Submission to Committee C
National Parliament, Democratic Republic of Timor-Leste

From La’o Hamutuk
regarding the
Proposed RDTL General State Budget for 2010

4 November 2009

Introduction
La’o Hamutuk, as a local civil society organization, closely follows policies and legislation on Timor-Leste’s fiscal, tax and budgetary situation. As in the past, we would like to offer some information and perspectives to help Committee C, the National Parliament and the Government make wise decisions which benefit current and future generations of Timor-Leste’s people. We hope that the topics we address below will be useful to your deliberations, and we are always ready to provide additional information or respond to questions.

We are relieved that the 2010 General State Budget\(^1\) does not propose to increase expenditures, as every previous Government budget did. We also appreciate that this budget does not transfer more than the Estimated Sustainable Income from the Petroleum Fund, and that it does not ask Parliament to approve external borrowing or to invest the Petroleum Fund in risky equities. Nevertheless, a number of the items in this budget are worrisome, and would seem to move Timor-Leste further into the “resource curse” that afflicts nearly all impoverished countries which depend on Petroleum Revenues.

We are also concerned that the budget documents demonstrate a fundamental misunderstanding of Timor-Leste’s current and near-term economic situation, an unduly optimistic picture which could lead us to move in dangerous directions. If we fail to deal with present realities, we will never take on the difficult, complex, long-term planning and policy-making processes needed to improve the lives of the majority of Timor-Leste’s citizens, who are young, poor, rural, and enduring inadequate basic services for health, education and infrastructure.

This submission addresses the following topics:

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Risking or experiencing the Resource Curse

Timor-Leste is one of the most oil-revenue-dependent countries in the world. As La’o Hamutuk and others frequently remind policy-makers, this brings a set of dangers which can result in serious, long-lasting negative consequences of our people. But they are not unavoidable, and well-considered, strategic policy decisions can ensure that our petroleum revenues are a benefit, not a curse.

The IMF recently pointed out that Timor-Leste is far more dependent on oil than other Oil Producing Countries (OPC), with oil revenues providing 98.2% of government revenues. Our oil revenues are 481% of non-oil GDP, much more than the only other two countries where they exceed 100%: Equatorial Guinea (119%) and Congo (131%). The average of other OPCs surveyed by the IMF had oil revenues of 46.2% of non-oil GDP, less than one-tenth of ours.

One of the consequences of large oil revenues – sometimes called a rentier economy – is that spending decisions are made without much long-term thinking or planning. Money comes in easily, and goes out just as easily. And when the oil money runs out – at it will from Bayu-Undan in 15 years – we will have nothing to replace it with. Our Petroleum Fund can help, but with a growing population who require and expect improved services, a constant-dollar withdrawal won’t be enough, especially when most of the money quickly goes overseas to pay for imported goods.

We are concerned that the 2010 State Budget does not demonstrate long-term vision and planning. In many cases, the policies implemented are attempted short-term quick fixes which can be purchased with dollars, rather than the more difficult, but more sustainable, program and economic development which will improve the lives of current and future generations of Timor-Leste citizens.

The 2010 budget contains some capital projections for future years, but many of them are incomplete. In some cases (such as the $7 million Water Park in the MTCI Department of Tourism budget), Book 2 shows a multi-year allocation which is not shown in Books 1 and 3. The Ministry of Foreign Affairs budget does not include any projections for 2011 expenses, notwithstanding that this is required by the new Budget and Financial Management Law. How can Parliament make wise decisions if you do not know the full cost of some items, or what is planned for the next year or two?

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3 OGE 2010, page 152.

The budget should serve the people, not the state

Like previous State budgets, this one focuses on improving the efficiency and capacity of government, rather than providing services to citizens who live outside of Dili. It highlights the need to increase “domestic revenues,” rather than to expand the domestic economy. It does not prioritize sectors which can directly improve the lives of most people – education, health and rural infrastructure.

