Timor-Leste:
Debt Financing: What factors should Parliamentarians consider?

Presentation by Vivek Suri
World Bank

To Parliament Committee C Workshop

16 November 2011

Financing to meet infrastructure needs

- Funds to finance pressing Infrastructure needs – A priority in the SDP
- Infrastructure: Roads, water and sanitation, electricity, port, airports
- Infrastructure: Schools, medical centers, hospitals
- Such projects normally have large economic returns

Project selection is critical

- Before even considering financing: ‘high quality’ projects need to be identified
- High quality = High economic and social returns
- Economic return should be greater than cost of financing
- Economic return difficult to measure compared with financial return for a project
- Economic return includes benefits and costs that extend beyond a project
- Implementation capacity also needs to be assessed
  - Promising moves in this area recently

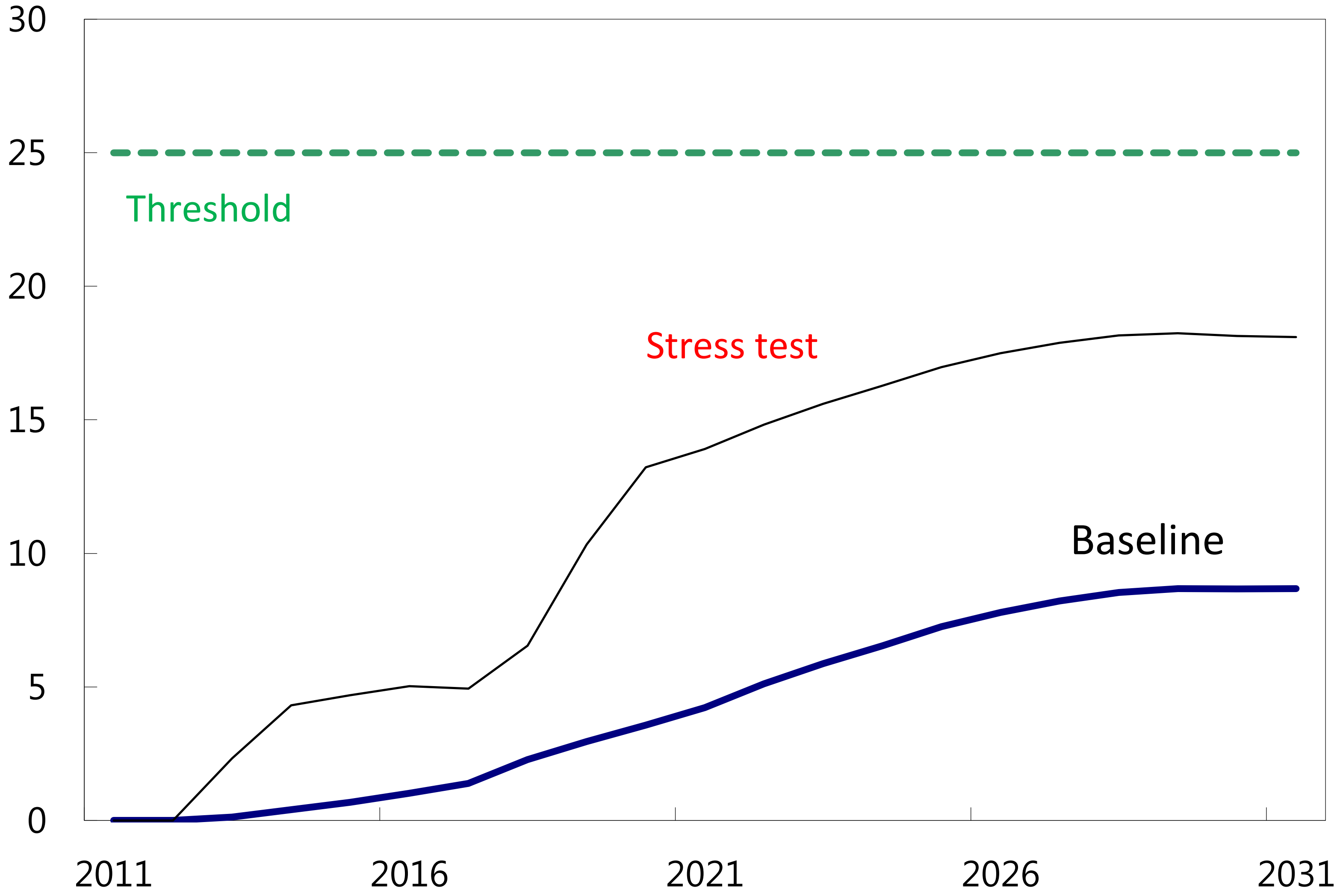
PF Drawdown versus Borrowing

- PF investments provide return
- 4.2 percent since inception
- Drawdown from PF means loss of return
- ESI will be lower
- The loss in return is the “cost” of financing from the PF
- Cost for a loan is the interest plus any fees

Does borrowing make financial sense?

- Under current market conditions and assuming that PF does as well as in the past
- Borrowing from IDA makes financial sense by a big margin
- Borrowing from IBRD makes financial sense
- IDA and IBRD also bring non-financial benefits in terms of technical assistance
- Assist with project selection, design, implementation and supervision
- Diversification of financing sources

