

# 2013 State Budget Book 1

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# **Part 1: Speech of the Prime Minister**

This speech will be included after the 2013 State Budget has been presented to parliament.

# Part 2: Description and Analysis of the 2013 State Budget

## 2.1: Executive Summary

### 2.1.1: Introduction

The Government is determined to transform Timor-Leste into an upper-middle income country with a secure, healthy and well-educated population by 2030. The Programme of the Fifth Constitutional Government of Timor-Leste outlines detailed policies to achieve this goal. This 2013 State Budget appropriates expenditures to finance these policies.

Table 2.1.1.1 shows the Combined Sources Budget for Timor-Leste. Total expenditure in 2013 is \$1997.9 million. This comprises Government expenditure of \$1,797.5 million and \$200.4 million from Development Partners. Commitments from Development Partners are 10.0% of the total budget, demonstrating that Timor-Leste is not heavily dependent on external assistance to finance its development programs.

**Table 2.1.1.1: Combined Sources Budget 2011-2017, \$ million<sup>1</sup>**

	2011 actual	2012 budget *	2013 budget**	2014 budget	2015 budget	2016 budget	2017 budget
<b>Combined Sources Budget</b>	<b>1,379.8</b>	<b>2,028.3</b>	<b>1,997.9</b>	<b>2,088.9</b>	<b>2,080.0</b>	<b>2,017.1</b>	<b>2,052.6</b>
<i>Government Expenditures by Fund</i>	1,095.9	1,806.5	1,797.5	1,950.5	2,047.4	2,014.0	2,052.6
CFTL	604.7	893.9	1,002.2	1,042.3	1,084.0	1,127.3	1,172.4
HCDF	16.8	37.5	42.4	40.0	45.0	45.0	49.0
Infrastructure Fund	474.4	875.1	752.9	868.2	918.4	841.7	831.2
<i>Development Partner Commitments</i>	283.9	221.8	200.4	138.4	32.6	3.1	0.0

\* Final 2012 Budget after rectification and rollover

\*\* After rollover

Sources: National Directorate of Budget and Development Partnership Management Unit, Ministry of Finance, 2012

<sup>1</sup> A note regarding data in tables and figures: Throughout the Budget book, numbers are generally given to one decimal place in tables and graphs, usually either in millions of US Dollars or as percentages. Occasionally on close inspection it may seem that minor errors have been made in the decimal place when adding up the figures in order to get to a 'total'. This is a result of rounding error, which is inevitable when displaying such large figures in a readable manner. A rounding error is not really an error it is just the way maths works when long figures are displayed to a few decimal places. For example, using the numbers for Minor Capital \$47,150,000 and Capital and Development \$891,895,000 gives the total \$939,045,000. When rounded to a million the figures are \$47.2 and \$891.9 but the correct rounded total is \$939.0, not \$939.1.

Table 2.1.1.2 shows a consolidated fiscal table for Timor-Leste. This table shows expenditure, revenue, financing and key economic indicators. The Government has slightly decreased (by \$9.0 million) the overall budget between 2012 and 2013 in order to maintain fiscal sustainability and ensure that aggregate demand within the economy is consistent with acceptable levels of inflation. Due to the decline in total expenditure, increased revenue and a higher ESI excess withdraws from the petroleum fund are budgeted to decrease from 2012 to 2013. This is in line with long term fiscal sustainability. Strong economic growth is forecast to continue over the medium term.

**Table 2.1.1.2: Fiscal Table with Memorandum Items, \$ million**

	2009 actual	2010 actual	2011 actual	2012 budget*	2013 budget**	2014 budget	2015 budget	2016 budget	2017 budget
<b>Total Expenditure by Appropriation Category</b>	<b>603.8</b>	<b>760.3</b>	<b>1,095.9</b>	<b>1,806.5</b>	<b>1,797.5</b>	<b>1,950.5</b>	<b>2,047.4</b>	<b>2,014.0</b>	<b>2,052.6</b>
<i>Recurrent</i>	394.2	506.1	507.8	757.3	858.5	888.7	927.6	962.9	1,003.6
Salary and Wages	87.3	91.5	111.6	139.0	160.3	166.7	173.3	180.3	187.5
Goods and Services (including HCDF)	212.8	245.9	253.5	384.6	461.7	476.1	498.5	516.7	539.5
Public Transfers	94.1	168.7	142.6	233.7	236.5	245.9	255.8	266.0	276.6
<i>Capital</i>	209.6	254.3	588.2	1,049.1	939.0	1,061.9	1,119.8	1,051.1	1,049.0
Minor Capital	38.7	38.3	27.2	49.2	47.2	49.0	51.0	53.0	55.2
Capital and Development (including all Infrastructure Exp.)	170.9	215.9	561.0	1,000.0	891.9	1,012.8	1,068.8	998.1	993.8
<b>Domestic Revenue ***</b>	<b>90.8</b>	<b>96.4</b>	<b>108.5</b>	<b>134.1</b>	<b>146.3</b>	<b>162.9</b>	<b>181.5</b>	<b>200.1</b>	<b>218.4</b>
<b>Non-Oil Fiscal Balance</b>	<b>-513.0</b>	<b>-664.0</b>	<b>-987.4</b>	<b>-1,672.4</b>	<b>-1,651.2</b>	<b>-1,787.7</b>	<b>-1,865.9</b>	<b>-1,814.0</b>	<b>-1,834.2</b>
<b>Financing</b>	<b>513.0</b>	<b>664.0</b>	<b>987.4</b>	<b>1,672.4</b>	<b>1,651.2</b>	<b>1,787.7</b>	<b>1,865.9</b>	<b>1,814.0</b>	<b>1,834.2</b>
Estimated Sustainable Income (ESI)	408.0	502.0	734.0	665.3	787.0	785.3	771.6	757.9	746.5
Excess Withdrawals from the PF	104.0	309.0	321.0	829.6	410.8	931.7	971.4	934.4	964.7
Use of Cash Balance	1.0	-147.0	-67.6	134.4	409.8	0.0	2.0	0.0	0.0
Borrowing/Loans	0.0	0.0	0.0	43.1	43.6	70.6	120.9	121.7	123.0
<b>Selected Economic Indicators</b>									
Nominal GDP (Non-Oil Sector)	775.6	859.1	975.9	1,292.7	1,506.9	1,769.2	2,099.7	2,507.1	3,006.5
Fiscal Deficit / GDP (Non-Oil Sector)	66.1%	77.3%	101.2%	129.4%	109.6%	101.0%	88.9%	72.4%	61.0%

\* Final 2012 Budget after rectification and rollover

\*\* After rollover

\*\*\* The domestic revenue figure shown is that used when the Government estimated revenue for the outer years. This figure is slightly different from that shown in the audited accounts.

Sources: National Directorate of Budget, National Directorate of Economic Policy, Petroleum Fund Administration Unit and Major Projects Secretariat, Ministry of Finance, 2012

## 2.1.2: Economic Overview

The “Timor-Leste’s National Accounts 2004-2010” publication<sup>2</sup> describes both the composition and the value of Timor-Leste’s economy. In 2010, GDP was \$4,140.4 million of which 79.3% came from the petroleum sector. GDP from the non-oil sector stood at \$859.1 million. During 2011 Timor-Leste’s non-oil economy benefited from strong government expenditure which boosted the growth of specific sectors, such as construction, leading to a nominal value of \$975.9 million. Regarding the real non-oil economic growth rate trend, Timor-Leste has achieved one of the highest rates of growth in the world, averaging 11.9% per year since 2007.

Strong economic growth in 2011 has been accompanied by very high inflation, reaching 15.4% (year-on-year) in December 2011. After increasing to nearly 18% in January 2012, inflation decreased to 10.1% in March<sup>3</sup> and has since stabilised at c. 11%. The lower inflation rate observed at the end of the first quarter of 2012, compared to the last quarter of 2011 and the very start of 2012 can be mainly attributed to an improvement in international factors. These are the strengthening of the US\$ compared to Timor-Leste’s main trading partners, which reduces the price of imported goods, and relatively lower international prices for individual commodities. Nevertheless, an inflation rate of 11% is still relatively high compared to other countries. The Government is determined to ensure that inflation further declines over the medium term and recognises that carefully controlling growth in total expenditure will be important in achieving this goal. This policy is reflected in this 2013 State Budget which slightly reduces total expenditure in 2013 compared to 2012.

## 2.1.3: Expenditure

Total expenditure in 2013 is \$1797.5 million; representing a 0.5% decrease compared to 2012. The Government has reduced total expenditure to contribute towards fiscal sustainability and the control of inflation. Capital and Development expenditure in 2013 has been reduced by 10.8% compared to 2012 partly to maintain fiscal sustainability but also because the Government recognises the need to ensure that infrastructure spending is set at a level whereby projects can be implemented effectively. Recurrent expenditure has been sharply increased. Between 2012 and 2013 expenditure on Salaries and Wages and Goods and Services has substantially increased. Increased spending on war veterans’ programmes, civil service pensions, the new career regime for health professions and the payment of voluntary teachers

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<sup>2</sup> National Directorate of Statistics (DNE), 2012. (N.B.: With the release of the first preliminary 2011 GDP from expenditure side (GDP-E) estimates, the 2004-2010 figures for GDP-E have also been revised due to the changes in the respective sources data, including the data on development partners spending, household expenditure, and other, and the consequent changes in other indicators)

<sup>3</sup> The 15.4% Inflation rate refers to Timor-Leste CPI change; Timor-Leste CPI is currently measured on a quarterly basis, therefore the 18% and 10% figures refer to Dili CPI change which is instead measured monthly.

have contributed to higher recurrent expenditure. The Government considers these expenditures to be in accordance with the goals and policies stated in the SDP. Expenditure on fuel for generators and operation and maintenance of electrical power plants has also increased in 2013. This increased spending is necessary to maintain and operate the high quality power generation facilities that have recently been constructed.

#### **2.1.4: Revenue**

Domestic revenue collections are forecast at \$146.3 million in 2013. This represents a 9.2% increase compared to the 2012 forecast of \$134.1 million. This increase is being driven in particular by increases in some taxes – corporate, excise and withholding – and is partially offset by a forecast reduction in the rice programme.

In 2013 domestic non-oil revenue collections are forecast to finance 8.1% of total expenditure. High projected rates of economic growth, as well as growth in revenues mean that by 2017 total domestic revenues are projected to rise to \$218.4 million, over 10% of projected expenditure.

Petroleum revenues from Bayu-Undan and Kitan peaked in 2011 and are forecasted to decline to \$2,309.1 million in 2013, before temporarily levelling off until 2017. The Petroleum Fund balance is set to increase from \$9,310.3 million at the end of 2011 to \$10,776.7 million by the end of 2012, and \$12,375.7 million by the end of 2013.

#### **2.1.5: Financing**

The non-oil deficit is equal to domestic revenue minus total expenditure. This is an important financial/economic indicator as it gives an approximate indication of the amount of additional money and demand that Government spending is contributing to the economy. The non-oil deficit in 2013 will be \$1,651.2 million. This deficit is mainly financed by withdrawals from the Petroleum Fund. Loans of \$43.6 million and the use of \$409.8 million of cash held in Government bank accounts also contribute to the financing of this deficit.

## **2.2: A Review of Recent Reforms in Public Financial Management**

### **2.2.1 Overview of Public Financial Management Reforms**

The Public Financial Management (PFM) system consists of the institutions, laws and information technology infrastructure through which the Government spends, collects and manages money. A strong and effective PFM system is essential for maintaining strong economic growth, controlling corruption and efficiently delivering Government services. In Timor-Leste an effective PFM system is critical to transforming mineral resources into public wealth.

The Government has implemented a broad-based and sustained PFM reform programme. This reform programme is complex and covers many different aspects of PFM and therefore only selected key aspects of it are described here. Other publically available documents, such as the Ministry of Finance's Strategic Plan, describe the entire reform programme in more detail. The key goals and components of the Government's reform programme described here are: a) petroleum tax audit, b) providing budget documentation that transparently describes the State Budget, c) improving expenditure management, d) transparency and e) improving analysis and evidence-based policies and expenditures.

### **2.2.2 Comprehensive Petroleum Tax Audit**

The Government is determined to ensure that petroleum companies' taxpayers pay their taxes in accordance with the applicable taxation laws of Timor-Leste. Since December 2010 NDPR has been undertaking a comprehensive tax audit of petroleum companies, which has already led to the collection of over \$300 million of additional taxes, including interest and penalties. The comprehensive tax audit is on-going and the primary focus is the examination of approximately \$4,800 million of capitalised expenditures relating to the Bayu-Undan project (including the LNG Pipeline and the Darwin DLNG), Transfer Pricing, Capital Gains and approximately \$44,000 million of revenue accruing to the taxpayers and their related parties during the 2005-2010 tax years.

