Implications of recent changes to Timor-Leste’s Petroleum Fund

Timor-Leste Studies Association 2019
By: Charles Scheiner, La’o Hamutuk
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Petroleum Fund origin and objectives

- Avoid resource curse
- Stabilization – oil prices and production vary
- Sustainability – after the oil runs out
- Buffering – keep state expenditures separate from oil money
- Transparency – avoid corruption, inform citizens, improve policy decisions
- “For the benefit of current and future generations”
Changes to the Petroleum Fund

We were world leaders in 2006, average in 2017, and worse now.

**Timor-Leste**

2017 RESOURCE GOVERNANCE INDEX

Timor-Leste's oil and gas sector scores 49 of 100 points in the 2017 Resource Governance Index (RGI), ranking 43rd among 89 assessments and eighth among 15 assessments in the Asia Pacific region. This overall score is lowered by a poor score in the enabling environment component. Even though both extractive sector components, value realization and revenue management, achieve similar scores, there is great variation in performance at the subcomponent level. The oil and gas sector constituted 98 percent of exports and 97 percent of government revenues in 2013, making this sector a key facilitator of economic development.¹

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**Legal framework**

- **Petroleum Activities Law no. 11/2005 (PAL)**
  
  Regulates how Timor-Leste contracts with petroleum companies and what rules they must follow, transparency, environment, etc.

- **Petroleum Fund Law no. 9/2005 (PFL)**
  
  - All oil money goes in to the Fund. Withdrawn only with Parliamentary approval (normally through GSB)
  
  - Mandates regular publication, consultation and transparency.
  
  - Estimated Sustainable Income (ESI) guideline: 3% of (balance + prudent projections of future petroleum revenue)
  
  - Investment rules: Initially all U.S. gov’t bonds; diversified in stages to international bonds and equities, and then to private debt.
  
  - 2011 revision: Changed investment profile, weakened ESI and debt collateral rules
  
  - 2018 unauthorized and authorized extraordinary withdrawals
  
  - 2019 investment rules overridden by revision to PAL
### Changes to the Petroleum Fund

#### Legislation When Days Consultation Parliament

**Petroleum Fund Law no. 11/2005**
- 2004-5
- 304 days
- Three rounds of hearings nationwide, 25 submissions
- Unanimous passage after two months of hearings and debate

**Petroleum Activities Law no. 9/2005**
- 2004-5
- 335 days
- Many workshops, one round of hearings, nine submissions
- Pending in PN for seven months, no hearings before enactment

**Revisions to Petroleum Fund Law**
- 2010-11
- 457 days
- Many workshops, two hearings, four submissions
- Discussed for two weeks, passed with few changes

**$70m extraordinary transfer from PF**
- May 2018
- 0 days
- No legislative process, probably illegal
- Not submitted for approval

**$140m extraordinary transfer from PF**
- July 2018
- 10 days
- None. LH made submission to rumored broad draft, which was replaced by a one-time transfer
- One-off transfer approved

**Revisions to Petroleum Activities Law**
- Oct-Nov 2018
- 23 days
- Secret draft. Brief Parliamentary hearing on preliminary version
- Major addition just before final vote. Vetoed, overridden, challenged in court. Retroactive

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**Petroleum revenue peaked in 2012, and this is how it flowed in and out of the Petroleum Fund.**

The basic structure hasn’t changed, but details have.

**From 2005 thru 5/2019:**
- $22.4 bn oil revenues
- $5.3 bn invest. return
- $10.7 bn withdrawn
- $17.1 bn balance

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**Timor-Leste’s Petroleum Revenue Streams**


- Purchasers of oil and gas from Baux-Undan and Kitano
- Bayu-Undan and Kitano joint ventures
- Companies operating costs & profit
- Australia taxes $141
- National Petroleum Authority (Australia-TL joint agency)
- TL share 90% $1.277
- Australia share $12
- PF Investment income $401
- Australian Petroleum Fund
- End-of-2012 balance $11.775 million
- $665 Est. Sustainable income transferred
- $830 transferred above ESI

**Timor-Leste State Budget**

$1.195 million spent during 2012

- $254 Donor-funded projects
- $691 Recurrent
- $503 Capital
- $671 State operations & services

Infrastructure, education, administration, veterans, health, social assistance, development, police, agriculture, P-ESTI, courts, etc.
Changes to the Petroleum Fund

Only South Sudan, Libya (and Equatorial Guinea?) are more dependent on oil and gas exports than Timor-Leste was before 2014.