Debt-service to revenue likely to remain manageable



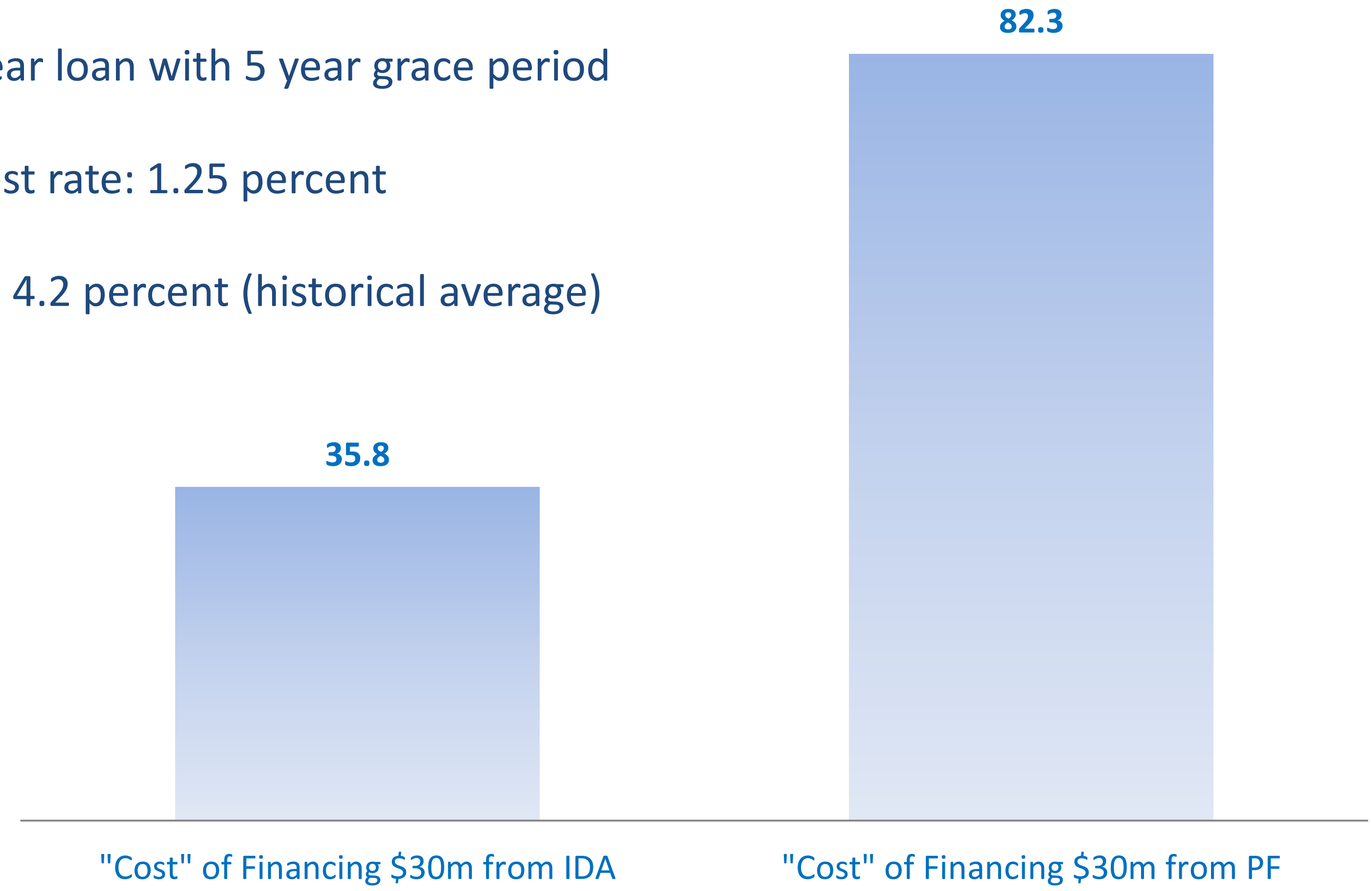
IDA borrowing versus PF drawdown

Amount borrowed or drawn down: US$ 30 million

IDA: 25 year loan with 5 year grace period

IDA interest rate: 1.25 percent

PF return: 4.2 percent (historical average)