The capitalised expenditure associated with Kitan Project is also under tax audit. NDPR is variously assisted by top-flight law and accounting firms hired specifically to support the comprehensive tax audit for both the Bayu-Udan and Kitan Projects.

NDPR has developed and implemented New Audit Guidelines as the manual for the audit of the petroleum taxpayers. The NDDR national audit staff was constituted in 2011 and members of

the Audit Team continue to improve their skills through participation in audit and training seminars to prepare them for the field audits.

To close certain loopholes and provide clarity in the existing tax legislations, several Public Rulings as well as new Tax Regulations were issued between 2011 and 2012 tax years. It is reasonably anticipated that the new Regulations will save Timor-Leste approximately \$50-100 million over the next five years by “clogging” tax loopholes, especially those associated with related party transactions.

### **2.2.3 Providing Budget Documentation that Transparently Describes the Government’s Policies**

The Government has made a sustained effort to further improve the quality, clarity and comprehensiveness of the budget documentation provided to parliament and citizens. There are currently six budget books and a Citizen’s Guide to the Budget (published shortly after the annual budget law is promulgated by the President). Together these documents achieve the following goals:

- **Describe the Government’s overall fiscal policies:** Budget Book 1 clearly shows total expenditure, revenue and financing over the medium term. The impact of excess withdraws on the ESI and fiscal sustainability are shown and described.
- **Explain the main activities financed by spending:** Budget Book 2 shows the main activities that ministries will use their budgets for.
- **Show how spending contributes to district development:** Budget Book 3 describes the distribution of spending between districts and specific projects that contribute to district development.
- **Provide a detailed breakdown of the budget:** A breakdown of the budget by chapter, title, division and item is provided in Budget Book 4.
- **Explain and analyse donor commitments:** This goal is achieved in Budget Book 5.
- **Provide information on the budget of different programmes and projects in the Infrastructure Fund and Human Capital Development Fund:** This is achieved in Budget Book 6.
- **Provide a simplified, non-technical overview of the budget:** through the “A Citizen’s Guide to the State Budget” publication.

Together these documents provide a comprehensive overview of the budget and its impact. An important report by the IMF rated Timor-Leste as “A” – the highest grade attainable - for comprehensiveness of information included in the budget documentation. This means that the information provided by the Government in the budget documentation compares favourably to many other countries. Going forward, the Government is committed to better linking expenditures to activities and improving the accuracy of the medium term forecasts in the budget documentation.

#### **2.2.4 Improving Expenditure Management**

The Government has improved expenditure management mainly through the strengthening of the Integrated Financial Management Information System (IFMIS). Line ministries now have access to this system and can raise commitments up to the limit imposed by the budget. They can also access reports showing their cash expenditures, obligations and commitments to date. The final approval for payment of invoices and virements (as allowed by law) across ministries’ budgets is still controlled centrally by the Ministry of Finance using the IFMIS system. This arrangement provides an appropriate balance between the decentralisation of expenditure management to line ministries who are responsible for providing public services and the centralised control and recording of expenditures. The implementation of this system has both increased execution rates and reduced fiduciary risk. It has also allowed real time reporting to the public through the transparency portal.

Over the medium term the Government plans to further strengthen expenditure management. The full implementation of a contract management module, which line ministries are currently receiving training on, will allow the Government to better understand when payments are likely to become due. This in turn should minimise the risk of short term debt occurring due to late payment of invoices and should allow the Government to better manage cash throughout the financial year. It will also allow the Government to better review contracts and ensure they provide strong value for money and are not overly generous to contractors.

#### **2.2.5 Transparency**

The Government is committed to transparency. The creation of the online transparency portal has been a key tool in achieving this goal. The portal consists of the Budget, Aid, E-procurement and Results sub-portals. These sub-portals draw data from the IFMIS and present them in an interactive and clear way so that all citizens can gain a better understanding of policy, procurement and expenditure and hold the Government to account.

The Budget sub-portal is now fully operational. It provides live, real-time access to data on expenditures and revenues. This allows the public to instantly view how budget execution and

revenue collection are proceeding at any time during the year. The publication of such data is in line with international best practice and makes Timor-Leste an international leader among developing countries in the publication of financial data.

The Aid Management sub-portal provides detailed data on commitments and actual disbursements from donors. This allows citizens to see what development partner money is being spent on and how it is contributing to development in Timor-Leste.

The E-procurement sub-portal shows both current procurement opportunities and awarded contracts. The current procurement opportunities portal provides an open, level playing field to different contractors and encourages strong competition for Government tenders. In the long term this will drive down costs and allow the achievement of better value for money. The database of awarded contracts allows the public to gain a better understanding of Government expenditure and form an opinion on whether contracts have or have not represented value for money. The Government is committed to improving the number of contracts recorded in this sub-portal and the details on each contract over the medium term.

The results sub-portal shows what has been achieved by key Government projects and programmes. This allows the public to better understand the impact of Government policies.

## **2.2.6 Improving the Analysis, Review and Efficiency of Expenditure**

The Government recognises that strong economic growth and poverty reduction will depend on well-targeted and efficient spending. The Government is therefore committed to a programme of constantly reviewing, critiquing and amending policies to ensure that public money is well spent. Such a process requires high-level oversight. Therefore over the coming year a committee that will review and suggest amendments to the Government's policies and expenditures with the aim of ensuring that they fully contribute towards the implementation of the SDP will be established. This committee will commission and review expenditure reports and analysis with the aim of ensuring that no dollar spent by the Government is wasted. Over the first year this committee will: a) review and comment on a report on Infrastructure Fund spending; b) review a report on spending on the PDD1 and PDD2 programmes (consolidated as the PDID programme from 2013 on); c) commission reports on topics that may include: long term fiscal sustainability and spending in the social sectors; and d) review regular reports drafted by the Ministry of Finance on Government expenditure.

The work of the commission will be in addition to, and not instead of, ongoing activities to record and monitor expenditure. The Government will for instance continue to report to parliament on expenditures on a quarterly basis and the accounts will continue to be audited by an independent, international audit company.

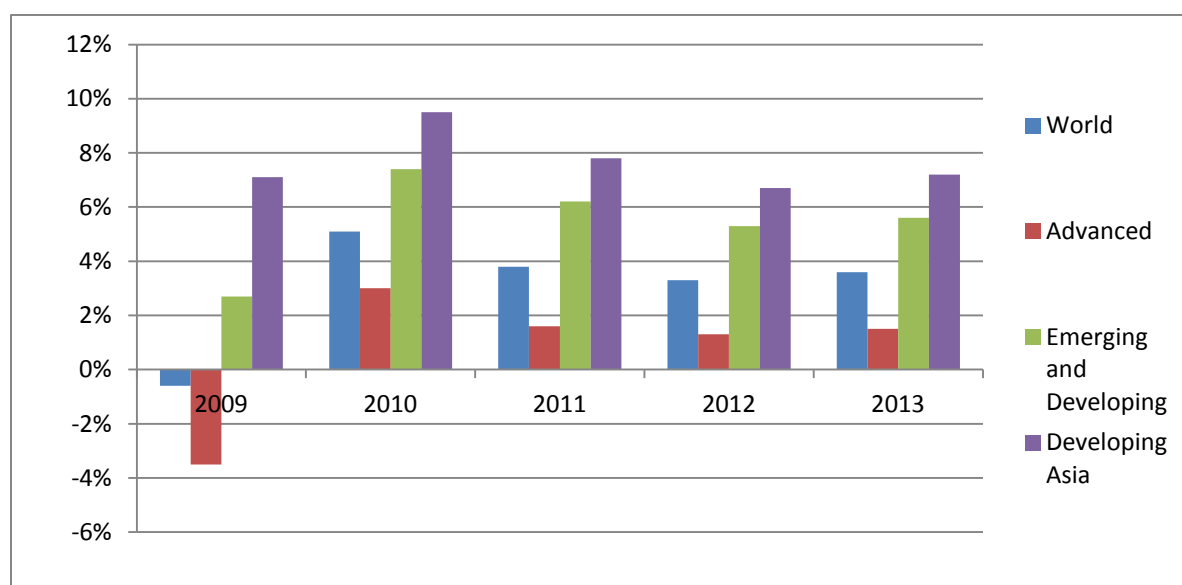
## 2.3: Economic Overview

### 2.3.1: International Economy

#### 2.3.1.1: Trends in International Growth

Global growth slowed to 3.9% in 2011 from 5.3% in 2010 due to the continued weak recovery from the financial crisis, especially in advanced economies, which has continued in 2012. Overall, global growth is projected to continue to slow to 3.3% in 2012 before moderately increasing to 3.6% in 2013 (Figure 2.3.1.1.1)<sup>4</sup>. Despite suffering from reduced export growth rates because of the slowdown in Europe and the United States, and from lower domestic demand, developing Asia remains the fastest growing region, driving both the emerging and developing economies' growth.

**Figure 2.3.1.1.1: Real Economic Growth 2009 – 2013(%)**



Sources: National Directorate of Economic Policy, Ministry of Finance, 2012 and IMF WEO October 2012

Growth in advanced economies is projected to be 1.3% in 2012 and 1.5% in 2013. The ongoing euro crisis continues to foster uncertainty and provide a drag on a robust recovery in Europe and other markets. After a strong first quarter, the data from the U.S. and the U.K. once again also suggest that growth continues to be slow, and unemployment remains high.

Developing economies are projected to grow by 5.3% in 2012 and 5.6% in 2013. Although the rapid growth seen in countries such as China, India and Brazil has slowed somewhat, it is still

<sup>4</sup> Unless otherwise stated, the figures reported in the International Economy section are from the IMF World Economic Outlook, October 2012.

high compared to the developed world, and should be helped by looser policies introduced at the end of 2011.

**Table 2.3.1.1.1: Real Regional GDP Growth Rates (%)**

Country	Actual			Projection	
	2009	2010	2011	2012	2013
China	9.2%	10.4%	9.2%	7.8%	8.2%
Australia	1.4%	2.5%	2.1%	3.3%	3.0%
Singapore	-1.0%	14.8%	4.9%	2.1%	2.9%
ASEAN-5	1.7%	7.0%	4.5%	5.4%	5.8%
Indonesia	4.6%	6.2%	6.5%	6.0%	6.3%
Vietnam	5.3%	6.8%	5.9%	5.1%	5.9%
Philippines	1.1%	7.6%	3.9%	4.8%	4.8%
Thailand	-2.3%	7.8%	0.1%	5.6%	6.0%
Malaysia	-1.5%	7.2%	5.1%	4.4%	4.7%
<b>Timor-Leste*</b>	<b>12.8%</b>	<b>9.5%</b>	<b>10.8**</b>	<b>10.6***</b>	<b>10.4***</b>

\* Timor-Leste GDP refers to the non-oil sector only

\*\* Preliminary estimate

\*\*\* Targets

Sources: National Directorate of Economic Policy, Ministry of Finance, 2012 and IMF WEO October 2012

### 2.3.1.2: Trends in International Prices

In this climate of weak growth and decreasing demand, global inflation is projected to fall from 4.5% in the final quarter of 2011 to 3-3.5% in 2012-13. This decline reflects reductions in projected consumer prices for both advanced and emerging and developing economies, expected to decrease to 1.9% and 6.1% for 2012 and to 1.6% and 5.8% for 2013, respectively.

#### Oil Prices<sup>5</sup>

Oil prices rose in the first quarter of 2012 due to increasing economic activity and rising tension over potential instability in the Middle East affecting supply. Since March, both of these trends have become less of a factor which has been consequently reflected in a more than 22% drop in prices to \$90 a barrel at the end of Q2 2012<sup>6</sup>. However, in July and August prices have increased again to above \$105 because of production disruptions in North America, the North Sea and the Middle East associated with the seasonal increase in demand<sup>7</sup>. Overall, oil prices are expected to average \$106 across 2012 and moderately decline throughout 2013 to \$105. Future markets

<sup>5</sup> For a description of how international oil prices affect oil revenues in Timor-Leste see "Petroleum Revenues", section 2.5.3.

<sup>6</sup> Simple average of WTI, UK Brent and Dubai crude oil prices.

<sup>7</sup> US Energy Information Administration Short-Term Energy Outlook, September 2012.

indicate that the prices of oil are expected to decline in the medium term. These forecasts reflect, amongst other factors, expectations of weak global oil demand continuing and both OPEC and non-OPEC increases in crude oil production.