Water is a basic necessity for everyone. New roads to remote villages can enable our rural majority to interact better with their fellow citizens. These can boost the local economy, but more importantly they will improve the quality of life of women, children and men in the most underserved parts of our country. Many Dili residents already have running water and roads, and we suggest that the Government’s development plan should prioritize infrastructure which serves the people who need it most. We support the shift of infrastructure priorities from electricity mega-projects to water and rural roads, and encourage the government to continue in that direction.

In 2008, Timor-Leste’s non-oil exports were $13 million – mostly coffee – and merchandise imports were $258 million, nearly three times higher than in 2006. 5 In the medium term, Timor-Leste needs to develop our economy to reduce import dependency. This, the only way to raise people above the poverty line, will primarily be agriculture for local consumption, with smaller contributions from tourism and petroleum processing. Agriculture is the mainstay of most Timorese people’s lives and the only way we can achieve food sovereignty to prevent starvation and reduce costly imports, but this vital sector is underserved.

Maintaining constant personnel levels across the board is irresponsible. After the staff increases of the last few years, Timor-Leste probably has enough public servants sitting in offices in Dili. But the Ministries which directly interact with our population, especially health and education, are understaffed, underfunded, and provide a level of service far below what we should accept.

Money allocated to training and overseas scholarships will help improve the capacity of today’s public servants, but the budget gives little attention to the National University or primary and secondary education. The number of teachers is frozen, but right now our children are deprived of four months of education while their teachers are being trained. Our population of school-age children goes up by 6,000 every year, and we are working hard to increase the number of girls and boys who stay in school, but we do not increase the number of teachers. We need to invest in human capital – not just buildings and infrastructure. Timor-Leste will need qualified, educated workers and managers in our future multi-sectoral economy, the only way to lift ourselves out of poverty and prepare for the day when oil revenues can no longer pay for our necessities or cover a huge balance of payments deficit.

During the last decade, half a generation of Timorese children has not been adequately educated to support the future development of this country. We should be ashamed that we are not allocating the necessary human, financial and political resources to bring our public primary, secondary and tertiary education up to a reasonable standard.

Using the Petroleum Fund sustainably

La’o Hamutuk agrees with the Government not to withdraw more than the Estimated Sustainable Income of $502 million from the Petroleum Fund during 2010, and we appreciate that spending will stay below the ESI during 2009, as it did during 2008, notwithstanding budgetary dreams to spend unsustainably. We hope that future budgets will also respect the ESI, and expect that budget allocations will more accurately predict actual spending as public officials gain more experience. If there is to be a 2010 Budget Rectification, we encourage Government and Parliament to keep it within sustainable spending levels.

The ESI estimate has been enlarged almost every year, and we fear that this may not reflect reality. This year’s ESI calculation, which increased largely because of expected rising oil prices, is not prudent. We also believe that the predicted long-term return from investing the Petroleum Fund – 3% above inflation – is not realistic. This year’s ESI estimate reduces the discount rate used to calculate Net Present Value of future petroleum revenues from 3% to 2.6%, reflecting a lower expected global return on investments. However, lower global rates of return will also reduce the return from investing the Petroleum Fund. If we lower the assumption about the Fund’s long-term real rate of return from 3% to 2.6%, the ESI in 2050 drops from $494 million to $428 million. It is no longer sustainable, as it cannot support a 3% annual withdrawal if it only earns 2.6% interest.

More worrisome, the actual rate of return during the four years that the Petroleum Fund has operated has been only 1.7% above inflation. If this continues, the ESI in 2050 will be only $310 million. Our population will be more than three million by then, and this will provide $103 per citizen per year – only 28¢/person/day.

The following graph is from a spreadsheet model La’o Hamutuk developed to explore the effects on ESI and Petroleum Fund revenues for various assumptions. This example illustrates the assumptions made by the Ministry of Finance in the draft 2010 State Budget. We are happy to share the model with Committee C and anyone else who is interested in understanding these issues.
The Ministry of Finance’s Action Plan in the 2010 State Budget expects to revise the Petroleum Fund law by July 2010, and to “further diversify” its portfolio. We hope that Parliament will engage fully with this process, including extensive analysis and public consultation, before putting Timor-Leste’s only significant resource into risky investments. The fiscal record of this Government to date does not instill confidence in their ability to make wise investment decisions, and we are concerned that relying on research done before last year’s global financial crisis could lead to misguided decisions.