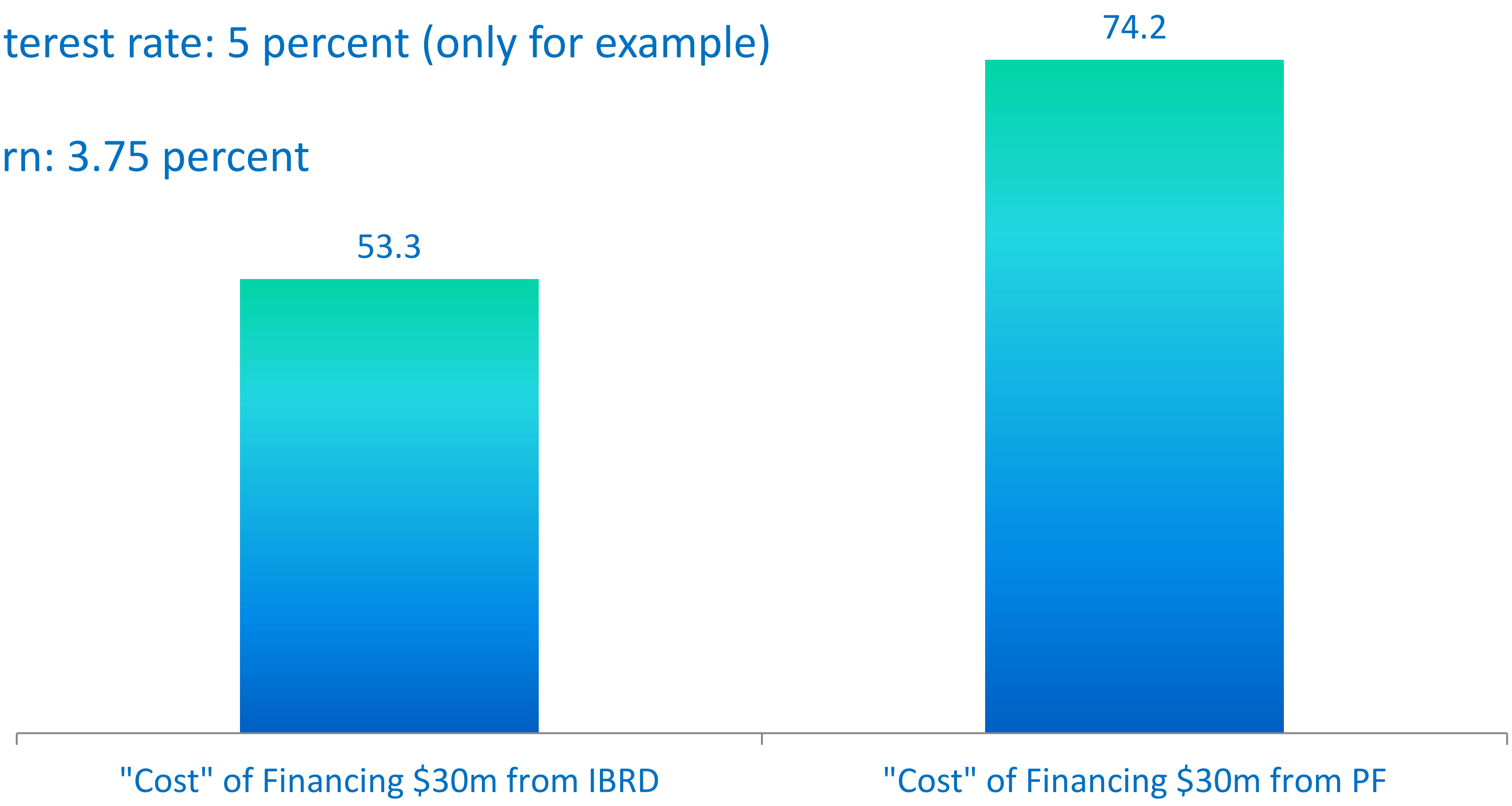
IBRD borrowing versus PF drawdown - II

Amount borrowed or drawn down: US$ 30 million

IBRD: 25 year loan with 5 year grace period

IBRD interest rate: 5 percent (only for example)

