

# La'ó Hamutuk

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**Submission to the**

**Petroleum Fund Steering Group**

**Ministry of Planning and Finance**

**Democratic Republic of Timor-Leste**

**from**

**La'ó Hamutuk**

**regarding the**

**Timor-Leste Petroleum Fund Draft Act**

**1 March 2005**

This submission is in two parts: this narrative and the annotated text of the draft Act, with our comments and suggested changes section-by-section.

## Summary

- The draft Act still needs significant improvements to accomplish its goals.
- The Fund should encourage responsible fiscal policy and preparation for Timor-Leste's post-petroleum era, incorporating clearer and broader objectives than "for the benefit of current and future generations."
- All forms of petroleum-related revenues should go into the Fund, and withdrawals for any reason should be explicitly reported.
- Binding rules should limit how much of the fund can be spent in a given year, and how many years withdrawals can exceed sustainable levels.
- The Council of Ministers and Parliament should enact a separate resolution authorizing the amount (not a ceiling) for each annual withdrawal from the fund to the budget.
- The Fund should be restricted from use for debt service, in addition to the laudable prohibition of its use as collateral.
- Investment rules should facilitate long-term, less-liquid investments in more currencies than the U.S. dollar alone, and should incorporate ethical principles.
- The Investment Advisory Board should be broadened, strengthened and given more independence.
- The Petroleum Fund Consultative Council should be broadened into an independent, effective watchdog, able to act on its own initiative, obtain all necessary information, communicate freely with the public and refer irregularities to higher authorities.
- The independent auditor should be able to audit all aspects of fund operations and management, as well as the bases for estimating sustainable income.
- Transparency and public information needs to be strengthened throughout, with no exception for "confidential information" and prompt publication. Documents "adapted for public information" must also be released in their original form.
- A Public Register should be established, outside of the Ministry and Central Bank, to facilitate access to information.
- Petroleum companies should provide information about payments they make to Timor-Leste, without confidentiality shields.
- Penalties and responsibility should be clearly defined for violations of this Act.
- Transitional appointment procedures for the auditor and investment manager need to be clarified.
- The calculation of Estimated Sustainable Income needs to be made as accurate as possible, with full explanation of its limitations.

## Introduction

The East Timor Institute for Reconstruction Monitoring and Analysis, La'o Hamutuk, appreciates this second round of public consultation on the Petroleum Fund for Timor-Leste, and we hereby submit our comments on the draft Act. We are also attaching an annotated copy of the Act, with our observations and suggested changes section-by-section.

This public consultation on the Petroleum Fund is significantly better than other processes for public consultation in Timor-Leste, such as the one on the Petroleum Regime. We appreciate the Ministry of Planning and Finance's interest in community views, and the efforts you have made to incorporate some of them in the Fund Act. Nevertheless, we believe the current Act is still inadequate to achieve "wise management of the petroleum resources for the benefit of both current and future generations."<sup>1</sup>

We agree with your observation that most countries in Timor-Leste's situation fall victim to the "resource curse," and that far-seeing, effective measures must be taken to avoid that situation. We also agree that no law can substitute for good governance, sound fiscal planning and long-term perspective. Nevertheless, laws are the best instrument to protect people's rights in a democratic society, and we encourage every legislative effort to make poor governance and short-sighted decisions more difficult and less likely. A Petroleum Fund by itself cannot avoid the resource curse, but a fund well-designed for the realities and necessities of Timor-Leste will help avert and minimize some of the poor decisions and devastating consequences that oil and gas development often brings to newly-democratic, impoverished nations like ours.

In our previous submission<sup>2</sup> on the Petroleum Fund discussion paper,<sup>3</sup> we discussed many issues which are still relevant. Although you have incorporated several of our suggestions completely and others partially, a number of the most important ones have not been incorporated in the draft Act. We will not repeat our entire arguments in this submission, and encourage you to refer our earlier one for additional documentation and elaboration.

Thank you for adopting some of our earlier suggestions, including:

- The inclusion of on-shore as well as off-shore petroleum revenues in the Fund.
- The fiscal policy of maintaining the value of Timor-Leste's petroleum wealth. Newly available information causes us to wonder if that policy is indeed the

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<sup>1</sup> *Timor-Leste Petroleum Fund Draft Act*, preamble and many other places.

<sup>2</sup> La'o Hamutuk, *Submission to the Petroleum Fund Steering Group, Ministry of Planning and Finance, Democratic Republic of Timor-Leste regarding the Public Consultation Discussion Paper on Establishing a Petroleum Fund for Timor-Leste*, 5 December 2004 available at <http://www.etan.org/lh/misc/PetFundSub/LH%20PetFund%20submission.htm>

<sup>3</sup> RDTL Ministry of Planning and Finance, "*Establishing a Petroleum Fund for Timor Leste: Public Consultation Strategy Paper*" October 2004. Available at [http://www.mopf.gov.tp/download/tax\\_policy/PF-DiscPaper-Final.pdf](http://www.mopf.gov.tp/download/tax_policy/PF-DiscPaper-Final.pdf)

best one, given that Timor-Leste's population is projected to increase by 245% from today to 2050.<sup>4</sup>

- Specifying that income earned by the Fund is re-deposited in the Fund.
- Engaging in a second round of public consultation prior to submitting the draft Act to the Council of Ministers.

We also appreciate that you have partially incorporated some of our recommendations, even though improvements are necessary to make them completely effective:

<b>The draft Act:</b>	<b>It should also:</b>
Prohibits using the Fund as collateral for borrowing (Art. 11).	Disallow the use of Fund money for debt service.
Provides information for more informed and extensive discussion in Parliament prior to approving transfers from the Fund (Art. 7).	Require Parliament to pass specific legislation, in addition to the State Budget, for each transfer from the Fund.
Creates a Petroleum Fund Consultative Council (CC formerly the Council of Eminent Persons, Art. 15-17).	Expand the CC to include a broader range of society, and empower it to publish reports and refer cases to investigatory or prosecutorial authorities when appropriate.
Defines a principle of transparency (Art. 18).	Eliminate obstacles to transparency such as "confidential information" and "adaptation for public information." A Public Register should be created to contain explicitly named reports and information in a timely manner, without censorship or editing.
Defines a single account for all petroleum-related payments (Art. 6).	Require oil companies to make all petroleum-related payments into the Fund, and to publicly report such payments, with sanctions for non-compliance.

Unfortunately, you did not incorporate our ideas in a number of critical areas, including:

- Facilitating long-term planning for after Timor-Leste's oil and gas reserves have been exhausted.
- Binding rules to limit how much money can be withdrawn from the Fund each year, and encourage or prohibit use of Fund money for certain types of expenditures, as São Tomé<sup>5</sup> has done.

<sup>4</sup> United Nations, *World Population Prospects: The 2004 Revision*, published February 2005, page 44. Timor-Leste's population is projected to increase from 947,000 in 2005 to 3,265,000 by 2050. According to this report, Timor-Leste currently has the highest rate of natural population increase and the second-highest fertility rate of the world's 192 countries.

<sup>5</sup> São Tomé é Príncipe's Parliament unanimously passed its Petroleum Revenue Management law in November 2004, and President Fradique de Menezes signed it on 29 December. The law and related materials are at [http://www.earthinstitute.columbia.edu/cgsd/STP/index\\_stp.htm](http://www.earthinstitute.columbia.edu/cgsd/STP/index_stp.htm).

- Diversifying the investment portfolio to include longer-term, less liquid assets as well as investments in currencies than the United States dollar.
- Ethical Guidelines for investment, as used in Norway.

## **Protecting our children's inheritance**

As La'o Hamutuk has said many times, the petroleum industry is one of the world's most widespread, profitable and powerful. Many industrialized nations are addicted to vast quantities of inexpensive energy. This addiction, magnified by huge profits available to transnational oil companies, motivates decision-makers so forcefully that it takes extraordinary, unified efforts to protect the citizens of poor, oil-producing countries. No government is immune to this manipulation, and Timor-Leste cannot rely on the possibility of being an exception.

Our petroleum wealth will have been entirely transformed into money before the middle of this century. Although most of that money will go to oil companies, Timor-Leste will receive a significant share. If we have not saved and invested it wisely, preparing for our post-petroleum future, our grandchildren's children may endure worse poverty, unemployment, maternal mortality, illiteracy, disease and lack of services than we live with today. This is the experience of people all over the world, and the current draft Petroleum Fund Act and Petroleum Regime will not put Timor-Leste on a different path.

Our Government is bypassing legal processes in its haste to issue petroleum licenses by this November, rushing the Petroleum Regime legislation through without adequate consultation or discussion. The Government has contracted for seismic exploration and is soliciting oil companies to explore in Timor-Leste territory before laws to regulate such activity have been submitted to Parliament or released to the public.

This has set an unfortunate precedent for the power of petroleum over democracy. In the future, Timor-Leste needs to protect itself against potential abuses from any ill-intentioned, corrupt institutions and individuals made greedy by the many billions of dollars available from our resources.

## **Fiscal policy**

Countries with oil revenue windfalls have far more difficulty implementing sound fiscal policy than those without such income. A well-designed petroleum fund is needed to help overcome this impediment and to encourage the same wise economic and financial planning which would have to be undertaken if there were no oil money. Oil money makes it too easy to make bad short-term decisions; the negative consequences of those decisions often only become apparent decades later, when a different government is in power. An effective petroleum revenue management system is one component of avoiding this problem.

A Petroleum Fund does not guarantee solid fiscal policy, but it can encourage responsible planning and management, helping to shelter each year's revenues from immediate political and economic demands, making it more likely that wise

decisions will be made for long term. A Fund can assist Timor-Leste's future leaders in making decisions that are no worse than if we had no gas or oil.

At the 14 February public consultation in Dili, Government officials stated<sup>6</sup> that they recently enacted a policy on savings and expenditures (although we have not been able to obtain a copy). A policy guideline is not a substitute for law. Please refer to our previous submission<sup>2</sup> for specific suggestions and examples of how this can be implemented in law – there is much to learn from practices of both Norway and São Tomé.

The draft Petroleum Fund Act says six times that the Fund exists “for the benefit of current and future generations.”<sup>7</sup> This is a very vague standard, which will be impossible to assess until it is too late. A more useful goal would be sustainability for the indefinite future, providing for Timor-Leste's people in our post-petroleum era beginning about 50 years from now. There should also be goals covering human rights, building human and physical infrastructure, moving toward renewal energy, developing non-oil sectors of our economy and other objectives to prepare our nation for the future.

## Budgetary process

The draft law puts the decision of how much Fund money to spend into the annual budget process. As we wrote before, this process is unavoidably influenced by many short-term, political and special-interest pressures. We continue to recommend that the Fund Act or other legislation establish clear, binding rules limiting how much of the Fund may be spent each year. These rules should also direct Fund revenues toward particular human and physical investment, and away from boondoggles and militarism.

In the attached section-by-section commentary, we suggest improvements to how money is withdrawn. The Council of Ministers and the Parliament should enact a separate resolution for each transfer from the Petroleum Fund. This resolution should specify the amount of money, what it will be used for, its relation to current Fund income and its impact on future dividends. Such a provision would promote broader debate in Parliament before the approval of any withdrawal from the Fund, and avoid entangling the withdrawal discussion with controversies relating to other items in the State Budget. It would make the Fund more transparent to the public, who can hold elected officials accountable for spending Fund assets.

If the transfer is above sustainable levels, extraordinary reasons should be specified, as well as a forecast as to whether such high transfers will be required in subsequent years. Non-sustainable withdrawals for more than two consecutive years should be prohibited.

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<sup>6</sup> *Timor-Leste Petroleum Fund Draft Act* presentation by José Teixeira, 14 February 2005, slide 14. Also *A Petroleum Fund for Timor Leste: Frequently Asked Questions*, MoPF February 2005, answer to question 3.

<sup>7</sup> Draft Petroleum Fund Act. This phrase occurs twice in the preamble and in Articles 8.7, 10.5(a), 15.2(c) and 17.1(a).