### Agricultural Commodity Prices

Bad harvests in the U.S., Eastern Europe and Central Asia raised concerns of the possibility of a food price crisis. In July international agricultural commodity prices surged, in particular for maize, soy and wheat, with monthly increases in prices for single commodities reaching 25%. However, the latest international market data indicate that it is unlikely that a crisis such as 2007-08 will reoccur in the next few months. A major reason for that crisis was the poor rice yields. This year however, production in China, Indonesia, Thailand, Philippines and the U.S. more than offsets the bad crop year in other Asian countries such as India, Cambodia and Nepal<sup>8</sup>. Moreover, the consequences of the worst U.S. drought in over half a century on maize production may have been overblown<sup>9</sup>.

For Timor-Leste, close monitoring of international food price dynamics is strongly advisable (see Focus Box: International agricultural commodity prices - high and volatile) as the evolution of such prices are likely to have a strong impact on domestic inflation. In fact, the weights of food and beverages in Timor-Leste's consumer price index (CPI) imply that approximately 60% of total household expenditures are spent on food, and a large proportion of this is imported.

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<sup>8</sup> FAO Cereal Supply and Demand Brief, September 2012; FAO Food Outlook, May 2012.

<sup>9</sup> USDA World Agricultural Supply and Demand Estimates, September 12, 2012.

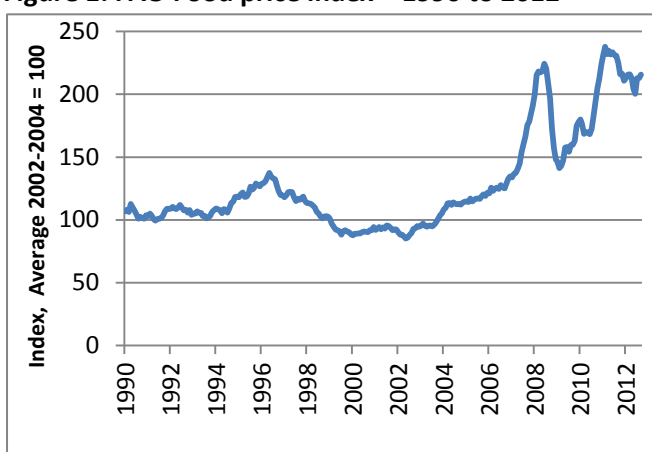
## Focus Box: International agricultural commodity prices - high and volatile

### Trend

In recent years, food price volatility has increased considerably. After the 2007-08 food crisis which led to dramatic food inflation, food insecurity and consequentially civil disorder in several emerging and low income countries, food prices fell sharply during the second half of 2008 and the first months of 2009 (Figure 1). Prices then regained and surpassed their 2008 peak level during most of 2011 before gradually decreasing once again below the 2008 level. In July 2012, however, there was a 6.2% increase in the FAO food price index, which raised the possibility of a new food price crisis. At the time of writing, this seems to have been averted, but caution is warranted given uncertainties about supply and demand dynamics in the short-run.

For the medium-term outlook, reports indicate that volatility is expected to continue in future years, affecting producers and consumers, but also governments which need to ensure policies are developed to counteract the negative effects.

Figure 1: FAO Food price index – 1990 to 2012



Sources: National Directorate of Economic Policy, Ministry of Finance and Food and Agriculture Organisation of the United Nations (FAO) 2012

### Causes

High and volatile prices result traditionally from disequilibria in specific market fundamentals, i.e. disruptions in the supply and/or demand of agricultural produce. The most common factors affecting supply are weather events (droughts, floods, hurricanes, etc.), the presence and spread of pests and/or diseases, and low stocks reinforcing the inelasticity of supply of agricultural commodities in the short-term. Demand-side factors mostly relate to population growth and rising incomes in emerging and developing countries, which result in increased demand for agricultural goods. Recently, however, additional factors have been reinforcing volatility in agricultural commodity prices and are therefore worth considering in light of both the current increase in prices and longer-term prospects. These include, amongst others, climate change related shocks (which amplify the frequency and force of floods

and droughts), increasing association between agricultural commodity prices and energy prices, and financial speculation. Agricultural commodity prices were traditionally linked to energy prices via the impact of oil prices on agricultural inputs (fertilisers) and on transport costs. Today this link is being reinforced by increased use of agricultural produce to provide biofuel alternatives to petrol. Regarding financial speculation, it is increasingly being cited as a 'new' cause of increased price volatility, although evidence remains inconclusive. What used to be a mechanism for commercial traders (i.e. farmers, processors, traders) to hedge against future risk of price changes and to obtain liquidity has been transformed into a vast market used by financial speculators and hedge and pension funds to diversify their investments and increase their returns. This flow of trade from financial investors is thought to have led to disturbances in the derivatives markets for agricultural commodities and thus to increased movements in prices, notably in the short-term.

### Recommendations

When reacting to volatility in agricultural commodity prices, both short-term and long-term actions should be considered. In the short-term, careful and continuous monitoring<sup>10</sup> and proactive preparation for the possible implementation of safety nets for consumers and producers are advised. Moreover, and on a more general/international level, subsidies for biofuels should be reduced, better international trade policy coordination should be ensured (e.g. to avoid the negative effects of export restrictions from main exporting countries), and greater transparency and possibly regulatory improvements should be implemented with respect to futures markets.

In the longer term it is essential, particularly for food-importing developing countries such as Timor-Leste, to assist local farmers in increasing domestic production so as to reduce dependency on imported foods. This can be done by implementing fundamental regulatory reforms (e.g. land reforms), investing directly in the agricultural sector (e.g. irrigation schemes; education and training; insurance schemes; research and development; input subsidies – use of improved seeds, fertilisers, pesticides/fungicides), investing in sectors that affect the agricultural value chain (e.g. infrastructures that reduce bottlenecks – rural and urban roads, bridges).

<sup>10</sup> In recognition of this the G20 launched in June 2011 the Agricultural Market Information System (AMIS) aimed at forecasting market outlooks for key agricultural commodities.

## 2.3.2: Domestic Economy

In May 2012, the 2004-2010 National Accounts were published<sup>11</sup>. This section provides information based primarily on this publication. Further preliminary data were used to provide estimates for 2011<sup>12</sup>.

### 2.3.2.1: Gross Domestic Product (GDP)

The economy of Timor-Leste is very reliant on the petroleum sector. Table 2.3.2.1.1 shows that almost 80% of Gross Domestic Product (GDP) originates from the petroleum sector.

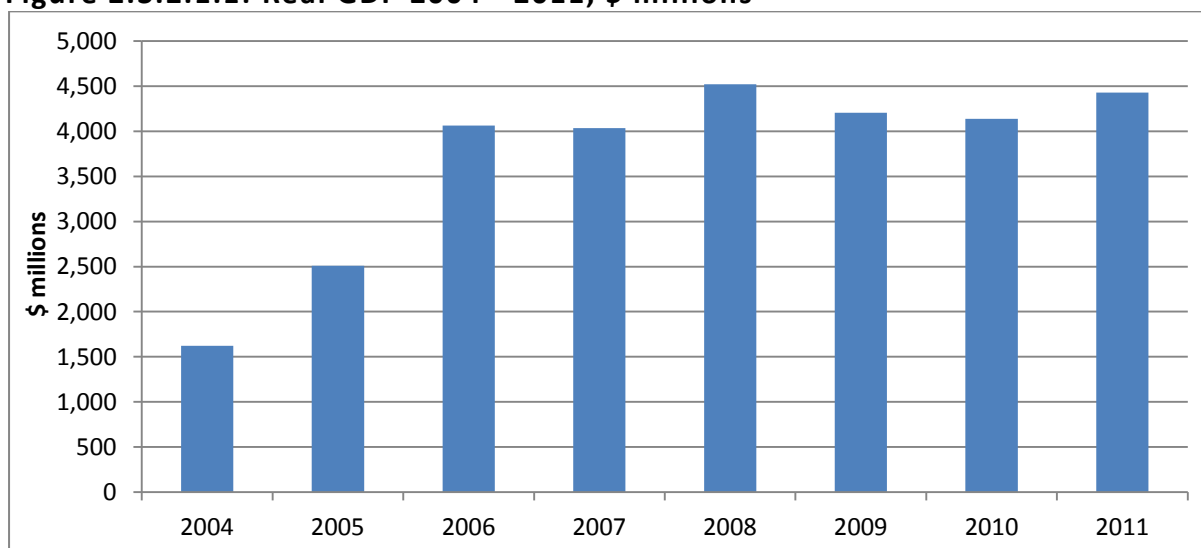
**Table 2.3.2.1.1: Real GDP by Sector, Timor-Leste 2011**

	GDP, \$ millions	Percent of Whole
<b>Whole Economy</b>	<b>4,430.6</b>	<b>100.0%</b>
Petroleum Sector	3,478.4	78.5%
Non-petroleum Sector	952.2	21.5%

Sources: National Directorate of Economic Policy and Statistics Directorate, Ministry of Finance 2012

Between 2004 and 2011, GDP increased substantially, reaching more than \$4,400 million in 2011. In 2011 GDP was over 2.7 times the 2004 GDP level. However, between 2004 and 2011 GDP peaked in 2008 (at around \$4,500 million). Real GDP subsequently declined in 2009 and 2010, and, although it increased by 7.0% in 2011, it remains below 2008 levels (Figure 2.3.2.1.1). Given the weight of the petroleum sector in GDP mentioned above, and the dynamics governing the revenues from this sector (see section 2.4.2.), this evolution is not surprising, and justifies focusing on the non-oil sector of GDP when considering the development of the Timorese economy.

**Figure 2.3.2.1.1: Real GDP 2004 - 2011, \$ millions**



Sources: National Directorate of Economic Policy and Statistics Directorate, Ministry of Finance 2012

Notes: 2011 preliminary estimate

<sup>11</sup> National Directorate of Statistics (DNE), 2012

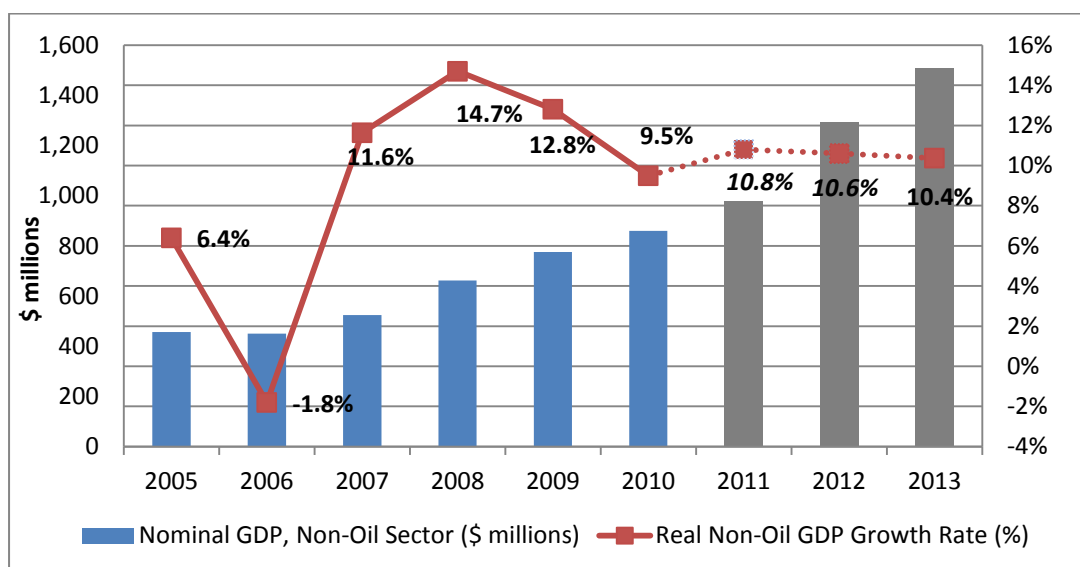
<sup>12</sup> The preliminary data were obtained using the Expenditure Approach to measuring GDP. For this reason, sector/category specific decompositions are not yet available for 2011. As a result, the sector/category decompositions described in section 2.3.2.2 are limited to the 2004-2010 time horizon and are based on the GDP from production side (GDP-P) data (DNE, 2012).

### 2.3.2.2: Non-Oil Economy

Figure 2.3.2.2.1 illustrates the evolution of actual GDP in the non-petroleum sector from 2005 to 2010, preliminary estimates for 2011 and the targets for 2012 – 2013. Since the 2006 crisis, the country has benefitted from strong economic growth, averaging 11.9% per year up to 2011. The latest actual data available reveal that non-oil GDP reached \$859.1 million in 2010, having grown 9.5% in real terms since 2009.

