

La'o Hamutuk

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**To: Sr. Antonio Freitas, Director-General for Policy Analysis and Research,
Ministry of Finance, RDTL**

Sr. Elias dos Santos Ferreira, Director, National Statistics Directorate, RDTL

Ms. Judy Henson, Australian Bureau of Statistics

Mr. Mark Jorgensen, Australian Bureau of Statistics

Re: Revision of Timor-Leste's Consumer Price Index (CPI)

Thank you for inviting La'o Hamutuk to participate in the 16 November workshop and for encouraging us to give input to the process of updating Timor-Leste's Consumer Price Index. We appreciate DNE's focus on providing information which is useful to Government, civil society and others as we work together to develop Timor-Leste for the benefit of all of its people. We believe that a solid understanding of today is essential to developing good strategies for tomorrow, and are glad that DNE has asked users of your publications for input.

We are not academically-training economists or experts in statistics, but we offer a few comments which may improve the accuracy and usefulness of the CPI as a tool for advancing economic and social justice here. Representing inflation is a challenging undertaking which cannot be reduced to a single monthly number, and we hope our observations will help you support policymakers and others to measure, understand and control the increasing cost of living for Timor-Leste's citizens.

Timor-Leste's economy and consumption patterns are very different from Australia or other developed countries. There must be experts who understand how to measure CPI in a place like Timor-Leste, and we hope that they can be tapped, either now or in the future.

Timor-Leste has a varied economy, and the small size of the country makes this diversity more extreme and more difficult to average. In addition to the obvious differences for the 25% of Timorese who live in Dili (who are generally wealthier, have more consistent income (albeit with a "13th month" salary payment), and purchase from stores and importers), there are differences within and among the districts. Those which border Indonesia are more likely to purchase "informal" imports, while those with coffee production have seasonal variations. In each district, those who live in towns with shops and services have different consumption patterns from those in more remote areas. Therefore, we are concerned that increasing the

frequency of national CPI statistics by reducing the breadth of places sampled may introduce unintentional biases.

We appreciate that the CPI measures the effect of price changes on households, rather than counting money. In an economy like Timor-Leste, where a small fraction of the population has the great majority of wealth and income, measures based on dollars (such as GDP and GNI) give a misleading picture of the lives of most of our citizens. In spite of double-digit GDP growth in recent years, the percentage of people living in poverty has increased to more than 50%, and we hope that the revised CPI can reflect the costs of living for that disadvantaged and vulnerable majority, nearly all of whom live outside Dili.¹

Economists observe that market principles often don't apply here, in spite of our "free market" economy. When buyers are unaware that a product is cheaper in another store or neighborhood, or if going to that location is too difficult or expensive, sellers can charge more. When vendors don't understand that it is better to get something than lose everything, they ask the same price for fish or produce until it becomes unsellable. The "law of supply and demand" is often broken. We suggest that the collection and publication of price data could include the variation of prices among stores or localities, not only the averages, to help understand and reduce inflation from lack of information.

Timor-Leste is extremely import-dependent, and the prices of imports (when available) are often very different than the prices of local products for which they substitute. We are afflicted with the "Dutch Disease" which often affects countries whose *rentier* economies depend on exporting natural resources.² The DNE's recent trade report shows that our 2011 exports were only \$13 million (90% of which was coffee), while we imported \$319 million worth of merchandise. The Central Bank's Balance of Payments is more striking – during 2011 \$1,764 million left Timor-Leste while only \$381 million came in (plus \$3,240 million in oil income, which could drop to zero in about 12 years). For reasons suggested below, import price changes are often mysterious, uncontrolled or volatile, and we hope that the CPI process can help us understand them.

Imports are mostly purchased by more affluent, urban people, and a CPI which mainly includes imported goods will not reflect most people's lives. Is it possible to disaggregate the data, to enable comparison of changes in price differences between, for example, imported and locally produced rice? Increasing local production to substitute for imports is essential to Timor-Leste's future, and such data would assist policy development.

Approximately half Timor-Leste's population lives below the poverty line, largely in rural areas, and we suggest that a separate CPI be calculated to indicate their costs of living. With

¹ According to Table 2.1.1 of the 2009-2010 Demographic and Health Survey, 94% of households in the poorest two quintiles by household wealth are in districts other than Dili, although only 78% of the total population lives outside Dili district.

² Timor-Leste is the second most petroleum-export-dependent country on earth. During 2011, 97% of state revenues and 79% of our entire GNI came from converting nonrenewable petroleum wealth to cash.

fewer options and less resources, they are hit harder by inflation, and it is important to measure and understand these effects.

For example, a significant portion of Timor-Leste's imports are for vehicles and fuel, but almost no rural people have cars or motorcycles. They walk, occasionally using horses or public transportation when they require goods or services not available in their vicinity, such as health care or education. Rather than purchase Aqua, they walk long distances to undrinkable sources. Rather than purchase LPG or kerosene, they gather firewood. They cannot purchase many tradable items which others buy, sometimes doing without, producing for themselves or bartering in the nearby subsistence economy. But when they really need to purchase something, inflation makes their small amount of money buy even less. How can the CPI reflect their reality?

The workshop stimulated a discussion about how to identify the causes of inflation, which may include high government spending inside the country, lack of local productive capacity, foreign exchange rates, supply bottlenecks, price-fixing, importer or retailer oligopolies, limited consumer choice and knowledge, and others. We agree that a better understanding is needed for developing effective economic and budgetary policies, but perhaps it is asking too much for CPI to explain it. Can ABS, and/or DNE, with support from AusAID or other donors, undertake an in-depth analysis to supplement initial work already done by the IMF and the Ministry of Finance?

On another topic, we wonder about excluding the costs of owner-occupied housing from the CPI. While imputed rent may not be appropriate, construction and maintenance of homes is a significant part of most household's expenditures. For poor people, dwellings may require frequent repair or rebuilding, and when purchased materials are needed, they can be expensive. However, the lack of facilities in many poor people's homes (such as plumbing, electricity, sanitation and indoor kitchens) makes it difficult to compare them with those of more affluent people. We do not know how to incorporate housing costs, but hope that you can find a good way.

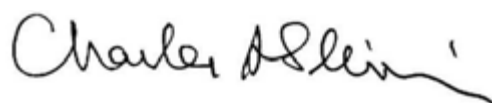
Thank you very much for considering our ideas, and we are happy to engage in further discussion. We wrote this in English to facilitate understanding by ABS people, but can translate it into Tetum if you wish, as we believe that Timorese people are the ultimate owners of this process, as well as the ones most affected by it.

Sincerely,



Juvinal Dias

La'ó Hamutuk Natural Resources and Economy Team



Charles Scheiner



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