The Government of Timor-Leste repeatedly says it wants to safeguard future generations' petroleum birthright. To do that effectively we need structures to protect those assets no matter who holds power in the future. Timor-Leste's government has signed treaties and contracts which last for decades, constraining future governments to meet the requirements of international oil companies and foreign governments. Why can't we take similar action to help secure the well-being of our own grandchildren?

The Ministry of Planning and Finance (MoPF) believes that Parliament should not legislate rules governing Fund transfers, and rejects requiring a Parliamentary act for each transfer out of the Fund. They ask "Who is supposed to decide funding to areas of priority if not Parliament elected by the people?"<sup>8</sup> However, Parliament's powers are not respected if unrestricted discretion for use of Fund money is placed in the State Budget which, according to our Constitution, is "prepared by the Government."<sup>9</sup>

For reasons we do not understand, the Ministry of Finance argues<sup>10</sup> defensively against empowering Parliament to make a more deliberate decision on withdrawing money from the Fund. Similarly, many of the reasons given by the Ministry for rejecting rules guiding the use of Fund assets seem specious. This is curious, especially in light of the high respect that document pays to Parliament's ability to represent the needs of the citizenry. Is there some non-obvious reason why the drafters are so resistant to this idea?

The Ministry of Planning and Finance (MoPF) says that "A bad government will almost always find a way to implement bad policies."<sup>11</sup> To us, this is an odd reason not to legislate good policies. A determined murderer will almost always find a way to kill his victim, but is that a reason not to have a law against murder? Even with a good law, there will still be some murders – but fewer than there would have been without law enforcement. With strong and effective protection and oversight of Timor-Leste's petroleum revenues, our future generations are more likely to receive their fair share of our petroleum wealth.

We appreciate the intention behind Article 7, providing Parliament with information to make informed decisions about Fund sustainability and transfers, with additional information if the proposed transfer exceeds the sustainable amount. We agree that avoiding unsustainable transfers is important.

We welcome the prohibition of the use of the Petroleum Fund as collateral for borrowing. We agree with the current Government that Timor-Leste should not

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<sup>8</sup> *A Petroleum Fund for Timor Leste: Frequently Asked Questions*, MoPF February 2005, answer to question 2.

<sup>9</sup> *Constitution of RDTL*, Section 145: "1. The State Budget shall be prepared by the Government and approved by the National Parliament."

<sup>10</sup> For many examples, see *A Petroleum Fund for Timor Leste: Frequently Asked Questions*, MoPF February 2005.

<sup>11</sup> *A Petroleum Fund for Timor Leste: Frequently Asked Questions*, MoPF February 2005, answer to question 1.

borrow with one hand while saving with the other, but are concerned that Article 11 may not provide adequate protection.

If a future Government decides to borrow money, the lender would expect interest and principal to be paid out of the budget. Since the Fund automatically pays for any budget deficit, it is in effect guaranteeing the loan, as collateral without encumbrance. The best course is not to borrow at all, so the Fund should be designed not to facilitate debt. Fund money should be prohibited from paying for debt service. Furthermore, the Estimated Sustainable Income could be lowered by the annual debt service payments, and the calculated Petroleum wealth reduced by the outstanding debt.

## Investment Rules and Advisory Board

The draft Act does not incorporate La'o Hamutuk's prior suggestions about how the Fund should be invested. Article 9 says that the Fund must be invested in low-risk, high-liquidity financial assets in U.S. dollars outside Timor-Leste. Our concerns about this are detailed in our previous submission.

With the U.S. dollar likely to continue to fall,<sup>12</sup> U.S. dollar-denominated securities are probably not the most secure or highest-returning investments Timor-Leste can make. More specifically, we object to Article 9.2(b)(ii), which gives the United States Federal Reserve an exemption from the credit rating requirement specified in Article 9.2(b)(iii). We also suggest more flexible rules regarding currency, liquidity and duration of the investments.

We also urge the government to legislate Ethical Guidelines for investment of petroleum revenues, as Norway has done. We believe that the people of Timor-Leste do not want their money invested in military activities or governments that violate human rights or illegally occupy other countries. We doubt that Timor-Leste's citizens would choose to lend their money to indirectly support the United States occupation of Iraq. This is discussed in our proposed new article 9½ in the attached annotated Fund Act.

La'o Hamutuk supports the creation of an Investment Advisory Board (IAB), but the draft Act falls short in several areas. This board has no power and no independence. It has no civil society or independent representatives – all of its members are appointed by the Prime Minister or the Minister of Planning and Finance; most work for the Central Bank or the Finance Ministry. Since those institutions are responsible both for managing the Petroleum Fund and preparing the annual budget, it would be better to have some IAB members outside those institutions, who can be more objective. People with experience in socially responsible investing and public accountability would be welcome additions to the IAB, as would representatives appointed by civil society. The 1997 Asian financial crisis painfully demonstrated the fallibility of "investment experts," and we prefer some members more grounded in reality.

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<sup>12</sup> A recent discussion is the lead article in the January 2005 *Economic Bulletin* of the Banking and Payments Authority of Timor-Leste, which discusses "the ongoing fall of the exchange rate of the American dollar" resulting from "an atmosphere of distrust regarding the American dollar."

Article 10.10 provides for the Minister to release edited IAB advice to the public when required by Parliament. The IAB should be able to publish its own reports, including recommendations and debates, in a timely manner – not only when the Annual Report is published, after decisions have already been taken. As we discuss below, there is no “confidential information” in such reports that might require censorship – this is the public’s money, and the public has the right to know how it is invested, and why.

Article 8.2 says “the Minister shall not make any decisions in relation to the investment strategy or management of the petroleum Fund without first seeking the advice of the IAB in accordance to Article 10.” But Article 10.2 says “if the IAB does not provide the advice requested in a timely manner ... the Minister shall make the decision.” There is no requirement for the Minister to make his request in a timely manner, and no definition of what a timely manner is. Article 10.3 allows the Minister to ignore the IAB entirely. The board could be completely ineffective and nobody would know.

## **Democracy and accountability**

The power to manage the Fund is largely vested in the Central Bank (currently the Banking and Payments Authority, BPA) and the Ministry of Planning and Finance (MoPF), institutions which are responsible for day-to-day financial operations and annual budgets, and they may not have the long-term perspective required to safeguard our great-grandchildren’s inheritance.

We agree that these are the appropriate institutions for budget, investment and finances, but the Petroleum Fund Act should create legal and structural oversight, checks and balances. Effective oversight will strengthen those institutions, as envisioned in the Petroleum Fund Executive Summary.<sup>13</sup> Functioning, independent and representative oversight is essential not only for transparency and accountability, but also to build a democratic and participatory system.

As we discussed in our previous submission, the BPA continues to operate illegally. Since its Governing Board has only three members, it has never had a valid meeting, which requires five for a quorum.<sup>14</sup> This ongoing disregard for law is not a hopeful sign. If the BPA does not obey its own organic statute, how can it be relied on to obey the laws governing the Petroleum Fund? We hope the Governing Board will be legally constituted before the BPA is handed millions of dollars more in

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<sup>13</sup> “The Petroleum Fund allows for a strengthening of the responsibilities, powers and capacity of key public sector institutions, such as Parliament, the Government, the Ministry of Planning and Finance and the Central Bank.”

<sup>14</sup> According to the BPA Annual Report for 2003/4 (page 66), “The Governing Board consisted of three executive members throughout the year, although there is statutory provision for the appointment of up to four other non-executive members. With the small number of members, no board committees have been formed.”

However, UNTAET Regulation 2001-30, which defines the BPA, specifies a seven-member governing board and requires a quorum of five for a legal meeting. None of the BPA Governors other than BPA managers have ever been appointed.

public funds. We also suggest that the “outside members” of the BPA Board of Governors include an independent investment advisor.

Article 8.8 requires that the Central Bank reports to the public on the Fund within 40 days after the end of each quarter, which is good, but it does not specify what must be in the report. Since the draft Act has no Public Register, there is no mechanism for making this report and other information accessible to the public. Currently, other Central Bank reports are “public” but a person must have access to internet or go to the BPA office and ask for a copy. Making information accessible means ensuring that everyone is aware of it and taking active steps to distribute it. Saying it is “public” and keeping it in a cabinet in someone’s office is not enough.

## **Oversight**

Effective oversight is essential to any system managing large amounts of public money, especially when a government is as inexperienced as that of Timor-Leste, having recently wrested itself from a regime rife with corruption and secrecy.

The Petroleum Fund Consultative Council (CC) is a step toward oversight – but only takes us part of the way there. This is a “watchdog” without powers; when it barks nobody will come. We strongly recommend broadening and empowering the CC to make it a guard dog, an oversight body with teeth:

- The CC must publish its own reports and advice promptly, both for the public and for Parliament.
- When Parliament receives advice from the CC, Parliament should disclose whether or not it followed the advice, with a clear explanation if the advice was rejected.
- The CC members representing of civil society, business sector and religious organizations should be chosen by those sectors, not by the government.
- Additional CC members should be included to represent youth, opposition political parties, popular organizations and people in rural areas.
- The CC should have the power to investigate evidence or allegations that the law is not being followed by an individual or institution, and to refer the case and provide information and assistance to the Provedor or General Prosecutor. Such referral must be allowed without the intervention of the Finance Ministry or the Central Bank.
- As part of its public consultation function (Article 17.4) and at other times, citizens should be able to bring information to the CC for further action. This is not only for advising Parliament, but for overseeing Fund management.
- The CC should have access to all information in the possession of the Ministry of Finance, the Central Bank, the Investment Advisor and the Petroleum Ministry.
- The CC (and the Independent Auditor) should have access to information from the petroleum companies about all payments they make to Timor-Leste for oil and gas operations, and how those amounts were derived (see below).

- The CC should review not only the legality of Fund operations, but also the wisdom of operational decisions. If members of the CC feel it appropriate, they should publish reports or findings in the media and speak to the public, especially if the Fund managers fail in their duty of transparency.

We urge that the Office of the Provedor be operational before the Petroleum Fund commences. The Provedor's mandate includes investigating anyone with responsibility for public funds or assets, which means not only the MoPF and the Central Bank, but also Fund operations outside Timor-Leste.

### **Audit**

Independent, external, annual audit reports of the Fund should be made public in full. If the Auditor finds any irregularity, he/she should be able to refer the case to the Provedor or the General Prosecutor.

We are concerned that the Act does not provide for appointment of an Independent Auditor until several parts of the judiciary are operational – which could be a long time given the scarcity of qualified judges. This position needs to be filled before July 2005, when the Fund will begin operation. To ensure independence, the Auditor should be selected by the Consultative Council, not the Government.

Audits should include receipts, transfers and investment of Fund monies inside and outside of Timor-Leste, as well as payments by petroleum companies. When the Auditor certifies the Government's "amount of the estimate of sustainable income" to Parliament (Articles 7.3(c) and 7.4(c)), the Auditor should also evaluate and report on the assumptions and models underlying the estimate, verifying their validity against globally-accepted projections of fuel prices, inflation rates, and interest income.

### **Transparency and access to information**

We welcome Article 18 "Transparency as a Fundamental Principle," and Article 14 requiring a public Annual Report. We hope that the principle and the spirit of transparency will be implemented throughout the Fund. The Petroleum Fund is a public trust, derived from publicly owned resources. There is no justification for secrecy regarding any aspect of the Fund's operation. The Act proclaims "the highest standard of transparency" (Article 18.1) – but that standard is lowered throughout the Act.

### **Loopholes for censorship**

The drafters seem obsessed with disclosure of "confidential information," mentioned six times in the Petroleum Fund Act,<sup>15</sup> nearly every place the Act discusses providing information to the Public. This invitation to censorship should be removed. Public institutions and public servants have no excuse for confidentiality in relation to the Fund, and any private firm, such as an investment advisor, can be informed in their contract that Timor-Leste practices genuine transparency.

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<sup>15</sup> Articles 8.8, 10.10, 17.3, 17.7, 18.1 and 20.5.

Every item of information should be available to the public unless there is a compelling reason (such as national security or personal privacy, neither of which apply to institutional actions) to keep it private. The concepts of commercial or other confidentiality that apply to other taxpayers and bank accounts are not appropriate for the Petroleum Fund.