PF return: 3.75 percent



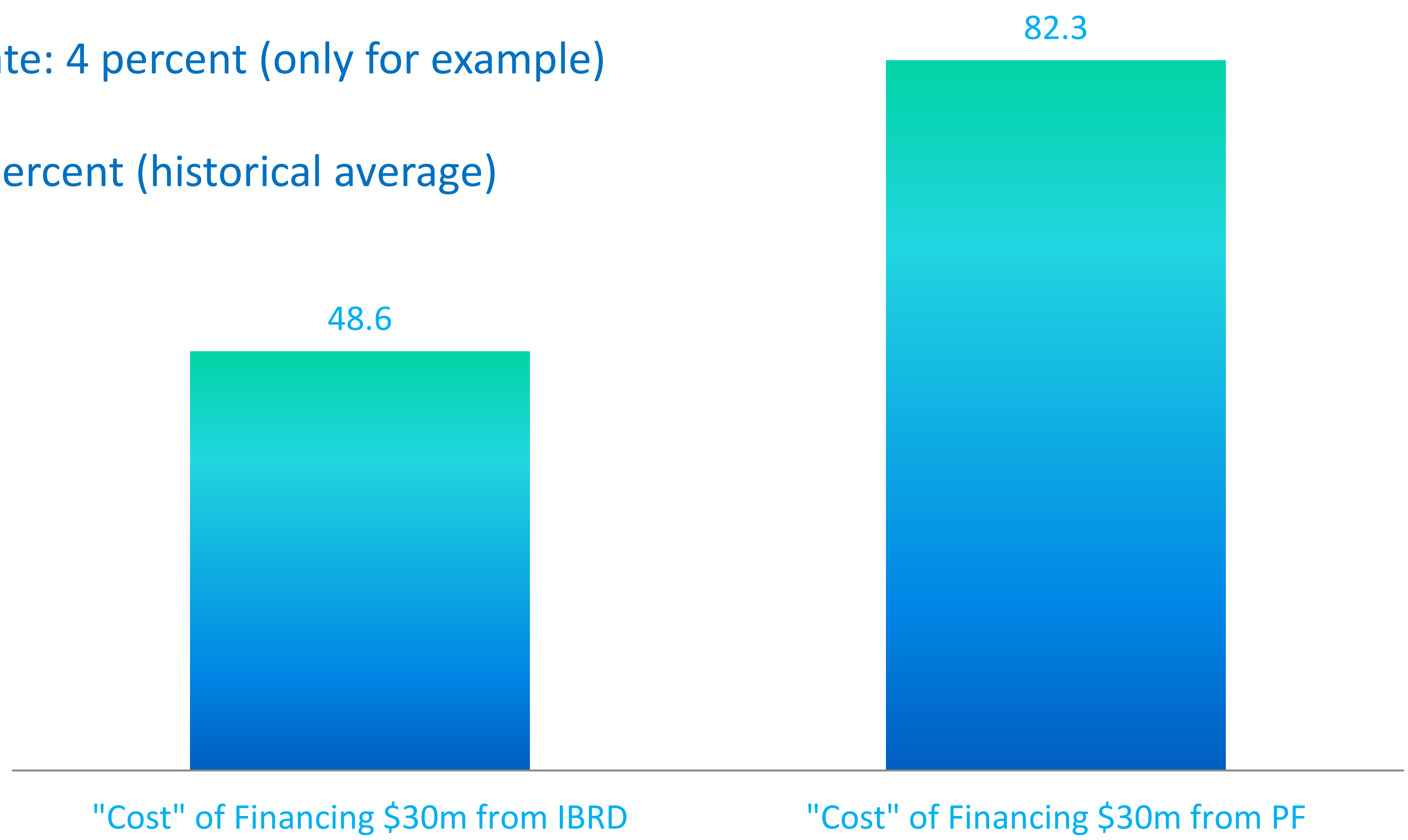
IBRD borrowing versus PF drawdown - I

Amount borrowed or drawn down: US$ 30 million