Preliminary estimates for 2011 indicate that real GDP in the non-oil sector increased by 10.8%. This increase reflects very strong growth in construction activity during the year, spurred mostly by the execution of Government-financed projects. Although representing less than 10% of the non-oil economy (see Figure 2.3.2.2.2. for 2010 data), growth in this sector more than outweighed the relative decline in the dominant agricultural sector, which has been falling, in real terms, for two consecutive years. 2012 should offer brighter prospects for agriculture, as production of both rice and maize (the main staple crops in Timor-Leste) has recovered from the dramatic decrease seen in 2011, and should, between them, exceed domestic consumption.

**Figure 2.3.2.2.1: GDP, Non-Oil Sector 2005 – 2013**



Sources: National Directorate of Economic Policy and Statistics Directorate, Ministry of Finance 2012  
 Notes: 2011 preliminary estimate; 2012-2013 targets

Within the non-oil economy, a further sub-classification comprising three broad sectors, namely the primary, secondary and tertiary sectors is presented in Table 2.3.2.2.1. The primary sector, includes activities related to the goods obtained from the earth (e.g. subsistence and commercial agriculture, forestry, fishing, mining and quarrying), the secondary sector includes construction activities and the production of manufactured goods, and the tertiary sector is composed of the service industry (including private and public sector services).

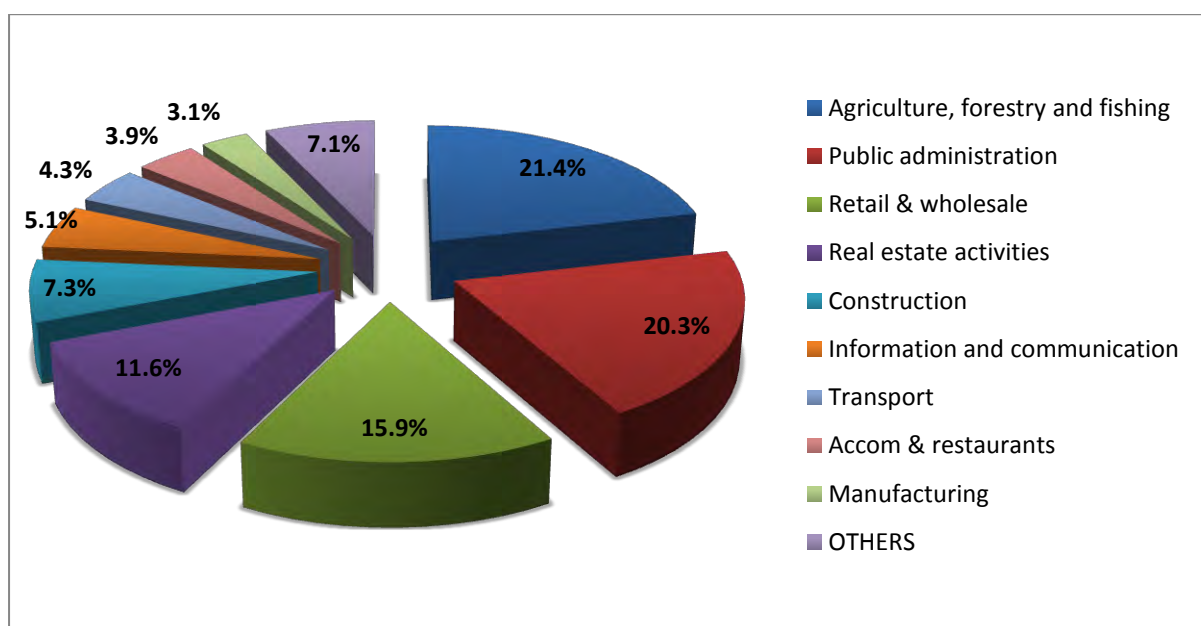
**Table 2.3.2.2.1: Real GDP, Sector Shares in Non-Oil Economy (%)**

	2004	2005	2006	2007	2008	2009	2010
<b>Real Non-oil GDP</b>	<b>100.0%</b>	<b>99.9%</b>	<b>99.9%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>
Primary	29.3%	28.7%	30.7%	26.8%	25.1%	24.2%	21.6%
Secondary	9.9%	10.8%	8.8%	9.3%	10.1%	10.2%	10.4%
Tertiary	59.6%	58.8%	59.9%	64.0%	66.1%	66.4%	68.4%
Plus Taxes less Subsidies on Products	1.2%	1.6%	0.5%	-0.1%	-1.3%	-0.8%	-0.4%

Sources: National Directorate of Economic Policy and Statistics Directorate, Ministry of Finance 2012

This table shows that the primary sector has declined during the past seven years which data are available for, to the benefit of the secondary and tertiary sector. In particular, the share of the primary sector has decreased by over 8 percentage points. Most of this decrease was captured by the tertiary sector: this sector's share increased by 7.7 percentage points between 2004 and 2010, reaching over 68% of the total in 2010. The importance of this is that a thriving service sector is seen as an important goal within the Timor-Leste Strategic Development Plan (SDP)<sup>13</sup>. Finally, the secondary sector, which in Timor-Leste is particularly small because of the current lack of industrial activity, remains small up to 2010: its share has increased by less than half a percentage point during this period, and remains slightly over 10%.

**Figure 2.3.2.2.2: 2010 GDP, Non-Oil sector by Category (%)**



Sources: National Directorate of Economic Policy and Statistics Directorate, Ministry of Finance 2012

Regarding the contribution of the main categories of 2010 non-oil economy; the agriculture, forestry, and fishing sector, public administration sector, and retail and wholesale sector

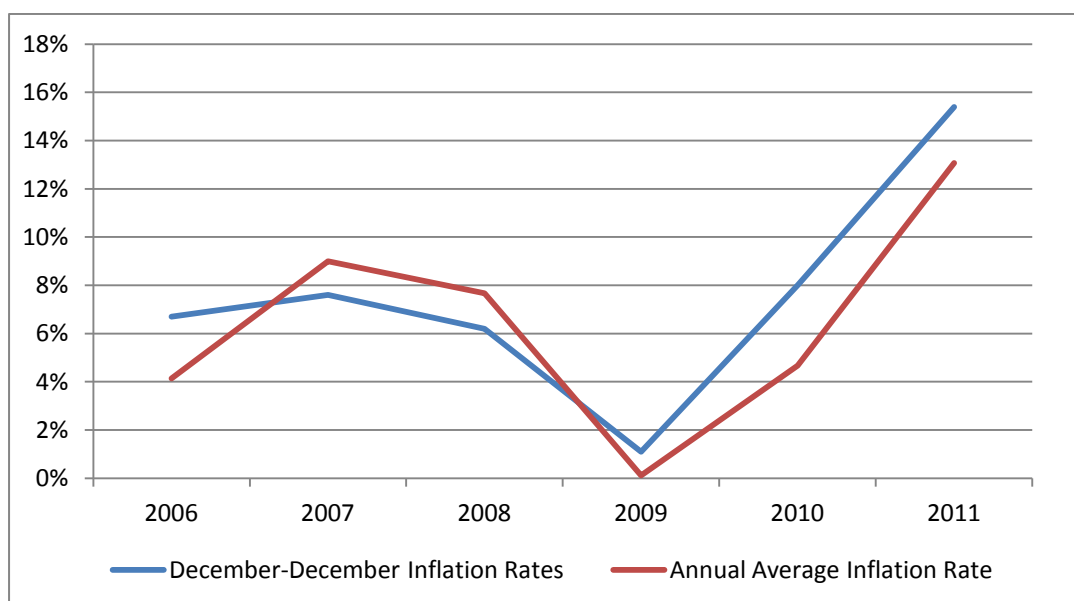
<sup>13</sup> SDP – Timor-Leste Strategic Development Plan, Government of Timor-Leste, 2011

were the major contributors, with respective shares of 21.4%, 20.3%, and 15.9% (Figure 2.3.2.2.2).

### 2.3.2.3: Domestic Inflation

In Timor-Leste, inflation is measured by the consumer price index (CPI), which is a measure of the cost of goods and services purchased by the average Timorese consumer. The National Directorate of Statistics (DNE) collects the prices of these goods on a monthly basis for Dili and on a quarterly basis for Timor-Leste<sup>14</sup>. This is shown for Timor-Leste since 2006 in Figure 2.3.2.3.1.

**Figure 2.3.2.3.1: Change in Consumer Price Index Timor-Leste 2006-2011 (%)**



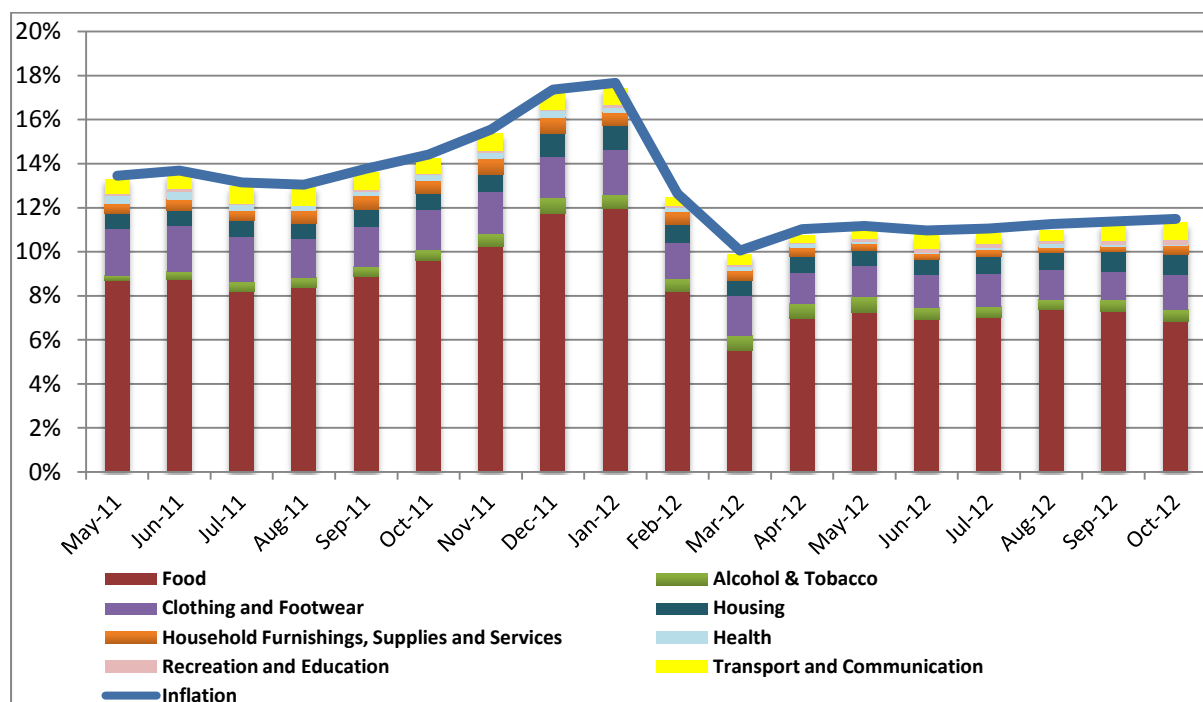
Sources: National Directorate of Economic Policy and Statistics Directorate, Ministry of Finance 2012

Year-on-year inflation in Dili peaked in January 2012 at 17.7%; it then fell to 10.0% in March, the lowest rate since January 2011, and has since stabilised around 11%. In October 2012 Dili CPI was 11.5% higher than October 2011. A similar trend can be observed for Timor-Leste's quarterly inflation index. Year-on-year inflation peaked at 15.4% in December 2011 and dropped to 11.0% at the end of Q3 2012.

Movements in the CPI for both Dili and Timor-Leste as a whole are in line with movements in prices of food and beverages, as this category alone makes up approximately 60% of the CPI basket weight, as shown in Figure 2.3.2.3.2. Increasing domestic food production and reducing supply bottlenecks (easier access to markets) and improving the agricultural value chain would help reducing reliance on specific imported goods, and, by fostering domestic supply, ease inflationary pressures on foods.

<sup>14</sup> Up to 2008 data for Timor-Leste was also reported monthly, but have been thereafter quarterly. This explains the relative smoothness of the graph after this year.

**Figure 2.3.2.3.2: Change in CPI Díli Year-on-Year by Category (%), May 2011 to October 2012**



Sources: National Directorate of Economic Policy and Statistics Directorate, Ministry of Finance 2012

The main drivers of inflation have been the depreciation of the US\$ with respect to Timor-Leste’s main trading partners’ currencies, the increase in commodity prices (in particular of foods) and increased domestic demand driven by government expenditure.

