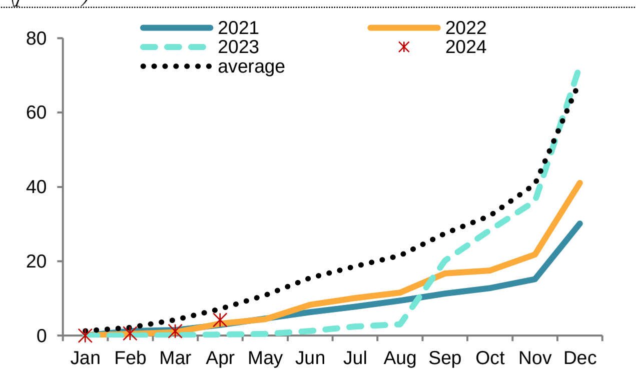


Figure 1.11: …while capital spending was implemented below the historical average

(percent)



Source: Ministry of Finance and World Bank staff calculations

The persistently low rates of budget execution underscore structural deficiencies in public financial management. While potentially influenced by a combination of factors, including public investment management bottlenecks and political instability, budget execution serves as a reliable indicator of the absorptive capacity of the country. The declining trend in execution rates, concurrent with a steady increase in budget allocation, suggests that resource allocation may have outpaced the capacity for effective implementation. Historically, these low execution rates can be partially attributed to recurring delays in budget promulgation. Since 2015, there have been at least four instances of such delays, ranging from two weeks in 2016 to over eight months in 2018 and 2019 (Table 1.3). Additionally, disruptive events like the 2017 election, the COVID-19 pandemic, and the 2021 natural disaster have further hampered the budget execution process. In the absence of such disruptions in 2024, a higher budget execution rate could have been achieved, suggesting that the allocated budget may have exceeded the government's absorptive capacity.

Table 1.3: Recurring delays in budget promulgation occurred several times between 2016 and 2020

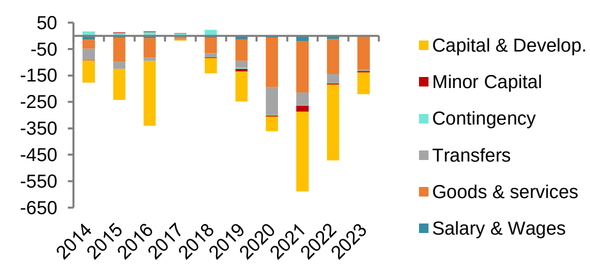
Budget	Submission (Government)	Approval (Parliament)	Promulgation (President)	Delay / Important Events
2015	19 Sept 2014	18 Dec 2014	29 Dec 2014	No delay
2016	29 Oct 2015	18 Dec 2015/8 Jan 2016	14 Jan 2016	2 weeks
2017	13 Oct 2016	9 Dec 2016	28 Dec 2016	No delay / Election
2018	7 Aug 2017	7 Sep 2018	27 Sep 2018	8 month
2019	22 Nov 2018	22 Dec2018	7 Sep 2019	>1month
2020	15 Sep 2020	8 Oct 2020	19 Oct 2020	>9 months
2021	15 Oct 2020	12 Dec 2020	28 Dec 2020	No delay / COVID
2022	15 Oct 2021	16 Dec 2021	03 Jan 2022	No delay
2023	03 Oct 2022	17 Nov 2022	15 Dec 2022	No delay / Election
2024	21 Nov 2023	20 Dec 2023	22 Dec 2023	No Delay

Source: Ministry of Finance and news articles

Challenges in budget execution primarily stem from the capital and development category. The capital and development category is chiefly responsible for discrepancies between the initial budget and actual expenditure, including instances of over-execution in 2014 and 2016, and under-execution in most other years (Figure 1.12). The establishment of the Infrastructure Fund (IF) in 2011 was intended to enhance the capacity to execute the capital budget. However, this institutional development does not appear to have resulted in a proportional improvement in the execution rate of the capital and development budget, partly because it has been accompanied by even larger allocations.

Figure 1.12: Under execution of capital and development spending led to low total budget execution

(deviation from respective latest budget (USD million))



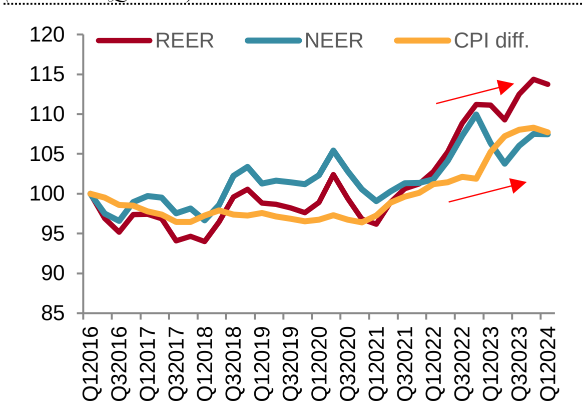
Source: Ministry of Finance and World Bank staff calculations

Despite substantial budget allocations for public investment, Timor-Leste's potential growth remains notably subdued, suggesting inefficiencies in the allocation and execution of capital spending. While capital expenditure has been considerable, constituting roughly one-third of total government outlay and exceeding regional comparators, it has not yielded commensurate economic expansion. This situation is atypical, with public investment reaching approximately 20 percent of GDP while potential growth stagnating at a mere 1-2 percent. This discrepancy between high public investment and low growth may be attributable to suboptimal distribution of resources between public infrastructure and private sector initiatives. Despite a significant infrastructure deficit, government expenditure may be directed towards projects that do not effectively address supply bottlenecks or alleviate production costs for the private sector. As such, such expenditure patterns result in minimal growth as they fail to tackle the fundamental constraints inhibiting economic growth.

1.5. The strengthening US dollar has contributed to an easing of price pressures, yet food inflation remains persistently elevated.

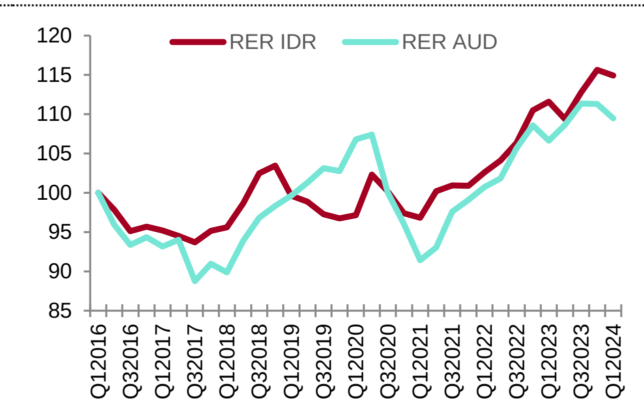
The appreciation of the US dollar has contributed to easing inflationary pressures. The nominal effective exchange rate (NEER) and real effective exchange rate (REER) appreciated by approximately 1.1 and 3.3 percent yoy, respectively, during 2020-2023 (Figure 1.13). In the first three quarters of 2024, the REER appreciated by 2.4 percent yoy, and the NEER by 1.0, due to the global strength of the US dollar and higher inflation in Timor-Leste compared to its trading partners (Figure 1.14). The NEER has a positive and significant impact on headline inflation (World Bank 2023). The NEER measures the value of a country's currency against a basket of other currencies. For Timor-Leste, which uses the US dollar as its official currency, an appreciation of the US dollar against the currencies of Timor-Leste's trading partners reduces the local prices of imported goods and services, thus easing inflationary pressure. Consequently, inflation in tradable goods decreased significantly to 4.7 percent in the first four months of this year, from an average of 11.9 percent year-on-year during the same period last year, partly due to this exchange rate movement.

Figure 1.13: REER and NEER continued to appreciate due to global strength of USD and TL's inflation
(index, 2016Q1=100)



Source: BCTL
Note: REER: real effective exchange rate which measuring the average of the bilateral RERs between the country and each of its trading partners along with each trade weights
NEER: Nominal effective exchange rate

Figure 1.14: US dollar also appreciated against the currencies of Timor-Leste's trading partners
(index, 2016Q1=100)



Source: BCTL
Note: RER; real exchange rate indexes (adjusted with relative price of goods) between two countries i.e Timor-Leste with Indonesia or Timor-Leste with Australia

Price pressures have begun to subside, yet food price inflation remains persistently elevated. Following two years of unusually high headline inflation, the first quarter of 2024 demonstrates a considerable decline in the overall inflation rate. Prior to 2022, average annual inflation rates were 1.6 percent. This figure rose significantly to 7.0 percent and 8.4 percent in 2022 and 2023, respectively, due to pent-up demand, geopolitical tensions, logistical bottlenecks, and adverse weather conditions that negatively impacted food supply (Figure 1.15). While a downward trend in price pressures was observed in the first quarter, mirroring trends in Timor-Leste's major trading partners, the inflation rate rose again in April 2024. Notably, tradable goods experienced a year-on-year increase of 4.5 percent in April 2024 (Figure 1.16), suggesting that imported inflation played a significant role in domestic price increases.

Figure 1.15: Inflation plummeted for the first three months this year contributed thanks to both food and non-food price deflation
(percent contribution and change YoY)

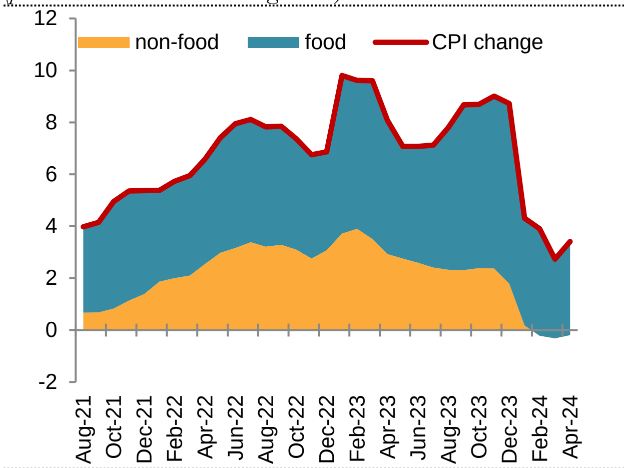
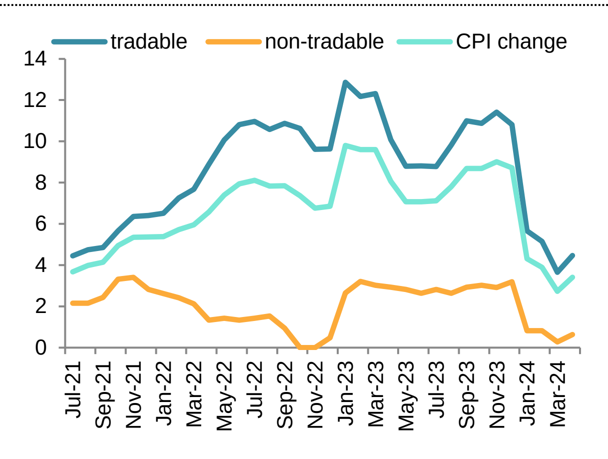


Figure 1.16: Tradable goods' inflation dropped partly due to appreciation of USD
(percent, change YoY)



Source: INETL and World Bank staff calculation

Food prices have been a primary driver of the recent surge in inflation. Despite stable or slightly increasing prices in most consumption categories, food prices have risen substantially. This significantly impacts aggregate prices, as food constitutes 54.1 percent of the Timorese consumption basket. Notably, rice prices have shown a staggering 25 percent year-on-year increase in average since January 2024 (Figure 1.17), continuing the double-digit inflation observed since June 2023. Factors contributing to persistently high rice prices include reduced international supply (partly due to India's ongoing export ban) (Figure 1.18), slower harvests caused by unpredictable rainfall, and increased transportation and fertilizer costs. Domestically, local crop failures due to unfavorable weather conditions have also played a role[6].