**Now is not the time to borrow**

The proposed 2010 State Budget does not ask Parliament to approve Timor-Leste taking out a loan, but it implies that such approval has already been granted, and that only a “directive” is required before the Government can borrow. It also discusses an already-signed MoU with Portugal which would “arrange and pay for agreed infrastructure projects” to be “repaid at a later date” but which “would not be part of the General Budget of the State.” Another paragraph says that the Government will “seek approval” from Parliament when it decides how much to borrow, which is expected to be around $3 billion over a project life of several years.

In September, Parliament passed the Budget and Financial Management Law which came into effect on 21 October. Article 20 empowers the Minister of Finance to take out loans in the name of the State after Parliament approves the amount of the loan but not the conditions, repayment terms, interest rates or consequences of default.

In most debtor countries, borrowed money primarily benefits more affluent people, but the impact of repaying falls most heavily on the poorest. A loan agreement has higher legal force than the State Budget, and when Parliament is eventually asked to appropriate the repayment installments (in the Budgets for each year repayment will be made), Parliament has no power to delay or prevent State funds from going to the creditor.

The experience of other oil-dependent countries is that borrowing often makes the resource curse come sooner or be more severe. When money comes easily, and planning is not considered important, policy-makers are often tempted to spend even more than current revenues.

It makes no sense to take out a loan while oil revenues are coming in, only to have to repay it after the oil is used up. Although Article 9 of the Budget and Financial Management Law pays respect to equity between current and future generations, the borrowing that it enables does the opposite – wasting our children’s future to pay for current-day whims. It undercuts the basic objective underlying the Petroleum Fund– to use today’s non-renewable resources for lasting benefit, rather than squandering them now and imposing the burden of loan repayments on our grandchildren.

At Committee C’s workshop two weeks ago, several speakers tried to convince you that Timor-Leste should borrow because the interest might be low. But even a zero-interest loan has to be repaid.

The important question is not how to borrow, but why:

- What will the money be used for?
  Is it guaranteed to increase economic growth and domestic revenues enough to repay the loan?

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7 GSB2010, page 35.
8 GSB2010, page 51.
9 GSB2010, page 35.
Does the money have to be used to buy from the country which gave the loan? If hiring a Portuguese company makes the road twice as expensive as it would have been to hire someone else, we will effectively pay 100% total interest.

How much has to be repaid? When?

Where will the money to repay come from?

If Timor-Leste cannot repay, what are the consequences?

Although the Petroleum Fund law does not allow the Fund to be used as collateral for a loan, anyone offering a loan knows that 98% of Timor-Leste’s state income comes from petroleum revenues, and that those revenues (or the Fund) are available to fill budget deficits. To put it another way, who would expect Timor-Leste to repay $3 billion dollars if we didn’t have any oil resources?

Even at concessional interest rates, repaying a loan will permanently lower the amount of money Timor-Leste has to use from the Petroleum Fund. Let’s explore what happens if we borrow $3 billion in 2010 at 2% interest, and pay it back over 30 years. When the loan is fully repaid in three decades, we will have paid back $4.14 billion. We will have depleted our Petroleum Fund, reducing the long-term ESI by $125 million every year after that, as shown in the following graph:

![Graph showing oil revenues, ESI withdrawal, total withdrawal, per capita withdrawal, and debt repayment over time.]

Although the Budget documents do not say when the Government will ask Parliament for approval to go into debt, it is likely to happen before the end of 2010. These documents contain other hints that there will be a mid-year budget rectification, such as only $44.5 million “set aside” for transfers by the Ministry of Social Solidarity, which the Ministry believes should be more than $96.4 million “pending confirmation of the larger estimates from MSS.”