If the drafters reject our suggestion and insist on “confidential information,” this phrase must be clearly and narrowly defined and time-limited. Every time a document is redacted for confidentiality this must be disclosed, with an explanation of the deletion. Otherwise it’s a blindfold which will be abused by those with something to hide.

We are also concerned about four provisions<sup>16</sup> which require that reports or information be “adapted for public information” before being released. It is indeed helpful to publish clearer versions so that people can understand them more easily, but this is no reason not to release the original. The Act should be changed so that the uncensored, unedited document or report is public in each of these cases, in addition to versions adapted for wider accessibility. All versions of the Annual Report should be published in several languages.

### **Public Register**

Although the Fund Act does not provide for a Public Register, we urge that one be created. Our proposed new Article 18½ in the section-by-section portion of this submission includes a list of information which should, at minimum, be included, uncensored, in a timely manner.

We do not know if an effective Public Register is included in the Petroleum Act as passed by the Council of Ministers. If that Act includes a well-structured, accessible Public Register, the Fund might be able to utilize it.

### **Information from companies**

The Petroleum Fund Act primarily defines functions internal to the government of Timor-Leste, but there is one important area where it needs to apply to companies involved in petroleum exploration and production. In order for the CC, the independent auditor and the public to have confidence that reports of Fund receipts (Article 6.1) are accurate and complete, they need information from the companies about payments they have made. This is in keeping with the growing international movement for transparency within extractive industries. Verification of the Estimated Sustainable Income may also require information from the companies.

The Petroleum Act and Production-Sharing Contracts should also contain this requirement, but the orientation of the drafters of that legislation, as well as earlier versions, give us concern that requirements in those documents may not be sufficient. Consequently, we urge that the Petroleum Fund require companies to cooperate with the CC, the Auditor, the Provedor and the Parliament in providing information about all payments they make to Timor-Leste and the TSDA. This

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<sup>16</sup> Articles 8.8, 14.2, 17.3, and 20.5.

information should also include how the amounts of each payment were determined. The companies will be required to provide such information to the Petroleum Ministry on a regular basis;<sup>17</sup> these statements should be public as part of the Petroleum Fund management.

La'o Hamutuk's submissions on the Petroleum Regime and Petroleum Fund Discussion Paper proposed that the Public Register include:

"All payments of \$1,000 or more to the TSDA, the Government of Timor-Leste (or to any agency or agent of that government or Authority) in connection with petroleum development by any person, corporation or other business. This includes not only income and other taxes and royalties, but any other payments (including bonuses, finder's fees, etc.) within or outside of Timor-Leste for the purpose of facilitating or implementing Petroleum activities in Timor-Leste. Each payment report should include the date the payment was made, the amount, the payer, the payee, the purpose of the payment, and any services or goods received in return."<sup>18</sup>

Although some oil companies may not welcome this requirement for transparency, they will obey the law – especially if there are penalties for non-compliance. Representatives of the two oil companies most involved in the Timor Sea have recently said that they will comply with whatever disclosure law Timor-Leste adopts, even if they do not like it.

Some existing contracts and regulations governing Timor-Leste's relations with oil companies do not practice transparency. When the Petroleum Fund Act requires companies to provide information, its provisions should explicitly override existing provisions in laws, contracts or mining codes which might be cited as a reason not to disclose information.

The government of Timor-Leste has announced it will implement the principles of the Extractive Industries Transparency Initiative (EITI), and one of the basic ones is that the companies should publish what they pay. Embedding this requirement in the Petroleum Fund Act not only carries out our Prime Minister's public promise, but enables the managers and overseers of the Petroleum Fund to do their jobs.

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<sup>17</sup> Annex C of the draft model Production Sharing Contract circulated for public comment in August 2005 requires the companies to submit quarterly and annual Production Statements (§5), Value of Production and Pricing Statements (§6), Cost Recovery Statements (§7) and Statements of Expenditure and Receipt (§8). In our submission on the Petroleum Regime, La'o Hamutuk proposed that these statements be included in the Public Register.

<sup>18</sup> La'o Hamutuk, *Submission to the Timor Sea Office and the TSDA regarding the Proposed Petroleum Regime for Timor-Leste*, 29 September 2004 and *Submission to the MoPF regarding the Public Consultation Discussion Paper on Establishing a Petroleum Fund for Timor-Leste*, 5 December 2004.

## Conclusion

This part of our submission discusses La'o Hamutuk's main concerns regarding the draft Petroleum Fund Act. Some additional and more detailed concerns and changes are described in the attached annotated copy of the Draft Act.

We appreciate the efforts of the Ministry of Planning and Finance and others involved in designing Timor-Leste's Petroleum Fund to solicit and consider input from many perspectives, including civil society. We hope that our participation in this process will help strengthen the Petroleum Fund, to buttress the Government's stated determination to safeguard our petroleum wealth and protect our people from the environmental, economic, political and societal curses that oil and gas development has brought to so many.

Unfortunately, we have yet to see Government actions, including this draft Act, which adequately respond to the dangers of the "paradox of plenty."

La'o Hamutuk urges every one in Timor-Leste – including the Government, interim Petroleum Ministry, Ministry of Planning and Finance, TSDA and Timor Sea office – to increase their recognition of the dangers facing our people if we don't handle petroleum development properly. We also hope that Parliament, NGOs and other civil society organizations will work constructively and with determination not only to safeguard our petroleum revenues, but to save our people from the war, pollution, corruption and economic ruin that so often plagues countries like Timor-Leste.

**TIMOR-LESTE PETROLEUM FUND DRAFT ACT, PUBLIC CONSULTATION**  
**MINISTRY OF PLANNING AND FINANCE AND PETROLEUM FUND STEERING GROUP, February 2005**

**Section-by-section comments and suggested changes from La’o Hamutuk, 1 March 2005.**

This document is the second part of our submission on the Petroleum Fund Draft Act, and should be read together with the narrative part of our submission.

<b>Executive Summary</b>	<b>La’o Hamutuk comments</b>
<p>This purpose of this Act is to establish a Petroleum Fund for Timor-Leste. The provisions in the Act reflect the discussion paper on the key policy issues that was released on 18 October 2004, as well as submissions received during the ensuing period of broad public consultations.</p>	
<p>The objective of the public consultation is to get comments from civil society and the public at large on this draft Act by 1 March 2005. After considering the submissions the Government will submit the Act establishing the Petroleum Fund to Parliament. Subject to the approval by Parliament and promulgation by the President, the Petroleum Fund can be operational from 1 July 2005 (the start of the 2005-2006 fiscal year).</p>	<p>This draft Act should be revised, and the revisions released to the public, before it is submitted to the Council of Ministers and the Parliament.</p> <p>Also, regulations must be written and positions filled before the Fund is operational. It’s hard to see that happening in two months.</p>
<p><u>The design of the Petroleum Fund is based on the following key principles:</u></p>	
<ul style="list-style-type: none"> <li>• <b>The Petroleum Fund shall be a tool that can contribute to the wise management of Timor-Leste’s petroleum resources</b>, for the benefit of both current and future generations.</li> </ul>	<p>The phrase “for the benefit of both current and future generations” occurs often in this Act, but it is vague, especially as to how far into the future it applies. The Act should have a goal of providing sustainable income for Timor-Leste for the indefinite future, including after our petroleum reserves have been exhausted.</p>
<ul style="list-style-type: none"> <li>• <b>The Petroleum Fund builds on international best practice and reflects the circumstances of Timor-Leste.</b> It is based on the petroleum fund used in Norway, one of the few models internationally that are generally seen to function well and contributing to a wise management of the petroleum wealth. The proposed model for Timor-Leste is currently referred to as the “Norway Plus” model, reflecting additional accountability, transparency and information features that are judged appropriate for Timor-Leste’s circumstances.</li> </ul>	<p>As we discussed earlier, São Tomé e Príncipe is a more appropriate and relevant model for Timor-Leste. Furthermore, several of the best elements of Norway’s Fund are omitted from the proposal for Timor-Leste, making this “Norway Minus.”</p>
<ul style="list-style-type: none"> <li>• <b>The Petroleum Fund builds on the Constitution.</b> The Petroleum Fund Act lays down the key parameters for the operation and management of the Fund in accordance with article 139 in the Constitution, which states that the petroleum resources shall be owned by the State, shall be used in a fair and equitable manner in accordance with national interests, and that the petroleum extraction should lead to the establishment of mandatory financial reserves. The proposed Petroleum Fund builds on the constitutional framework, giving to the Parliament and the Government the powers that correspond to their competencies.</li> </ul>	

<ul style="list-style-type: none"> <li>• <b>The Petroleum Fund allows for a strengthening of the responsibilities, powers and capacity of key public sector institutions</b>, such as Parliament, the Government, the Ministry of Planning and Finance and the Central Bank. There will be an Investment Advisory Board advising the Minister of Planning and Finance to enhance the quality of advice preceding decision-making. There will also be an independent Consultative Council to advise Parliament on the operations of the Fund, acting as a “watchdog” and contributing to an informed public debate and a sound management of the petroleum wealth.</li> </ul>	<p>The independence of the Investment Advisory Board and Consultative Council needs to be strengthened, and they need to be able to invoke investigatory and prosecutorial authorities when appropriate, on their own initiative, and to freely share their findings and opinions with the public.</p>
<ul style="list-style-type: none"> <li>• <b>The Petroleum Fund is to be a tool that contributes to sound fiscal policy</b>, and thereby help deliver on a sustainable basis strong economic growth and improved public services. The design of the Petroleum Fund acknowledges that good planning and execution of public sector budgets are key to avoiding the resource curse found in so many petroleum producing countries. The Petroleum Fund is to be coherently integrated into the budget process, supporting a fiscal policy framework that strikes the right balance between current consumption, investing in physical assets (infrastructure and human development) and investing in financial assets.</li> </ul>	<p>This Act and the Fund should encourage planning for our nation’s post-petroleum era. This would include long-term planning, development of non-petroleum sectors, and investing in human and physical infrastructure.</p>
<ul style="list-style-type: none"> <li>• <b>The Petroleum Fund is to be prudently managed</b>, invested securely in low-risk financial assets abroad.</li> </ul>	
<ul style="list-style-type: none"> <li>• <b>The management of the Petroleum Fund shall be carried out with the highest standard of transparency and accountability.</b> This is a key element in building public confidence and support for a wise strategy of managing the petroleum resources. This can allow Timor-Leste to avoid the negative experiences found in so many petroleum producing countries, where petroleum has proved to be a curse instead of a blessing.</li> </ul>	<p>“Highest” is not a relative term. There are many ways transparency in this Act could be improved and made more effective.</p>
<p><b>The draft Petroleum Fund Act has the following key features:</b></p>	
<ul style="list-style-type: none"> <li>• <b>The Petroleum Fund’s income:</b> all revenues emanating directly or indirectly from Timor-Leste’s petroleum resources will flow into the Fund, as well as the return on the Fund’s investments (net of management expenses). All the income of the Fund shall flow into an ‘earmarked receipts account’. The Fund’s opening balance on 1 July 2005 will be the accumulated First Tranche Petroleum payments, plus an amount to be determined by the Government to take into account the large petroleum revenues during the current fiscal year. [Articles 5 and 6]</li> </ul>	
<ul style="list-style-type: none"> <li>• <b>The Petroleum Fund’s expenditure:</b> transfers from the Fund can only be made to a designated State Budget account, and the sum of all transfers in a fiscal year can not exceed a ceiling set by Parliament when approving the State Budget. This ceiling will as a general rule correspond to the amount necessary to finance the deficit on the State Budget excluding petroleum revenues. The Budget approved by Parliament decides the level of domestic tax revenues and spending – be it on current public consumption or on investment in infrastructure and human capital. Since it is the Budget’s financing need that determines the outflow from the Petroleum Fund, the Budget also decides the net allocation to the Petroleum Fund that gets invested in financial assets. This creates a direct link between the Budget approved by Parliament and the development of the Fund, and the Petroleum Fund will give a good representation of the Government’s rate of savings and net financial asset position. [Article 7]</li> </ul>	<p>The Parliament should pass a separate annual resolution authorizing a set amount, not a ceiling, for transfers from the Fund.</p>
<ul style="list-style-type: none"> <li>• The Government has separately adopted a savings/expenditure policy of maintaining the real value of the petroleum wealth, which will serve as a reference to determine the amount of money that should flow out of the Fund. This policy translates to spending the estimated sustainable income from petroleum, which is the amount that can be spent each year forever and therefore can be said to strike a good balance between the interests of current and future generations. On current calculations, this policy allows for a significant increase in Government spending in the medium term.</li> </ul>	<p>We have been unable to obtain a written document describing this policy. Is it a public document?</p> <p>How has it been adopted, and who has approved it? How will it be reviewed and revised?</p>