Figure 1.17: Consumer price inflation was driven mainly by rice and vegetable prices…
(percent contribution and change YoY)

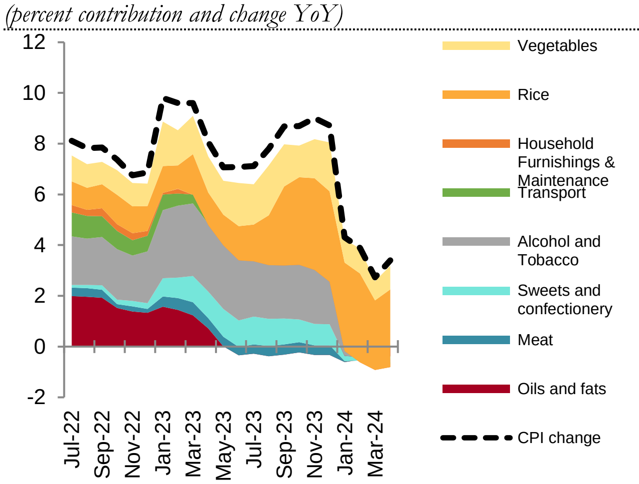
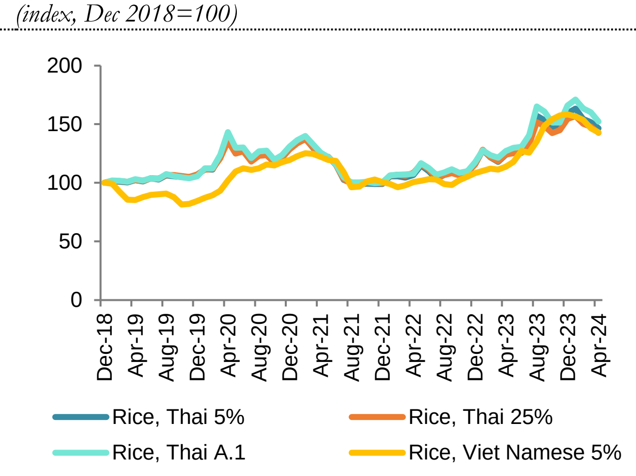


Figure 1.18: …driven in turn by high international rice price
(index, Dec 2018=100)



Source: INETL and World Bank staff calculation

Source: World Commodity Prices Pink Sheet

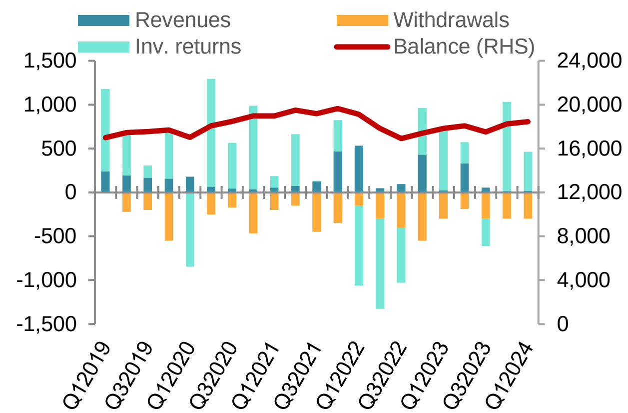
[6] The ongoing El Niño phenomenon, potentially one of the strongest on record, has resulted in significantly less rainfall than usual from October 2023 to January 2024. This dry spell, expected to continue until April 2024, further hinders agricultural production and exacerbates food price inflation.

1.6. The Balance of the Petroleum Fund grew but its long-term sustainability is at risk.

The balance of the Petroleum Fund (PF) remained relatively stable throughout the year. As of the end of March 2024, the PF's capital was valued at USD 18.45 billion, equivalent to 11 times the value of 2023 GDP. Petroleum Fund resources increased by 3.4 percent from USD 17.83 billion at the same time last year (Figure 1.19). This growth was driven by higher-than-expected oil and gas prices in 2023, the payment of petroleum revenues from FY 2022 transferred to the Fund in FY 2023, and reduced withdrawals due to low budget execution amid the political transition. The future value of the Fund is anticipated to continue declining due to the absence of inflows, volatile investment returns, and withdrawals exceeding the ESI level (Box 1.1). The 2024 budget projects total withdrawals to reach nearly USD 1.4 billion, which is approximately 2.6 times the ESI.

Figure 1.19: The petroleum fund balance stabilized for the first quarter this year partly due to contained withdrawals last year

(USD million)



Source: INETL, World Bank Commodity Markets Reports, and World Bank Staff calculation

Box 1.1: The Petroleum Fund served as primary budget financing but is at risk of rapid declining

The Petroleum Fund serves as the primary funding source for the state budget. Since July 2021, the Fund's investments in financial markets have been allocated into two distinct portfolios:

- Liquidity Portfolio: This low-risk portfolio is comprised of cash and short-term bonds, excluding equities. It is structured to fund anticipated withdrawals over the next three years on a rolling basis.

- Growth Portfolio: This portfolio allocates 35% to equities, with the remainder in government bonds. While equities offer higher long-term returns, they are subject to greater short-term volatility. The growth portfolio's extended investment horizon permits a higher risk tolerance compared to the liquidity portfolio.

The Fund has additionally invested in private debt instruments issued by Timor Gap E.P. to support the national petroleum company's investment in the Greater Sunrise project. These loans undergo independent valuation annually.

As of March 2024, the Petroleum Fund's annual return since inception stands at 4.35 percent, with the equity portfolio significantly contributing to these returns. The liquidity portfolio has effectively maintained its value, providing stability during periods of decline in equities and bonds.

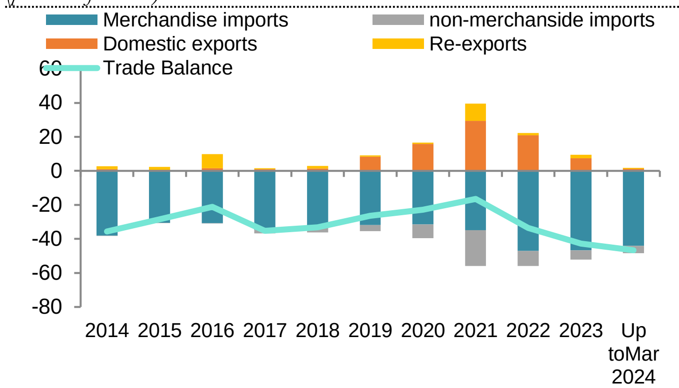
The balance of the Petroleum Fund is influenced by petroleum revenue, investment returns, and budgetary withdrawals. Initially, the Fund's value increased primarily due to high petroleum revenue surpassing government withdrawals during the frontloading expenditure phase. Subsequently, the balance plateaued as petroleum revenue diminished. Recently, the Fund's balance has grown owing to unexpectedly high investment returns.

Projections indicate that the Petroleum Fund will decline in the coming years, with outflows anticipated to exceed inflows and investment returns. Petroleum production from Bayu-Undan ceased in 2023. According to State Budget expenditure projections, withdrawals from the Petroleum Fund are expected to significantly surpass projected investment returns. As the Fund's balance decreases, the lower-risk, lower-return liquidity portfolio's relative size will increase, replenished annually from the growth portfolio to cover the expected withdrawals for the next three years.

1.7. The cessation of oil production and the slowdown in coffee output exacerbates preexisting external imbalances.

Substantial government expenditure and a strengthening US Dollar exacerbated Timor-Leste's external imbalances. Total exports experienced a sharp decline of close to 60 percent in 2023, following a contraction of nearly 40 percent the previous year (Figure 1.20). Although service exports, mainly driven by tourism, showed steady growth, the significant reduction in oil, gas, and coffee production led to a narrower export base, further intensifying the external imbalances. In contrast, merchandise imports expanded by 3 percent in 2023. By the end of March 2024, the trade deficit reached USD 193 million, equivalent to approximately 11percent of GDP. While total imports for the first quarter of 2024 remained stable compared to the same period in the previous year, exports contracted significantly by 87 percent.

Figure 1.20: Continuously large imports with decreasing exports has resulted in further trade deficits
(percent of GDP)



Source: Monthly Trade Report, INETL and World Bank Staff calculation
Note: Nominal GDP number include oil since 2019. 3 months GDP in 2024 is estimated by taking the average GDP in 2021 and 2022

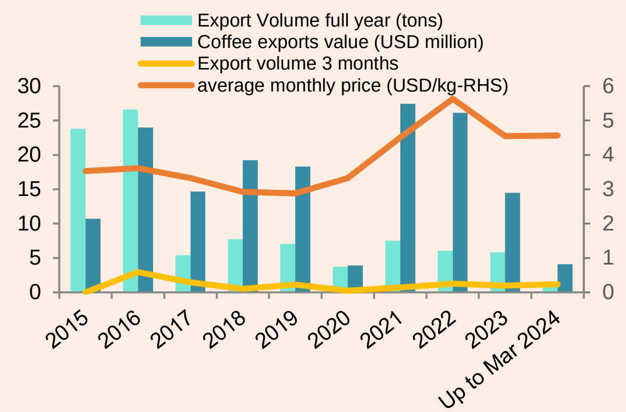
The persistent trade deficit burdened the current account, worsened by shrinking primary income and a reversal in net remittances. The substantial trade deficit emerged as the primary contributor to the enduring current account deficit. While primary income remained stable for five quarters, it is projected to decline as oil sector activities, classified as non-resident activities in the Balance of Payments Statistics, diminish. Notably, despite consistent growth in remittance inflows, data from BCTL, the Central Bank of Timor-Leste, indicates that secondary income has shifted as remittance outflows from foreign workers in Timor-Leste surpassed inflows of remittances from Timorese workers abroad.

Box 1.2: Challenges and Opportunitis in Timor-Leste's Coffee Sector

In discussions regarding Timor-Leste's diversification efforts, the coffee sector takes center stage. Coffee is Timor-Leste's largest non-oil and gas export, constituting over 90 percent of total exports in the first quarter of 2024 (Figure 1.21). However, mirroring the country's overall export decline, coffee exports in 2023 fell to nearly half of their 2022 levels. This decrease in export volume partially correlates with a 19 percent drop in average monthly coffee prices in 2023, following a period of continuous growth since 2020.

Figure 1.21: Coffee exports remain small both in terms of value and volume

(volume (tons), export value (USD million), and coffee price (USD/kg (RHS)))



Source: Monthly Trade Report, INETL, World Bank Commodity Markets Reports, and World Bank Staff calculation

Note: Coffee price is taking the average price of Arabica Coffee in each respective year or the past 3 months in 2024

Timor-Leste's coffee industry faces significant productivity and quality challenges. From 2020 to 2022, despite rising prices, export volumes remained stable. Low farm yields, averaging less than 200 kg of green beans per hectare compared to the global average of 880 kg, are a significant issue stemming from aging coffee trees and inadequate farm management.[7]

Climate change, with increasingly erratic rainfall and rising temperatures, further impacts yields and production consistency. The generally low quality of coffee produced, historically sold as a low-value commodity, is another concern. Farmers often harvest unripe cherries, and processors use rudimentary methods that do not yield desirable flavor profiles. As a result, returns for farmers and firms are constrained, discouraging investment in improved practices.