The Ministry of Health writes that its "capital plan is presently restricted to $10.3 million," but it "expects to ... bid for further capital works in a mid-year budget review." The Ministry of Finance’s Action Plan does not mention either borrowing or a mid-year budget update, but that doesn’t mean they’re not on the agenda. We look forward to continuing this discussion with Commission C, and encourage you to use all the expertise and Constitutional powers you can to ensure that shortsighted decisions do not exacerbate long-term poverty for our people.

**Timor-Leste’s 12.8% non-oil GDP growth last year is a distraction**

This number is cited by journalists, the UN and Government officials almost every day, and often used by the IMF, IFC and World Bank. Where does it come from, and what does it mean?

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Gross Domestic Product (GDP) is not a good indicator of a nation's economic health. In addition to ignoring the gap between rich and poor, it goes up when a country suffers a disaster or depletes a non-renewable resource. For example, if rising sea levels flooded Dili, forcing people to rebuild their homes and businesses, this would increase GDP while actually making people's lives worse. A composite measure such as the Human Development Index\(^\text{14}\) captures quality of life more accurately. Nevertheless, the Government chooses to focus on non-oil GDP, so we will explore what this claimed growth actually means.

The first mention of 12.8% growth we found is in the IMF's April 2009 Selected Social and Economic Indicators\(^\text{15}\):

The IMF calculates that non-oil GDP (at current prices) increased from $398 million in 2007 to $499m in 2008; after correcting for inflation, this is 12.8% real growth.

The same IMF document says that government expenditure (cash basis) increased from 56% of non-oil GDP ($223m) in 2007 to 106% ($523m) in 2008. Government Budget Execution Reports\(^\text{16}\) give actual spending figures of $140m (est.) for 2007 and $480m for 2008, while a more recent IMF report\(^\text{17}\) puts government expenditures at $191m in 2007 and $528m in 2008, as well as combined sources spending at $349m and $720m.

Although the sources show some variation, they agree that government spending in dollars-of-the-day increased by far more than 100%, at least $300 million, between 2007 and 2008.

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\(^{14}\) For the last few years, Timor-Leste's Human Development Index has been static. See Timor-Leste Human Development Unchanged in 2007 at http://www.laohamutuk.org/reports/09HDI.htm.

\(^{15}\) IMF, Selected Social and Economic Indicators distributed to the TLDPM on 4 April 2009.

\(^{16}\) RDTL Ministry of Finance Budget Execution Reports, 2007 and 2008.

\(^{17}\) IMF, RDTL: 2009 Article IV Consultation—Staff Report, July 2009, page 27. Figure for 2007 estimated by La'o Hamutuk based on IMF 2006 and 2H2007 figures.
It is difficult to analyze how much government spending was in the domestic economy, as a significant part was paid to import materials (such as rice and construction materials) and to foreign companies. (During 2007-8, Timor-Leste’s trade deficit grew by $54 million.\textsuperscript{18}) However, the amount of the $300m government spending increase which entered the local economy is probably more than the $100 million growth in non-oil GDP, meaning that the non-government economy is smaller in 2008 than it was in 2007. This could mean that domestic economic activity which formerly served private purposes is now being purchased by the government, or that the private sector is actually shrinking, albeit more slowly than the Government sector is growing. How can this be considered strong economic growth?

The non-oil, non-government sector is small and did not grow significantly (if at all) between 2007 and 2008. The “multiplier effect” of government spending (being recirculated into the local economy as public servants and government contractors spend the salaries and payments they receive) is negligible.

La’o Hamutuk is concerned that Timor-Leste’s policymakers are basing their decisions on a mirage of a growing non-oil sector, when that growth actually consists almost entirely of government spending, 98.2% of which is financed by oil revenues.\textsuperscript{19} Our petroleum revenues fluctuate with world market prices and will decline as Bayu-Undan production falls from its 2008 peak, but the most dangerous fact for Timor-Leste’s future is that oil and gas deposits are finite and non-renewable. Timor-Leste’s revenues from Bayu-Undan and Kitan will drop to zero in about 15 years. Even if Sunrise is eventually developed, that will extend oil income for only a few decades.