State revenues in 2018: $154 million was lost from investing the Petroleum Fund
$447 million from oil and gas revenues
$167 million from non-petroleum sources

Executed 2018 State Budget: $1,154 million ($1,277m appropriated)
$983 million transferred from the Petroleum Fund
$167 million from non-petroleum (domestic) revenues
$39 million from loans which will have to be repaid

State activities, paid for with oil money, are nearly half of the “non-oil” economy because some of this money circulates in the local economy.

Petroleum and investment “income” goes to the state, not the people.

Petroleum Dependency (nominal USD)

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Petroleum GDP</td>
<td>$4,234</td>
<td>$2,591</td>
<td>$1,496</td>
<td>$820</td>
<td>$895</td>
</tr>
<tr>
<td>Non-oil GDP</td>
<td>$1,403</td>
<td>$1,451</td>
<td>$1,597</td>
<td>$1,684</td>
<td>$1,593</td>
</tr>
<tr>
<td>Productive (agric. &amp; manuf.)</td>
<td>$305</td>
<td>$307</td>
<td>$288</td>
<td>$287</td>
<td>$284</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Petroleum GDP</th>
<th>Non-oil GDP</th>
<th>Productive (agric. &amp; manuf.)</th>
<th>GDP Total</th>
</tr>
</thead>
<tbody>
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<td>2013</td>
<td>$4,234</td>
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<td>$2,591</td>
<td>$1,451</td>
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</tr>
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<td>2015</td>
<td>$1,496</td>
<td>$1,597</td>
<td>$288</td>
<td>$3,381</td>
</tr>
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<td>$820</td>
<td>$1,684</td>
<td>$287</td>
<td>$2,791</td>
</tr>
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<td>$895</td>
<td>$1,593</td>
<td>$284</td>
<td>$2,769</td>
</tr>
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</table>

Petroleum and investment “income” goes to the state, not the people.
Changes to the Petroleum Fund

The PF hasn’t grown in four years.

The Fund’s balance is the same as it was four years ago. It dropped a billion dollars in the fourth quarter of 2018.

Oil taxes and royalties are declining, but investments are volatile.
We depend on investments now, not oil and gas.

State (including Petroleum Fund) income and expenditures

- Domestic revenues
- Oil & gas revenues [tax corrected]
- Return on P.F. investments
- Loans taken out
- Executed state spending
- Transfers from P.F.

Million USD per year


Where TL’s oil income comes from

- Over-collected taxes
- Elang-Kakatusa (2000-05)
- Kitan (2011-15)
- Bayu-Undan (2004-23)
- Returned over-collected taxes
- Petrol. Fund Investment return

Annual revenue to TL (billion USD)

Changes to the Petroleum Fund

The Petroleum Fund reached $17.1 billion four years ago and has not increased since then. It is likely to decline from now on.

The 2011 revision allowed 40% in equities (stocks) and the recent change allowed 5% in “Petroleum Operations” (Greater Sunrise).
Changes to the Petroleum Fund

More stocks bring more volatility

2018-2019 changes to Petroleum Activities Law

- Prohibits prior Audit Court review of petroleum-related contracts and agreements.
- Allows TimorGAP to own more than 20% of a project (which it already does for several projects).
- A last-minute addition overrides the P.F. Law to enable up to 5% of the Fund to be invested in petroleum operations within Timor-Leste.
- The law was vetoed by the President, but the veto was overridden.
- The Court of Appeal has ruled that the main points are legal and constitutional.
PF Law Article 15: Investment Rules

1. Under the criteria in this article, to qualify as eligible investment, the investment instrument must be issued or the investment be located abroad, in an internationally recognized jurisdiction.