<ul style="list-style-type: none"> <li>• The Act has specific reporting requirements imposed on the Government and the Consultative Council if the State Budget proposes to withdraw from the Petroleum Fund more than the <b>estimated sustainable income from petroleum</b>. While there at times may be good reasons to spend more than the estimated sustainable income, the provisions in the Act should contribute to making sure that such decisions are transparent and well informed. [Articles 7 and 17]</li> </ul>	
<ul style="list-style-type: none"> <li>• <b>The management of the Petroleum Fund:</b> The Government has responsibility for the overall management of the Fund, and the Minister of Planning and Finance will exercise key functions and competences. The operational management will be delegated to the Central Bank in accordance with a management agreement, and it is envisaged that other investment managers will be appointed. [Article 8]</li> </ul>	
<ul style="list-style-type: none"> <li>• <b>The Investment Advisory Board</b> is an expert body that shall advise the Minister on any matter relating to the management of the Petroleum Fund. Members of the Board will include the Director of the Treasury, the Head of the Central Bank, two persons with significant experience in investment management and one other person. [Article 10]</li> </ul>	<p>This Board needs to be expanded to insure independence from the Government, the Finance Ministry and the Central Bank.</p>
<ul style="list-style-type: none"> <li>• <b>The investment of the Petroleum Fund:</b> The Fund’s savings will from the beginning be invested securely in low risk financial assets abroad. The Act stipulates that investments must be USD denominated debt instruments with a low credit risk (a minimum credit rating of Aa3 by Moody’s or AA- by S&amp;P). This will in practice mean investments mostly in government bonds, which means that the financial risk is seen to be limited and the expected investment return moderate. The investment strategy shall be reviewed within five years, when a larger Fund and improved institutional capacity may suggest a different asset allocation. [Article 9]</li> </ul>	
<ul style="list-style-type: none"> <li>• <b>There will be independent, external audits</b> carried out by an internationally recognized accounting firm to bolster confidence that money going to, from or remaining in the Petroleum Fund are not misappropriated. The external auditor will also certify the calculation of the estimated sustainable income, and prepare a report on payments made by companies as Petroleum Fund receipts. [Articles 1, 7, 14, 20 and 23]</li> </ul>	<p>The audit report should also validate and explain the assumptions on which the sustainable income calculation is based. It should look at investments, not just income and expenditures. Audit reports should be made public in full.</p>
<ul style="list-style-type: none"> <li>• <b>There will be an independent Consultative Council.</b> The Council is to advise Parliament on the operations of the Fund, acting as a “watchdog” and contributing to an informed public debate and a sound management of the petroleum wealth. Members of the Council will be appointed by the President, Parliament, Government and civil society, and there will in addition be seats for former Presidents, Speakers of Parliament, Prime Ministers, Ministers of finance and Heads of the Central Bank. [Articles 15, 16 and 17]</li> </ul>	<p>The Consultative Council should include representatives from a broader range of civil society. These appointments should not be made by the Minister, but by the sectors of society they represent, to ensure that they are accountable to the people whom they represent.</p>
<ul style="list-style-type: none"> <li>• <b>There are accountability, transparency and information features</b> to contribute to a wise management of the petroleum wealth. There will be a high degree of transparency of operations, including comprehensive and accessible reporting requirements – both on the management of the Fund and on whether the spending of petroleum revenues is consistent with long-term considerations. There are also information requirements on payments made by companies as Petroleum Fund receipts, which is a core element of the <i>Extractive Industries Transparency Initiative</i>. [Articles 7, 10, 14, 17, 18 and 20]</li> </ul>	<p>There is room for a great deal of improvement in these areas, as discussed elsewhere in this submission.</p>

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<p>This Act establishes a Petroleum Fund which seeks to meet with the constitutional requirement laid down in Article 139 in the Constitution of the Republic. This provision states that the petroleum resources shall be owned by the State, shall be used in a fair and equitable manner in accordance with national interests, and that the petroleum extraction should lead to the establishment of mandatory financial reserves.</p>	
<p>The Petroleum Fund shall contribute to a wise management of the petroleum resources for the benefit of both current and future generations. The Petroleum Fund shall be a tool that contributes to sound fiscal policy, where appropriate consideration and weight is given to the long-term interests of Timor-Leste's citizens.</p>	<p>The Act and its implementers need to go beyond the vague “for the benefit of both current and future generations.” The Fund Act should specify goals involving transition to the post-petroleum era, human rights, building human and physical assets and capacity, moving towards renewable energy. It should also discourage use of Fund money for military expenditures, weapons, one-time projects, etc. Since the preamble of the Act will be the standard by which the Investment Advisory Board, Consultative Council and others judge whether the Fund is being properly managed, it needs to be explicit, detailed and carefully thought out.</p>
<p>Efficient planning and proper execution of public sector budgets are key components of a sound management of the petroleum wealth. The Petroleum Fund is to be coherently integrated into the State Budget, and shall give a good representation of the development of public finances. The Petroleum Fund shall be prudently managed and shall operate in an open and transparent fashion, within the constitutional framework.</p>	<p>As discussed below and in our narrative and earlier submissions, the Act should include binding rules to improve the ability of Timor-Leste officials to properly plan and execute their budgets. In the absence of such rules, windfalls of petroleum revenue, magnified by short-term pressures, almost invariably lead to bad policy.</p>
<p>This Act lays down the key parameters for the operation and management of the Petroleum Fund. The Act governs the collection of and management of receipts associated with the petroleum wealth, regulates transfers to the State Budget, and provides for Government accountability and oversight of these activities.</p>	
<p>Therefore, pursuant to Article 139 of the Constitution and for the purpose of establishing a fund of income from the exploitation of non-renewable petroleum resources for the needs of both current and future generations, The Government presents to the National Parliament, pursuant to paragraph c), item 1, Article 97, and paragraph a), item 2, Article 115, of the Constitution of the Republic, the following draft law:</p>	
<p><b>Chapter I – General Provisions</b></p>	
<p><b>Article 1: Citation</b></p>	
<p>This Act may be cited as the Petroleum Fund Act.</p>	
<p><b>Article 2: Definitions</b></p>	
<p>1.1 In this Act, unless the context requires otherwise:</p>	
<p>“Central Bank” means the authority to be established under Section 143 of the Constitution of the Republic or, until such authority is established, the <i>Banking and Payments Authority</i>;</p>	

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“Code” means the Petroleum Mining Code agreed and adopted by Timor-Leste and Australia under Article 7 of the Treaty, as amended, varied, modified or replaced from time to time, and regulations made and directions given under it;	This is referenced only once, in the definition for petroleum authorization.
“estimated sustainable income” for a fiscal year means the amount determined in accordance with the formula set out in Schedule 1;	
“Exchange of Notes” means:	This is referenced only once, and this Act would be clearer if it were spelled out in Article 6.2, rather than here.
(a) Exchange of Notes Constituting an Agreement between the Government of Australia and the United Nations Transitional Administration in East Timor, of 10 February 2000; or	
(b) Exchange of Notes Constituting an Agreement between the Government of Timor-Leste and the Government of Australia, of 20 May 2002.	
“fiscal year” means the period of twelve (12) months from 1 <sup>st</sup> July to 30 <sup>th</sup> June;	
“independent auditor” means the auditor appointed, from time to time, for the purpose of auditing the Government accounts as set out in the Timor-Leste law, or an internationally recognised accounting firm appointed pursuant to Article 23;	
“investment manager” means the Central Bank and any person appointed as investment manager under Article 8;	
“Minister” means the Minister in charge of finances;	
“Parliament” means the National Parliament of Timor-Leste;	
“petroleum” has the same meaning given to it in the Petroleum Act;	
“Petroleum Act” means the Petroleum Act, 2005, as amended, varied, modified or replaced from time to time, and regulations made and directions given under it;	This is only referenced in the previous and next definitions. Given that the Petroleum Act has not yet been enacted or released to the public, we do not know what it says.
“petroleum authorisation” means:	
(a) an access authorisation, a petroleum contract, a prospecting authorisation or a seepage use authorisation, or any agreement made in respect of such an authorisation or contract, granted or entered into under the Petroleum Act; or	
(b) an authorisation or production sharing contract, or any agreement made in respect of such an authorisation or contract, granted or entered into under the Code;	
“Petroleum Fund” means the Petroleum Fund for Timor-Leste established under Article 5;	
“Petroleum Fund receipts” has the meaning given to it in Article 6;	
“petroleum operations” means authorised activities under a petroleum authorisation;	
“State Budget” means the State Budget referred to under Section 145 of the Constitution of the Republic;	
“tax revenue” means any tax or duty imposed under Timor-Leste law;	

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<p>“Timor-Leste” means the Democratic Republic of Timor-Leste; and</p>	
<p>“Treaty” means the Timor Sea Treaty between the Government of Timor-Leste and the Government of Australia signed on 20th May 2002, as amended, varied, modified or replaced from time to time.</p>	
<p>2.2 All terms in the present Act that are defined in the Timor-Leste law on budget and financial management have the same meaning given to it in that law.</p>	<p>Can the law be referenced specifically?</p>
<p><b>Article 3: Scope of the Act</b></p>	
<p>This Act shall provide for the establishment and management of the Petroleum Fund, and the procedural rules relating thereto.</p>	
<p><b>Article 4: Inconsistencies</b></p>	
<p>For the purposes of this present Act, in the event of any inconsistency between the provisions of the Act and the provisions in the law of Timor-Leste on budget and financial management, the provisions of the present Act shall prevail.</p>	
<p><b>Chapter II – The Petroleum Fund for Timor-Leste</b></p>	
<p><b>Article 5: Petroleum Fund for Timor-Leste</b></p>	
<p>5.1 There is hereby established a Fund known as the Petroleum Fund for Timor-Leste.</p>	
<p>5.2 The Petroleum Fund shall have an earmarked receipts account into which the Petroleum Fund receipts set out in Article 6 are credited. Transfers from the Petroleum Fund shall be made only in accordance with Article 7.</p>	
<p><b>Article 6: Petroleum Fund Receipts</b></p>	
<p>6.1 The following amounts are Petroleum Fund receipts:</p>	<p>The Act should specify that oil companies (including a Timor-Leste National Oil Company) and all other entities make payments directly into the Fund.</p> <p>The Act should forbid any petroleum-related payments, by any party, to places other than the Fund. There should be penalties for companies not complying with the Act, including for making payments outside of the Fund.</p>
<p>(a) the gross revenue, including tax revenue, of Timor-Leste from any petroleum operations, including prospecting or exploration for, and development, exploitation, transportation, sale or export of petroleum, and other activities relating thereto;</p>	<p>This should include all revenue from the sale of seismic or other data.</p>
<p>(b) any amount received by Timor-Leste from the Designated Authority pursuant to the Treaty;</p>	