The total appropriation in the proposed budget for 2010 is less than was appropriated for 2009. Given likely improvements in budget execution, actual expenditures during the two years may be about the same, perhaps $100 million higher than 2008 levels. During 2007-2008, about 40% of the budget increase was reflected in increasing non-oil GDP. If this happens again, the non-oil GDP will grow to $539 in 2009, (an increase of 8% before inflation), far less than the increase to $599m projected by the IMF or the 7.5% annual real growth figures projected in the budget.\textsuperscript{20} Since government spending will be constant or decline in 2010 and following years, further GDP increases are likely to be small, unless other parts of the economy grow rapidly and unexpectedly.

In developed economies, a surge in government spending can be an “economic stimulus” to “prime the pump” and re-energize the economy after a crisis or recession. But when you prime a pump that

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\textsuperscript{18} RDTL National Statistics Directorate Trade reports.

\textsuperscript{19} IMF Staff Report July 2009. Page 16. The report says that “Timor-Leste is the most oil-dependent country among the Oil Producing Countries and therefore also the most exposed to lower oil prices.”

\textsuperscript{20} GSB2010, Book 1, pages 13-14.
has no water at its input, nothing comes out. Economic development for a country like Timor-Leste takes more time and more work than re-opening a temporarily closed factory or re-hiring laid off workers. Wishing alone won’t make it happen – we need realistic goals, long-term planning and focused policies. If we ignore our petroleum dependency and the fact that our private sector relies on government spending of oil revenues, we condemn Timor-Leste’s people to increasing poverty after the oil money runs out.

The majority of our people live outside the cash economy, primarily by subsistence agriculture. Those with paying jobs in cities work mostly for the government, NGOs or international agencies. The few genuine private businesses are in construction (largely on government-funded projects), house rental and hospitality (mostly for internationals paid by foreign agencies), or retail re-sale of imported goods. None of these can provide a foundation for long-term, sustainable economic development.

La’o Hamutuk does not have a simple answer for the economic development of Timor-Leste. There is no easy way out, no quick fix by building highways, infrastructure mega-projects or five-star hotels. But until we as a nation recognize the difficulties of our current situation, we will never find the multi-faceted solution we need.

Actual domestic revenues are half as much as the budget claims

Our concern that the non-oil economy is small, ignored and stagnant is heightened by the discussion of “domestic revenues” in the 2010 State Budget. Although we agree that is important for the state to reduce its petroleum dependency by increasing domestic revenues, policies to achieve this must be based on a realistic evaluation of what these are and on growing the domestic economy.

Increasing the effectiveness of tax collection may generate slight increases in government revenue but does nothing to improve the economic life of Timor-Leste’s people. In fact, we are suffering from the results of last year’s misguided “Tax Reform,” which slashed Timor-Leste's tax rates far below those of other nations. According to the World Bank, Timor-Leste's total business tax is now 0.2% of profits, in comparison with a 36.8% average in East Asia/Pacific countries, and a 44.5% average in OECD countries.

Although the budget documents explain the lack of positive impact from the tax cuts because "businesses pay taxes one year later," this conveniently forgets that immediate benefits were promised last year (lower prices and attracting foreign investment), as well as that sales, import, excise and wage taxes, which were are sharply reduced, are paid every month or quarter. It is clear that "Tax Reform" has not benefited Timor-Leste’s overall economy, although it probably increased the gap between rich businessmen and the poor people who depend on government services.

The 2010 budget anticipates domestic revenues of $87.2 million, down from $90.3 estimated for 2009 but increased over the $69.5m actually received during 2008. However, even these small numbers overstate the actual amount of domestic economy. A significant part of the “domestic revenues” are money paid by one part of the government to another (wage taxes on government workers and consultants, taxes and duties on government contracts and imports, etc.), while another large portion comes from government agencies or programs which sell services but operate at a loss (Electricity and Ports Authorities, reselling rice, etc.). When these are removed (see table below), actual domestic revenues for 2010 will be about $46.1 million, about half of what is estimated. When compared with $502 million to be transferred from the Petroleum Fund, 91.6% of the government’s operating income (leaving out additional oil revenues saved in the Petroleum Fund) is from oil revenues.