4. No more than 5% of the Petroleum Fund should be invested in other eligible investments, provided that:
   a) The Minister has included such other asset class, which is part of the investment, in the proposed distribution of portfolios submitted to the National Parliament under Article 14.5, and
   b) The rules and criteria for selection, management and evaluation of each individual financial instrument within a certain asset class, have been approved by the Minister and published.

5. The exposure of the Petroleum Fund to:
   a) Any company or the issuing entity for the eligible instruments, with the exception of sovereign states, can never exceed 3% of the total value of the Petroleum Fund;

Petroleum Activities Law as amended, Article 22: State Participation

6. The Petroleum Fund may be applied directly in Petroleum Operations, in the national territory or abroad, through the execution of commercial transactions, through Timor Gap, E.P., pursuant to Article 15.4 of Law no. 9/2005 ... republished by Law no. 12/2011.

7. Contracts for purchase and sale, acquisition, assignment, transfer, transfer, novation, merger, encumbrance or any other legal transaction entered into or payments made by Timor-Leste or any other Timorese public corporation, including entities wholly owned or controlled by them, is designed to allow the participation of Timor-Leste or any other Timorese public legal person, including through entities fully owned or controlled by them, or of the Petroleum Fund, in Petroleum Operations and, as well as for the conduct of these, are not subject to prior inspection by the Audit Chamber of the High Administrative, Tax and Audit Court.
Changes to the Petroleum Fund

What just happened?

• Last September and October, Timor-Leste agreed to pay ConocoPhillips and Shell $650 for their participation in the Greater Sunrise Joint Venture, amounting to 56.56% of the project.

• The proposed 2019 State Budget included $350m for this, and Parliament added $300m at the last minute. After a Presidential veto, the appropriation was removed from the Budget.

• In February, the interim Minister of Finance informed the Central Bank and Parliament of a new PF investment policy, which was then approved by the Council of Ministers. On 11 March, the Ministry signed a new management agreement with BCTL.

• On 10 April, the PF loaned $650 million to TimorGAP for 18 years.

• On 16 April, following Australian regulatory approval, TimorGAP paid the money to ConocoPhillips and Shell.

• Timor-Leste now owns 57% of Sunrise, and will be responsible for 57% of the offshore, in-field capital costs and 100% of the on-shore costs. It may earn some revenues in the future.

In four years, the loan to TimorGAP will exceed the 5% legal limit.

TimorGAP will pay 4.5% annual interest on the $650 million loan, with an 8-year grace period and an 18-year repayment term.
Recent context and developments

- Very little future oil income. Kitan has finished and Bayu-Undan is 95% depleted. The Maritime Boundary Treaty will help a little, but Sunrise will probably provide less annual income than Bayu-Undan did.
- TL’s population, expectations, maintenance and salaries keep going up.
- U.S. and global financial markets are volatile and uncertain.
- About 5% of the Petroleum Fund is no longer liquid or tradeable.
- No serious, comprehensive, unbiased public analysis has evaluated the financial, economic, social and environmental costs, benefits and risks of the Sunrise project to Timor-Leste’s people, or the alternatives.
- Timor-Leste can force Sunrise gas to be liquefied in Beacu, but will have to come up with $10-$20 billion in capital costs and find the expertise to design, build, manage and operate this complex project for the next 30 years. The money and attention given to it reduces the likelihood of more sustainable economic development options.
- Renewable energy is getting cheaper, and growing awareness of the climate emergency will make fossil fuels less valuable in the future.

What will Tasi Mane really cost?
This estimates capital expenditures only, not operational costs. Most have never appeared in state budget forecasts.