IBRD: 25 year loan with 5 year grace period

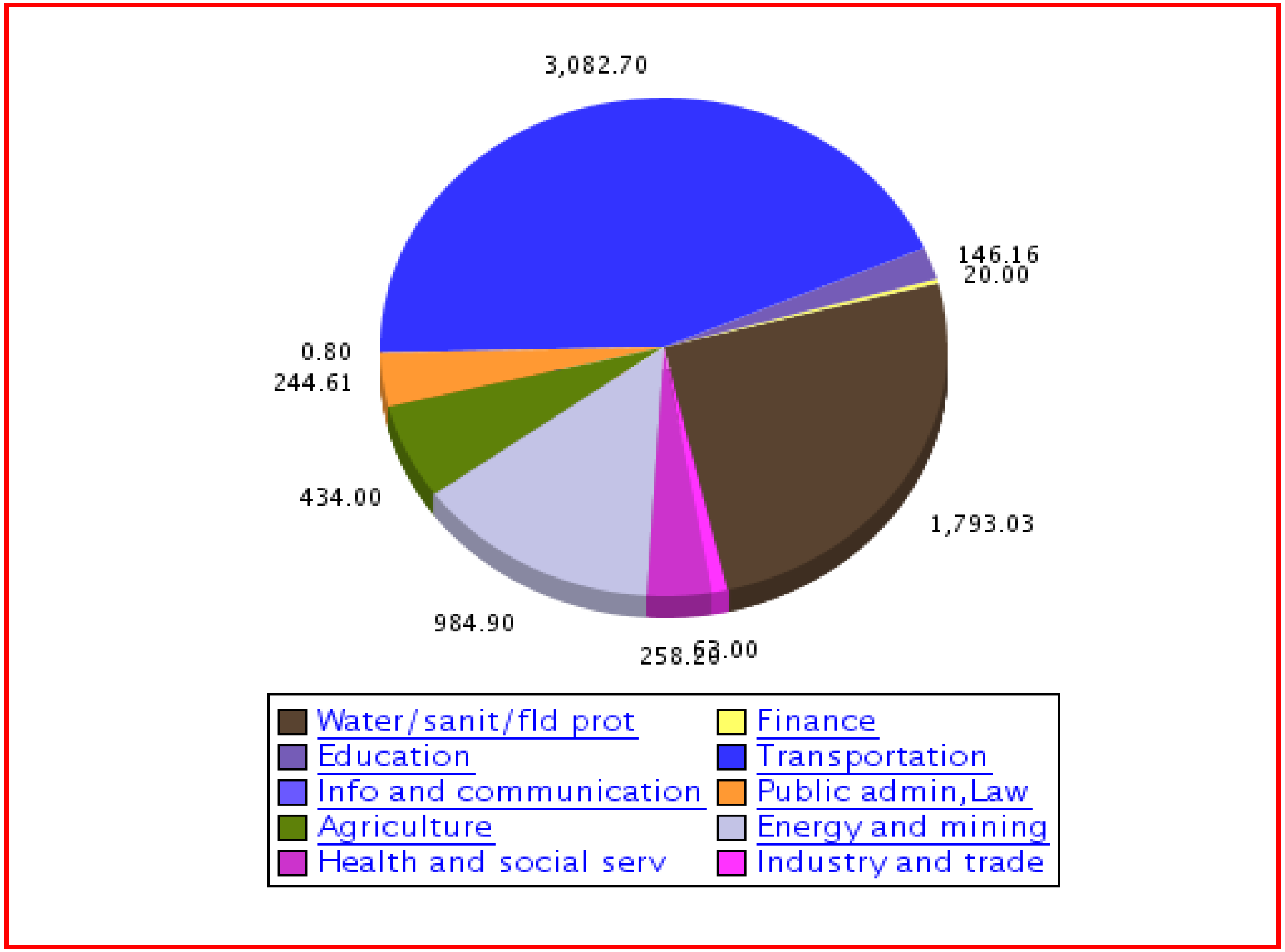
IBRD interest rate: 4 percent (only for example)

PF return: 4.2 percent (historical average)