Recently, bright spots have emerged in the Timorese coffee industry, with a new generation of producers cultivating and processing high-quality coffee. This shift towards premium coffee has the potential to significantly benefit the economy. However, to unlock this potential, both private and public investment are crucial. If properly leveraged, the growing coffee demand, particularly from China, presents a positive outlook for Timor-Leste's coffee exports.[8]

[7] https://ourworldindata.org/grapher/coffee-yields?tab=table
[8] https://news.bloomberglaw.com/business-and-practice/chinas-new-love-of-coffee-is-coming-for-yours-javier-blas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2. Outlook and Risks

Timor-Leste's economy continues to recover from recent shocks, with a projected growth rate of 3.6 percent for 2024-2026. With limited foreign direct investment and exports, government expenditure remains the primary driver of this growth (Table 2.1). However, the ultimate growth trajectory will depend more on the effectiveness and efficiency of government spending rather than its level. Specifically, efficient investments in capital spending aimed at addressing infrastructure deficiencies and reducing production costs for the private sector are expected to be particularly impactful. Additionally, the influx of visitors, spurred by efforts to join ASEAN, along with steady remittance inflows, will provide further support for the economy.[9]

Table 2.1: Economic Forecast

(percent)

	2020	2021	2022	2023e	2024f	2025f	2026f
Real non-oil GDP growth	-8.3	2.9	4.0	2.3	3.0	4.0	3.8
Private Consumption	-1.3	-2.7	14.0	3.0	4.0	5.0	5.5
Government Consumption	4.9	2.9	-0.2	3.1	2.4	2.5	1.4
Gross Fixed Capital Investment	-46.9	-6.1	29.4	9.7	9.4	8.2	8.5
Public investment	-47.2	-14.9	29.7	12.0	10.7	9.1	9.3
Private Investment	-45.5	40.9	28.6	2.3	5.0	5.0	5.5
Export, Goods and Services	-47.3	79.3	30.3	5.0	2.0	2.0	2.0
Import, Goods and Services	-7.0	-9.0	22.8	4.9	5.0	5.0	5.0
Inflation (Consumer Price Index)	0.5	3.8	7.0	8.4	3.3	2.8	2.5
Fiscal Balance (percent of non-oil GDP)	-25.3	-47.0	-60.7	-43.8	-42.7	-44.9	-46.9
Current Account Balance (percent of non-oil GDP)	-19.1	2.8	-17.0	-19.8	-41.1	-42.4	-44.8

Source: INETL, World Bank Staff Estimate and Forecasts

The fiscal deficit is projected to remain around 44.8 percent of GDP in the medium term. This fiscal gap is primarily a function of planned government spending and the efficiency of its execution, given the relative stability of non-oil domestic revenues. The relatively lower fiscal deficit in 2023, for instance, was not due to deliberate policies but due to sluggish budget execution. While fiscal policy played a critical role in mitigating the impact during the pandemic, expenditure levels have remained elevated and have not yet returned to pre-pandemic levels. In the absence of revenue-generating measures, the mildly expansionary fiscal stance adopted by the authorities for the medium term suggests a gradual increase in the deficit. This will necessitate further withdrawals from the rapidly depleting Petroleum Fund.

Price pressures are projected to moderate. Headline inflation is expected to decrease to 3.3 percent in 2024. This decline is attributed to falling global commodity prices. While food prices in general are forecast to decrease, rice prices nevertheless may see a temporary increase in 2024 before subsiding in 2025 (Word Bank 2024). This potential rise is linked to supply concerns in major exporting countries due to El Niño and ongoing export restrictions from India. Despite the overall easing trend, the cumulative impact of high inflation rates over the past two years has been significant, disproportionately burdening the poor and vulnerable segments of the population. The impact of recent developments on poverty reduction however remains uncertain due to the absence of updated data. A new Living Standards Survey is planned for 2024.

[9] The upside risk for growth in 2024 includes increased infrastructure spending in preparation for the Papal visit in September, as well as heightened consumption by both Timorese residents and visitors during the three-day event.

The current account balance is projected to remain in substantial deficit. This weakness in the external position reflects both reduced oil revenues, following the cessation of hydrocarbon production in Bayu-Undan, and increased imports of goods and services. As a small island economy with limited domestic production capacity, stemming from low diversification and a public sector-dominated economy, the demand generated by substantial government spending necessitates a high level of imports. Without concerted efforts to enhance domestic capacity through diversification and fiscal consolidation, the current account deficit is expected to persist, posing a risk to external sustainability.

The economic outlook faces several downside risks. Prolonged geopolitical tensions could sustain or increase oil and food prices, with potential disruptions to gas supply and grain exports further exacerbating food price inflation. The El Niño phenomenon and extreme weather events also pose a risk to food availability and prices. Additionally, rising energy prices are expected to impact transportation and electricity costs. Lastly, a downturn in international stock markets could negatively affect the Petroleum Fund's investment returns, similar to the experience in 2022.

The year 2024 presents a unique opportunity for reform in Timor-Leste, marked by the confluence of a newly elected government with a strong mandate and a period of relative stability following years of challenges. The nation has endured political instability, a global pandemic, natural disasters, international conflict, and political transitions. Now, with calmer conditions prevailing, the time is opportune to implement long-overdue reforms. Structural reform and fiscal consolidation are paramount, and as detailed in Box 2.1, these two agendas are intrinsically linked and must be addressed concurrently for lasting and meaningful change. The alignment of political will and economic stability provides a window of opportunity that, if seized, could usher in a new era of sustainable growth and development for Timor-Leste.

Timor-Leste's recent accession to the World Trade Organization (WTO) and ongoing efforts to join ASEAN present a unique opportunity to drive domestic reforms. WTO membership provides a once-in-a-generation chance to initiate and sustain significant structural reforms that would be difficult to achieve without binding policy commitments. Aligning domestic policies with international best practices through WTO accession can offer Timor-Leste stable market access and an improved business climate, both of which are crucial for attracting much-needed foreign direct investment, as detailed in Chapter 3.

Box 2.1: Towards Better and More Sustainable Spending

Successive governments since 2006 have embraced an extreme expansionary fiscal policy stance based on large spending and low taxation. This approach is unsustainable and requires a major overhaul. Very high public expenditure levels, averaging about 85.0 percent of GDP between 2007 and 2023, combined with low domestic revenue collection, below 10.8 percent of GDP, are exerting significant pressure on the country's petroleum wealth. The PF is expected to deplete within approximately 10 years due to the cessation of petroleum revenues and large withdrawals to finance the state budget. The exhaustion of the PF would necessitate a strong fiscal adjustment, jeopardizing the delivery of basic public services.

Despite acknowledging the risk of a fiscal crisis in many recent budget publications, a comprehensive plan to avoid such a crisis has yet to be produced. A reform strategy to prevent such a crisis would require the government to first commit to a fiscal strategy that preserves the size of the PF and, consequently, avoid withdrawing more than the Estimated Sustainable Income (ESI). Maintaining the size of the PF is essential to ensure that future generations have sufficient resources to shape their own destiny and that the PF serves its perpetuity purpose.

Failing to stop withdrawals from the PF beyond the ESI would create a negative fiscal feedback loop. This a situation where the ESI becomes smaller due to extra withdrawals, necessitating further withdrawals to cover the deficit, which then makes the ESI for the following year even smaller. Furthermore, at USD 522.1 million in the 2024 budget (28 percent of GDP), the size of the ESI is nearly 3 times the domestic revenue from tax and non-tax sources combined. Given the difficulty of mobilizing revenue, especially in fragile countries setting like Timor-Leste, it is relatively easier for the government to focus on maintaining the ESI rather than on mobilizing new sources of revenue to replace it.

A commitment to respecting the ESI would create a significant gap in meeting spending needs, necessitating simultaneous reforms. Firstly, the government must considerably reduce its expenditure. While Timor-Leste, as a young post-conflict country, has various development needs, benchmarking analysis indicates that many other countries of similar size and economy manage to achieve more with less. Implementing various efficiency measures could potentially yield savings of 50 percent of GDP, roughly translating into USD 921 million. Substantial savings should be achieved across all types of government spending while protecting basic service delivery and the poor.

The second reform that needs to be undertaken is revenue enhancement. Given the finite nature of petroleum resources, it is critical to establish a strong foundation for sustainable revenue mobilization through the tax system. Efforts to introduce VAT, implement property taxes, adjust the rate of Personal Income Tax, and improve the tax administration system should commence immediately, as these reforms will take time to prepare, implement, and yield results. Property tax, in particular, though typically generating marginal revenues, can be a significant reform. It necessitates a robust land and building titling system, which has been a persistent issue for private sector development in the country. Benchmarking exercises indicate that Timor-Leste could potentially collect 5 percent of GDP, or roughly USD 92 million in the 2025 budget through these reforms.

The third reform involves utilizing concessional resources offered by donors and development partners. Budget documents indicate that returns from the PF investments can be more than twice the cost of borrowing from concessional loans. Therefore, engaging in concessional loans would result in fewer withdrawals from the Petroleum Fund, allowing more time for the Fund to grow. Additionally, concessional loans often come with extensive technical assistance, which can be beneficial for developing infrastructure projects or regulations that create an enabling environment for faster growth.

Structural reform to diversify the economy is essential. A dynamic private sector will drive the economy, create jobs, and stimulate higher private consumption, private investment, and exports. There is a strong correlation between fiscal reforms and structural reforms; the more robust the structural reforms, the easier the burden of fiscal consolidation, and vice versa. For example, better spending on infrastructure can reduce the cost of doing business for the private sector. In turn, a more flourishing private sector would aid revenue mobilization through higher VAT, CIT, and PIT collections.

Finally, the impact of significant budget reductions on growth can be minimized. This is due to the low estimated fiscal multiplier in Timor-Leste (see, for instance, World Bank 2021, International Monetary Fund 2024). The effects of reduced spending can be mitigated through more efficient and effective allocation of resources. A short-term adjustment period may be observed post fiscal consolidation adjustment before the economy stabilizes and returns to normalcy.

3. Leveraging WTO Accession for Economic Transformation

3.1. Introduction: Timor-Leste's Trade and Development Context

Since gaining independence in 2002, Timor-Leste has made significant strides, yet it now stands at a pivotal point. The depletion of the Petroleum Fund and unresolved issues regarding access to the Greater Sunrise oil fields signal challenges to fiscal sustainability. Despite high government expenditure, there has been no sustained source of economic growth, and the country's revenue streams are limited. Timor-Leste's economy is heavily reliant on international trade, which accounted for 89 percent of its GDP in 2021 (Figure 3.1 A). Timor-Leste's import to export ratios of 9.2 (goods) and 7.6 (services) are indicative of heavy dependance on foreign sources (Figure 3.1.B). In contrast, exports are considerably lower, with exports of goods and services accounting respectively for less than 2 and 6 percent of GDP for most of the last decade, underscoring the country's competitive challenges (Figure 3.1 C-D).

Despite Timor Leste's heavy reliance on international trade, **the 2020 Economic Recovery Plan points to the risk of protectionism and places emphasis on import substitution to bolster domestic production.** This strategy faces obstacles due to the small domestic market, geographical isolation, vulnerability to natural disasters, high trading costs, and the limited private enterprises and investments. Concerns about clearance times, fees, and border arrangements are prevalent among trading entities and were highlighted in the World Bank's Logistics Performance Index (LPI). Timor Leste scored 1.5 out of 5 on the LPI, reflecting poor perceptions of its customs and cross-border trade capabilities. Furthermore, the private sector in Timor-Leste is constrained by limited access to finance, which hampers its ability to attract necessary investments for expansion.

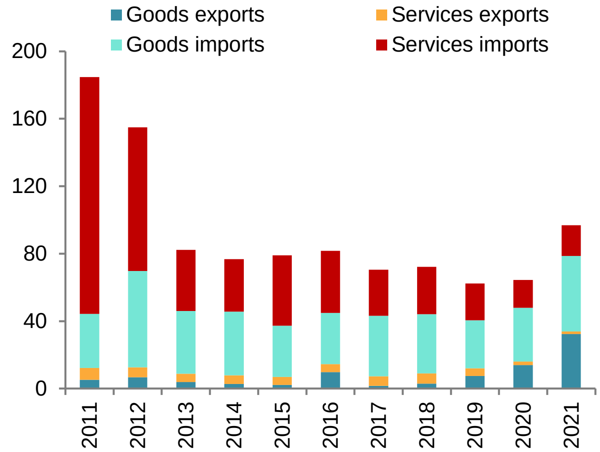
Timor-Leste's export options are limited, with minerals and fuel comprising 94 percent of exports, and coffee representing 90 percent of agricultural exports (Figure 3.1 E-G). Efforts to diversify exports have yielded limited results to date, with oil, gas, and coffee accounting for 99.2 percent of exports in 2021. The country's exports reach approximately 40 markets, mainly in the Asia-Pacific region, with Singapore, Japan, South Korea, and China being the top destinations (World Bank, 2023).

