



Submission to Committee C National Parliament, RDTL

from

La’o Hamutuk

Regarding the

Proposed Rectification of 2015 State Budget

31 March 2015

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This is a translation of a slightly revised version of the submission La’o Hamutuk provided to the Ad Hoc Committee of National Parliament on 30 March 2015 in response to the request from Committee C. Because Parliament gave us less than two working days to write that submission, La’o Hamutuk decided to edit it a little bit more before publication, in order to better inform the Plenary Debate in Parliament.

Introduction

First of all, La'o Hamutuk appreciates the invitation from National Parliament Committee C to share our perspectives on the 2015 Budget Rectification. Although time is short, we will try to provide some ideas and information, and we hope that the suggestions below will help you to make good decisions to bring Timor-Leste to become a sustainable, healthy and equitable nation, with benefits to current and future generations.

We will be disappointed if this Budget Rectification maintains the fiscal envelope at the same level as the original budget, since we believe that we can save several million compared with the original \$1.57 billion budget. The restructuring of the Government, efforts not to waste money and make spending more efficient, falling fuel prices, and the strengthening U.S. dollar compared with currencies in nations we import from, exemplify gains for Timor-Leste to make our budget less expensive.

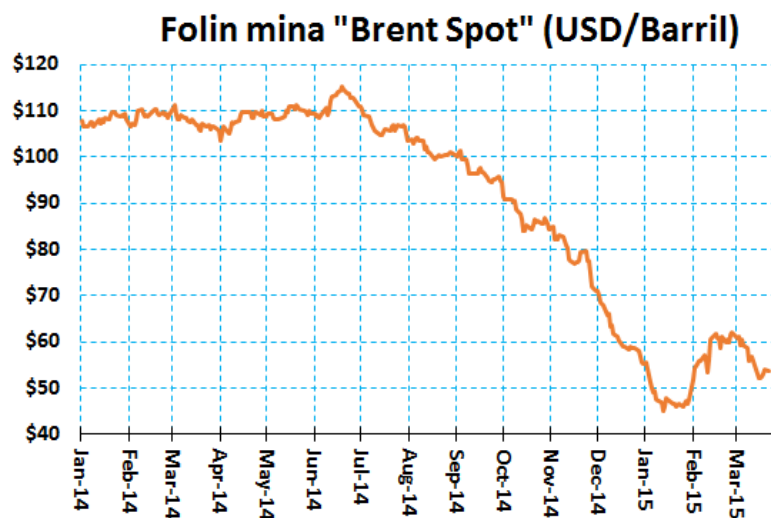
However, Government decided not to revise total expenditures. However, the world oil price fell greatly during the last nine months and, according to estimates by the Ministry of Finance,¹ this could reduce Timor-Leste's future oil and gas revenues by \$2.38 billion, compared with what we expected to receive.

We hope that Parliament will consider this when you think about spending Timor-Leste's finite oil wealth. Even if we eventually find more oil and gas fields, or if Bayu-Undan production continues longer than expected, the value of these resources will be less than it would have been a year ago.

This proposed rectification also includes \$25 million in new expenditures, but basically, this budget is a continuation of programs which were approved in the original budget. Therefore, our open letter² to the Distinguished Members of Parliament from last 25 November about the proposed 2015 State Budget remains relevant. This submission will not repeat what we wrote in that letter, but instead will focus on how we can reduce spending in 2015 by considering efficiency, efficacy and sustainability.

Prudence requires better Estimation of Sustainable Income (ESI).

In the original 2015 State Budget, the Government planned to withdraw \$1,327 million from the Petroleum Fund, composed of the \$638 million Estimated Sustainable Income (ESI) calculated last year, and \$689 million which will be withdrawn in addition to ESI. The Finance Ministry projected the ESI based on the average of the low and reference scenarios of the



¹ Paragraph 2.4.3.2 of the proposed Budget Rectification book,

² <http://www.laohamutuk.org/econ/OGE15/LHKartaOJE15PN28Nov2014en.pdf>

Brent crude oil price published by the U.S. Energy Information Administration (EIA) in April 2014, which projected a price of \$90/barrel during 2015. At that time, the actual Brent price was \$108, but unfortunately, the price fell sharply during the second half of 2014, to less than \$50/barrel at the beginning of 2015.

The sensitivity analysis in Budget Book 1 (Figure 2.6.3.2.3) says that if the Brent price changes by \$10/barrel, the ESI will change by \$25 million. However, the Brent price has fallen about \$50 during the last several months. According to the Ministry's estimate of \$2.38 billion in lost revenues, this could reduce the 2015 ESI by around \$71 million.