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21 Lei Tributária No. 8/2008, published 30 June 2008. See http://www.laohamutuk.org/misc/AMPGovt/tax/NewTaxLaw08.htm for La’o Hamutuk’s analysis before and after the law was enacted.
24 The budget documents are inconsistent. In some tables, these figures add up to $91.2 million.
The budget documents acknowledge:

*Of the major sources of public sector revenue, only direct taxes (and rice sales) have increased over the period 2005-08; all other revenue sources – indirect taxes, user fees and charges and revenue from autonomous agencies – have stagnated or declined. However, indirect taxes are poised to jump in 2009 as the government begins to pay import and sales tax on its imports.*

La’o Hamutuk tried to calculate how much of each part of “domestic revenues” actually comes from domestic economic activity – that is, what will continue to come in when the State has no more oil money to spend. The results are depressing, underlining the urgency of developing the non-oil economy. The following table is extracted from the 2010 budget, with the two right-hand columns added by La’o Hamutuk:

### Domestic revenue projections in the 2010 General State Budget (million USD)

<table>
<thead>
<tr>
<th></th>
<th>2008 actual</th>
<th>2009 est.</th>
<th>2010 GSB</th>
<th>2010 reality</th>
<th>Explanation of “reality”</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxes (direct and indirect)</td>
<td>37.3</td>
<td>52.4</td>
<td>60.5</td>
<td>34.2</td>
<td>$26.2 million of this is one branch of the State paying taxes to another: wage and income tax on government workers; import duties on rice and other government-imported goods; sales and excise taxes on items purchased for State activities. The money to pay these revenues comes from State expenditures (funded by oil money), so they are not net domestic revenue, and will not exist when oil money stops. We have not subtracted at least $10 million more which comes from taxing international contractors, imports and consultants paid by development partners, although this comes out of Combined Sources Budget expenditures and should not be thought of as domestic revenues.</td>
</tr>
<tr>
<td>User fees, charges, other</td>
<td>6.2</td>
<td>7.8</td>
<td>9.2</td>
<td>9.2</td>
<td></td>
</tr>
<tr>
<td>Rice sales and interest</td>
<td>18.4</td>
<td>21.5</td>
<td>7.0</td>
<td>-18.1</td>
<td>This is the net loss from the Government purchasing rice at $25.1 million and re-selling it for $7 million. It’s difficult to calculate precisely, as some rice imported in previous years will be paid for or re-sold in 2010. However, the main point is that buying rice overseas and selling it to domestic customers at a loss does not produce “domestic revenues” or contribute to a sustainable domestic economy.</td>
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</tbody>
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26 GSB2010 Table 2, Book 1 page 21, with additional information from other parts of the budget.
Cancelling the heavy oil power plant

From the beginning, La’o Hamutuk has not agreed with the Government’s plan to electrify the nation with second-hand, heavy fuel oil generators from China because we believe that Timor-Leste has great possibilities for alternative and renewable energy which can meet our country’s current and future needs.

On 22 October, the Prime Minister informed Parliament that the heavy oil project is running into problems, and that $70 million of the $85 million appropriated for it during 2009 will be reallocated into the Pakote Referendum.

The proposed 2010 budget allocates $48 million to be spent this year on the heavy oil project and national electric grid, much less than the $160 million which the 2009 budget expected would be spent on it during 2010 (see table below). Nothing is now being budgeted to spend on it for 2011 or afterwards. (In addition, $2m/year was budgeted for 2009 and 2010 for a consultant to supervise the project; the 2009 GSB allocation for $2m to be spent in 2011 has been removed from the 2010 budget.)