Timor-Leste's socio-economic challenges necessitate economic diversification and the development of a robust private sector to contribute to overall development and economic growth. Opportunities exist in niche agricultural exports such as seaweeds, vegetables, wood, copra, and vanilla. Joining the WTO and ASEAN and strengthening ties with entities such as the EU will enhance trade relations. Policymakers in Timor-Leste must therefore prioritize policy reforms to address these challenges, expand domestic and international commercial trading opportunities, and ensure a thriving domestic market.

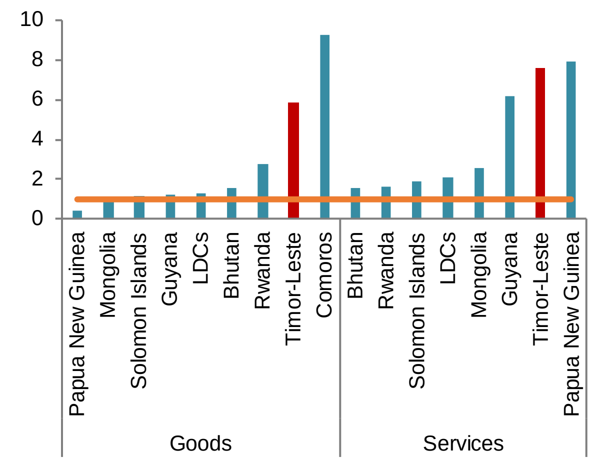
The country's recent accession to the WTO is a step towards enhancing international market access and building partnerships to accelerate development. To realize its diversification policies and strategies, Timor-Leste is also pursuing ASEAN membership, holding Observer status since 2022. In both cases, the country will need to develop critical economic infrastructure and enact key reforms if it is to leverage the full benefits of membership in both integration processes.

Figure 3.1: The Importance of Trade for Timor-Leste

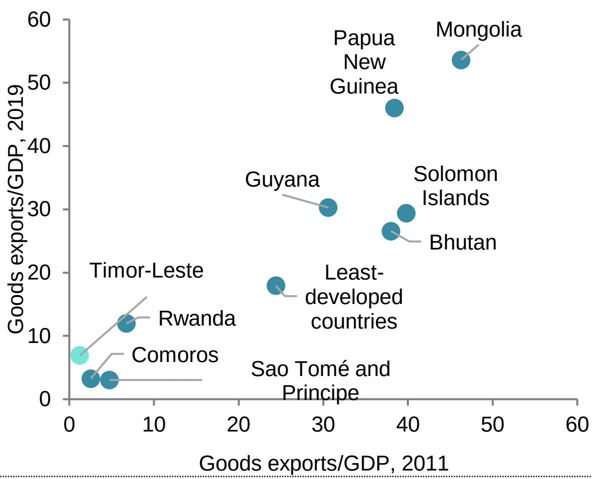
A. Trade openness (export and imports, percent of GDP)



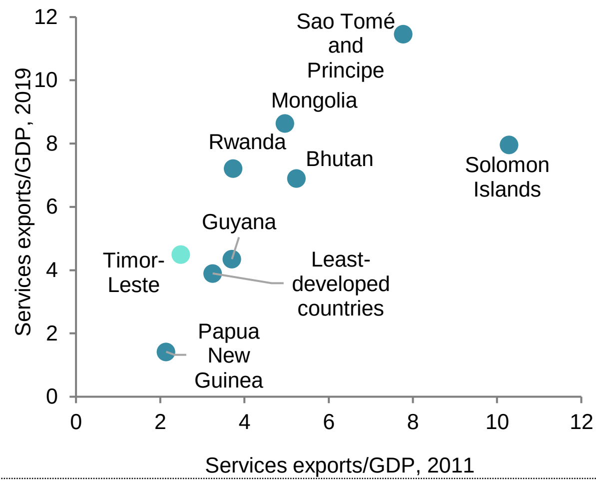
B. Ratio of imports/exports (2011-2021)



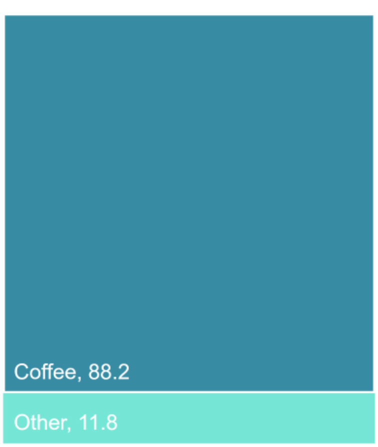
C. Goods exports/GDP: 2011 versus 2019



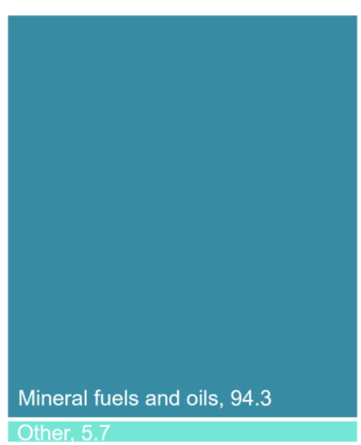
D. Services exports/GDP: 2011 versus 2019



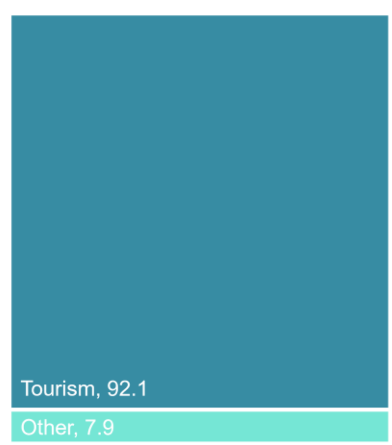
E. Agricultural exports (percent, 2021)



F. Goods exports (percent, 2021)



G. Services exports (percent, 2021)



Source: World Bank, WTO
Note: Services exports represent commercial services only

3.2. Export Competitiveness Challenges and Constraints

Timor-Leste grapples with a range of structural challenges that hinder its ability to grow and diversify exports. The country's small domestic market constrains the potential for businesses to achieve economies of scale. Timor-Leste's geographical remoteness, particularly from countries other than its immediate neighbors (Indonesia and Australia), present significant obstacles to trade. These include limited transportation options, which lead to elevated trade costs, and subpar infrastructure, notably internet and cellular connectivity. The country's export sector is also subject to the volatility of global prices for its primary exports, such as oil and agricultural products, which, in turn, fuel export revenue unpredictably. Timor-Leste's vulnerability to natural disasters, ranging from heavy rainfall and droughts to earthquakes, poses additional risks to agricultural output and can cause substantial damage to critical economic centers and infrastructure.

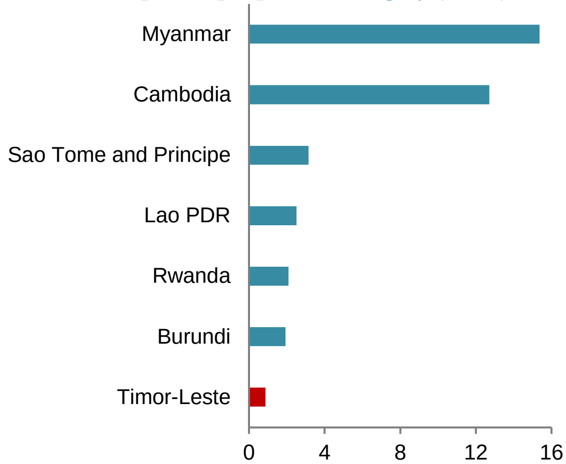
Timor-Leste's exports are highly concentrated, with a few large firms enjoying dominant positions. The country's export market is characterized by a small number of exporters per product category, averaging only 0.9, which is substantially lower than peers like Lao PDR and São Tomé and Príncipe, and significantly lower than Cambodia and Myanmar (Figure 3.2.A). This leads to a situation where only a small number of large firms control most of the export market. The average annual export value per firm and product is USD274,000, with a median of USD205,000, suggesting that a small number of large exporters skew the distribution (Figure 3.2.B).

Timor-Leste's economy shows a moderate dependence on imported inputs for exports. The country's domestic value-added ratio (DVAR) stands at 0.76, indicating that a significant portion of production inputs are imported (Figure 3.4.A-B). Agricultural exports are less reliant on imports, with a higher DVAR of 0.81, compared to nonagricultural goods at 0.70 (Figure 3.4.A-B). This is due to the inherent characteristics of agricultural products, which generally require fewer imported inputs. Over the period from 2011 to 2021, Timor-Leste's DVAR has risen, reflecting the greater use of domestic inputs, increases in primary goods exports, and shifts in the structure of trade flows. Despite a lower DVAR than similar countries, Timor-Leste's exports to China have a higher domestic value-added, aligning with China's import profile that favors primary goods, while exports to the East Asia-Pacific region are among the lowest in DVAR, indicating a high use of imported inputs (Figure 3.3.A-B).

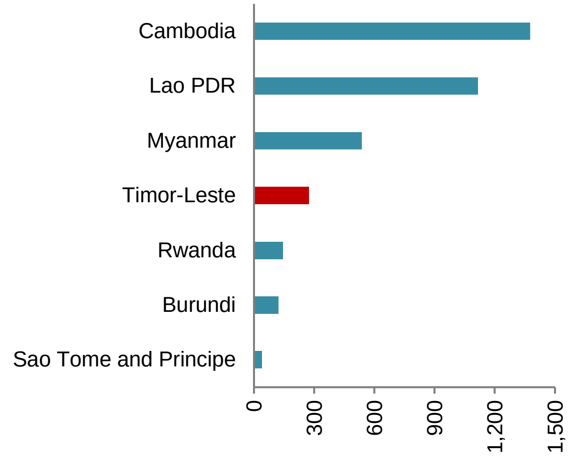
To improve integration into global value chains (GVCs) and capitalize on the benefits of global and regional trade, Timor-Leste could implement several policies. These include further tariff liberalization and harmonization of non-tariff measures to encourage imports of intermediate goods for export production, and promoting FDI to bring in needed foreign capital, technical know-how and expanded market access. Strengthening institutional quality and the rule of law is also essential for heightened GVC participation, as it ensures the enforcement of contracts critical to firm-to-firm interactions. Additionally, customs reforms aimed at reducing trade costs, such as implementing trade facilitation measures and complying with international standards such as the WTO's Trade Facilitation Agreement and the World Customs Organization's Revised Kyoto Convention, could help overcome trade barriers, reduce trade costs and enhance GVC trade.