In the rectification, the Government proposes to withdraw the same amount of money from the Petroleum Fund, having decided not to consider the effect of oil prices on ESI, for the reason that the official EIA annual projections have not come out – although every month EIA publishes price projections for the next two years, during which time nearly half of Timor-Leste's remaining oil and gas will be extracted.³

Therefore, we continue to suggest that it would be better for the Government to be more cautious in its spending policy, to avoid the risk posed to our economy by the uncertainty of future oil prices. The Petroleum Fund law itself requires "prudent estimates," and the ESI estimate appropriately uses a lower price than the EIA Reference Case. Therefore, we suggest that Parliament ask the Government to make these changes to the ESI calculation in the original 2015 budget:

\$638 million	ESI estimate in original 2015 State Budget
- \$ 71 million	Lower oil prices, resulting in \$2.38 billion lower revenues
- \$ 3 million	Withdrew \$100 million above ESI from Petroleum Fund in 2014
+ \$ 3 million	Oil and gas revenues in 2014 were \$111 above prudent projections
- \$ 13 million	\$426 million lost in Petroleum Fund balance due to currency fluctuations
- \$ 50 million	Future oil and gas production will be lower due to commercial considerations
= \$504 million	La'o Hamutuk's suggested ESI in the 2015 Budget Rectification.

Based on our suggestion above, the ESI will be lower by \$134 million. However, Government plans to withdraw more than double the ESI -- the original 2015 Budget would take 208% of ESI from the Petroleum Fund during 2015. If we continue with this imprudent percentage but use La'o Hamutuk's updated ESI number, the amount withdrawn from the Petroleum Fund this year would be \$1,048 million, \$279 million less than before. Therefore, from the revenue perspective, total expenditures during 2015 should be \$1,291 million.

³ In their March 2015 Short Term Energy Outlook, EIA projected a reference Brent price of \$59/barrel during 2015 and \$75/barrel in 2016. The ESI calculation in the 2015 budget had been based on EIA reference prices of \$102 and \$99, respectively (averaged with low prices of \$77 and \$75).

In truth, goods and services are already cheaper.

The restructure reduced the number of Government members from 54 to 38, which will save some money, as some ministries have been combined and some directorates eliminated. From this change, the rectification managed to save \$47.5 million in spending, including reductions of \$17.8 million from PNDS and \$2.0 million from fuel for EDTL.

Since his first week as Prime Minister, Dr. Rui Maria de Araujo has been visiting Government institutions to encourage them to be efficient, effective and accountable. This has come with the promise that “We cannot continue allowing waste and the ineffective use of public monies.” The public, including La’o Hamutuk, has high expectations that this Government will indeed be able to save money and reduce spending.

Sadly, in this rectification, Government plans to spend \$516.9 million for goods and services, slightly more than \$516.3 million in the original budget, although the prices of many things have dropped.

The original budget included \$115 million for vehicle and generator fuel. Because the international wholesale price of gasoline has fallen by nearly half since the budget was prepared, we should be able to save at least \$50 million, reducing spending without affecting state activities. Unfortunately, the proposed rectification cuts only \$2 million from EDTL generator fuel appropriations, allowing the vendors who supply fuel to pocket the savings.

EDTL should also improve its efficiency. The recently released World Bank/Ministry of Finance Public Expenditure Review on Infrastructure⁴ identifies that about half of the electricity generated never gets to customers. According to the latest Quarterly Statistical Indicators⁵ from the National Statistics Directorate-General, during 2014 EDTL generated 349 megawatt-hours (MWh), but only 126 MWh were consumed. We think that when EDTL reduces these losses, it will save fuel and money.

In addition, nearly 39% of Timor-Leste state spending is for non-fuel imports from countries with currencies other than the U.S. dollar, and 14% more is to import services. About \$497 million imports goods, and \$22 million for services. During the last 12 months, the dollar-rupee exchange rate has increased by 14%; the dollar has also risen compared to currencies in other countries we import from.



Therefore, we should be able to save about \$50 million in goods and services spending compared with the original budget, and still purchase the same things. When we suggested this to the Government last February, the Ministry of Finance declined to accept this idea, which we see as donating the benefits from the stronger dollar to the profits of Timor-Leste’s suppliers –rather than obtaining maximum value for our people’s money.

⁴ <http://www.laohamutuk.org/DVD/docs/WBMPERinfReport13Mar15en.pdf>

⁵ <http://www.laohamutuk.org/DVD/DGS/QSI4q2014.pdf>

Reviewing project costs can further reduce spending.

As in the original budget, the proposed rectification continues to spend large amounts on mega-projects such as Tasi Mane, Tibar Port, ZEESM and other infrastructure. To date, we have never seen specific official information about the costs and advantages of these projects, which are often much more expensive than similar projects in other countries. We urge that more effort be made to analyze and explain the total costs, benefits and risks of these projects, which could consume a large amount of Timor-Leste's money.