<table>
<thead>
<tr>
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<th>2010 reality</th>
<th>Explanation of “reality”</th>
</tr>
</thead>
<tbody>
<tr>
<td>Autonomous Agency Revenues</td>
<td>7.6</td>
<td>8.6</td>
<td>14.5</td>
<td>-47.2</td>
<td>Some autonomous agencies receive large subsidies and operate at a loss, which is shown in the expense part of the budget. A more logical analysis would consider the net revenues from these agencies. EDTL’s net loss is more than $45 million after subtracting operating costs and fuel subsidies (the loss is actually much larger, but it is hard to calculate the past and current capital subsidy in the Ministry of Infrastructure budget), and APORTIL loses $4 million after subtracting expenditures for the authority and the Berlin Nakroma. The expenses of ANATL are about the same as its revenues, and IGE makes a slight profit, but much smaller than the losses of EDTL and APORTIL.</td>
</tr>
<tr>
<td>Total domestic revenues</td>
<td>69.5</td>
<td>90.3</td>
<td>91.2</td>
<td>-18.2</td>
<td>If we consider only the revenues from activities which produce a net gain (rather than those which lose money), and remove monies paid by the government to itself, actual domestic revenues in 2010 will be $46.1 million, about half of what is stated in the proposed budget.</td>
</tr>
</tbody>
</table>

27 Abbreviations for autonomous agencies: Electricity of Timor-Leste (EDTL), Port Authority of Timor-Leste (APORTIL), Airport and Air Navigation Administration of Timor-Leste (ANATL), and the Equipment Management Institute (IGE).

28 Office of the Prime Minister of RDTL, note to Parliament regarding “Pacote do Referendo,” 22 October 2009, Ref. No. 1834/GPM/X/09, Section II.
The 2010 budget anticipates a total project cost of $73 million: $10 million spent in 2008, $15 million in 2009 and $48 million in 2010. We believe that this mega-project cannot be implemented for that amount – it was originally budgeted at $390 million, and then reduced to $375 million. The budget documents acknowledge that the project has had delays, but if it is not going to be completed, it should be stopped entirely.

In a paid newspaper announcement last month, the Secretary of State for Water, Electricity and Urbanization discussed revisions to the project, (including enlarging the Hera generating station, while downsizing the others) but claimed that it is still going ahead. We are dubious, especially given that work virtually stopped at the Hera site more than two months ago. The Action Plan for the Ministry of Infrastructure does not mention this project, which is budgeted to consume 31% if the Ministry's total 2010 capital appropriation.

Chinese Nuclear Industry Construction Company No. 22 has already shown it cannot implement this project on time with a stable design. It is essential for people with wider expertise to analyze, evaluate and suggest improvements before any more money is spent. Parliament should not approve further funding for it without a full cost estimate over the life of the project. Given the controversies and delays, we encourage Parliament to insist on public consultation regarding not only its environmental impact (as required by law), but also on the detailed specifications, schedule and design.

We suggest that the Government evaluate how to provide electricity with an integrated system which would include decentralized, renewable technologies being implemented under the State Secretary for Energy Policy, hydroelectric and gas seep projects already studied, and the possible use of oil and gas from Sunrise or other Timor-Leste resources. After deciding upon the most appropriate, clean, sustainable and reliable electricity system (which might include transitional generating facilities burning imported fossil fuels), we can design a national grid and a plan for implementation.

Rather than pouring good money after bad, 2010 should be the “year of thinking” for the electricity sector – at a cost of far less than $50 million. Beginning in 2011, we can implement a system which will meet our people’s needs, use State money efficiently and avoid destroying Timor-Leste’s environment.

**Shedding light on Electricity of Timor-Leste (EDTL)**

Several State activities are not well-integrated between ministries, or are distributed across the budget in ways that make it difficult to know actual costs. One of the hardest is the generation of electricity by EDTL. A huge subsidy of EDTL operation, $30.9 million for diesel fuel, is a Whole of Government appropriation, not included in the EDTL or Infrastructure Ministry budget. In addition, the Ministry of Infrastructure’s Capital and Development budget includes $19.3 million for EDTL repairs, maintenance and other costs which should be Goods and Services. As these are likely to recur every year, we wonder why they are not listed for 2011 and beyond.

The state budget says that EDTL took in $7.0 million in revenues in fiscal 2009, increasing to $8.4 million in 2010. The agency will absorb more than $100 million in total subsidies during 2009-2010 (not including money spent on the heavy oil power plant). An agency whose expenses are seven times its revenues cannot be considered a source of income, and we worry that the losses will increase if heavy oil or other centralized generation using non-renewable fuel eventually comes on line.