Figure 3.2: Export Competitiveness Data: Exporters

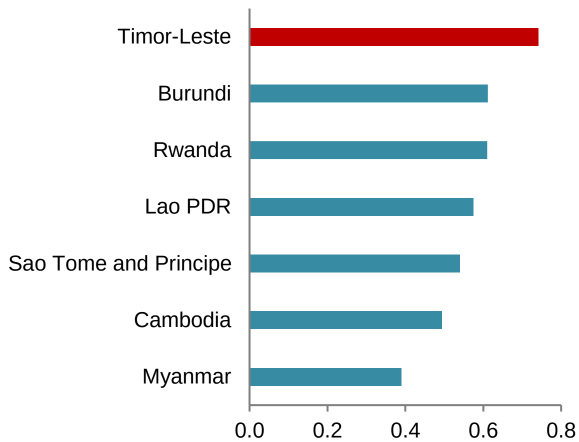
A. Number of exporters per product category (count)



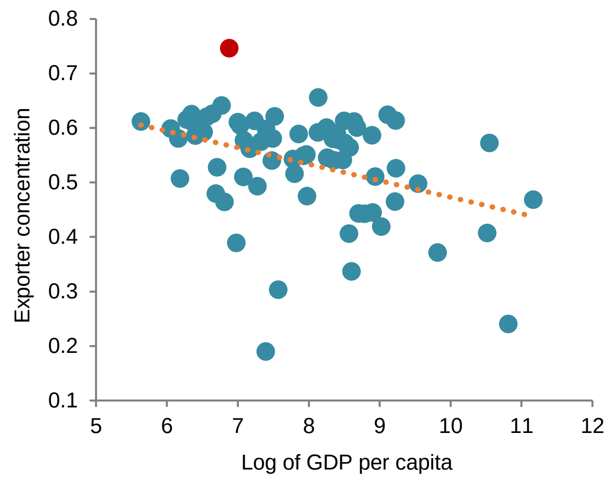
B. Average exporter size (US$, thousand)



C. Concentration of exporters



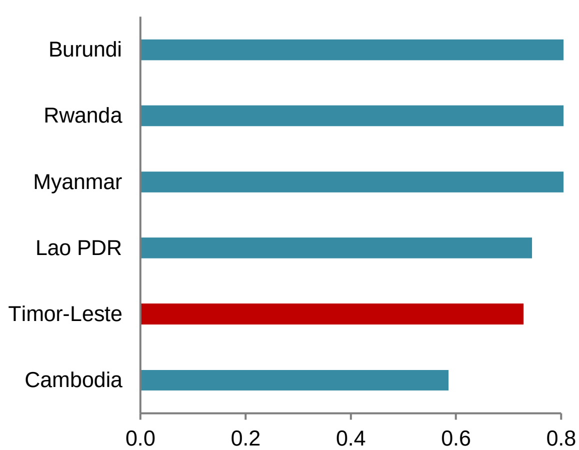
D. Exporter concentration and level of development



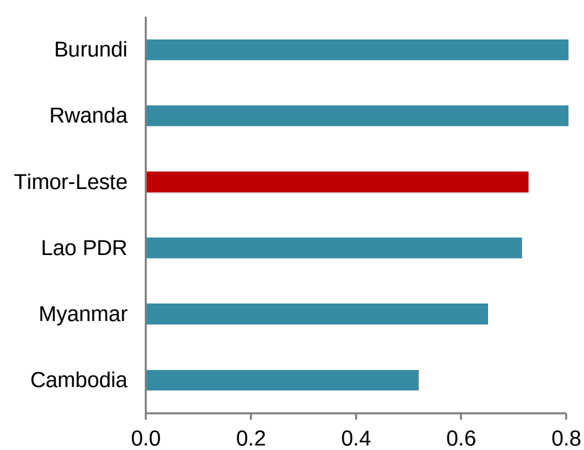
Source: World Bank estimations based on the EDD

Figure 3.3: Export Competitiveness Data: Entry, Survival and Exit

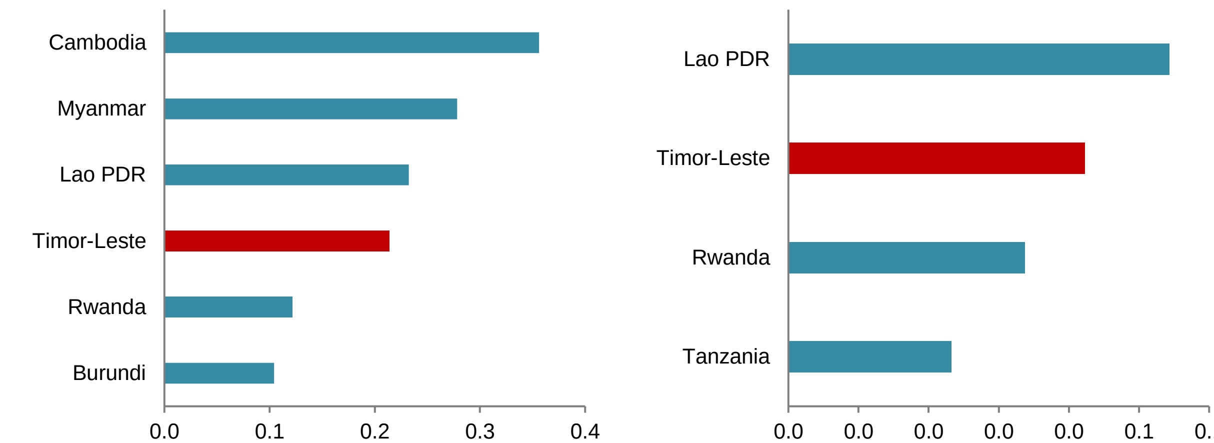
A. Exporter entry



B. Exporter exit



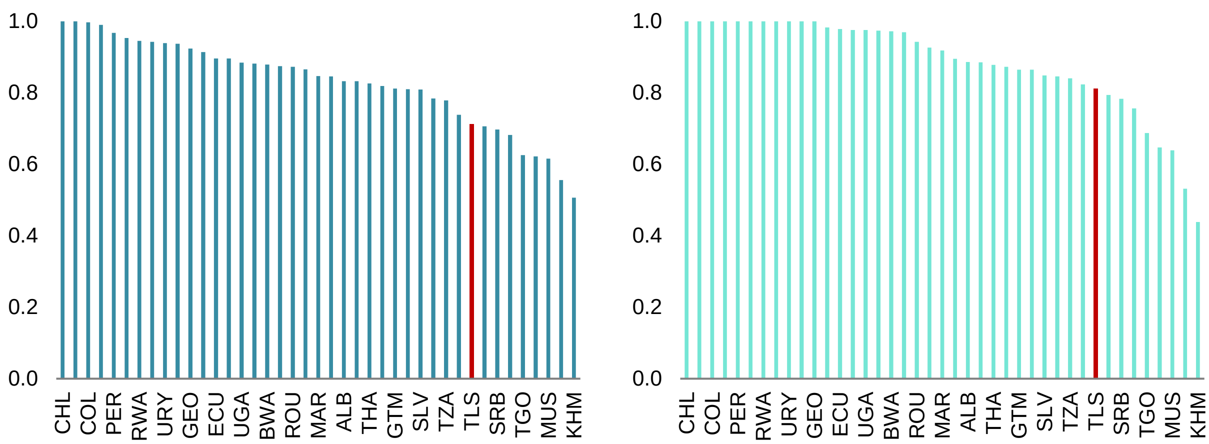
C. 1-year survival of exporters **D. 3-year survival of exporters**



Source: World Bank calculation based on the EDD

Figure 3.4: Export Competitiveness Data: Importing-exporters and domestic value added in exports.

A. Average DVAR: non agriculture **B. Average DVAR: agriculture**



Source: World Bank estimations based on the EDD

Timor-Leste's tariff structure prior to joining the WTO consisted of a flat 2.5 percent import tax on all products, complemented by a 2.5 percent sales tax on these imports (Figure 3.5.A). Excise taxes are levied on certain items, including alcohol, tobacco, and petroleum. Although these tariffs exist, they do not significantly contribute to national revenue, representing only about 1 percent of total revenues (Figure 3.5.C). Timor-Leste enjoys benefits such as preferential market access and reduced export barriers through the Generalized System of Preferences (GSP), such as provided by the United States, EU, and Japan. Following its accession to the WTO, the country has put forth a market access offer and established a schedule for bound tariff rates. Nonetheless, the complete liberalization of tariffs could offer economic benefits, especially to the private sector, by fostering productive capacity and diversification, and by facilitating access to more affordable capital goods and materials necessary for business.

Timor-Leste faces challenges with Non-Tariff Measures (NTMs), both domestically and in its export markets. The country maintains certain regulations that can hinder trade. Timor-Leste implements a tiered import authorization system. Traders must first obtain a Taxpayer Identification Number (TIN). They then need an import authorization issued by SERVE. For lower-risk imports, SERVE automatically grants authorization. However, imports classified as medium or high-risk require non-automatic import licenses issued by relevant sectoral ministries or agencies whose delivery can take up to one month. Additionally, 95 percent of Timorese exports face a high number of NTMs in destination markets. For instance, agricultural exports are subject to a significant level of licensing and quotas, affecting over half of all such products. These restrictions vary considerably by destination, ranging from a low of 8 percent to a high of 94 percent. Additionally, exporters face numerous non-tariff measures (NTMs) in most markets, including price controls and additional taxes.

A persistent obstacle to Timor-Leste's export growth and diversification is the inadequacy of its national quality infrastructure (NQI) for standards assessments. This encompasses physical infrastructure, such as metrology laboratories and testing facilities, as well as the associated certification procedures and regulatory frameworks. These elements are crucial for Timorese exporters to comply with the increasingly stringent product standards and NTMs demanded by its trading partners. Establishing this infrastructure would support efforts to diversify non-oil exports, particularly by enhancing the competitiveness of the Timorese coffee sector in the global market.

In responding to the above challenges, Timor-Leste has developed a 5-year action plan to adhere to the WTO's Technical Barriers to Trade (TBT) and Sanitary and Phytosanitary (SPS) agreements. This plan aims to comply with new standards and regulations and to build the institutional framework needed to meet these agreements. Close to a third of Timorese products entering certain countries are subject to pest control treatments, underscoring the necessity for Timor-Leste to improve policies and access to meet NTM requirements in export markets.

Timor-Leste continues to face challenges in ensuring reliable, predictable, and effective trade facilitation. The UN Global Survey on Digital and Sustainable Trade Facilitation 2023 revealed low scores on implementation of best practices for the country, with Transparency at 53.3 percent, Formalities at 16.7 percent, Institutional Arrangements and Cooperation at 44.4 percent, Paperless Commerce at 40.74 percent, and Cross-Border Paperless Trade at 5.56 percent[10]. Traders and freight forwarders have reported difficulties in accessing reliable information, and customs clearance for imported goods can take upwards of 10 days (Figure 3.6.C-D). The full implementation of the WTO Trade Facilitation Agreement (TFA) is anticipated to cut Timor-Leste's trade costs by 16 percent.