<table>
<thead>
<tr>
<th>Component</th>
<th>Location</th>
<th>Status</th>
<th>Spent through 2018</th>
<th>Budgeted 2019</th>
<th>Budgeted 2020-2021</th>
<th>Estimated total capital cost</th>
<th>Percent of budgeted</th>
</tr>
</thead>
<tbody>
<tr>
<td>Airport</td>
<td>Suai</td>
<td>Constructed</td>
<td>70</td>
<td>10</td>
<td>3</td>
<td>90</td>
<td>92%</td>
</tr>
<tr>
<td>Supply base</td>
<td>Suai</td>
<td>Tender pending</td>
<td>6</td>
<td>10</td>
<td>668</td>
<td>850</td>
<td>80%</td>
</tr>
<tr>
<td>Highway</td>
<td>Suai-Fatukai</td>
<td>Mostly built</td>
<td>267</td>
<td>50</td>
<td>8</td>
<td>340</td>
<td>96%</td>
</tr>
<tr>
<td>Highway</td>
<td>Fatukai-Beacu</td>
<td>Not started</td>
<td>3</td>
<td>-</td>
<td>-</td>
<td>1,320</td>
<td>0%</td>
</tr>
<tr>
<td>Airport</td>
<td>Viqueque</td>
<td>Not started</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>60</td>
<td>0%</td>
</tr>
<tr>
<td>Oil refinery &amp; pipelines</td>
<td>Betano</td>
<td>Pending design</td>
<td>3</td>
<td>-</td>
<td>-</td>
<td>1,500</td>
<td>0%</td>
</tr>
<tr>
<td>Gas pipeline, LNG plant &amp; port</td>
<td>Sunrise-Beacu</td>
<td>Pending design, financing</td>
<td>12</td>
<td>-</td>
<td>-</td>
<td>6,000</td>
<td>0%</td>
</tr>
<tr>
<td>51% share of Greater Sunrise Joint Venture</td>
<td>Offshore</td>
<td>Borrowed directly from the Petroleum Fund</td>
<td>-</td>
<td>650</td>
<td>-</td>
<td>650</td>
<td>100%</td>
</tr>
<tr>
<td>39% of Sunrise upstream capital expenditure</td>
<td>Offshore</td>
<td>Pending design, financing</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>6,840</td>
<td>0%</td>
</tr>
<tr>
<td>Administrative and other costs</td>
<td>Dil</td>
<td>Ongoing</td>
<td>49</td>
<td>12</td>
<td>50</td>
<td>400</td>
<td>28%</td>
</tr>
<tr>
<td>TOTAL</td>
<td></td>
<td></td>
<td>410</td>
<td>732</td>
<td>729</td>
<td>18,050</td>
<td>10%</td>
</tr>
</tbody>
</table>
What other changes are being considered?

- Seeking external financing for Tasi Mane infrastructure, but it may be hard to find
- Amending the PF and PA laws next month before ratifying the Boundary Treaty
- Legal changes needed before the loan to TimorGAP exceeds 5% of the PF
- Allocating part of the PF to invest in Timor-Leste outside of the budget process
- Eliminating the ESI guideline altogether
- Using the PF as collateral for debts
- Bankrupting the country

If current plans continue, TL may be unable to finance its budget in 11 years. The Boundary Treaty and Sunrise help a little, but not enough.

This model does not include the Betano refinery or Sunrise and the Beaçu LNG plant.
If the Fund pays for Tasi Mane, it crashes in 5 years.

Sunrise plan approved in 2022 with pipe to TL. Sunrise has 5.1tcf gas and TL gets 70% of it. Natural gas is worth 40% as much as oil. With 2018 NRT fields.
Petroleum Fund investments return 3.6% yr nominal. During 2016-2018 the fund earned 1.7%.
Domestic revenues increase 3.3% yr now and 2.0% yr after 2030. During 2016-2018, these revenues (without EDI1, or taxes from the state) declined. EDI1 earns 60% of fuel cost from users. It recovered 58% in 2015-18.
Expenditures 2019: 2019 Q1, then calculated from LIM model, spending grew up 4.0% yr now and 4.0% yr after 2030. In 2012-2016, recurrent spending (excl. EDI1 fuel) went up 14% yr.
Annual maintenance costs 8% of installed capital, includes: Suk Supply Base & airport ($940m), L/Cost Base ($160m), Sunrise LNG ($12800m), other Tasi Mane Project ($1500m), Z530M ($500m), Dilairport ($2200m) and Tasi port ($530m). Includes $183m in contracted and budgeted loans.