### 2.3.2.4: Employment

A recent publication provides a valuable description of the employment structure in the economy. The 2010 Labour Force Survey (LFS) indicates that at the time the survey was conducted the labour force comprised 262,000 individuals, of which 252,000 were employed and about 9,000 were unemployed. Amongst the employed, 27.9% were urban and the remaining 72.1% were rural workers, and 68.2% of total employed were males. These data suggest that the official unemployment rate in Timor-Leste was below 4%. However, according to the LFS a very significant portion of the population (58.3% of those over the age of 15) were found to be inactive, that is they were neither employed nor unemployed.

These figures indicate that Timor-Leste’s population remains very strongly orientated towards agricultural work and the weight of female labour remains extremely low. Moreover, the high rate of inactivity in the population, which mostly reflects the high number of students in the country, suggests that the labour force is likely to increase significantly in future years. This means that a high number of jobs will have to be created in order to avoid an increase in the unemployment rate.

### 2.3.3: Short to Medium-Term Prospects (2012-2017)

**Table 2.3.3.1: Economic Targets and Forecasts 2012-2017**

	2012	2013	2014	2015	2016	2017
Real Economic Growth, Non-Oil Sector (%)	10.6%	10.4%	10.2%	11.5%	12.1%	12.8%
Inflation (rolling year, %)	11.7%	7.6%	7.7%	7.7%	7.7%	7.7%
Domestic Revenues (\$ millions)	134.1	146.3	162.9	181.5	200.1	218.4

Sources: National Directorate of Economic Policy and Statistics Directorate, Ministry of Finance 2012

Strong, double-digit economic growth is targeted for the medium run (Table 2.3.3.1). These rates of growth reflect the effort of the Government to invest in capital formation; the backbone of medium to long-term economic activity in the country. This involves needed investments in physical capital, in particular via the infrastructure fund, but also in human capital, since a healthy and well educated population is paramount for the long term development of Timor-Leste.

Most of the projects financed through the infrastructure fund are multi-year projects. The bulk effect of these investments on the economy will thus only appear once the projects have been completed and economic agents will be able to make use of these investments.

The effects of the Government's human capital investment initiatives, reflected for instance in a strong HCDF budget and in increases in salaries and wages for health professionals and for professionals in higher education benefitting from the new career regime, are also likely to be mirrored in economic growth only in the medium to longer term.

In parallel, the Government aims at developing key non-petroleum economic sectors, such as tourism and agriculture, which will both benefit from the above-mentioned investments but also from specific ongoing additional projects, notably from particular projects of the PDD1 and PDD2, and the newly established PDID.

These are the main and driving factors behind the above 12% targeted rates of real economic growth from 2016 onwards.

Very high rates of real economic growth in the second half of this decade also reflect the Government's efforts and determination to reduce inflation in the medium term to rates below 8%. These rates of inflation are recognised as being above the 4-6% target range set in the SDP, but are considered realistic given the context of strong economic activity. Rates of inflation within the 4-6% target range are to be attained and maintained in the second decade of the SDP.

Domestic Revenue projections are discussed in section 2.5.2.

## 2.4: Expenditure and Development Partners' Commitments

### 2.4.1 Expenditures by Fund

The next table shows expenditure by fund in millions of US\$. CFTL, the Infrastructure Fund and HCDF account for 55.8%, 41.9% and 2.4% of total Government expenditure respectively in 2013. Expenditure in the Infrastructure Fund has fallen in 2013 as the Government aims to maintain fiscal sustainability and ensure existing projects are implemented effectively. CFTL fund expenditure has increased due to higher spending on the social sectors and the need to maintain and run the recently constructed electricity generation infrastructure.

**Table 2.4.1.1 Expenditure by Fund, \$ millions**

	2011 actual	2012 budget *	2013 budget**	2014 budget	2015 budget	2016 budget	2017 budget
<b>Combined Sources Budget</b>	<b>1,379.8</b>	<b>2,028.3</b>	<b>1,997.9</b>	<b>2,088.9</b>	<b>2,080.0</b>	<b>2,017.1</b>	<b>2,052.6</b>
<i>Government Expenditures by Fund</i>	1,095.9	1,806.5	1,797.5	1,950.5	2,047.4	2,014.0	2,052.6
CFTL	604.7	893.9	1,002.2	1,042.3	1,084.0	1,127.3	1,172.4
HCDF	16.8	37.5	42.4	40.0	45.0	45.0	49.0
Infrastructure Fund	474.4	875.1	752.9	868.2	918.4	841.7	831.2
<i>Development Partner Commitments</i>	283.9	221.8	200.4	138.4	32.6	3.1	0.0

\* Final 2012 Budget after rectification and rollover

\*\* After rollover

Sources: National Directorate of Budget and Development Partnership Management Unit, Ministry of Finance, 2012

### 2.4.2 CFET / CFTL Expenditures

The CFTL fund is the core fund of the Government of Timor-Leste. Ministries' budgets are included in this fund and expenditures are made against all five appropriation categories. The next table shows expenditure by appropriation category in the CFTL fund. The main point to note with regards to this table are that Salaries and Wages and Goods and Services have significantly increased by 15.3% and 20.8% respectively between 2012 and 2013, while Transfers have risen more modestly, by 1.2%.

**Table 2.4.2.1: CFTL Expenditure by Appropriation Category, \$ millions**

	2011 budget	2012 budget*	2013 budget**	2014 budget	2015 budget	2016 budget	2017 budget
<b>Total CFTL Expenditure</b>	<b>604.7</b>	<b>893.9</b>	<b>1,002.2</b>	<b>1,042.3</b>	<b>1,084.0</b>	<b>1,127.3</b>	<b>1,172.4</b>
<i>Recurrent</i>	491.0	719.9	816.0	848.7	882.6	917.9	954.6
Salary and Wages	111.6	139.0	160.3	166.7	173.3	180.3	187.5
Goods and Services	236.7	347.1	419.3	436.1	453.5	471.7	490.5
Public Transfers	142.6	233.7	236.5	245.9	255.8	266.0	276.6
<i>Capital</i>	113.8	174.0	186.2	193.6	201.4	209.4	217.8
Minor Capital	27.2	49.2	47.2	49.0	51.0	53.0	55.2
Capital and Development	86.6	124.8	139.0	144.6	150.4	156.4	162.6

\* Final 2012 Budget after rectification and rollover

\*\* After rollover

Source: National Directorate of Budget, Ministry of Finance, 2012

The next five sections discuss new measures and expenditures for Salaries and Wages, Goods and Services, Public Transfers, Minor Capital and Capital and Development in detail.

### 2.4.2.1: Salaries and Wages

Increased Salaries and Wages expenditure, to \$160.3 million, is in line with the Government's policy of creating an effective civil service and improving the qualifications, professionalism and services provided by staff in key sectors such as security, higher education and health. The main policies which have increased expenditure on Salaries and Wages in 2013, compared to 2012, include:

- Increasing the Salaries and Wages budget for the Ministry of Health to \$21.1 million, mainly due to the new career regime for health professionals. This regime will increase the pay of health professionals with appropriate qualifications, motivating them to work in a conscientious, efficient and effective manner. In addition, the Government will be able to employ and adequately compensate recently qualified health professionals returning from Cuba. Better qualified and more motivated staff should improve the quality of healthcare in Timor-Leste over the long term.
- The payment of teaching staff who previously worked on a voluntary basis in the Ministry of Education at a cost of approximately \$10 million.
- An increase in UNTL's budget for Salaries and Wages to \$7.6 million due to the new career regime for professionals in higher education. This regime will lead to more competitive and fairer salaries for employees in the higher education sector. It should also motivate staff to improve their qualifications and allow the recruitment of more qualified staff. In the long term this regime should also contribute to better quality higher education, a goal which is emphasised in the SDP and Programme of the Fifth Constitutional Government of Timor-Leste.

- An increase in PNTL's salaries and wages budget to \$13.6 million. This increase is associated with the employment of more policemen and policewomen to further improve security.
- An increase in FFDTL's Salaries and Wages budget to \$7.9 million; this increase is associated with the recruitment of new soldiers to increase the capability of the defence forces.
- An increase in allowances to \$9.1 million in the Ministry of Foreign Affairs associated with the establishment of embassies in the United Kingdom of Great Britain and Northern Ireland and New Zealand, and consulates in Darwin and Atambua.

#### **2.4.2.2: Goods and Services**

The budget for this category is \$419.3 million. The main new measures in this area include:

- \$117.8 million to pay for fuel for generators in EDTL. The Government believes that this budget is necessary to pay for the increase in fuel required as EDTL generates more electricity. The increase in generation capacity is due to the completion of the Hera power plant, and the expected completion of the Betano power plant in February 2013.
- The Goods and Services budget of the Ministry of Public Works has been increased by \$10.0 million to pay for the operation and maintenance of the Hera power plant. This budget should help ensure that Hera continues to run efficiently and effectively in the long term.
- \$7.0 million for the purchase of medicines and drugs in the Ministry of Health. The Government considers that this budget will contribute to better healthcare and outcomes in Timor-Leste.
- \$3.0 million in Agriculture for the purchase of seeds. This budget should lead to an increase in the volume and value of production in the agriculture sector in future years, contributing to food security and reducing under-nutrition.

#### **2.4.2.3: Public Transfers**

The total budget for public transfers in 2013 is \$236.5 million. The main measures in this area include:

- \$84.8 million in the National Directorate for Veterans and Liberation Issues in the Ministry of Social Solidarity to pay personal benefits for war veterans.
- \$38.2 million to be used to pay benefits of \$30 a month to those over 60 years of age and those who have a proven disability which prevents them from working.

- \$18.0 million in the Prime Minister’s office principally to support international and local NGOs and religious organisations. These bodies make an important contribution to Timor-Leste’s culture, spiritual well-being and development.
- \$10.5 million for the cash for work programme in SEFOPE. This programme contributes to the reduction of unemployment.
- \$8.0 million in the Ministry of State Administration to pay for the new PNDS programme to assist villages. This programme should boost local development.
- \$3.7 million to pay the pensions of those in the public service. This amount is based on a detailed costing of pensions which was based on the provisions of the recently approved law.
- \$3.0 million for land compensation and \$5.0 million for the “Ita nia rai/your land” programme in the Ministry of Justice.

#### **2.4.2.4: Minor Capital**

\$47.2 million has been allocated for minor capital in 2013. This represents a decrease of 4.1% compared to 2012. This is in line with the Government’s policy of carefully controlling growth in expenditure for this appropriation category. New measures affecting minor capital include:

- \$5.0 million for the purchase of medical equipment in the Ministry of Health. This budget includes money to purchase operation theatre lights and tables, ECGs (electronic heart monitoring machines), anaesthetic machines, a defibrillator and other medical equipment. This spending should improve the ability of the health service to diagnose and treat diseases, especially non-communicable conditions.
- \$5.0 million for purchasing equipment for the electricity metering system in the Ministry of Public Works.
- \$3.0 million for the purchase of water and sanitation equipment in the Ministry of Public Works.
- \$1.3 million for the purchase of furniture in PNTL and FDTL. This budget is necessary to furnish 300 houses that are used as living quarters for soldiers and the police.
- \$1.2 million for the purchase of vehicles and equipment to improve safety and efficiency at airports. This expenditure includes the purchase of a fire engine for the airport.

#### **2.4.2.5: Capital and Development**

The next table shows CFTL Capital and Development expenditures. The majority of expenditure is on district development programmes. These programmes build on the success of previous district development projects by continuing to finance the development

of small scale infrastructure according to the needs of local communities. Roads, education facilities, health facilities, water supply and sanitation and irrigation systems will be constructed under these programmes. Projects in these programmes are tendered to Timorese owned construction companies; boosting local development and keeping profits within Timor-Leste. These programmes also provide employment opportunities to many Timorese workers and are contributing to development, economic growth and poverty reduction in all districts throughout Timor-Leste.

**Table 2.4.2.5.1 PDID and Other CFTL Capital and Development Expenditures, \$ millions**

	2011 budget	2012 budget*	2013 budget**	2014 budget	2015 budget	2016 budget	2017 budget
PDD1 Sub-district, Suco and Aldeia (re-appropriation)	15.8	34.4	18.8	N/A	N/A	N/A	N/A
PDD2 District (re-appropriation)	26.6	30.1	6.3	N/A	N/A	N/A	N/A
PDID Program (from 2013 on)	N/A	N/A	68.2	97.0	100.9	104.9	109.1
Ministries / Agencies	44.1	60.3	45.7	47.5	49.5	51.4	53.5
<b>Total Capital and Development</b>	<b>86.6</b>	<b>124.8</b>	<b>139.0</b>	<b>144.6</b>	<b>150.4</b>	<b>156.4</b>	<b>162.6</b>

\* Final 2012 Budget after rectification and rollover

\*\* After rollover

Source: National Directorate of Budget, Ministry of Finance, 2012

The Government is committed to a fair and transparent distribution of PDID, PDD1 and PDD2 projects in districts throughout Timor-Leste. In this regard, meetings are organised with Suco chiefs, citizens and community leaders to identify the demand for different projects. These projects are then collated and reviewed by the Ministry of State Administration to ensure that spending on these programme is in line with fiscal sustainability. The Ministry of State Administration also determines the distribution of the PDID, PDD1 and PDD2 budget between different districts using a formula that partly depends on population per district. The Budget Review Committee makes the final decision regarding the inclusion of projects in the State Budget proposed to Parliament. The Government is committed to transparently and clearly showing expenditure in different districts. Budget Book 3 shows total spending and spending per capita for PDID and ongoing PDD1 and PDD2 projects in each district.