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(c) any amount received by Timor-Leste from the investment of Petroleum Fund receipts, net of management expenses including that paid to the Central Bank pursuant to the management agreement referred to in Article 8.3;	Management expenses should be shown as Fund withdrawals, not pre-deducted from receipts. This is essential for auditing and oversight, and to ensure that excessive management fees are not charged.
(d) any amount received from direct or indirect participation of Timor-Leste in petroleum operations; and	Does this section refer to profits and/or income received by the future National Oil Company?
(e) any amount received by Timor-Leste relating, directly or indirectly, to petroleum resources not covered in subparagraphs (a) to (d).	<p>This should explicitly include money paid by Australia according to the March 2003 “Memorandum of Understanding Between the Government of the Democratic Republic of Timor-Leste and the Government Of Australia Relating to the Exploitation of the Sunrise and Troubadour Petroleum Fields in the Timor Sea” if the IUA comes into effect.</p> <p>It should also include money to be paid by Australia in compensation for Timor-Leste forgoing downstream development rights or boundaries, as is envisioned in the proposed “Hong Kong solution” to the boundary dispute.</p> <p>Also revenues and compensation to be recovered from Australia for revenue they already collected from illegal exploitation of Laminaria-Corallina and other fields, or from escrow accounts relating to such revenue. Also fines or interest collected on this – plus any damages awarded by a court in connection with these activities.</p>
6.2 The opening balance of the Petroleum Fund is the total amount of the payments received by Timor-Leste, up to the commencement of the present Act, as <i>First Tranche Petroleum</i> , from the Joint Authority pursuant to the terms of the Exchange of Notes, or from the Designated Authority pursuant to the terms of the Treaty, increased by such amount, if any, as determined by the Government.	<p>Plus any amounts listed in 6.1(a and e) additions above which have been received by the time the Fund becomes operational.</p> <p>There should be an audited, public report on the opening balance of the Fund and its components.</p>
<b>Article 7: Transfers</b>	Rules should set binding limits on the amount which can be withdrawn from the Fund in a given year. Otherwise, Parliament could decide to spend the entire Fund in a single year.
7.1 The only debits permitted to the Petroleum Fund are electronic transfers made in accordance with this article to the credit of a single State Budget account.	<p>This article is contradicted by the tax refund in Article 7.5 below, as well as the exception for management expenses implicit in article 6.1(c).</p> <p>If debits not permitted by this article are made, is that a criminal offense? Who is responsible? What are the penalties?</p>

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<p>7.2 The total amount transferred from the Petroleum Fund for a fiscal year shall not exceed the appropriation amount approved by Parliament for the fiscal year. Subject to Article 7.3, transfers from the Petroleum Fund by the Central Bank in the fiscal year, shall only take place after publication of the budget law, or any subsequent changes thereto, in the <i>Jornal da República</i>, confirming the appropriation amount approved by Parliament for that fiscal year.</p>	<p>This should not be a ceiling, but a fixed amount like the rest of the budget. Unspent money can be carried over to the following year's budget, reducing the amount needed from the Fund for that year.</p> <p>This Act should require a specific resolution by the Council of Ministers and the Parliament for each transfer from the Fund to the budget, as in Norway. The resolution should specify the amount of money, what it will be used for, its relation to current Fund income and its impact on future dividends.</p> <p>All authorizations of transfers, actual transfers, budget resolutions and related reports should be promptly recorded in the Public Register. See proposed new article 18½ below.</p>
<p>7.3 Subject to Article 7.4, no transfer shall be made from the Petroleum Fund in the fiscal year unless the Government has first provided Parliament with reports:</p>	<p>All of these reports, unedited, should be made public before or when they are given to Parliament.</p>
<p>(a) specifying the estimated sustainable income for the fiscal year for which the transfer is made;</p>	<p>The report needs to explain how these figures are calculated, not just the amount, and what assumptions were made. See our comments on Schedule 1 below.</p>
<p>(b) specifying the estimated sustainable income for the preceding fiscal year; and</p>	<p>The report should also specify the estimated sustainable income (ESI) for future years, based on the proposed amount of the transfer (if it is less than the sustainable income, future ESI will increase). A more sophisticated ESI calculation, as suggested in our comments on Schedule 1 (projecting the Fund's earnings year-by-year, instead of assuming they will be constant) could yield variations in ESI from year to year.</p>
<p>(c) from the independent auditor certifying the amount of the estimated sustainable income in paragraphs (a) and (b).</p>	<p>The auditor certifies the assumptions and models which the ESI is derived from, not only the amount (See Schedule 1 comments).</p>
<p>7.4 No transfer shall be made from the Petroleum Fund in a fiscal year in excess of the estimated sustainable income for the fiscal year unless the Government has first provided Parliament with:</p>	<p>All of these reports, unedited, should be made public before or when they are given to Parliament.</p>
<p>(a) the reports described in Article 7.3(a) and (b);</p>	
<p>(b) a report estimating the amount by which the estimated sustainable income for fiscal years commencing after the fiscal year for which the transfer is made will be reduced as a result of the transfer from the Petroleum Fund of an amount in excess of the estimated sustainable income of the fiscal year for which the transfer is made;</p>	<p>This report should also indicate the impact of exceeding the ESI on the total amount which can be withdrawn from the Fund, not only on the reduction of the ESI. If Parliamentarians realize that an excess transfer of \$10 this year will cost Timor-Leste \$44 over the next 50 years (assuming 3% annual Fund revenues), they might be more reluctant to do it.</p>
<p>(c) a report from the independent auditor certifying the estimates of the reduction in estimated sustainable income in paragraph (b); and</p>	
<p>(d) a detailed explanation of why it is in the long-term interests of Timor-Leste to transfer from the Petroleum Fund an amount in excess of the estimated sustainable income.</p>	<p>This explanation should include whether or not withdrawals larger than the ESI are anticipated for each of the next few years, and why.</p> <p>There should be a prohibition on exceeding the ESI level for more than two consecutive years.</p>

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7.5 Transfers from the Petroleum Fund are exceptionally permitted for purposes of refund of tax, in the event of overpayment of tax under Article 6.1(a). This amount represents a reduction of the Petroleum Fund receipts, and shall not be considered as part of the appropriation approved under Article 7.2.	<p>Does this only apply to Supplemental Petroleum Tax? From our reading of the earlier draft of the Petroleum Tax Act and Model PSC, other tax overpayments are credited to the following year rather than refunded. This article should reference relevant articles of other acts.</p> <p>Each tax refund should be timely and publicly reported as a negative receipt, including the date, amount, payee and reason for the transfer.</p>
<b>Chapter III – Investment and Protection Rules</b>	
<b>Article 8: Management of the Petroleum Fund</b>	
8.1 The Government is responsible for the overall management of the Petroleum Fund. In the exercise of any management functions and competences entrusted thereto, the Minister shall be accountable before the Prime Minister, and they both shall be accountable before the Council of Ministers and before Parliament.	<p>Every person listed in this article is responsible to obey all laws of RDTL (including this one), and subject to penalties if they do not.</p> <p>Does this mean that each member of the Council of Ministers or Parliament could be sanctioned if the Minister or Prime Minister fails to manage the Petroleum Fund according to law?</p>
8.2 The Minister shall not make any decisions in relation to the investment strategy or management of the Petroleum Fund without first seeking the advice of the Investment Advisory Board in accordance with Article 10.	See comments on Article 10.2, which propose deletion of the limitations in articles 10.2 and 10.3.
8.3 The Minister shall enter into an agreement with the Central Bank for the operational management of the Petroleum Fund and the Central Bank shall be responsible for the operational management of the Petroleum Fund.	Since this Act specifies that the Central Bank operates the petroleum Fund, why is such an agreement needed? What does it say that is not in this Act? In any event, the agreement should be public and subject to approval by the Council of Ministers and the Board of Governors of the Central Bank.
8.4 The Central Bank may propose to the Minister, either of its own motion or at the request of the Minister, the appointment of one or more investment managers to be responsible for managing the investment of amounts in the Petroleum Fund.	<p>The appointment of investment managers should be public.</p> <p>If they are to be paid from the assets or revenues of the Petroleum Fund, that must be included in the public announcement, auditor's reports, and estimates of sustainable income.</p>
8.5. The Central Bank may appoint an investment manager proposed under Article 8.4 only if the Minister is satisfied that:	
(a) the investment manager is a legal person with sufficient equity capital and adequate guarantees and insurances against operational risks;	In addition to the characteristics listed in (a-c), investment managers should have familiarity and experience with ethical investing, as well as long-term asset management.
(b) the investment manager has a sound record of operational and financial performance; and	
(c) the references and reputation of the investment manager in the field of fund management are of the highest standard.	They should have an excellent record of integrity and be committed to following Timor-Leste's principle of the highest level of transparency, willing to forego any predilection they might have to keep information confidential.

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8.6 The Government tendering procedures shall be followed for any appointment made pursuant to Article 8.5.	<p>Is UNTAET Regulation 2000-10 the current law on public tender processes? This should be referenced specifically, as well as which articles of that law apply.</p> <p>Will this require the appointment of the manager who proposes the lowest management fees? That is one factor, but the factors listed in 8.5, including additional ones we suggest, may be more important.</p>
8.7 The Petroleum Fund shall be managed prudently in accordance with the principle of good governance for the benefit of current and future generations. The duty of the investment manager is to maximise the return on the Petroleum Fund investments having regard to appropriate risk as indicated by the investments permitted under Article 9, any subsidiary legislation under this Act, any instructions by the Minister and the management agreement referred to in Article 8.3.	<p>The investment and management of the Petroleum Fund should include ethical guidelines, as in Norway. Maximizing the rate of return is important, but it should not be done at the costs of violating human rights, financing unsustainable development, or profiting from war or occupation.</p> <p>The Fund should be invested according to socially responsible principles that should be included in this Act, and the investment managers should act according to those principles as well.</p> <p>All instructions by the Minister referred to in this article should be public.</p> <p>As discussed above, “for the benefit of current and future generations” is an inadequate standard.</p>
8.8 The Central Bank shall present to the Minister quarterly reports on the performance and activities of the Petroleum Fund no later than twenty (20) days after the end of each quarter. The Central Bank shall provide for the publication of its reports in such form and manner as may be adapted for public information no later than forty (40) days after the end of the quarter. The Central Bank shall ensure that in releasing, or allowing access to, such reports measures are taken to prevent the disclosure of confidential information.	<p>There should be specific requirements for the contents of such reports, including all income, expenditures, and investments made to, from and by the Fund during the reporting period, as well as other information. All management fees and commissions paid should also be reported.</p> <p>Complete report must be published, in addition to any “adapted” versions.</p> <p>No censorship of “confidential information.”</p>
<b>Article 9: Investment Rules</b>	
9.1 Amounts in the Petroleum Fund shall be invested only in qualifying instruments described in Article 9.2.	The Fund is strongly protected against risky investment, but not against unsafe spending. This seems incomplete; it is like locking a window while leaving the door wide open.
9.2 Subject to Article 9.3, a qualifying instrument is:	
(a) a debt instrument denominated in United States Dollars that bears interest or a fixed amount equivalent to interest, that is:	This should not be restricted to U.S. currency, particularly since most of the goods purchased by the government of Timor-Leste come from countries which use other currencies. This may also be bad policy financially, as the dollar continues to fall.
(i) rated Aa3 or higher by the Moody's rating agency or rated AA– or higher by Standard & Poor's rating agency; and	
(ii) issued by or guaranteed by the World Bank or by a sovereign State, other than Timor-Leste, provided the issuer or guarantor is rated Aa3 or higher by the Moody's rating agency or rated AA– or higher by Standard & Poor's rating agency; or	

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(b) a United States Dollars deposit with, or a debt instrument denominated in United States Dollars that bears interest or a fixed amount equivalent to interest issued by:	
(i) the Bank for International Settlements;	
(ii) the Federal Reserve Bank of the United States; or	This clause should be removed. It is redundant with 9.2(b)(iii), except that it makes the United States exempt from the credit rating requirement.
(iii) the Central Bank of a sovereign State, other than Timor-Leste, with a long-term foreign currency rating of Aa3 or higher by the Moody's rating agency or AA- or higher by the Standard & Poor's rating agency.	
9.3 The investment manager shall dispose of an instrument if it ceases to be a qualifying instrument because of a change in the rating of the instrument or the issuer of the instrument within one month of the instrument ceasing to be a qualifying instrument.	Any such disposal should be publicly announced and included in the Public Register.
9.4 The average interest rate duration of Petroleum Fund qualifying instruments under Article 9.2 shall be less than six (6) years.	Longer-term, less liquid investments should comprise the majority of the Fund's holdings. Not only does this encourage savings and planning for future generations, but it helps reduce brokers' and currency exchange fees, making it more profitable to invest in a wider range of securities, including those not in U.S. dollars.
9.5 A derivative instrument that satisfies Article 9.2 is a qualifying instrument only if the financial exposure does not exceed the exposure that would have resulted from investing directly in the underlying instrument.	
9.6 The range of instruments included as qualifying instruments in Article 9.2 shall be reviewed by the Minister at the end of the first five (5) years of the Petroleum Fund existence, having regard to the size of the Petroleum Fund.	This review and consequent recommendations should be made public. If it results in changing the qualifying instruments listed in 9.2, an act of Parliament would be required to amend this Act.