Austerity starts in 2024, cutting 94% from planned outlays in 2025-2028.

From Final 2019 Budget Book 4B, ... but not in Book 1’s totals or deficits.

D2 - MINISTÉRIO DO PETRÓLIO E MINERAIAS
MINISTRY OF MINERAL RESOURCES AND OIL ($’000)
D20201 - DIREÇÃO NACIONAL DE ADMINISTRAÇÃO E FINANÇAS
NATIONAL DIRECTORATE OF ADMINISTRATION AND FINANCE ($’000)

<table>
<thead>
<tr>
<th>Rubrica de Despesas / Expense Item</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
</tr>
</thead>
<tbody>
<tr>
<td>Despesas / Expenses</td>
<td>12,422</td>
<td>29,208</td>
<td>3,151,656</td>
<td>3,277,722</td>
<td>3,408,831</td>
<td>3,545,185</td>
</tr>
<tr>
<td>Transferências / Transfers</td>
<td>12,094</td>
<td>28,747</td>
<td>3,151,177</td>
<td>3,277,224</td>
<td>3,408,313</td>
<td>3,544,646</td>
</tr>
<tr>
<td>Pagamentos Pessoais / Personal Benefit Payments</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Concessões Publicas / Public Grants</td>
<td>12,094</td>
<td>28,747</td>
<td>3,151,177</td>
<td>3,277,224</td>
<td>3,408,313</td>
<td>3,544,646</td>
</tr>
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</table>
Borrowing for Tasi Mane delays austerity by two years, but keeps TL poor for decades.

Oil price: Brent Reference (4EOZ2018). Bayu-U proved, per 05/82019.
Sunrise plan approved in 2022 with pipe to TL. Sunrise has 5.1cf gas and TL gets 70% of it.
Natural gas is worth 40% as much as oil. With 2018 MBT fields, Petroleum Fund investments return 3.4%/yr nominal. During 2016-2018 the fund earned 1.7%.
Domestic revenues increase 3.6%/yr now and 2.0%/yr after 2030. During 2016-2018, these revenues (without EDTL) or fees from the states) declined. EDTL recovers 60% of fuel cost from users. It recovers 16% in 2015-18.
Expenditures 2019 per 2019-20, then calculated from 10 model. Spending goes up 4.0%/yr now and 4.0%/yr after 2030. In 2012-2016, recurrent spending (excl. EDTL, fuel) went up 4%/yr.
Annual maintenance costs 8% of installed capital. Includes Nat Supply Base & airport ($940m), S.Cassai Hwy ($160m), Sunrise LNG ($1.2bn), other Sunrise Project ($1.5bn), DEEM ($500m), OIL airport ($200m) and Tiber port ($110m).
Includes $17.2bn in contracted and budgeted loans: including roads and bridges ($10bn), and $800m for Tasi-Baude Highway (project cost $1.6bn) at 5%, repaid 20 yrs. $10bn for Sunniq Infield and LNG Plant (project cost $32.8bn) at 5%, repaid 30 yrs. $1.0bn for Refinery (project cost $1.5bn) at 5%, repaid 30 yrs.

Austerity starts in 2026, cutting 98% from planned outlays in 2027-2030.

We don’t have very much oil.

<table>
<thead>
<tr>
<th></th>
<th>Timor-Leste (70% Sunrise)</th>
<th>TL without Sunrise</th>
<th>Australia</th>
<th>Brunei</th>
</tr>
</thead>
<tbody>
<tr>
<td>Known oil and gas reserves per person at end of 2017</td>
<td>657 barrels</td>
<td>69 barrels</td>
<td>1,050 barrels+ (1,040 without Sunrise)</td>
<td>6,300 barrels</td>
</tr>
<tr>
<td>How long reserves will last at 2017 production rates</td>
<td>21 years</td>
<td>2 years</td>
<td>32 years+</td>
<td>24 years</td>
</tr>
</tbody>
</table>
Thank you.

You will find more and updated information at

• La’o Hamutuk’s website
  http://www.laohamutuk.org

• La’o Hamutuk’s blog
  http://laohamutuk.blogspot.com/

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