CFTL capital and development expenditure continues to be relatively small. This matches with the Government's policy of mainly constructing new infrastructure through large multi-year projects which are included in the Infrastructure Fund.

### **2.4.3: Infrastructure Fund**

Infrastructure matters. Roads, reliable electricity supply and telecommunications systems are necessary to develop and support a modern, productive economy. Timor-Leste's current infrastructure is inadequate and may be constraining private sector growth. The

Government is committed to improving this situation by building the core infrastructure necessary for high levels of economic growth. In order to construct these facilities, the Government established the Infrastructure Fund in 2011. The Major Projects Secretariat (MPS), the National Procurement Commission (NPC) and National Development Agency (ADN) were also established to evaluate, procure and monitor projects in the Fund.

Table 2.4.3.1 shows the distribution of the Infrastructure Fund budget by programme. Column B shows the 2012 final budget, after rollover and rectification. The Government's current forecast of actual end of year 2012 expenditure is then shown in column C. The rollover from 2012 to 2013 is displayed in column D. The rollover is calculated based as the final budget minus forecasted end of year expenditure. The additional amount being appropriated in 2013 is then shown in column E. The 2013 final budget for each programme is shown in column F and is equal to the rollover from 2012 to 2013 (column D) plus the new appropriation (column E).

Every effort has been made to forecast end of year expenditure accurately. The Ministry of Finance forecasted end of year expenditure separately for each project based on a detailed review of its stage in the procurement cycle and if applicable a review of relevant contracts and an evaluation of when payments to contractors were likely to fall due. Programmes may, however, under- or overspend due to factors which are impossible to forecast and which are outside of the Government's control. The Government may, for example, predict that a section of a road will be completed in November; with payment to a contractor falling due in December. Higher than normal rains in October and November may delay construction and mean the contractor is no longer entitled to payment in December. This in turn would result in the forecast being higher than actual expenditure.

The rolling over of the Infrastructure Fund's unspent balance is in accordance with international best practice and the Government's policies. For many large Infrastructure Fund projects multi-year contracts are signed between the Government and private sector contractors. These contracts normally specify multiple payments; with each payment depending on a component of the construction/project being finished. Delays in construction due to weather conditions or other events beyond the Government's control can cause payments to be delayed. This can result in the budget for one year not being fully utilised because it initially covered payments which have now been delayed to the next financial year. The Government, by rolling over the Infrastructure Fund's budget for each project, is ensuring that money to pay contractors on multi-year projects is effectively ring-fenced. This simplifies budgeting because projects' budgets do not have to be calculated from scratch each year. It can also increase execution because the budget after rollover should be large enough to cover payments which may become due. By securing budgets over many years, this system also provides a degree of security to contractors and reduces their perceptions of the risk of non-payment. Companies are often prepared to accept lower profit margins on projects where they consider that the risk of not being paid for work is

low. In the long term rolling over the Infrastructure Fund's budget may then contribute to lower procurement costs and more efficient expenditure.

Table 2.4.3.1 also shows the distribution of Infrastructure Fund expenditure across different programmes. The largest three programmes in terms of budgeted expenditure are Electricity, the Tasi Mane project and Roads which account for 23.1%, 18.5% and 15.4% of total expenditure respectively. This distribution of expenditure is in line with the Government's policies with the SDP and programme of Government strongly emphasising the importance of these sectors to the development of Timor-Leste.

### 2.4.3.1 Infrastructure Fund Expenditures by Program, \$ millions

A. Infrastructure Project	B. 2012 Budget after Virements and Rollover	C. 2012 F'casted Actual	D. Rollover 2012 to 2013 (=B-C)	E. 2013 Additional App'tions	F. Final 2013 Budget (=D+E)	G. 2014 Budget	H. 2015 Budget	I. 2016 Budget	J.2017 Budget
Agriculture and Fisheries	9.2	3.5	5.8	4.2	10.0	26.9	37.0	20.7	10.0
Water and Sanitation	13.5	4.9	8.6	2.8	11.4	13.2	27.0	35.0	37.0
Urban and Rural Development	7.1	0.0	7.1	0.5	7.6	5.0	1.0	0.0	0.0
Electricity	301.8	291.8	10.0	163.9	173.9	91.5	89.0	49.0	39.0
Roads	114.4	45.9	68.5	47.5	116.0	166.8	115.2	85.6	45.9
Bridges	31.1	17.3	13.8	6.5	20.3	13.0	7.2	2.0	2.0
Airports	9.5	0.0	9.5	0.0	9.5	26.0	24.0	20.0	20.0
Ports	10.7	0.7	10.0	1.0	11.0	21.8	29.0	35.0	50.0
Information Technology	12.0	6.2	5.8	4.7	10.5	7.2	5.5	0.0	0.0
Public Buildings	49.9	13.0	36.9	12.1	49.0	97.9	65.6	17.3	0.0
Education	11.3	1.4	9.9	2.5	12.4	18.6	22.0	20.0	0.0
Millennium Development Goals	117.5	14.0	103.5	-15.5	88.0	81.5	65.0	65.0	61.1
Health	6.4	4.1	2.3	0.3	2.7	3.4	3.0	0.0	0.0
Security and Defence	12.6	4.8	7.8	13.1	20.9	6.0	1.5	0.0	0.0
Social Solidarity	1.9	1.6	0.4	1.3	1.7	1.8	1.0	1.0	1.0
Tasi Mane Project	123.0	21.6	101.5	38.0	139.4	184.0	269.4	330.5	400.0
Preparation, Design and Supervision of New Projects	0.0	0.0	0.0	25.2	25.2	33.2	35.2	38.9	42.3
Loans Program	43.1	0.0	43.1	0.5	43.6	70.6	120.9	121.7	123.0
<b>Total Infrastructure (by Program)</b>	<b>875.1</b>	<b>430.8</b>	<b>444.4</b>	<b>308.5</b>	<b>752.9</b>	<b>868.2</b>	<b>918.4</b>	<b>841.7</b>	<b>831.2</b>

Source: National Directorate of Budget, Ministry of Finance, 2012

### 2.4.4: Human Capital Development Fund

Table 2.4.4.1 shows the Human Capital Development fund budget by programme. The rollover for each programme is clearly shown. The largest programme in the HCDF is Scholarships. This programme should significantly contribute to the development of human capital in Timor-Leste.

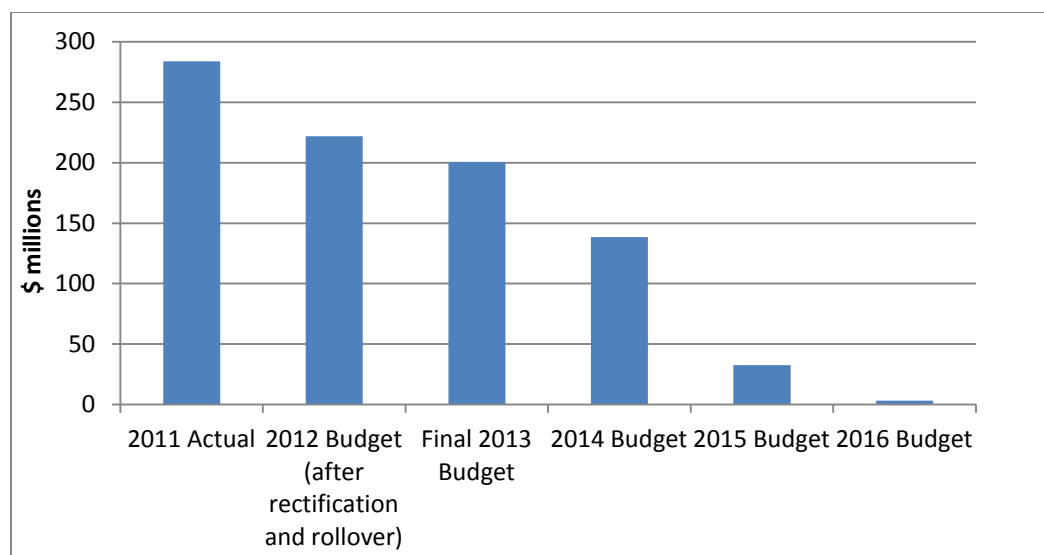
**Table 2.4.4.1 Human Capital Development Fund by Program, \$ millions**

	Rollover 2012 to 2013	2013 Additional App'tions	Final 2013 Budget	2014 Budget	2015 Budget	2016 Budget	2017 Budget
Vocational Training	0.6	4.3	4.8	0.0	0.0	0.0	0.0
Technical Training	0.0	3.1	3.1	0.0	0.0	0.0	0.0
Scholarships	6.4	16.9	23.3	11.9	11.2	9.5	9.5
Other Training	1.6	9.7	11.2	2.1	12.0	11.0	12.0
New allocations (HCDF)	0.0	0.0	0.0	26.1	21.8	24.5	27.5
<b>Total</b>	<b>8.5</b>	<b>33.9</b>	<b>42.4</b>	<b>40.0</b>	<b>45.0</b>	<b>45.0</b>	<b>49.0</b>

Source: National Directorate of Budget, Ministry of Finance, 2012

## 2.4.5 Development Partners

**Table 2.4.5.1: Development Partners' Commitments 2011-2016, \$ millions**



Source: Development Partnership Management Unit, Ministry of Finance, 2012

Development partners will provide a total of \$200.4 million in grants to Timor-Leste in 2013; representing 10.0% of the total Combined Sourced Budget. Book 5 outlines and discusses the details of these commitments. It should be noted that concessional loans are not included in these numbers.

## 2.4.6 Supporting Timor-Leste's Culture

The Government is committed to honouring and supporting the unique culture of Timor-Leste and the dignity of its people. For this reason the 2013 State Budget includes funding to support cultural and religious activities. Specific expenditures in this area include, but are not limited to:

- \$18.0 million in the Prime Minister's office to support international and local NGOs and religious organisations. These bodies make an important contribution to Timor-Leste's culture, spiritual well-being and development.
- Expenditures to support museums and cultural events in the Ministry of Tourism's budget.

## 2.5: Revenues

### 2.5.1: Overview of Revenue Projections

Table 2.5.1.1 shows total projected revenues for Timor-Leste up to 2017. The gradual trend of petroleum revenues declining is in general set to continue, with the exception of 2015. Domestic revenues, while still growing robustly, continue to make up a small proportion of overall revenues and thus do not completely offset the decline from petroleum. This leads to a picture of falling total revenues, which underlines the importance of focusing on domestic revenue streams going forward.

**Table 2.5.1.1 Total Revenue, 2011 – 2017, \$ millions**

	2011	2012	2013	2014	2015	2016	2017
	Actual	Estimate	Projection				
<b>Total Revenues</b>	<b>3,348.6</b>	<b>2,887.5</b>	<b>2,455.4</b>	<b>2,134.8</b>	<b>2,358.2</b>	<b>2,344.7</b>	<b>2,276.9</b>
Domestic Revenues	108.5	134.1	146.3	162.9	181.5	200.1	218.4
Petroleum Revenues	3,240.1	2,753.4	2,309.1	1,971.9	2,176.7	2,144.7	2,058.5

Source: National Directorate of Economic Policy and Petroleum Fund Administration Unit, Ministry of Finance, 2012

### 2.5.2: Domestic Revenues

#### 2.5.2.1: Overview

**Table 2.5.2.1.1: Domestic Revenue 2011 – 2017, \$ millions**

	2011	2012	2013	2014	2015	2016	2017
	Actual	Estimate	Projection				
<b>Total Domestic Revenue</b>	<b>108.5</b>	<b>134.1</b>	<b>146.3</b>	<b>162.9</b>	<b>181.5</b>	<b>200.1</b>	<b>218.4</b>
Direct Taxes	27.9	39.2	42.0	48.3	55.0	61.8	68.9
Indirect Tax	50.7	57.4	64.0	70.3	78.4	86.7	95.2
Other Tax Revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fees and Charges	11.6	12.7	14.5	15.0	15.6	16.3	16.9
Social Game Receipt	0.5	0.2	0.3	0.3	0.3	0.3	0.3
Rice Sales	1.0	5.0	2.5	2.6	2.7	2.8	2.9
Sales of Local Produce	0.0	0.2	0.3	0.4	0.4	0.4	0.4
Interest	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Auto Agencies	16.8	19.3	22.7	25.9	28.9	31.6	33.6

Source: National Directorate of Economic Policy, Ministry of Finance, 2012

Domestic Revenues are comprised primarily of taxes, fees and charges, other non-tax revenue streams (including the rice subsidy program) and the autonomous agencies. Table 2.5.2.1.1 shows the projected growth path for each of these categories, which are generally on the increase. Domestic revenues are set to increase by 9.2% in 2013 from the 2012 level.