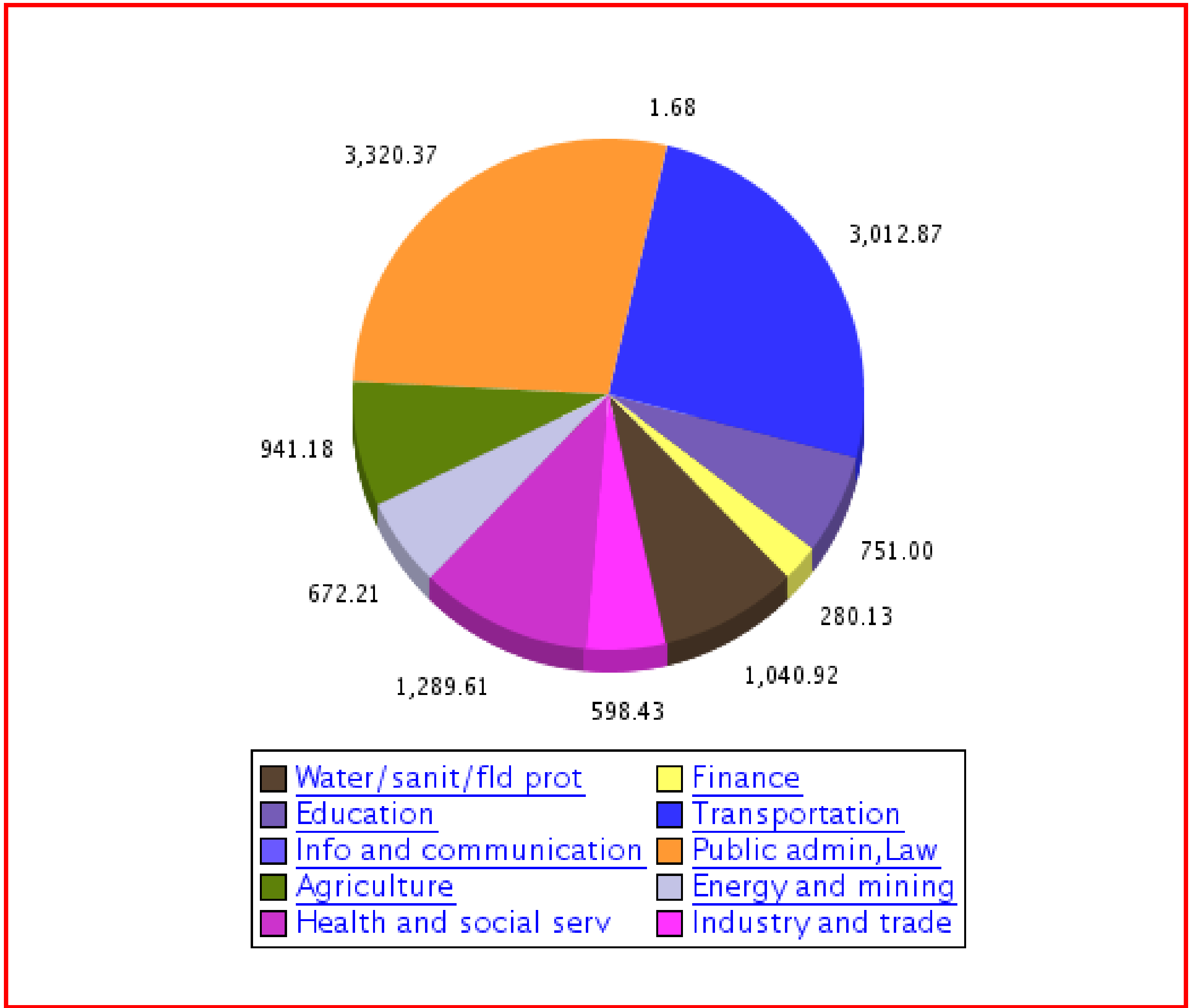
Several Middle Income Countries borrow from IBRD

- China: A country with high level of reserves and access to international financial markets



Several Middle Income Countries borrow from IBRD

Brazil: A resource rich country with access to international financial markets



How much to borrow?

- Conduct “Debt Sustainability Analysis”
- How much is loan repayment plus interest in comparison with projected government revenue (importantly ESI)
- How much is debt in relation to GDP
- Does debt servicing prevent other key expenditures
- What are the risks – “stress tests”

What types of borrowing?

- Concessional versus commercial
- Short-term versus long-term
- Currency of borrowing
- Are public enterprises borrowing as well?
- Are there any guarantees being given by government?

Assessing risks is very important

- At present, Timor-Leste is at a low risk of debt distress
- Risk must be continually assessed
- Macro variables change (e.g. growth prospects, oil prices)
- Quality of Fiscal Policy may improve or deteriorate
- Types of risk
  - Interest rate risk (if borrow at variable rate)
  - Exchange rate risk (if borrow in ‘foreign’ currency)
  - Rollover risk (esp. if borrow short-term)

