Budget analyses and fiscal performance (Papua New Guinea and Timor-Leste)

Lead authors: Yurendra Basnett and David Freedman.

Two of the Pacific’s biggest economies have benefited from natural wealth, but capacity constrained public sectors face significant challenges in service delivery. The fall in commodity prices has impacted the revenue flows of both countries and their budgetary responses make for interesting comparison.

TIMOR-LESTE

A well-designed sovereign wealth fund has shielded Timor-Leste from the volatility and cash management challenges seen in PNG, but reliance on the Petroleum Fund also highlights the longer term challenge of achieving fiscal sustainability. Despite a large fall in petroleum revenues, down 76.2% (y-o-y) in the first 3 quarters, total government expenditure increased by 16.1% (y-o-y) in the first 10 months of 2016.

This stimulus has been driven by strong growth in capital investment, salaries and wages, and transfer payments. In July, the national Parliament approved an amendment to the budget, with additional appropriations for roads, electricity, a new international port, and the Tasi Mane project to develop a petroleum industry on the South Coast (Figure 8). The additional appropriations brought the revised capital budget to $846.0 million (equivalent to 54.3% of non-oil GDP). Capital investment accounted for 24.1% of total government expenditure during the first 10 months of the year, and was up by 91.0% (y-o-y). However, by the end of October, only 29.2% of the revised capital budget had been executed. Following changes to the Infrastructure Fund law completed in 2016, unspent funds would likely be retained for use in future years without re-appropriating the funds. Expenditures on salaries and wages rose by 11.7% (y-o-y) during January–October, while transfer payments rose by 6.6% (y-o-y). These transfer payments include grants to the Special Administrative Region of Oe'cusse (SAR), which accounted for 11.2% of planned expenditures under the revised budget. All budgeted transfers to the SAR were completed by June, but information on subsequent execution of these funds is limited.

Setting aside the payments to the SAR, expenditures on transfers actually fell by 24.1% (y-o-y). This partly reflects a spike in 2015 transfer payments to veterans of the fight for independence as back payments to newly registered veterans were completed.

Timor-Leste’s Petroleum Fund began 2016 with a balance of $16.2 billion (approximately $13,400 per capita) and the Fund’s investments have performed well in 2016, earning an overall return of 5.9% during the first three quarters. The Fund’s performance will become increasingly important as revenues from current petroleum production come to an end. Projections for petroleum taxes and royalties have been cut by 44.9% (Figure 9). As a result, the estimated sustainable income that can be withdrawn from the Petroleum Fund each year has fallen to $481.6 million compared with $544.8 million in 2016 and $787.0 million back in 2013.

Fiscal constraints highlight the need for careful prioritization of public spending. The 2017 budget prioritizes agriculture, nutrition, education, and infrastructure (Sustainable Development Goals 2, 4 and 9), which were identified as priorities for the 2017 Budget. The draft budget proposes a small reduction in total spending while continuing the government’s strategy of scaling up its capital investments (Figure 10). Budgeted expenditures for 2017 are $1.4 million, excluding grants—29.0% lower than the final appropriation for 2016 and 30.0% lower than the projection for 2017 contained in the 2016 budget. However, when taking into account the additional appropriations that were approved in the revised 2016 budget, planned spending during 2016–2017 is only 5.7% lower than the initial plan for 2016–2017. The prospect of a moderate reduction in public spending in 2017 have seen the government’s growth forecast for 2017 cut to 3.9%, rising to 6.5% in 2018.

The 2017 budget plans to spend $324.4 million for capital investments in 2017, and a further $4.14 billion during 2018–2021. These investments are concentrated in a small number of sectors, with roads, ports, airports, and the Tasi Mane project accounting for 74.6% of all planned investments (Figure 11). A new asset maintenance program has been included in the 2017 budget, but
the allocation for this program will not cover all maintenance needs as it is only equivalent to 1% of planned capital investment during 2016–2021. Proposed investments in water and sanitation are also well below the levels needed to meet national targets for access to clean water.

Timor-Leste continues to rely on its Petroleum Fund to finance the budget, but 2016 has seen good progress in domestic revenue collection. Non-oil revenues rose by 31.3% (y-o-y) during January–October on the back of a 25.0% increase in tax revenues and a 7.7% increase in non-tax revenues. These improvements are expected to continue during 2017–2021, with revenues projected to grow at an average of 5.9% per annum. As a result, projections for domestic revenues in 2020 are now 17.9% higher than the equivalent forecast from with 2016 budget.

Despite this growth, domestic revenues will only cover 11.4% of planned expenditures during 2017–2021. The government is planning to finance a further 13.8% of the budget with concessional loans with the remaining 74.8% to be funded from the Petroleum Fund. This will require withdrawals from the Fund that exceed the estimated sustainable income. As a result, the Petroleum Fund balance is projected to fall to $13.1 billion by 2021 (Figure 12).

Further strengthening of the systems for public investment management can help to ensure that Petroleum Fund withdrawals are used efficiently. Fiscal sustainability will also require continued strengthening of the tax administration and broadening of the tax base. Timor-Leste’s Sixth Constitutional Government has prioritized fiscal reforms and in 2016 it approved a new customs procedures code and passed legislation to establish new authorities for customs and other domestic revenues. There is also scope for key legislative reforms to be completed before the government’s term ends in 2017. This includes legislation to adjust tax rates and support the introduction of a value-added tax that would underpin future domestic revenue collection. If approved and implemented well, these reforms will help Timor-Leste on its path to a sustainable and diversified economy.