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	<p style="text-align: center;"><b>Proposed new Article 9<sup>1/2</sup>: Ethical Investment</b></p> <p>Similar to Norway's Ethical Guidelines, Timor-Leste's Petroleum Fund should incorporate rules governing investment which incorporate ethical guidelines and avoid Timor-Leste supporting activities against our national interest or beliefs.</p> <p>Since our Fund is to be invested outside Timor-Leste, it is part of our nation's international relations. Section 8 of the RDTL Constitution says, inter alia, that international relations shall be governed "<i>by the principles of national independence, the right of the Peoples to self-determination and independence, the permanent sovereignty of the peoples over their wealth and natural resources, the protection of human rights, ... the peaceful settlement of conflicts, the general, simultaneous and controlled disarmament, ... and establishment of a new international economic order capable of ensuring peace and justice in the relations among peoples.</i>"</p> <p>These principles are the basis for ethical rules for investment of the Fund. The Fund should explicitly seek to prevent negative outcomes associated with petroleum producing countries. It should therefore include rules regarding environmental protection, sustainable development and energy independence.</p> <p>The investment managers should be instructed to comply with these rules, and the "watchdog" mechanisms of the Consultative Council and others could verify compliance.</p>
<b>Article 10: Investment Advisory Board</b>	
10.1 There is hereby established an Investment Advisory Board that is responsible for:	<p>All the benchmarks, instructions, advice and recommendations from the Investment Advisory Board (IAB) (articles 10.1 and 10.2) should be made available to the Parliament, the Consultative Council and the public in a timely manner, preferably before the related decisions have been made. The documents should be released by the IAB directly, the Minister should not be responsible for publication (10.10) or able to interfere with this process.</p> <p>If the IAB does not have unanimous agreement, majority and minority reports should both be published. All advice from the IAB to the Minister should be public, preferably before the Minister makes his decision.</p>
(a) developing for the Minister performance benchmarks of desired returns from, and appropriate risks of, the investments of the Petroleum Fund;	
(b) advising the Minister on the investment instructions that the Minister shall provide to the investment managers of the Petroleum Fund appointed pursuant to Article 8;	
(c) advising the Minister on the performance of the investment manager or managers and making recommendations to the Minister on the appointment or removal of investment managers; and	

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(d) advising the Minister on the need for changes in the overall investment strategy or management of the Petroleum Fund, including the making of recommendations as to such changes.	This advice should also include compliance with sustainability rules, intergenerational equity and ethical investment guidelines.
	Additionally, the Investment Advisory Board (IAB) should be authorized to, at its own initiative or in response to requests from the Parliament or the Consultative Council, prepare reports, advice and/or recommendations on any issue related to the investment of or withdrawals from the Fund.
10.2 Subject to Article 10.3, the Minister shall seek the advice of the Investment Advisory Board before making a decision on any matter relating to the investment strategy or management of the Petroleum Fund. If the Investment Advisory Board does not provide the advice requested in a timely manner, having regard to the nature of the advice sought, the Minister shall make the decision.	Petroleum Fund assets are so important to the future of the people of Timor-Leste that they should never be invested or managed hastily. The exceptions from following or seeking IAB advice described in articles 10.2 and 10.3 should be deleted, restoring the spirit of 8.2 which involves the IAB in all investment strategy and management decisions.  If our recommendation in the previous paragraph is rejected, at minimum there need to be definitions of “timely” and a requirement that the Minister act in a timely manner to request the IAB’s advice.
10.3 If, having regard to the nature of the decision, there is insufficient time to seek the advice of the Investment Advisory Board in relation to a particular decision, the Minister shall make a decision without first seeking the advice of the Investment Advisory Board.	Delete this paragraph.
10.4 If the Minister makes a decision under Article 10.2 or 10.3, the Minister shall immediately report the making of the decision to the Investment Advisory Board. The Minister shall reexamine the decision having regard to any subsequent advice provided by the Investment Advisory Board.	If the Minister makes a decision without IAB advice or at variance with the advice from the IAB, the Minister must report to the IAB, Parliament and the public explaining the reasons for his action.
10.5 Any advice given by the Investment Advisory Board on investment strategy or management of the Petroleum Fund shall take into account:	
(a) the overall objective that the Petroleum Fund be a fund of income from the exploitation of non-renewable petroleum resources for the benefit of current and future generations;	As discussed above, “for the benefit of current and future generations” is an inadequate standard.
(b) the current conditions, opportunities and constraints in investment markets, and the constraints under which the Central Bank and other key institutions in Timor-Leste operate; and	
(c) the need to ensure that sufficient amounts are available when needed for transfers referred to in Article 7.	
10.6 The members of the Investment Advisory Board shall be:	The first two members of the Board have an inherent conflict of interest between providing objective advice and justifying their own actions as officials responsible for managing the Fund.  The appointments in (c) and (d) need to be people with no personal interests related to investment or other activities of the Fund. This Article should contain language or a reference to another statute prohibiting appointment of people with actual, apparent or potential conflicts of interest.

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(a) the Director of Treasury;	
(b) the Head of the Central Bank;	
(c) two persons appointed by the Minister with significant experience in investment management; and	Experienced people like these can make mistakes. The IAB needs people with a broader perspective, including ethical investment, inter-generational equity and management of publicly owned assets.
(d) one other person appointed by the Minister.	The IAB should include at least two people appointed by someone other than the Minister, given that the Minister also directly or indirectly appoints all other members. This is essential to ensure independent, objective advice.
10.7 The Central Bank shall provide the secretariat for the Investment Advisory Board and any support required by the board to carry out its functions.	
10.8 The Minister shall provide, in accordance with Timor-Leste law:	Everything the Minister does must be in accordance with Timor-Leste law. Which law is specifically intended to apply here?
(a) a person to sit on the secretariat of the Investment Advisory Board; and	
(b) appropriate remuneration for the members of the Investment Advisory Board appointed under Article 10.6(c) and 10.6(d).	
10.9 The Investment Advisory Board shall determine the rules of procedure under which it operates.	Transparency and accountability, and avoidance of conflicts of interest, are mandatory.
10.10 When required by Parliament, the Government shall provide Parliament with all advices given thereto by the Investment Advisory Board. The Minister shall ensure that in releasing, or allowing access to, advices given thereto, measures are taken to prevent the disclosure of confidential information.	All advice given by the IAB to the Government should be automatically given to Parliament, without waiting for a requirement. It should also be released to the public. There is no “confidential information” to censor, so the last sentence should be removed.
<b>Article 11: No Encumbrances on the Assets of the Petroleum Fund</b>	Borrowing by petroleum-producing countries is one of the most common paths to financial ruin, and we support the intent of this article.
11.1 Any amount that is invested pursuant to Article 9 shall, at all times, remain the property of Timor-Leste.	
11.2 Any contract, agreement or arrangement, to the extent that it purports to encumber the assets of the Petroleum Fund, whether by way of guarantee, security, mortgage or any other form of encumbrance, is null and void.	To make this article more effective, Fund assets must also be prohibited from be used for payments for debt service. The automatic use of the Petroleum Fund to fill annual budget deficits ensures that any level of government expenditure will be covered by the Fund, so the Fund becomes <i>de facto</i> collateral: if money is borrowed, debt payments are guaranteed by the Fund.  Perhaps there's a way to adjust the ESI to take debt into account, such that the amount which could be withdrawn sustainably from the Fund each year is reduced to account for payments which must be made on debt. Article 14.2(h) helps make this more visible, but there also need to be mechanisms to discourage borrowing.

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<b>Chapter IV – Supervision of the Petroleum Fund</b>	
<b>Article 12: Maintenance of Petroleum Fund Accounts and Records</b>	
12.1 The Director of Treasury is responsible for maintaining the Petroleum Fund accounts and records in accordance with the International Accounting Standards in force, to reflect the operations and financial condition of the Petroleum Fund.	Define “International Accounting Standards.” These are evolving (see <a href="http://www.iasplus.com/standard/standard.htm">http://www.iasplus.com/standard/standard.htm</a> ) and some have been replaced by IFRS. Should refer to a specific document or standards agency.
12.2 The Director of Treasury shall submit to the Minister quarterly management information reports and analyses on the performance and activities of the Petroleum Fund no later than twenty (20) days after the end of each quarter.	These reports should go promptly to Parliament and the public by inclusion in the Public Register (see Article 18 below).
12.3 The Director of Treasury is responsible for reporting on the performance and activities of the Petroleum Fund for the purpose of the annual financial statements of Timor-Leste.	These reports should go promptly to Parliament and the public by inclusion in the Public Register (see Article 18 below).
<b>Article 13: Internal Audit</b>	
The accounts, records, and financial statements of the Petroleum Fund shall be audited every six months by the Government bodies responsible for the internal audit of the concerned Government departments.	The audit reports should go promptly to Parliament and the public by inclusion in the Public Register (see Article 18 below).
<b>Article 14: Annual Report</b>	
14.1 The Minister/Government shall submit an Annual Report for the Petroleum Fund for a fiscal year to Parliament, at the same time as the annual financial statements of that year are submitted to Parliament.	
14.2. The Annual Report for the Petroleum Fund shall be prepared in a manner that makes it readily adaptable for public information, and shall contain the following information for the fiscal year for which the Report is prepared:	<p>The unedited, complete Annual Report and subsidiary documents should be public, in addition to any version adapted for public information, included in the Public Register. This is the primary report of Fund activities, so special efforts should be taken to make it easily accessible to the public.</p> <p>The information spelled out in this article is a minimum standard; the Annual Report should contain additional information which the Ministry, Central Bank, IAB or CC believes is helpful in increasing the public’s awareness, participation and sense of ownership of the Fund.</p> <p>In article 18½, we have listed reports and documents which should be included in a Public Register. Many of these, or at least summaries of them, should also be in the Annual Report. However, the Public Register will be more timely, enabling public participation in decisions before they are made, not just the ability to lock the barn door after the horse has escaped.</p>
(a) audited financial statements conducted by the independent auditor, comprising:	If the independent auditor is unwilling to sign off the audit, or includes any qualifications, then the Annual Report should disclose the auditor’s objections and what is being done to resolve them.
(i) an income and expenditure statement;	

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(ii) a balance sheet, including a note listing the qualifying instruments of the Petroleum Fund;	This should include each of the Fund's holdings, in a form similar to the Annual Report of the Norwegian Petroleum Fund.
(iii) details of all appropriations and transfers from the Petroleum Fund; and	Also details of all deposits into the Fund (see Article 6)
(iv) notes to the financial statements, as appropriate;	
(b) a report signed by the Minister describing the activities of the Petroleum Fund in the year, including all advice provided by the Investment Advisory Board, any reports prepared by the independent auditor under Article 20 and drawing attention to particular issues or matters that may be of concern or interest to Parliament;	
(c) a statement by the Treasurer drawing attention to any accounting issues or practices arising from the Report that may materially affect the interpretation of amounts or activities shown within it;	
(d) the income derived from the investment of Petroleum Fund assets during the fiscal year compared with the income of the previous three fiscal years;	
(e) a comparison of the nominal income realized on the investment of Petroleum Fund assets with the real return after adjusting for inflation;	
(f) a comparison of the income derived from the investment of Petroleum Fund assets with the benchmark performance indices provided to the Minister pursuant to Article 10.1;	
(g) a comparison of the estimated sustainable income for the fiscal year with the sum of transfers from the Petroleum Fund for the year;	Include projections of ESI for future years, as well as details of the underlying assumptions and data for its calculation (see comment on Schedule I).
(h) in the event of Government borrowings, the liabilities shall be reflected in the presentation of Petroleum Fund accounts so as to give a true representation of the past and expected future development of the Government's net financial assets and rate of savings; and	
(i) a list of persons holding positions relevant for the operation and performance of the Petroleum Fund, including:	
(i) the Minister;	
(ii) the Director of Treasury;	
(iii) the members of the Investment Advisory Board;	
(iv) the investment manager or managers;	
(v) the Head of the Central Bank; and	
(vi) the members of the Petroleum Fund Consultative Council.	Also the auditor