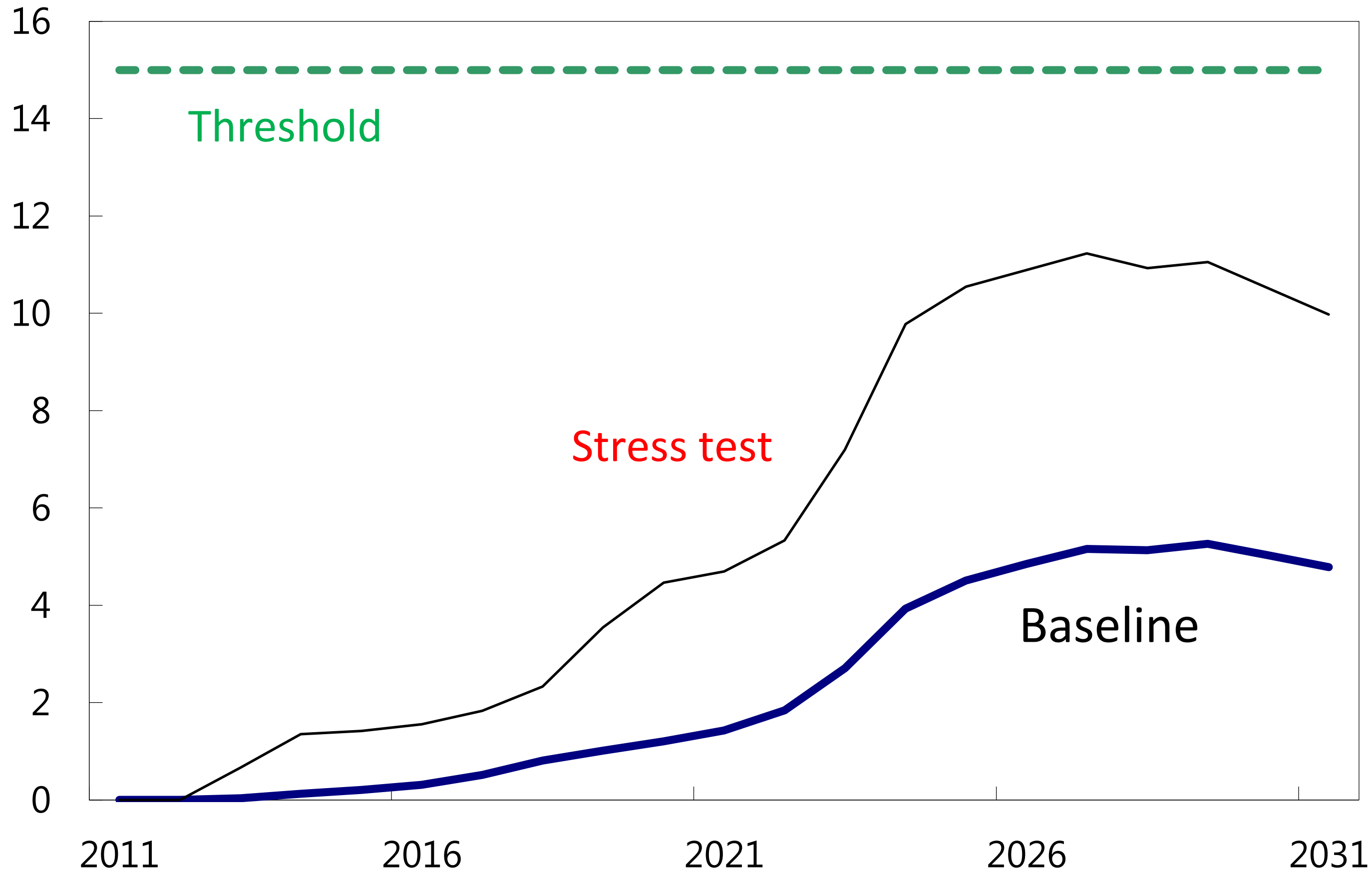
Parliament must scrutinize borrowing

- Parliament must be informed of all borrowing
- Borrow only against expenditure (projects) that are in the budget or otherwise approved by Parliament
- All forms of liabilities should be reported
- Contingent liabilities (explicit or implicit)
- Look at public and publicly guaranteed debt
- PF is a “good practice” example of transparent reporting

Parliament must scrutinize borrowing

- Is government borrowing consistent with the country’s development ambitions
- Is borrowing consistent with the objectives stated in the law or debt policy statement
- Is the government minimizing its financing costs with an acceptable level of risk?

Debt-service to exports likely to remain manageable



Debt-service to revenue likely to remain manageable