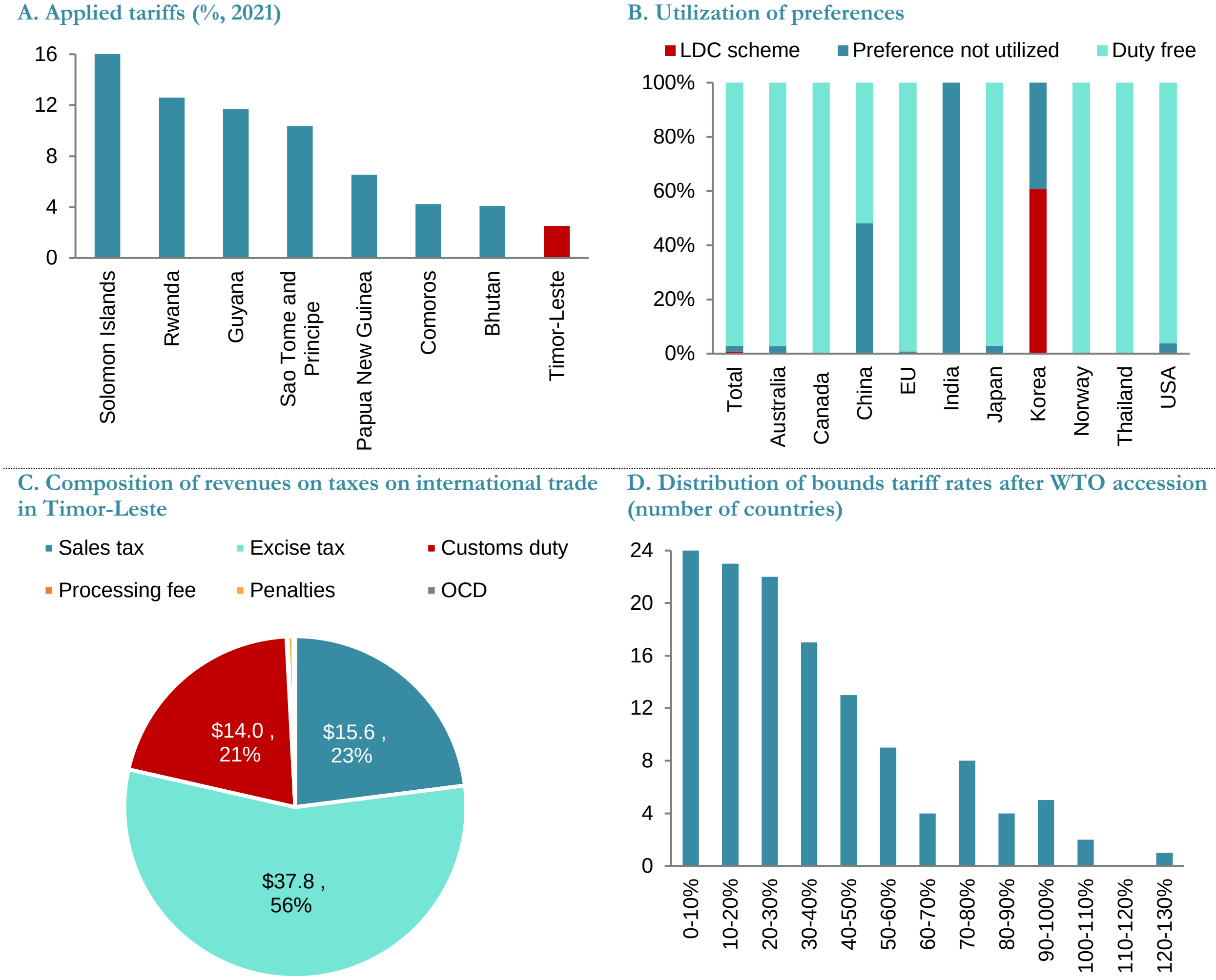
Timor-Leste is committed to an ambitious trade integration agenda to enhance development, although it maintains certain restrictions on services trade and foreign investment. Foreign investors are generally allowed to participate in most sectors[11]. The Private Investment Law stipulates that foreign skilled workers are guaranteed a minimum of five work permits under a Declaration of Benefits or Special Investment Agreement, but this is limited in sectors such as construction, which are reserved for Timorese nationals. The involvement of foreign construction companies is further constrained by ten Decree Laws that regulate procurement processes. While the construction sector faces certain complexities, Timor-Leste has taken steps to support its development program by signing bilateral investment treaties with several countries[12] and has implemented strategic plans such as the National Coffee Sector Development Plan 2019-2030, an Industrial Policy Strategy, and an Investment and Export Promotion Strategy.

[10] Scores are based on weighted implementation of trade facilitation best practices which include 60 trade facilitation measures classified under four grups: (1) WTO Trade Facilitation Agreement measures (e.g transparency, institutional arrangement and cooperation), (2) Digital trade facilitation measures (e,g, paperless trade), (3) Sustainable Trade Facilitation measures (e.g. agriculture trade facilitation), and (4) Other Trade Facilitation measures (e.g. trade finance facilitation). Full implementation of all measures equals to 100 percent. For example, on Transparency only 53.3 percent of best practice measures are implemented (United Nations, 2023).

[11] But are excluded from public communication, media services, and passenger transport.

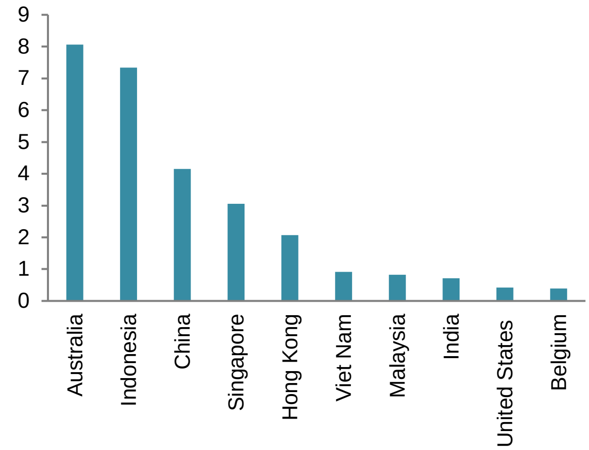
[12] Includes Portugal, Germany, Vietnam, Cambodia, Qatar, Kuwait, and the United States.

Figure 3.5: Tariffs and Revenues from International Trade

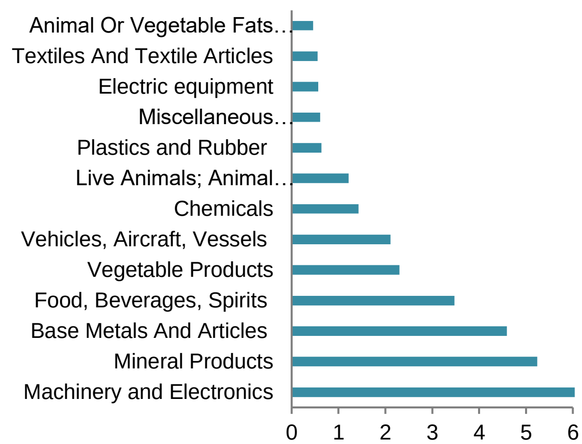


Source: Timor-Leste customs transactions trade data; World Bank, World Integrated Trade Solution (WITS) database: UNCTAD 2020.

E. Full liberalization of tariffs on intermediates and capital goods: impact on imports by trading partners (US$, millions)



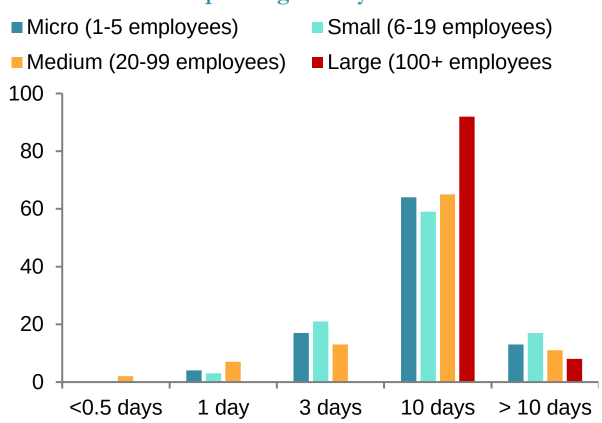
F. Full liberalization of tariffs on intermediates and capital goods: impact on sectoral imports (US$, millions)



Source: World Bank simulations using the GSIM model

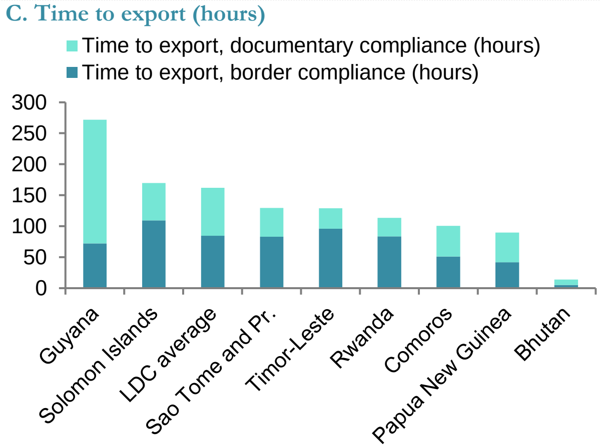
Figure 3.6: Trade Facilitation Indicators

A. Time to release imported goods by firm size

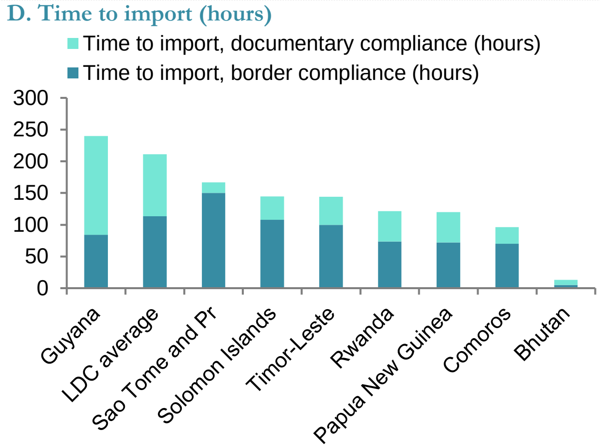


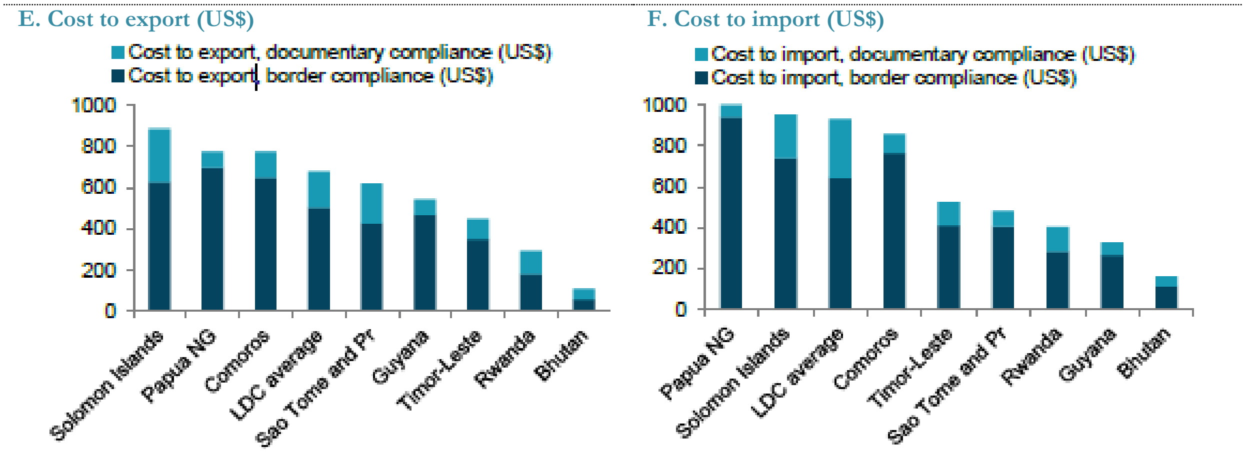
B. Usage of electronic import/export declarations system

C. Time to export (hours)



D. Time to import (hours)





Source: World Bank

3.3. Opportunities for Export Diversification and Growth

Timor-Leste's agricultural and food production sectors are underdeveloped and offer limited value-added products. Strategic policies focused on agriculture and food processing could provide a foundation for greater manufacturing diversity and opportunities. Addressing issues such as low productivity, technology adoption, land rights, market access, and investment is crucial. Over time, these policies could reduce the country's dependence on imported agricultural and food products to meet domestic needs.

Timor-Leste's agricultural deficit has grown significantly, from USD27 million (2.6 percent of GDP) in 2011 to USD179 million (11.5 percent of GDP) in 2021 (Figure 3.7.C), accounting for close to a third (30 percent) of the country's total goods deficit. Timor Leste's deficit is driven by imports of cereals, beverages, meat, and tobacco. The 2011-2030 Strategic Development Plan (SDP) aims to shift agriculture toward commercial farming, in line with the World Bank Country Partnership Framework 2020-2024 (CPF), which calls for economic diversification and expanding food exports. Enhancements in agricultural products, particularly coffee, which accounts for nearly 90 percent of agricultural exports (Figure 3.7.A-B.) and has seen a value increase from USD12 million in 2011 (1.2 percent of GDP) to USD27.6 million (1.7 percent of GDP) in 2021, are part of this effort. This includes adding roasting facilities, improving infrastructure, offering quality farm training, and implementing certification systems and information sharing.