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<b>Chapter V – Petroleum Fund Consultative Council</b>	
<b>Article 15: Petroleum Fund Consultative Council</b>	
15.1 There is hereby established a Petroleum Fund Consultative Council.	<p>The Petroleum Fund Consultative Council (CC) is described as a “watchdog,” but its powers are severely limited.</p> <p>The CC should be mandated to publish its own reports and its advice to Parliament in a timely manner and to communicate directly with the public, the media or any other person or organization.</p> <p>A watchdog is not a guard dog. A watchdog serves only to sound an alarm – there needs to be a higher power which will respond to the alarm.</p> <p>The CC should be able to seek the advice of the Provedor or other agencies concerned with oversight of public finances, and to share its findings with these agencies.</p> <p>If the CC finds a discrepancy or believes the law is not being followed, it must, on its own initiative without the intervention of the Minister or Parliament, refer the matter and all relevant information in its possession to the Provedor or General Prosecutor.</p>
15.2 The Petroleum Fund Consultative Council shall:	All such advice should be promptly public.
(a) advise Parliament on matters relating to the performance and operation of the Petroleum Fund;	
(b) advise Parliament on appropriations from the Petroleum Fund as set out in Article 17.2; and	
(c) in the context of the budgetary process, advise Parliament on whether the appropriations of the Petroleum Fund are being used effectively to the benefit of current and future generations.	As discussed above, “the benefit of current and future generations” is an inadequate standard.
<b>Article 16: Composition</b>	
16.1 The Petroleum Fund Consultative Council shall comprise the following members, who are to be appointed in accordance with procedures laid down by Parliament:	
(a) former Presidents of the Republic who were not removed from office;	
(b) former Speakers of the Parliament who have effectively been in office for at least three (3) years;	
(c) former Prime Ministers who have effectively been in office for at least three (3) years;	
(d) former Ministers in charge of finances who have effectively been in office for at least three (3) years;	

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(e) former Heads of the Central Bank who have effectively been in office for at least three (3) years;	
(f) a member appointed by the President of the Republic;	
(g) a member appointed by Parliament;	
(h) a member appointed by the Government;	
(i) a member appointed to represent civil society non-profit organisations;	The representatives of civil society, business sector and religious organizations should be chosen by the society, business and religious organizations, not by Government or Parliament. Although this may be more complicated, it is essential if the CC is to be a credible, independent “watchdog” on the Ministry and the Central Bank.
(j) a member appointed to represent the private business sector; and	
(k) a member appointed to represent religious organisations.	
	We suggest augmenting the representatives of civil society to include one or more NGO representatives, representatives of popular organization, youth representatives (since the purpose of the Fund is to provide for future generations, and the inclusion of many former holders of high office will heavily weight this council toward older people), people living in the districts outside Dili, and members of opposition political parties.
16.2 The members of the Petroleum Fund Consultative Council referred to in paragraphs (a), (b) and (c) of Article 16.1 are appointed from the end of their term in office for a period of ten (10) years. These members are not eligible for reappointment.	The first several seats will be vacant at least until after the 2007 election. If the government is stable, the CC could be very small.
16.3 The members of the Petroleum Fund Consultative Council referred to in paragraphs (d) and (e) of Article 16.1 are appointed from the end of their term in office for a period of five (5) years. These members are not eligible for reappointment.	
16.4 The members of the Petroleum Fund Consultative Council referred to in paragraphs (f), (g), (h), (i), (j) and (k) of Article 16.1 are appointed for a period of three (3) years. These members are eligible for reappointment for a second term.	
16.5 The members of the Petroleum Fund Consultative Council referred to in paragraphs (i), (j) and (k) of Article 16.1 shall be appointed according to procedures laid down by Parliament.	This is redundant with Article 16.1, which says that all CC members are appointed according to procedures laid down by Parliament. In the spirit of transparency, these procedures should be public and specified in this Act.
16.6 Subject to approval by Parliament, the Petroleum Fund Consultative Council may select and appoint as its international advisor for economic and financial matters, for a period of two (2) years, an academic or professional of the highest reputation and competence.	The CC should be able to have more than one international advisor, providing access to expertise and experience related to helping petroleum-dependent countries manage revenues to avoid negative long-term consequences. The CC should also be free to seek or accept advice from anyone it chooses. Any such advisors should be publicly disclosed.
16.7 A person shall not be appointed as a member of the Petroleum Fund Consultative Council if the person:	
(a) has been declared bankrupt or insolvent; or	

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(b) has been convicted of a criminal offence.	Or has a conflict of interest, with reference to specific definition in other legislation.
16.8 Members of the Petroleum Fund Consultative Council have security of tenure and, unless otherwise provided for by law, may not be suspended, retired or removed from office.	
16.9 The appointment of a member of the Petroleum Fund Consultative Council ceases if the member:	
(a) is declared bankrupt or insolvent;	
(b) is convicted of a criminal offence; or	
(c) is unfit for office.	Define “unfit for office.” A CC member should be permitted to refuse appointment or to resign for personal reasons. A conflict of interest should also be grounds for removing someone.
[16.10 Until such time as specific procedures for the removal of a member under paragraph (c) of Article 16.9 are established by law, the procedures applicable for the removal of judges shall apply.]	
<b>Article 17: Working Principles and Powers of the Petroleum Fund Consultative Council</b>	
17.1 In conducting its activities, the Petroleum Fund Consultative Council shall take into account:	
1. the overall objective that the Petroleum Fund be a fund of income from the exploitation of non-renewable petroleum resources for the benefit of current and future generations; and	As discussed above, “the benefit of current and future generations” is an inadequate standard.
2. the principles for the operation of the Petroleum Fund as outlined in this present Act.	
17.2 When:	
(a) the Government introduces legislation to Parliament to appropriate an amount from the Petroleum Fund, and	Is this separate legislation (as we suggest) or part of the budget (as the Act appears to say)?
(b) the amount the legislation would appropriate in the fiscal year is greater than the estimated sustainable income of the Petroleum Fund for the fiscal year,	The CC should submit an opinion even if the proposed transfer is at or below the ESI. It is for the benefit of Timor-Leste to keep withdrawals from the Fund as low as possible, even below the ESI, if the money is not needed in a given year. The CC can evaluate whether it believes the entire ESI amount can be spend effectively in a given year.
the Petroleum Fund Consultative Council shall submit, in a timely manner, an opinion to the Parliament on the Government’s proposed appropriation. If the Petroleum Fund Consultative Council does not provide its opinion in a timely manner, Parliament shall make the decision.	What is “timely”? When will the CC be notified of proposed withdrawal amount?

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17.3 Parliament shall provide for the publication of the advices of the Petroleum Fund Consultative Council, including minority opinions, in such form and manner as may be adapted for public information. Parliament shall ensure that in releasing, or allowing access to, advices of the Petroleum Fund Consultative Council measures are taken to prevent the disclosure of confidential information.	<p>The Council’s advice should automatically be published in full (in addition to any adapted version), when it is given to Parliament, to avoid possible political interference.</p> <p>Parliament should make public if it followed the CC’s advice, and if not, there should be a clear explanation of why.</p> <p>No censorship of “confidential information.”</p>
17.4 For purposes of advising Parliament, the Petroleum Fund Consultative Council shall consult widely in the community and, to this end, shall hold an annual forum on issues relating to the Petroleum Fund.	This specifies a minimum level of public consultation for the CC. The CC should be able to, on its own or at the request of a member of Parliament, hold additional fora or provide information to the public. The CC’s purpose in this is not only to advise Parliament, but to help ensure continuing public buy-in of the Fund, and to seek public views on how the Fund should be invested, managed and spent, as well as information about any possible mismanagement or corruption.
17.5 The Petroleum Fund Consultative Council shall determine the rules of procedure under which it will operate.	Within principles of transparency, accountability, etc.
17.6 Parliament shall provide adequate funding for the operations of the Petroleum Fund Consultative Council, including appropriate remuneration for members of the Petroleum Fund Consultative Council, through the budgetary appropriation for the operation of Parliament.	Is there staff or a secretariat for the CC? How is it established?
17.7 The Minister and/or the Head of the Central Bank shall furnish the Petroleum Fund Consultative Council with information it requests on any aspect of the operation or performance of the Petroleum Fund for the purpose of its monitoring of the Petroleum Fund. The Petroleum Fund Consultative Council shall ensure that measures are taken to prevent the disclosure of confidential information.	<p>The Council should have access to all information it deems necessary for its work from the Ministry of Finance, the Central Bank, investment manager, IAB, Petroleum Ministry, TSDA, National Oil Company and international petroleum companies.</p> <p>The Council should review not only the legality of Fund operations, but also the wisdom of operational decisions. If Fund managers fail in their duty of transparency, the Council should give information to the media and the public about Fund balances, inflows, expenditures, and interest.</p> <p>No censorship of “confidential information.”</p>
<b>Chapter VI – Transparency</b>	
<b>Article 18: Transparency as a Fundamental Principle</b>	
18.1 The management of the Petroleum Fund shall always be carried out, and the related duties of all relevant parties shall be discharged, with the highest standard of transparency. Unless it is demonstrated that certain information should be treated as confidential, it shall be deemed susceptible of public release.	A “highest standard” doesn’t allow any discretion – everything is transparent. We hope this will be implemented fully, with no censorship of “confidential information.”
18.2 In the exercise of its functions and competences, and as provided for in this present Act, Parliament, the Government, the Minister, Central Bank, Investment Advisory Board and the Petroleum Fund Consultative Council shall take all necessary measures to ensure transparency mechanisms and free access to public information.	Add investment managers to this list.

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<p>18.3 The Minister shall ensure that this present Act, any subsidiary legislation made thereunder, any instructions relating to the Petroleum Fund, the management agreement referred to in Article 8.3 and the reports referred to in Article 7.3 and 7.4 are readily available to the public.</p>	<p>Add “in a timely manner.”</p> <p>Many of these documents should be made public directly by their authors, without intervention by the Minister.</p>
	<p style="text-align: center;"><b>Proposed new Article 18½: Public Register</b></p> <p>Because of the large number of public documents and information associated with the Petroleum Fund and the multiplicity of institutions which produce these materials, we suggest that a Public Register be established for information relating to the Petroleum Fund.</p> <p>Since the principal purpose of this Register is transparency, those managing it should be protected from political or personal pressure. The Public Register should <u>not</u> reside in the Finance Ministry or the Central Bank.</p> <p>At a minimum, the Public Register should include the following in a timely manner, uncensored:</p> <ul style="list-style-type: none"> <li>• Information on the opening balance (Article 6.2) of the Fund, and how that revenue was received, from whom, and for what.</li> <li>• The proposed State Budget (Article 7.3) as soon as it is approved by the Council of Ministers.</li> <li>• Reports from the Government and auditor to Parliament regarding transfers (Articles 7.3 and 7.4), published at the same time they are given to Parliament. These reports should explain the underlying assumptions and calculations of the estimated sustainable income.</li> <li>• Information on any refunds of tax (Article 7.5).</li> <li>• The Agreement between the Minister and the Central Bank about Fund management (Article 8.3).</li> <li>• Appointments of and contracts with investment managers (8.4)</li> <li>• Instructions from the Minister to the Manager (8.7)</li> <li>• Quarterly reports from the Central Bank to the Minister (8.8)</li> <li>• A list of all investments made, sold, or disposed (9.2, 9.3)</li> <li>• The Minister’s review of the qualifications of investment instruments (9.6)</li> <li>• Performance benchmarks from the IAB (10.1(a))</li> <li>• Advice from the IAB to the Minister on various topics (10.1(b,c,d), 10.2, 10.3, 10.10)</li> <li>• Decisions by the Minister, plus an explanation if IAB advice was not followed (10.2, 10.3, 10.4)</li> <li>• Quarterly management reports by the Director of the Treasury (12.2)</li> <li>• Annual financial reports by the Director of the Treasury (12.3)</li> <li>• Results of internal audits (13)</li> </ul>