The 2015-2017 Government Program promises that "This Government makes it a priority to demand professionalism, better planning, cost control and cost-efficiency" in infrastructure construction and maintenance.

The original budget appropriates \$20.4 million for the Suai Supply Base and \$13.0 million more for Suai airport in 2015, which probably represents less than one-twentieth of the total cost of these projects. These are part of the Tasi Mane project to facilitate petroleum industry activities, primarily when the Greater Sunrise pipeline comes here. Unfortunately, the future of this field is still very uncertain.

Government, particularly the Ministry of Petroleum and Mineral Resources, continues to refuse to provide information about the economic viability, costs, and returns this project will entail. Recently, La'o Hamutuk wrote a letter to the National Procurement Commission asking them not to award a contract for a preliminary design for the LNG plant in Beacu, which could save \$5 million from the Infrastructure Fund in 2016, and billions more in the future.⁶

This rectification budget continues to waste money for projects with no rational cost analysis, weak planning, and poor efficiency. We suggest that Parliament should delay these expenditures until there is more certainty that the Sunrise pipeline will indeed come to Timor-Leste.

We should not ignore that, on 18 February, Woodside announced that it will suspend all activities related to Sunrise, because the drop in global oil prices has forced many companies to cut back on investing in new projects.⁷

Therefore, we suggest that it would be better to stop spending on projects which are still dubious, before we waste much more money. Parliament could ask Government to provide realistic estimates, including high and low cost scenarios, of the total cost of the Sunrise project, and its financial and other returns and benefits. We encourage you to analyze concrete plans, and not just to proceed on dreams.

Avoid adding unnecessary appropriations.

As mentioned above, despite the recent downsizing of Government, we are in the habit of spending more rather than saving money. The budget rectification reallocates money from extinct ministries and institutions to new ones, or adds money to ongoing institutions.

The original budget three months ago allocated \$82 million to the Oecussi Regional Authority, and we are disappointed and surprised that the rectification allocates \$10

⁶ <http://www.laohamutuk.org/Oil/TasiMane/Beacu/LHNPC-LNG17Mar2015en.pdf>

⁷ <http://www.laohamutuk.org/Oil/Sunrise/2015/UpstreamWoodsideDoubt18Feb2015.pdf>

million more to ZEESM and another \$1.5 million to celebrate the Portuguese colonization of the Timorese people.

Although we don't have information why these new expenditures are being made, we have heard that the \$10 million is to cover some deficits in ZEESM's program implementation. We think that new allocations like these should not happen again until Members of Parliament are informed about how the \$82 million already approved is being used. You and we are not able to see ZEESM's systems for procurement, accountability or project feasibility analysis, making us doubt whether these projects will be advantageous for Timor-Leste. The appropriations process is not transparent and doesn't follow normal procedures, so we cannot know its progress or monitor how money is spent via the Government's Transparency Portal (once it is working again).

Also, we don't need to create new unneeded expenditures just to spend money in ways that benefit only a few people. For example, \$8.5 million in new "Whole of Government Expenditures" will finance legal services, veterans, borrowing, Public-Private Partnerships, international conferences and military operations inside our land. The rest of Government has to live with the plans it made last year during the 2015 budget process, and therefore we do not agree that the Ministry of Finance's "Whole of Government" should receive special privileges from the budget revision process.

The Government recently published the *Business Activities Survey* for 2013,⁸ which estimates that formal private sector employment dropped 4.1% -- there were 1,700 fewer jobs at the end of 2013 than at the end of 2012 -- and that businesses' incomes were also lower. Although some of this drop is from the completion of the power plant projects, it is clear that our non-oil, non-government economy is barely growing.

Although inflation has dropped significantly (largely because of the strong U.S. dollar), our population continues to increase, and nearly 20,000 people enter the workforce every year. If the private sector of our economy continues to stagnate or shrink, how will these young people be able to support their families? This is vital to Timor-Leste's people, more urgent than spending public money to support Guinea-Bissau's military.

We hope that the National Parliament will view our concerns with more perspective and care, evaluating their decisions well to ensure that our people's money is truly used for people's needs. Today, many are poor, jobless, without clean water or food, lacking decent education and health care. Our people are our most important resource, and we should reduce imports in favor of products they produce, address their needs and invest in their future -- especially for the often-ignored majority living in rural areas.

We must rapidly overcome petroleum dependency.

The 2015-2017 Government Program considers developing the Tasi Mane Project as a foundation of our industrial base. One component, the Suai Supply Base, is designed to provide logistical support for offshore oil operations. We consider that this prolongs Timor-Leste's future dependence on oil and gas. Priorities like this have an "opportunity cost" -- we give up the chance to develop other social and economic sectors, such as education, health, agriculture, food processing, tourism and light industry.