## 2.5.2.2: Taxes

Table 2.5.2.2.1 shows revenue projections by category and tax type. Having sharply increased in 2012 to an estimated \$39.2 million, growth in direct taxes is projected to moderate its growth in 2013 to \$42.0 million before picking up again in outgoing years. These changes are largely due to the increased Government investment in the economy through capital expenditures. Building and construction contracts are subject to withholding tax and most of the growth in direct tax is due to this. However, with the budget for infrastructure decreasing in 2013, it is forecast that withholding tax will not grow by as much in that year, before resuming stronger growth in the following years. Income taxes are forecasted to continue increasing at a moderate rate, while corporate tax continues to grow faster as more private sector businesses open.

The projection for indirect taxes for 2013 is \$64.0 million, continuing the robust growth experienced in 2012 in outgoing years. This largely reflects the fact that, as a small developing island nation, Timor-Leste is very dependent on imports for domestic consumption and investment. Excise Tax and Import Duties are projected to make up over two-thirds of Indirect Taxes in 2013, as well as much of the growth going forward. Changes to tax policy, such as the introduction of a VAT could alter these projected paths in future years.

**Table 2.5.2.2.1: Total Tax Revenue 2011 – 2017, \$ millions**

	2011	2012	2013	2014	2015	2016	2017
	Actual	Estimate	Projections				
<b>Total Tax</b>	<b>78.6</b>	<b>96.6</b>	<b>106.0</b>	<b>118.6</b>	<b>133.4</b>	<b>148.6</b>	<b>164.1</b>
<b>Direct Taxes</b>	<b>27.9</b>	<b>39.2</b>	<b>42.0</b>	<b>48.3</b>	<b>55.0</b>	<b>61.8</b>	<b>68.9</b>
Income Tax	8.1	8.4	9.1	9.9	10.9	12.1	13.4
Individual Income	0.6	1.0	1.1	1.2	1.3	1.5	1.6
Individual Inc Other	7.4	7.3	8.0	8.7	9.6	10.6	11.8
Corporate Tax	4.2	6.5	7.6	9.0	10.3	11.6	13.0
Withholding Tax	15.6	24.3	25.3	29.4	33.8	38.2	42.5
<b>Indirect Taxes</b>	<b>50.7</b>	<b>57.4</b>	<b>64.0</b>	<b>70.3</b>	<b>78.4</b>	<b>86.7</b>	<b>95.2</b>
Service Tax	4.0	4.5	5.2	6.0	6.9	8.0	9.2
Sales Tax	8.2	15.4	15.9	18.6	21.2	23.9	26.5
Excise Tax	22.0	26.4	31.7	34.5	39.0	43.5	48.1
Import Duties	16.4	11.1	11.2	11.2	11.3	11.3	11.4
<b>Other Tax Revenue</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

Source: National Directorate of Economic Policy, Ministry of Finance, 2012

### 2.5.2.3: Fees and Charges

**Table 2.5.2.3.1: Fees and Charges Projections 2011 – 2017, \$ millions**

	2011	2012	2013	2014	2015	2016	2017
	Actual	Estimate	Projection				
<b>Total Fees and Charges</b>	<b>11.6</b>	<b>12.7</b>	<b>14.5</b>	<b>15.0</b>	<b>15.6</b>	<b>16.3</b>	<b>16.9</b>
Business Registration Fees	0.7	1.4	2.2	2.3	2.4	2.5	2.6
Postage Fees	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Property Rentals	2.8	2.9	2.9	3.1	3.2	3.3	3.4
Water Fees	0.1	0.0	0.0	0.0	0.0	0.0	0.0
National University Fees	0.6	0.7	0.7	0.7	0.8	0.8	0.8
Vehicle Registration Fees	1.2	0.7	0.7	0.7	0.7	0.8	0.8
Vehicle Inspection Fees	0.0	0.3	0.3	0.3	0.3	0.3	0.3
Vehicle Inspection Imported	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Drivers Licence Fees	0.0	0.1	0.1	0.2	0.2	0.2	0.2
Franchising Public Transport Fees	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Transport Penalties	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Other Transport Fees	0.0	0.0	0.0	0.0	0.0	0.0	0.0
ID and Passport	0.6	0.6	0.6	0.7	0.7	0.7	0.7
Visa Fees	1.2	1.0	1.0	1.0	1.1	1.1	1.1
Hospital and Medical Fees	0.1	0.3	0.3	0.3	0.3	0.3	0.3
Other Fees	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Court Fees	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Dividends, Profits, and Gains	2.5	3.6	4.3	4.5	4.6	4.8	5.0
Fines and Forfeits	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Mining and Quarrying	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Radio and Television Fees	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Bid Document Receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Auctions	0.1	0.3	0.4	0.5	0.5	0.5	0.5
Embassy Fees	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Illegal Logging Fines	0.1	0.1	0.2	0.2	0.2	0.2	0.2
Rental Government Property	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Investment Registration Fee	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Non-Tax Revenue	1.4	0.3	0.2	0.2	0.2	0.2	0.2

Source: National Directorate of Economic Policy, Ministry of Finance, 2012

Table 2.5.2.3.1 contains the projected income from User Fees and Charges, which are expected to increase from \$12.7 million in 2012 to reach \$14.5 million in 2013. Fees and Charges are the most changeable part of the revenue system, with several changes to its categories each year – such as the breakdown of fees regarding vehicles into several

categories in 2012, or new categories such as fines for illegal logging or rental of government properties. Therefore this section – and in particular its constituent parts – are subject to change in outgoing years based on new revenue streams or government policies.

#### 2.5.2.4: Other Revenue Streams

The other major revenue streams are Social Games Receipts, Rice Sales, Sale of Local Produce and Interest rates. Of these, Rice Sales are by far the largest and most variable, with future projections made difficult due to evolving Government policy, uncertainty regarding totals to be imported, totals to be sold at a subsidised level (as opposed to used in the school lunch programme) and future international rice prices. These projections are based on the Ministry of Commerce and Industry’s forecast purchases in 2013 and past prices of rice. Gradual increases forecast in outgoing years, though policy changes or fluctuations in rice and other food prices could alter these significantly.

The other revenue streams here have a much smaller impact on overall revenues, with Interest and Social Games revenue projected to remain low but steady in coming years. However, in terms of the Sales of Local produce, the Secretary of State of Food Security projects slightly faster increases in coming years, though this is again to some extent dependent on unknown variables such as international food prices.

#### 2.5.2.5: Autonomous Agencies

**Table 2.5.2.5.1: Autonomous Agencies 2011 – 2017, \$ millions**

	2011	2012	2013	2014	2015	2016	2017
	Actual	Estimate	Projection				
<b>Total Autonomous Agencies</b>	<b>16.8</b>	<b>19.3</b>	<b>22.7</b>	<b>25.9</b>	<b>28.9</b>	<b>31.6</b>	<b>33.6</b>
Equipment Management	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Aviation	1.3	1.3	1.4	1.5	1.5	1.6	1.6
Port	2.5	2.7	3.3	3.4	3.5	3.7	3.8
EDTL	12.4	14.9	17.9	20.9	23.7	26.2	28.0
SAMES	0.5	0.2	0.1	0.1	0.1	0.1	0.1

*Source: National Directorate of Economic Policy, Ministry of Finance, 2012*

Revenues from Autonomous Agencies (Equipment Management, Aviation, Port, EDTL and SAMES) are shown in Table 2.5.2.5.1., and are set to continue their steady growth path in coming years. Radical changes to infrastructure may change these revenue paths, as has already been seen in the case of EDTL’s receipts, which have increased significantly since the opening of the Hera power plant in 2011.

Indeed EDTL is by far the most significant contributor to this category, and is expected to see its revenues expand from \$14.9 million in 2012 to \$17.9 million in 2013. This is due to the increasing demand for electricity by businesses and domestic consumers, the continued

efforts to provide country-wide access to the grid and improvements in charging mechanisms.

Growth in Aviation revenue is projected to be steady, reaching \$1.4 million in 2013, though this could change depending on improvements to infrastructure or increased tourism.

Revenues from the port are projected at \$3.3 million in 2013, continuing a path of steady significant growth due to dependence on imports and large construction projects.

### 2.5.3: Petroleum Revenues and the Petroleum Fund

Petroleum revenues currently finance most of the state budget. The Petroleum Fund will contribute to a wise management of the petroleum resources for the benefit of both current and future generations.

#### 2.5.3.1 Inflows of Petroleum Revenues

The factors driving the inflow of petroleum revenues are prices, production and costs. Compared with the 2012 State Budget, the oil price in this material is assumed somewhat higher over the forecasting period, while there are only minor changes to production and cost. Petroleum revenues from Bayu-Undan and Kitan peaked in 2011 and are forecasted to decline to \$2,309.1 million in 2013 (excluding interest), before temporarily levelling off until 2017, as in Tables 2.5.3.1.1 and 2.5.3.1.2.

**Table 2.5.3.1.1 Estimated Petroleum Revenues 2011-2017, \$ millions**

	2011 Actual*	2012 Estimate**	2013 Budget	2014 Projection	2015 Projection	2016 Projection	2017 Projection
<b>Total Petroleum Revenue</b>	<b>3,461.4</b>	<b>2,961.3</b>	<b>2,796.8</b>	<b>2,586.2</b>	<b>2,868.8</b>	<b>2,922.9</b>	<b>2,932.8</b>
Petroleum Fund Interest received	221.2	207.8	487.7	614.3	692.1	778.3	874.3
<b>Total Petroleum Revenue Excluding Interest</b>	<b>3,240.1</b>	<b>2,753.4</b>	<b>2,309.1</b>	<b>1,971.9</b>	<b>2,176.7</b>	<b>2,144.7</b>	<b>2,058.5</b>
BU*** FTP/Royalties	202.6	170.5	154.4	147.5	153.9	147.4	141.3
BU Profit oil	1,692.6	1,388.3	1,137.8	969.6	1,138.2	1,166.3	1,112.9
BU Income Tax	574.5	410.3	395.6	418.9	405.9	374.6	366.9
BU Additional Profit Tax	569.4	450.8	395.6	326.6	440.3	423.9	409.9
BU Value Added Tax	15.6	13.1	13.4	12.9	9.4	9.9	10.2
BU Wages Tax	14.9	10.0	8.5	8.7	8.8	9.0	9.2
BU Pipeline Payments	8.0	8.2	8.2	8.2	8.2	8.2	8.2
BU Other Payments	100.2	50.8	31.7	9.6	0.0	0.0	0.0
BU Withholding Tax	17.5	0.0	0.0	0.0	0.0	0.0	0.0
Kitan	44.9	251.5	164.0	70.0	12.0	5.4	0.0

\* Actual Cash flow for 2011

\*\* Estimated 2012 as of July 2012. From 2012 onwards BU Withholding Tax is included in BU Value Added Tax.