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	<ul style="list-style-type: none"> <li>• Annual Reports and Annual Financial Statements (14), including all the items enumerated in 14.2</li> <li>• Advice from the CC to the Parliament (15.2(a), (b), (c))</li> <li>• Procedures for appointing some CC members (16.5)</li> <li>• Qualifications and appointment of CC advisors (16.6)</li> <li>• CC analysis and opinion on Fund appropriations (17.2), including minority opinions (17.3)</li> <li>• Notices, submissions and reports from the CC annual public form and consultations (17.4)</li> <li>• CC rules of procedure (17.5)</li> <li>• Auditor's report listing each payment made into the Fund (20.1 as amended)</li> <li>• Auditor's referral of discrepancies (20.4) and report (20.5)</li> <li>• Regulations to carry out the provisions of this act (24)</li> <li>• Details and assumptions underlying the calculation of estimated sustainable income (Schedule 1)</li> </ul>
<p><b>Article 19: Payments into the Petroleum Fund Account</b></p>	
<p>For all purposes of Timor-Leste law, a payment made as a Petroleum Fund receipt shall not be treated as paid unless it has been deposited, fully and effectively, in the Petroleum Fund earmarked receipts account.</p>	
<p><b>Article 20: Payments made as Petroleum Fund Receipts</b></p>	
<p>20.1 The independent auditor shall prepare a report for the Minister of all payments made as Petroleum Fund receipts for each fiscal year.</p>	<p>The Auditor's report should be made public in full in a timely manner.</p> <p>In addition to each receipt, the auditor's report should include all transfers and debits from the Fund, including transfers to the State Budget, management and brokers expenses and commissions (6.1(c)), tax refunds (7.5), legal fees, settlements, payments, etc. A separate section of the report should detail costs related to the Petroleum Fund -- the auditor, IAB, CC, Central Bank management costs, etc.</p> <p>In addition to the information the auditor receives from the Central Bank and the Ministry, the Auditor must have access to information from the oil companies about all payments they have make to Timor-Leste. Without this, it will be impossible for the auditor to verify that the reported receipts are correct. (See narrative part of this submission.)</p>
<p>20.2 The independent auditor's report shall state the aggregate amounts of payments made as Petroleum Fund receipts for each payer for the fiscal year.</p>	<p>The report should not be an aggregate, but each individual receipt. Should also explain what the payment was for (FTP, tax, etc.), for what project, how much oil was produced, what costs were recovered, etc. All of this is required by the PSC, but should be reported by the auditor.</p> <p>In addition, the companies should be required to make public reports of ALL payments.</p> <p>There must be no "commercial in confidence" exceptions.</p>

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20.3 If there are reasonable grounds for the independent auditor to believe that there is a discrepancy between the Petroleum Fund receipts and the payments made as Petroleum Fund receipts, the independent auditor may require any payer to provide any information and to make proof of facts necessary for the clarification of such discrepancy.	<p>The CC, General Prosecutor and Provedor should also be able to demand this information. It should not only be triggered by a discrepancy between receipts and payments, but by any apparent irregularity, including management of investments and calculation of the estimated sustainable income from the Fund.</p> <p>The Petroleum Act and Production Sharing Contracts also need to specify that every payer must cooperate with the auditor, CC, General Prosecutor and Provedor’s requests for information.</p>
20.4 If the independent auditor concludes that there is a discrepancy that cannot be accounted for, the independent auditor shall refer the matter to the Minister. In referring the matter to the Minister, the independent auditor shall provide all information that the independent auditor possesses regarding the discrepancy in question.	<p>If the auditor has any suspicion that the Minister or his subordinates or superiors are involved in an irregularity or discrepancy, he should inform the Minister and Consultative Council, while referring the matter to the Provedor or the General Prosecutor. The Auditor should consult with the IAB, CC or any other relevant official in attempting to ascertain the causes of a discrepancy.</p> <p>If such a referral is made, it must be announced publicly.</p>
20.5 The Minister shall provide for the publication of the independent auditor’s report in such form and manner as may be adapted for public information. The independent auditor shall ensure that in preparing the report measures are taken to prevent the disclosure of confidential information.	<p>No censorship of “confidential information.”</p> <p>The auditor’s report should be published in full, within a specified time, regardless of actions by the Minister, and in addition to any “adapted” versions.</p>
<b>Chapter VII – Penalties</b>	
<b>Article 21-A: Scope</b>	
The provisions included in this Chapter are without prejudice of criminal and civil liability under general law.	The IAB, Independent Auditor, CC, and/or Parliament should be able to refer any evidence or suspicion of violation of the law, including of this Act, to the Provedor and/or General Prosecutor for further investigation and possible judicial sanction.
<b>Article 21-B to “n”:</b>	
[To be drafted at a later stage, taking into account the developments in the general penal regime which are expected to take place in the near future.]	If this Act is to be in effect by July 2005, penalties need to be specified here. Other laws already passed contain specific penalties; they could be included here on a transitional basis.

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<b>Chapter VIII – Transitional and Final Provisions</b>	
<b>Article 22: Appointment of Investment Managers</b>	
<p>The requirement of Article 8.6 enters into force six (6) months after the date of entry into force of this present Act, and shall apply to all appointments of investment managers made thereafter. Any appointment of investment managers made during the six (6) months after the date of entry into force of this present Act shall lapse after the five (5) year period referred to in Article 9.6.</p>	<p>According to slide 17 of the presentation by José Teixeira at the public consultation on this Act on 14 February 2005, “investment management will from start be outsourced (to the US central bank).” If this is true, the appointment was made before the six-month period specified in this article. If it is reaffirmed after this Act enters into force, it should not last for five more years.</p> <p>Since an extralegal transitional appointment has apparently already been made, we propose that this article be amended to reflect actual practice, and that the transitional appointment expire one year after this Act enters into force, at which time new or the same investment managers would be appointed according to the procedures in Article 8.</p>
<b>Article 23: Independent Auditor</b>	
<p>Once the hierarchy of the administrative, tax and audit courts is established, and without prejudice of the powers and competences of such courts, there shall be appointed an independent auditor, which will be an internationally recognized accounting firm selected by the Government.</p>	<p>The CC should be responsible for recommending the auditor. If the auditor is selected by the Government alone, it will not be independent. The appointment should also be approved by Parliament.</p> <p>This article appears to say that no auditor can be appointed until the tax and audit courts have been established. There needs to be a transitional provision so that the auditor is functional in time to certify the estimated sustainable income (article 7.3(c)) prior to the first budget which includes a transfer out of the Petroleum Fund, or in time to prepare the first Annual Report (article 14), whichever comes first.</p>
<b>Article 24: Subsidiary Laws and Regulations</b>	
<p>The Government and the Minister may make regulations for the effective carrying out of the provisions of this present Act including regulations of a transitional nature consequent upon the making of this present Act.</p>	<p>Need a public rule-making process, with a chance for Parliament to be informed. All regulations should be included in the Annual Report and the Public Register.</p>
<b>Article 25: Entry into force and application</b>	
<p>25.1 This present Act enters into force on the day following its publication in the <i>Jornal da República</i>.</p>	
<p>25.2 This present Act applies to fiscal years commencing on or after 1 July 2005.</p>	<p>This is a very short time in which to make transitional and other regulations, appoint various people, and develop an investment strategy.</p>

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<p><b>Schedule 1: Calculating estimated sustainable income for a fiscal year</b></p>	
<p>I. Estimated sustainable income for a fiscal year is the maximum amount that can be appropriated from the Petroleum Fund in that fiscal year and leave sufficient resources in the Petroleum Fund for an amount of the equal real value to be appropriated in all later fiscal years as determined in accordance with the formula in paragraph II below. The amount determined in accordance with the formula in paragraph II below shall be certified by the independent auditor.</p>	<p>The validity and accuracy of the estimated sustainable income (ESI) projection is crucial to protecting the long-term interests of Timor-Leste. Yet this estimate is derived from incomplete data, and attempts to anticipate financial and petroleum market developments for the indefinite future.</p> <p>Recent projections (see narrative submission) show that Timor-Leste's population will grow rapidly over the next two generations. Even if the ESI is accurate and obeyed, the income from the Petroleum Fund for each Timor-Leste citizen each year will drop 71% by 2050.</p> <p>Although the auditor certifies this estimate (and his certification should include Paragraph III as well as II below), it is unclear who calculates the estimate and determines the underlying assumptions which will define the input data.</p>
<p>II. Estimated sustainable income for a fiscal year is calculated according to the following formula:</p> $r \times \text{petroleum wealth}$ <p>where:  <b>r</b> is the estimated average real rate of return, or real interest rate, on Petroleum Fund investments in the future and, at the commencement of this present Act, is 3.0%.</p>	<p>It's misleading to give a complex formula which implies certainty, but which is based on very uncertain raw data.</p> <p>How and when is <b>r</b> to be re-estimated in the future? Is it always the rate of return on the Petroleum Fund for the previous year, or does it involve averages and/or projections? Does it consider exchange rate variations between the U.S. dollar and other currencies?</p>
<p>III. In this Schedule, "petroleum wealth" is calculated according to the following formula:</p> $V + \text{present value } (R_1, R_2, \dots, R_n) = V + \sum_{t=1}^n \frac{R_t}{(1+i)^t}$ <p>where:  <b>V</b> is the estimated value of the Petroleum Fund at the end of the prior fiscal year  <b>R<sub>1</sub>, R<sub>2</sub>, etc.</b> are the published budget projections for expected annual Petroleum Fund receipts for that fiscal year (R<sub>1</sub>) and future fiscal years (R<sub>2</sub>, etc.)  <b>i</b> is the estimated nominal yield on a U.S. government security, averaged over the years in which Petroleum Fund receipts are expected  <b>n</b> is the number of years until no further Petroleum Fund receipts are projected to be received.</p>	<p>Timor-Leste has experienced large swings in anticipated and actual government oil revenue while preparing our budget over the last three years. Those projections go only five years into the future, for a single field whose ownership, production and taxation are already defined. The Government relied on projections by ConocoPhillips which turned out to be wrong in both timetable and amounts, leading to swelling and shrinking of projections of Timor-Leste's "financial gap."</p> <p>Estimating for many fields over decades will be far less exact. Will the Government rely on petroleum companies for this information, in which case there will be no data for fields not yet under Production Sharing Contracts, or will an agency of the Timor-Leste government make this estimate, considering the nation's entire potential petroleum wealth?</p> <p>The interest rate (<b>i</b>) should not be averaged over all years, but projected for each individual year.</p> <p>To be certifiable by the independent auditor, this estimate must include:</p> <ol style="list-style-type: none"> <li>1. Which petroleum fields and reserves are included, estimated extractable petroleum from each reserve, and at what Proved/Probable/Possible levels.</li> <li>2. Statements of projected selling prices for oil and gas for each year.</li> <li>3. Statement of when extraction from each field is to commence, and what the amount of production and expenditure for cost recovery will be for each year the field is in production.</li> </ol>

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	<ol style="list-style-type: none"> <li>4. Projections of when and if each field will recoup its investment, with consequent increase in “profit oil” tax receipts.</li> <li>5. For fields whose revenue is shared with Australia, including the JPDA and potentially unified Greater Sunrise, statements of what portion of revenues Timor-Leste will receive.</li> <li>6. Anticipated settlement of maritime boundaries with Australia, including any payments from Australia to Timor-Leste as part of this settlement.</li> <li>7. Projections for downstream revenues and incomes from a Timor-Leste National Oil Company.</li> <li>8. Anticipated rates of return from Petroleum Fund investments.</li> <li>9. Anticipated withdrawals above or below the ESI in the near future.</li> <li>10. Anticipated rates of inflation.</li> </ol> <p>Each of these assumptions must be enumerated and explained in a public document, certified by the independent auditor, which is revised at least annually.</p>
<p>Approved in Council of Ministers, on ..... 2005  The Prime Minister</p> <hr/> <p>Mari Alkatiri  The Minister of Planning and Finance</p> <hr/> <p>Madalena Boavida</p>	