⁸ <http://www.laohamutuk.org/DVD/DGS/BAS2013en.pdf>

Fundamentally, this project is designed to support development of the Greater Sunrise field and to bring its gas pipeline to Timor-Leste, which remains in doubt. It also relies on today's production from the Bayu-Undan and Kitan fields. Unfortunately, the revenues from these non-renewable resources will last for less than six years. Bayu-Undan, which has so far provided the largest part of our oil income, will be empty by 2020, and Kitan will be dry in 2017. Even before the oil price collapse, the 2014 and 2015 state budgets explained that Bayu-Undan production will be lower than previous budgets predicted.

In his speech to Parliament when the 2015-2017 Government program was presented, the Minister of Petroleum and Mineral Resources said that he does not believe that Bayu-Undan and Kitan will be dry soon, and is confident that TimorGAP can replace ConocoPhillips if the latter doesn't want to continue to operate Bayu Undan, and he continues to tell Parliament and the public that it is likely that Timor-Leste has many more potential resources which will continue to attract international oil companies.

However, we also need to consider that if the price of oil continues to be low, and our reserves are being depleted, this will not encourage oil companies to keep operating here, or attract new companies to come to invest, as they doubt the commercial benefits of new projects. When the oil prices drops, every oil company reduces its investment in new explorations.

Timor-Leste itself has confronted this problem when Woodside decided to suspend Sunrise activities. The Bayu-Undan Joint Venture also downgraded its production projects from Bayu-Undan two years ago. At that time, Timorese petroleum sector officials were skeptical and said that they would hire a consultant to do an independent evaluation because they didn't believe the companies' projections.

Unhappily, we do not yet know the results from this evaluation, and Parliament could ask Government to provide this information, rather than continuing to speculate in Parliament and public.

According to data from the National Petroleum Authority (ANP), during 2014 the JPDSA produced 24% fewer barrels of gas and oil than in 2013. In the same year, revenues from Kitan fell 85% and revenues from Bayu-Undan fell 35%. Spending plans should recognize that our oil and gas are running out.

During 2014, Kitan provided only \$50.1 million to Timor-Leste, less than 1/6 of the year before, due to a combination of lower prices and field depletion. Last week, on 23 March, the Japanese company INPEX, which owns 35% of the Kitan project, reduced its value by \$62 million because of "deteriorating market environments."⁹

From our projections, if today's spending patterns continue, the Petroleum Fund will be able to finance Timor-Leste's budget for only 5-8 years after 2020, when Bayu-Undan runs dry. At the end of February 2015, the balance in the Petroleum Fund was \$16.867 billion, only 0.3% more than it was six months earlier (\$16.818 in August 2014). Timor-Leste has already entered into a new phase of our financial reality—oil revenues passed their peak 2-3 years ago, and our Petroleum Fund is no longer growing.

Parliament should ask the Finance Ministry and Central Bank to model different scenarios of the return on investing the Petroleum Fund, and should choose a prudent rate of return

⁹ <http://www.laohamutuk.org/Oil/Project/Kitan/2015/INPEX%20writedown23Mar2015.pdf>

when calculating ESI and modelling sustainability. As 70% of our oil wealth has already been converted into monetary investments, the investment return has more impact on our financial future than the oil price. At present, the Ministry assumes that the Petroleum Fund investments will return 5.7% nominal annual return. However, during 2014, the nominal return from Petroleum Fund investments was only 3.3%, so it is clear that more prudent assumptions are needed to make wise decisions for Timor-Leste's future.

The ADB just published its new *Asian Development Outlook*,¹⁰ saying that "Declining petroleum production and low energy prices highlight the need to diversify [Timor-Leste's] economy by encouraging private investment." They warned that "As revenues from existing fields decline, prudent fiscal policy is needed to avoid rapidly depleting savings in the Petroleum Fund."

We encourage Parliament and all state institutions to think of the appropriations numbers in the Rectified State Budget for 2015 as maximum levels of allowable spending, rather than as targets for the goal of achieving 100% budget execution. If you can implement plans and serve people without spending the entire allocated amount, please do so. Nobody benefits from wasting public assets or obtaining poor value for money, and the recent pride in achieving 92% budget execution during 2014 is misguided. As the Sixth Constitutional Government strives to be more efficient than previous ones, we urge to you to be more careful custodians of the public's wealth. After all, Government's responsibility is to care for its citizens and provide for their future – not to dispose of dollars before 31 December.

Finally, we hope that Parliament is able to hear our suggestions, and will approve a Rectification of the 2015 Budget which is more consistent with economic reality and sustainable objectives. La'ó Hamutuk is, of course, ready to continue to help the Distinguished Members if you would like additional information.

Thank you for your attention.

Sincerely,



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La'ó Hamutuk Economics and Natural Resources Team

¹⁰ Timor-Leste pages at <http://www.laohamutuk.org/DVD/2015/ADBADO2015TL.pdf>