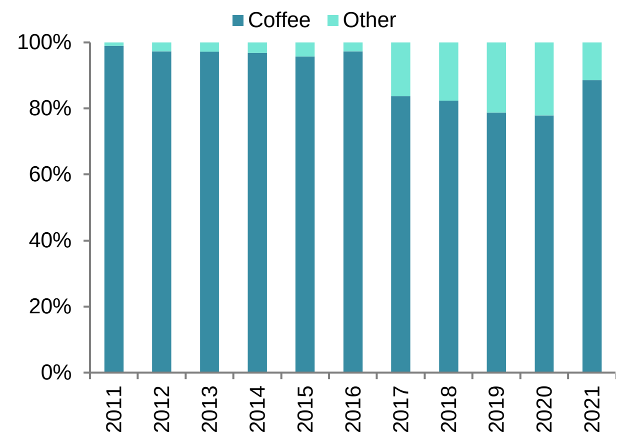
Policies that promote diversification and expansion could stimulate private sector growth in agriculture and food processing, enhancing production for domestic and export markets. Additionally, and despite market limitations and structural challenges, niche markets in manufacturing hold potential in diversifying the country's export basket (Figure 3.7.D.). Investments in technology that enhance productivity and specialization in manufacturing items such as wood products, accessories, and textiles could open revenue streams and export opportunities (Table 3.1 and Table 3.2).

Timor-Leste needs to leverage its comparative advantage[13] to expand its export portfolio beyond coffee. In this context, Timor-Leste's comparative advantages lie in products such as seaweeds, vegetable materials, copra, and vanilla (Table 3.1). This is evident by the sustained comparative advantage for coffee and vegetable materials observed between 2011-2015 and 2016-2021. However, the country has also lost its comparative advantage in areas like live fish, vegetable oils, and honey.

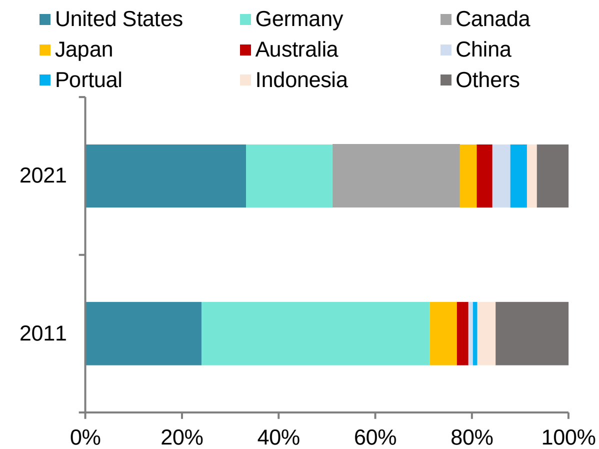
[13] Comparative advantage refers to a country's ability to produce a good or service more efficiently than others.

Figure 3.7: 8 Agricultural/Food Processing diversification opportunities

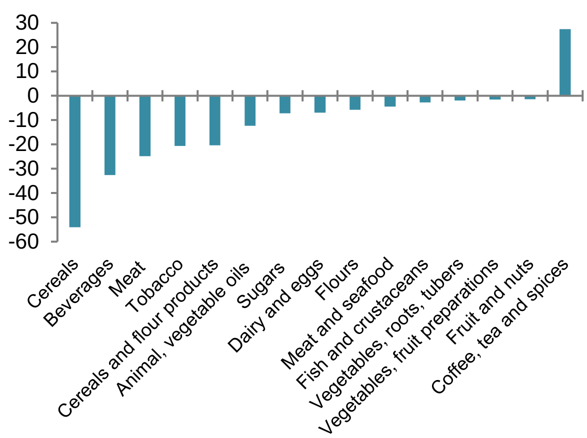
A. Agricultural and food exports (% of total)



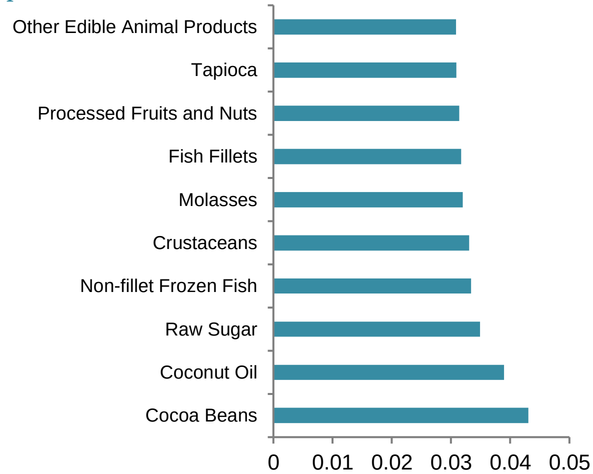
B. Main destination of coffee exports (% of total)



C. Agricultural and food deficit (US$ million, 2023)



D. Diversification potential based on current product space



Source: Timor-Leste customs transaction trade date; International Coffee Organization

Table 3.1: Maintained, new and lost agricultural/processing comparative

		2011-2015	2016-2021
		Mantained comparative advantages	
901	Coffee	457.5	73.1
1212	Locus beans, seaweed, sugar beet, sugar cane, fruit stones	5.1	48.4
1508	Ground nut oil and its fractions	50.7	13.8
1515	Fixed vegetable fats and oils	19.6	1.3
		New comparative advantages	
1203	Copra	0	201.1
905	Vanila	0	41.5
1210	Candlenut, hop cones, fresh or dried; lupulin	0	27.1
714	Roots or tubers	0	23.4
1302	Vegetable saps and extracts; pectic substances, pectinates and pectates; agar-agar and thickeners	0	8.6
1401	Vegetables materials of a kind used primarily for plaiting (for example, bamboos, rattans, reeds, rushes, osier, raffia)	0	3.4
802	Nuts (excluding coconuts, Brazil nuts, and cashew nuts)	0	1.1
		Lost comparative advantages	
1510	Oils and their fractions obtained solely from olives fractions	81.1	0
1211	Plants and parts of plants of a kind used primarily in perfumery, in pharmacy or for insecticidal, fungicidal or similar purposes	11.6	0

Table 3.2: Maintained, new and lost non-oil manufacturing comparative advantages

		2011-2015	2016-2021
		Mantained comparative advantages	
4413	Densified wood, in blocks, plates, strips or profile shapes	414.2	6.7
9605	Travel sets; for personal toilet, sewing, shoe or clothes cleaning	8.3	4.8
		New comparative advantages	
2942	Organic compounds	0	1.9
6309	Textiles; worn clothing and other worn articles	0	**1.1**
7118	Coins	0	1.2
7311	Containers for compressed or liquefied gas. Of iron or steel	0.4	1.3
		Lost comparative advantages	
4403	Wood in the rough, whether or not stripped of bark or sapwood, or roughly squared	11.4	0
4421	Wooden articles	7.9	0
6912	Ceramic tableware, kitchenware, other household articles and toilet articles; other than of porcelain or china	1.3	0
7602	Alumunium; waste and scrap	1.2	0.1
9015	Surveying, hydrographic, oceanographic, hydrological, meteorological or geophysical instruments and appliances, excluding compasses, rangefinders	2.0	0.7

3.4. Economic Benefits and Domestic Regulatory Reforms from WTO Membership

Since the WTO was established, the accession process has been pivotal in enhancing the legislative structures of applicant countries, particularly for those with low economic development. This process, governed by the Marrakesh Agreement, requires rigorous collaboration and consultation with experts, government officials, and the WTO. It involves inter-governmental committees that work to address and amend legal and economic challenges and improve regulatory frameworks. These reforms aim to facilitate better trade and to enhance the business environment for both foreign and domestic businesses, ultimately strengthening international business activities, trade, and economic governance. Enhanced legislative structures ensure that countries can fulfill their WTO commitments and actively contribute to global trade and business in the future.

Timor-Leste's recent accession to the WTO has led to comprehensive legislative and regulatory reforms aimed at meeting international trade standards and improving the country's business environment. The country is poised to benefit from increased trade-related assistance, foreign direct investment, and reduced trade costs, while also strengthening business regulations, infrastructure, digital capabilities, and market access. Support from international donors and development partners has proven instrumental in this regard. However, significant work remains in policy, regulation, implementation, and private sector engagement, requiring Timorese officials to further develop their expertise to maintain momentum towards their development goals.

Membership in the WTO has been shown to reduce trade costs and promote economic growth, particularly for developing countries. A UK government study covering accessions from 2000 to 2016 found that 79 percent of new WTO members experienced lower trade costs, with average tariff equivalent measures decreasing by 15 percent (Department for International Trade, 2022). Additionally, agricultural exports increased by 28.5 percent and manufacturing by 28.4 percent across all WTO members. These benefits, largely accruing to developing countries, underscore the WTO's role in fostering a more equitable global trading system that allows for special provisions to support economically disadvantaged members. Enhanced economic governance through WTO membership ensures deepened market access opportunities and adherence to the rule of law, creating a stable environment for businesses to thrive. In the case of Timor-Leste, the positive effects of joining the WTO are evident, with the promise of continued economic advancement beyond the first five years of membership.

Joining the WTO also offers Timor-Leste strategic benefits, including a stronger position in the global market and improved productivity. However, realizing these benefits depends on significant improvements in governance and the economic business environment, such as better legislation and infrastructure. Donor support can help drive domestic reforms, fostering competitiveness across various sectors such as tourism, education, and construction, and diversifying the economy. Prioritizing human capital, institutional quality, and digital capabilities will further transform the economy and attract foreign investment. As a WTO member, Timor-Leste can seek international support to boost its economic capacity, positioning itself for sustained trade and economic performance in the future.

To foster the growth of the services sector and attract foreign investment, policymakers should prioritize improvements in basic telecommunications infrastructure and adherence to the Joint Statement Initiative (JSI) on Services Domestic Regulation. The JSI on Services Domestic Regulation is a WTO initiative that aims to streamline regulations for service providers, making it easier for them to operate in Timor-Leste. Timor-Leste's pursuit of services-led growth is key to fostering economic transformation and human capital development. The focus on sectors such as production, storage, shipment, telecommunications, and digitization services will shift the economy from unskilled labor to one enriched by skilled human capital and knowledge spillovers. Investments in education, transportation, logistics, communication, and infrastructure are crucial, as highlighted in the 2020 Economic Recovery Plan, to improve domestic skills and trading capabilities. Although WTO membership is a step forward, it is not an immediate solution, and benefits will unfold over time through proactive policy actions (Sauvé, Lacey, and Lakatos 2024).

Timor-Leste can leverage tourism's potential for revenue by strategically focusing on this sector which needs significant investments in tourism infrastructure. Government support for training, attracting FDI, and improving accessibility is crucial, especially considering the current limited travel sources (mostly Indonesia, Singapore, and Australia). By joining the JSI on Services Domestic Regulation, boosting education, and incentivizing tourism investment, Timor-Leste can create a skilled workforce and streamline its overall development. It is in Timor-Leste's best interest to also join the JSI on Investment Facilitation for Development (IFD)[14]. Joining this JSI would help streamline procedures for FDI inflows and show a readiness to Join the JSI on E-commerce[15] which would allow Timor-Leste to enhance trade and progressively implement standards of sound digital governance.

Timor-Leste's membership in the WTO is a gateway to harnessing the potential of digital trade and development, offering access to the WTO's technical expertise and partnership opportunities. To establish a sustainable digital economy, Timor-Leste must develop comprehensive legislation that covers seven key pillars: e-commerce readiness, regulatory frameworks, trade facilitation, payment solutions, access to financing, ICT infrastructure, and skills development. The adoption of pro-competitive regulatory provisions and the liberalization of services are critical to bolstering participation in the digital economy, supported by low tariffs on ICT and related products (Sauvé, Lacey, and Lakatos 2024).