**The Pakote Referendum is a bad precedent**

Unfortunately, journalists and politicians of all parties single out “budget execution” as a way to evaluate government performance, as if simply spending money was the objective. Rather than measure the results of government programs – such as how many students are educated or sick people cured – disburseing dollars is seen as an accomplishment, and conserving public resources as a shortcoming. This kind of thinking underlies the *Pakote Referendum, which is a particularly glaring example of wasteful, uncontrolled, impetuous spending unrelated to the plans in the 2009 Budget.*

The *Pakote Referendum* is a textbook case of resource curse thinking, and we hope that Timor-Leste’s policy makers will not make similar mistakes again. If our local companies cannot compete without handouts of state money, how will they survive when the state has no dollars to give? If the projects local companies implement have no design, no accountability, no planning and three months to complete, how will they learn to build useful, long-lasting infrastructure?

The draft 2010 State Budget does not mention the *Pakote Referendum*, even though it was underway more than a month before the Council of Ministers approved the budget on 7 October. This $70 million spontaneous project arose because the Ministry of Infrastructure couldn’t spend its 2009 Capital and Development budget on the heavy oil project. When Government arbitrarily shifted $70 million to unplanned activities, it disregarded the competency of Parliament to approve and oversee the budget. It also violated UNTAET Regulation 2001/13 by transferring more than 10% of an item without Parliamentary approval. The Decree-Law on this project, promulgated on 23 October but retroactive to 1 October, weakens processes of competitive tendering and omits the Request for Proposal and Terms of Reference which usually define a project. There projects must be implemented in less than three months, without any planning, so we expect that only the contractors will receive significant benefits.

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33 GSB2010, Book 3, Table 1230108, page 184.
37 Decreto-Lei No __/2009: Aprovisionamento Especial para Projectos Prioritários
Government's budgetary planning and execution capabilities are improving, and we imagine that the 2010 State Budget Parliament is currently considering will be implemented more accurately. Nevertheless, we believe that the Pakote Referendum undermines Parliament's authority, and hope that you will not allow future budgets to be ignored or manipulated in this way. In addition to opening up avenues for corruption, waste and poor quality, it prevents proper accountability and sustainability for public works infrastructure projects, which are definitely needed by our people.

**Legal and institutional issues in the petroleum sector**

La'o Hamutuk agrees that the petroleum sector is an essential source of revenues which can help develop other sectors of our economy. We therefore encourage wise decisions in this sector, including engaging all citizens of Timor-Leste to participate in developing legislation and policies.

However, we are concerned about the hasty implementation of some of the items in the Action Plan of the State Secretariat for Natural Resources (SERN).\(^38\) Such projects as creating a National Oil Company (NOC), building an oil refinery and building an onshore LNG plant are major undertakings, involving complexities and risks as well as benefits. We do not believe they can be carried out in less than a year, as the plan indicates. Before a NOC law is passed – and it should be debated and approved by Parliament, not only the Council of Ministers – there must be widespread public consultation, as well as learning in more depth from the good and bad experiences of other countries.

More than a year ago, the National Petroleum Authority (ANP) was created by Decree-Law, outside of Parliament's view. However, it is not yet financially independent – the SERN budget allocation includes a $1.8 million subsidy for ANP (up from last year’s $1 million) as “professional services.”\(^39\) Although we appreciate that this is mentioned in the SERN Action Plan (unlike last year), we believe that Parliament needs information about ANP revenues and expenditures before you can approve the budget.

**Conclusion**

In addition to the larger issues discussed in this submission, La'o Hamutuk has concerns about many details in the 850 pages of budget documents. We are annexing a list of items which may represent misguided policy decisions or which we found inconsistent, confusing, misleading or contradictory. We hope that it helps Committee C and the Parliament get all the information and clarifications you deserve before amending and approving the State Budget for 2010.

Thank you for your attention, and we welcome your comments and questions.


\(^{39}\) OGE2010, Book 3, page 62, Table 060104.