Furthermore, the WTO provides Timor-Leste with opportunities to advance trade through technical assistance and reforms supported by WTO donors. This includes expertise in cross-border trade, improved border management, and infrastructure, as well as domestic regulation reforms that can reduce trade costs and streamline global to regional value chains. The WTO's Trade Facilitation Agreement (TFA) encompass measures such as customs clearance, revenue collection, and fraud detection, which can significantly improve trade efficiency. The Trade Facilitation Agreement Facility and the World Economic Forum's Global Alliance

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[14] The IFD aims to improve the investment climate and to promote international cooperation to facilitate the flow of investments between WTO members, especially to developing and least developing country members.

[15] The WTO E-commerce Joint Statement Initiative (JSI) seeks to level the playing field by establishing common rules on various e-commerce issues. These include enabling e-commerce, promoting openness and trust, addressing cross-cutting issues (transparency, domestic regulation and cooperation), and ensuring telecommunications and market access for e-commerce firms.

for Trade Facilitation offer resources for Timor-Leste to develop and implement these measures, enhancing the country's trade performance and competitiveness while also reducing trade costs.

The WTO's Aid for Trade initiative (AfT) empowers developing countries such as Timor-Leste to address trade constraints and integrate more fully into global trade flows. Joining the WTO unlocks access to significant trade-related technical assistance from a wider range of donors. Timor-Leste has already benefited from such support, and becoming a member is likely to increase such Aid for Trade assistance (Sauvé, Lacey, and Lakatos 2024). This can help Timor-Leste implement its WTO commitments and undertake further domestic reforms to boost trade. For example, through the WTO's e-commerce negotiations, Timor-Leste can secure economic growth opportunities by obtaining commitments from international donors, which are further enhanced by streamlined practices and technical assistance. To seize these opportunities, Timorese policymakers must implement regulatory reforms and build domestic digital capacity, including infrastructure enhancement and financial support mechanisms for digital businesses and entrepreneurs. This is key to closing financing gaps for startups and promoting private sector growth.

As a WTO member, Timor-Leste will have a platform to advocate for its trading interests and benefit from the organization's dispute settlement system. WTO driven regulatory reforms in Timor-Leste can be expected to boost FDI by creating a more conducive economic environment. FDI is expected to enhance production, human capital, trade, and infrastructure, contributing to overall efficiency. Streamlined services for licensing, payments, and administrative procedures will similarly improve business operations. These reforms will promote transparency, strengthen the rule of law, and combat corruption, signaling to investors the government's dedication to a predictable economic policy.

3.5. Way Forward to Maximizing WTO Benefits

Timor-Leste must strategically exploit the advantages offered by the WTO to propel itself towards a more vibrant and competitive economy. Timor-Leste's recent accession to WTO is a pivotal moment for the country. While gaining membership offers a range of potential benefits, to truly capitalize on this opportunity requires a proactive approach. Accession to the WTO has played an important role in opening trade and investment regimes (Takamiya, 2022). Timor-Leste needs to implement substantial reforms in its policies and institutions to reach full alignment with its commitments to the WTO. Modernizing institutions involved in foreign trade and investment requires significant investments, but the potential benefits from such adjustments outweigh their cost (Bacchetta and Drabek, 2002).

While the immediate benefits of WTO accession may not be immediately apparent, given Timor-Leste's limited export basket, this step presents a valuable opportunity for the country's next phase of development. By focusing on attracting investment and incorporating better technologies, Timor-Leste can leverage trade through its WTO membership to enhance economic productivity. The approach should be to import goods and services that boost export capabilities and acquire technologies that enable the country to move up the value chain. Attracting investments and incorporating better technologies are crucial for Timor-Leste to achieve sustained economic growth and transition from a lower-middle-income to an upper-middle-income status[16].

For Timor-Leste to achieve sustained economic growth, domestic reforms driven by the necessity to comply with WTO standards are essential. WTO membership for Timor-Leste is a long-term investment, laying the foundation for future growth but not guaranteeing immediate gains. Accessing new markets and trade opportunities is just the first step. To fully unlock this potential, a strong commitment to aligning domestic regulations with WTO norms is crucial. For example, as part of its WTO accession package, the Cambodian

[16] Based on the 2024 World Development Report: The Middle Income Trap. the report outlines a "3i strategy"—investment, infusion, and innovation—to help countries climb to high-income status. Lower-middle income countries such as Timor-Leste should adopt the 2i strategy by focusing on attracting more investment and technology infusion (World Bank, 2024).

authorities committed to adopt 46 legislations that were aimed at providing a fair and predictable business environment (IMF, 2006). These reforms have been critical in shaping import and export markets and have contributed to robust economic performance, with Cambodia today on the cusp of graduating from least developed country status.

The process of domestic reforms will require establishing priorities and clear timelines for compliance. Timelines should be ambitious yet achievable, demonstrating Timor-Leste's dedication to the WTO framework. Importantly, this entails a comprehensive review of existing regulations. Unnecessary trade barriers, such as excessive custom procedures or restrictive licensing requirements, should be addressed to comply with WTO standards.

Following its accession to the WTO, Timor-Leste has established a legislative agenda with specific timelines as part of its commitment to the organization. Notably, the legislative focus for 2024 includes the enactment of the revision of the Taxes and Duties Act, Insolvency Code and Competition Law, which are anticipated to enhance the predictability and fairness of the business environment. Additional regulatory reforms will soon follow, including the Law on Value Added Tax (2025), Export Promotion Law (2025), and Industrial Property Code (2025).

Timor-Leste could pave the way for a more vibrant private sector by streamlining regulations and fostering a more transparent business environment. These reforms have the potential to stimulate investment, innovation, and job creation. In addition, Timor-Leste's exports stand to become more competitive in the global marketplace by aligning with international standards. This not only increases foreign exchange earnings but also integrates Timor-Leste deeper into the global trading system, fostering knowledge transfers and technological advancements.

Timor-Leste can foster a more inclusive economic transformation by acknowledging the potential for disruption arising from market opening steps and providing support to those most impacted by domestic structural adjustments. Embracing domestic structural adjustments will not be without its challenges, such that it is important to acknowledge that any economic reform can create winners and losers. Sectors previously protected by trade and investment barriers may face increased competition. To ensure a smooth transition and inclusive benefits, Timor-Leste should also consider implementing adjustment policies. These policies could include retraining programs for workers in affected sectors, temporary financial assistance, or investments in new sectors with high growth potential.

To streamline trade and comply with WTO standards, Timor-Leste is advised to enhance border trade management, expedite the release of goods, and introduce electronic documentation. A central Trade Information Portal has been established to consolidate and clarify all trade-related information and procedures. Strengthening the National Trade Facilitation Committee (NTFC) will also be key in providing representation and services to trade and industry associations. Furthermore, Timor-Leste needs to develop and enforce new regulations and frameworks to meet the requirements of the WTO's TBT and SPS agreements, as well as the TFA. Moving towards a transparent and stable trade regime, liberalizing tariffs, and formulating a new national trade strategy are essential steps. Collaborative efforts between key government bodies, including the Ministry of Finance, Customs, Ministry of Health, and the Ministry of Tourism, Trade, and Industry (MTCI), are crucial for the successful implementation of these initiatives within the next 1-5 years. Such cooperation is expected to significantly improve Timor-Leste's trade environment.

Timor-Leste has entered the WTO, a significant milestone which can lay the foundations for building future economic pillars and integration with bilateral, regional, and international partners. Timorese leaders and policymakers have entered a new phase in their economic development chapter and have the challenge to continue the promises to maintain WTO membership and continue implementing efforts towards economic growth to improve the lives for their citizens. This can be done through embracing the various recommended domestic reforms and adopting new regulations as policymakers grapple the daring task of diversifying the Timorese economy.[17] The benefits of WTO membership stand to be leveraged and deepened through accession to ASEAN given Timor Leste's geography and the region's importance to its trade growth.

[17] WTO, Conclusion, pg. 29

Annex 1: Key Indicators

Annex Table 1: Economic Indicators

	2017	2018	2019	2020	2021	2022	2023e
Real sector	*(annual percentage change, constant)*						
Gross domestic product (non-oil)	-3.1	-0.7	2.1	-8.3	2.9	4.0	2.3
Final consumption expenditure	-1.3	0.8	3.5	1.5	-0.05	7.0	3.1
Gross fixed capital formation	-16.7	-1.5	-17.4	-46.9	-6.1	29.4	2.8
Consumer price index, period average	0.5	2.3	0.9	0.5	3.8	7	8.4
Fiscal sector	*(percentage of non-oil GDP)*						
Total Revenue	42	48	43	46	45	43	43
Domestic revenue	11	13	11	12	10	10	14
Estimated Sustainable Income	30	35	31	34	35	33	29
Total expenditure	74	74	73	72	92	104	86
Recurrent expenditure	58	52	55	62	83	92	73
Capital expenditure	16	22	19	10	9	12	13
Fiscal balance	-32	-26	-31	-25.3	-47.0	-60.7	-43.1
Monetary and Financial sector	*(as stated)*						
Credit to the private sector (% growth)	24.5	-2.4	4.3	11.2	5.8	34	21
Lending interest rate (%)	12.1	11.9	12	11.3	11	10.8	10.6
Nominal effective exchange rate (index)	94.8	96.3	97.4	98.7	96.5	101.6	101.7
Real effective exchange rate (index)	109	111.2	112	113.2	113.0	121.8	127.3
External sector	*(percentage of non-oil GDP)*						
Current account	-18	-12.1	7.8	-19.3	2.5	-15.3	-40.2
Goods and services	-59	-59.4	-54.1	-49.2	-47.3	-49.9	-51.0
Primary income	46	53.4	66.0	38.9	53.8	38.7	14.9
Secondary income	-4	-6.1	-4.1	-9.0	-4.1	-4.1	-4.1
Capital account	2	3.3	1.5	0.8	0.6	1.5	1.2
Financial account	31	15.8	-6.8	17.0	13.1	17.2	46.5
Direct investment	0	3.0	-33.7	4.5	3.9	3.7	3.5
Portfolio investment	21	12.4	28.7	15.3	11.0	14.1	43.1
Other investment	9	0.4	-1.8	-2.8	-1.9	-0.7	-0.1
Net errors and omissions	1	1.3	-3.6	1.5	0.0	0.0	0.0
Change in reserves	-16	-8.2	1.1	0.0	-16.2	-3.3	-7.5
Memorandum items	*(as stated)*						
Oil production (million BOE)	42	39	38	36	37	11.7	
Petroleum Fund, closing balance (USD billion)	16,7	15,8	17,6	18,9	19,6	17,4	18, 4

Source: Ministry of Finance, BCTL

Note: GDP 2023 is based on Government estimated number released on March 2024. Starting from 2019, the BOP figures include the Export and Import Value from Oil activities

Annex 2: Benchmarking exercises

To benchmark Timor-Leste's performance, this report uses three groups of peers: the regional peers, structural peers, and aspirational peers. Criteria adopted to select the peers are presented in the below table.

Annex Table 2: Peer Selection

Group	Definition	Selection Criteria	Selected countries
Regional peers	Neighbouring countries in the East Asia and Pacific region as per the World Bank classification	• (Relatively) Small countries in East Asia & Pacific	• Papua New Guinea • Fiji
Structural peers	Countries that have similar economic characteristics as Timor-Leste in 2016-2019	• Countries that had a GDP per capita, Human Development Index, population, an electricity access that are +/- 30 positions distant from TL's average rank in 2016-2019 • Countries that are commodity exporters	• Comoros • Sao Tome • Solomon Island
Aspirational peers	Countries that possessed similar structural characteristics as Timor-Leste, but grew (in per capita terms) significantly faster over time	• Countries that were low- or lower-middle-income and a medium-size population. • Countries that had a Human Development Index, real GDP per capita, population, life expectancy and access to electricity that were +/- 50 positions distant from TL's average rank in 2003-2006 • Countries that grew faster than TL by 2pp more than TL in 2003-2019, on average	• Botswana • Cabo Verde • Mauritius • Bhutan

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Chapter 1 and 2

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