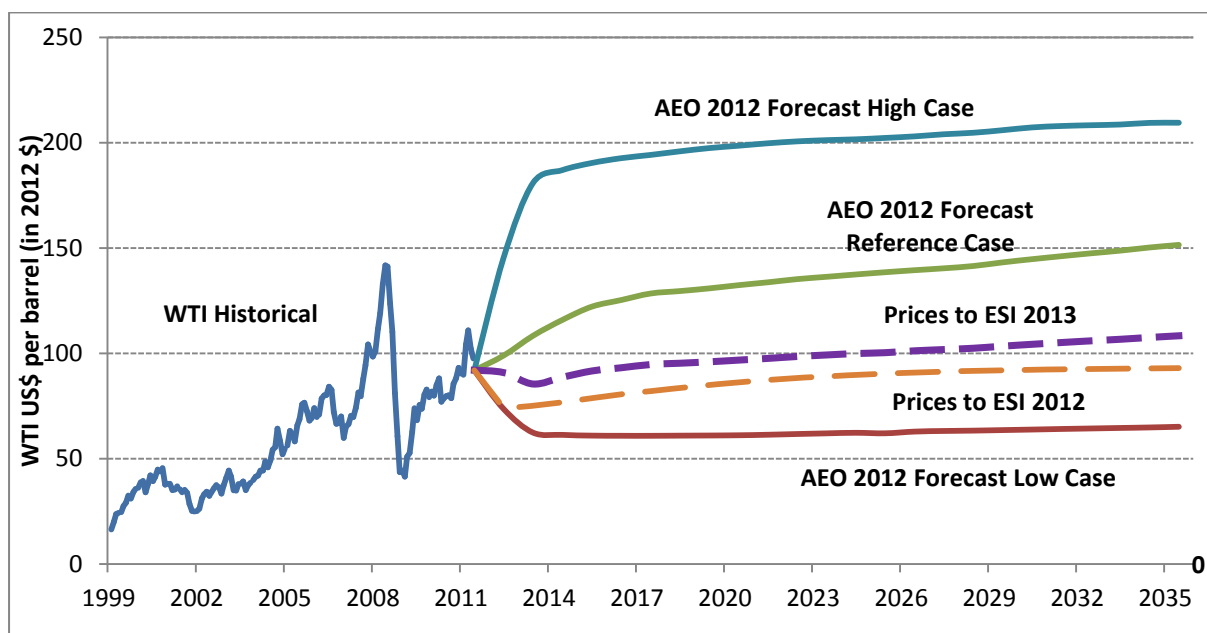
\*\*\* BU: Bayu Undan

Source: Petroleum Fund Administration Unit, Ministry of Finance, 2012

## Petroleum prices

The Petroleum Revenue forecasts are based on an average oil price (West Texas Intermediate - WTI) in 2012 of \$91 per barrel, compared with \$74 per barrel in the Budget 2012.<sup>15</sup> The average oil price is forecasted at \$87 and \$91 per barrel for 2013 and 2014, respectively, higher than previously expected. The average oil price over the expected remaining life of Bayu-Undan (and Kitan) is forecasted about 14% higher than in the Budget 2012. The oil price forecast is still prudent, as required by law, being lower than the most likely case of EIA<sup>16</sup> and WTI futures<sup>17</sup>, and significantly lower than EIA's high case, as in Figure 2.5.3.1.1.

**Figure 2.5.3.1.1 Historical Changes and Future Projections in the WTI Oil Price (\$ per barrel)**



Source: Petroleum Fund Administration Unit, Ministry of Finance, 2012

## Petroleum Production

The production forecast of liquids (condensate and LPG) for Bayu-Undan is similar to the one in the 2012 Budget. The total petroleum production from Bayu-Undan (also including LNG) is estimated to have peaked in 2011 and is now set to ebb off before ceasing in 2024, as in Table 2.5.3.1.2.

<sup>15</sup> The prices on Bayu-Undan and Kitan liquids products (condensate and LPG) are estimated based on historical relationships with the benchmark WTI. Liquefied Natural Gas (LNG) prices are forecasted using the provisional price formula negotiated between sellers and buyers. The price formula is renegotiated every three years.

<sup>16</sup> Energy Information Administration, [www.eia.gov](http://www.eia.gov)

<sup>17</sup> WTI Futures reflects the expectations of the parties (seller and buyer) in the oil market regarding the future oil price and quantity to be delivered.

Total production was 62 million barrels of oil equivalents in 2011, including 3 million barrels of oil equivalent from Kitan. Following a temporary increase in production at Kitan, total production is projected to be 65 million barrels of oil equivalents in 2012 before gradually starting to decline.

**Table 2.5.3.1.2 Sustainable Income Calculations – Oil Price Assumptions, Production and Revenue, 2002-2025**

Timor-Leste Petroleum sector				
	Average WTI oil price, \$/Barrel	Production , million barrels oil equivalent	Total Discounted Petroleum Revenues, \$ millions	Total Undiscounted Petroleum Revenues, \$ millions
<b>Total</b>	<b>0.0</b>	<b>932.8</b>	<b>15,451.5</b>	<b>33,997.8</b>
<b>Total from 1 January 2013</b>	<b>0.0</b>	<b>462.5</b>	<b>15,451.5</b>	<b>19,557.4</b>
to 2002	0.0	0.0	0.0	0.0
2003	0.0	0.0	0.0	10.2
2004	41.5	16.9	0.0	166.1
2005	56.6	29.0	0.0	318.7
2006	66.1	57.1	0.0	620.6
2007	72.3	57.7	0.0	1,307.4
2008	99.7	64.2	0.0	2,287.1
2009	62.0	61.8	0.0	1,640.6
2010	79.5	57.3	0.0	2,085.3
2011	94.9	61.7	0.0	3,251.0
2012	90.8	64.7	0.0	2,753.4
2013	86.6	60.4	2,260.4	2,309.1
2014	91.1	53.0	1,840.0	1,971.9
2015	95.6	52.5	1,931.8	2,176.7
2016	98.8	48.7	1,807.0	2,144.7
2017	102.3	45.2	1,643.3	2,058.5
2018	105.0	38.2	1,261.1	1,668.4
2019	107.8	39.5	1,263.0	1,764.7
2020	110.9	36.7	1,140.5	1,683.7
2021	114.0	35.3	1,019.5	1,590.0
2022	117.4	26.5	661.6	1,090.1
2023	120.5	20.8	507.7	883.6
2024	123.8	5.9	84.3	154.9
2025	126.7	0.0	31.5	61.1

Source: Petroleum Fund Administration Unit, Ministry of Finance, 2012

The Field Development Plan for the Kitan field was approved in 2010 and the production commenced in the Q4 of 2011. Total production is modest compared to the Bayu-Undan field. Kitan’s Low and Base Production Case are 26.8 and 35.5 million barrels of oil respectively over the lifetime of the project. The total revenue stream based on the Low Production Case is estimated at \$550.0 million, or some 5.0% of Bayu Undan.

### Costs

The estimated costs for the Bayu-Undan project are forecasted slightly higher than in the Budget 2012, which again was forecasted significantly higher than in the 2011 Budget. As discussed in last year’s budget, the change in the cost projections between 2011 Budget and 2012 Budget derives primarily from the strengthened AUS\$, in which a significant proportion of costs are incurred, and corrosion and other operational issues that require remedial action over the next few years.

### 2.5.3.2 Petroleum Wealth and ESI calculation

According to the Petroleum Fund Law, the Estimated Sustainable Income (ESI) is the maximum amount that can be appropriated from the Petroleum Fund in a fiscal year and leave sufficient resources in the Petroleum Fund for an amount of the equal real value to be appropriated in all later years. The ESI is set to be 3.0% of the Petroleum Wealth. However, the Government could withdraw an amount from the Petroleum Fund in excess of ESI given a justification that it is in the long term interest of Timor-Leste is provided to and approved by the National Parliament.

Petroleum Wealth, which comprises the balance of the Fund and the Net Present Value of future petroleum revenue, is estimated to be \$26,231.7 million as of 1 January 2013. Accordingly, the ESI is estimated at \$787.0 million for 2013. This is an increase of \$142.8 million compared with the 2013 ESI as estimated in last year’s budget. The key assumptions behind the calculations are listed in Table 2.5.3.2.1.

**Table 2.5.3.2.1: Key assumptions behind ESI**

Asset recognition	Forecast petroleum revenues are included only for projects with approved development plans. This includes Bayu-Undan and Kitan.
Petroleum Reserves and Production Forecasts	Production estimates are provided by project operators. Low case production is used, consistent with a 90.0% probability that actual will exceed the forecast.
Oil price forecast	ESI for Budget 2013 is prepared using the average of Energy Information Agency (EIA) low case and reference case for light sweet crude oil (WTI <sup>18</sup> ).

<sup>18</sup> The EIA “Low Sulphur Light Oil” is stated in EIA documentation to be the same as WTI.

Prices for specific petroleum products	Bayu Undan produces condensate, Liquefied Petroleum Gas (LPG) and Liquefied Natural Gas (LNG) while Kitan is planned to produce only condensate. Forecast assumptions for each product are derived from historic differentials observed with WTI. Liquefied Natural Gas (LNG) prices are forecast using the provisional price formula negotiated between the Darwin LNG (DLNG) facility and Japanese LNG buyers. The price formula is renegotiated every three years.
Production costs	Central estimate of future capital and operating costs as provided by project operators.
Discount rate	Under Schedule 1 of the Petroleum Fund Law, the interest rate used to discount future petroleum revenue is the expected rate of return on the portfolio of financial assets held in the Fund. The Fund's investment guidelines have recently been changed to 60.0% bonds and 40.0% equities.

Source: Petroleum Fund Administration Unit, Ministry of Finance, 2012

Table 2.5.3.2.2 shows the estimated Petroleum Wealth and the ESI from 2012 and onwards, assuming that withdrawals from the Fund in excess of the ESI are the same amount as shown in Table 2.5.3.3.2.

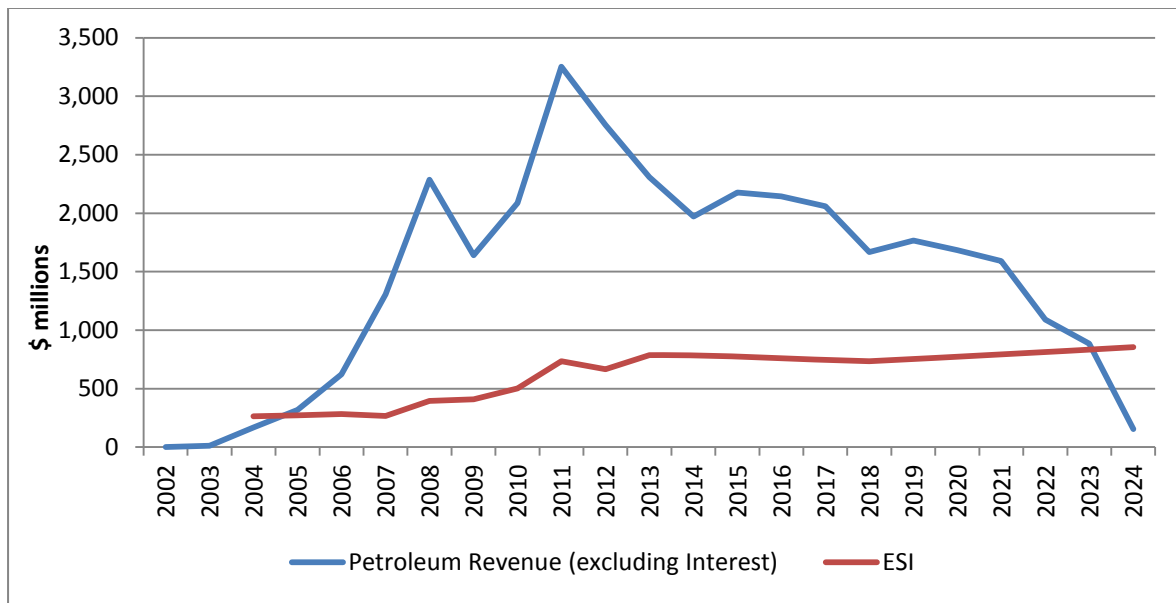
**Table 2.5.3.2.2 Petroleum Wealth and the Estimated Sustainable Income (ESI), \$ millions**

	2012	2013	2014	2015	2016	2017
	Budget	Projections				
Opening PF Balance	8,678.9	10,776.7	12,375.7	13,244.9	14,370.7	15,601.4
Net Present Value of Future Revenues	13,496.1	15,455.0	13,802.0	12,473.9	10,893.1	9,282.0
<b>Total Petroleum Wealth (PW)</b>	<b>22,175.0</b>	<b>26,231.7</b>	<b>26,177.8</b>	<b>25,718.8</b>	<b>25,263.8</b>	<b>24,883.4</b>
<b>Estimated Sustainable Income (PWx3%)</b>	<b>665.3</b>	<b>787.0</b>	<b>785.3</b>	<b>771.6</b>	<b>757.9</b>	<b>746.5</b>

Source: Petroleum Fund Administration Unit, Ministry of Finance, 2012

Figure 2.5.3.2.1 depicts the main rationale behind using the ESI as a tool in the fiscal policy, i.e. smoothing the spending of temporarily high petroleum income. The extraction path of a non-renewable resource is typically bell-shaped with significant shorter-term swings. The ESI is meant to shield against this volatility and safeguard a sustainable development in public finances.

**Figure 2.5.3.2.1 Timor-Leste Petroleum Revenues and Estimated Sustainable Income 2002-2025, \$ millions**



Source: Petroleum Fund Administration Unit, Ministry of Finance, 2012

### Changes in the ESI from 2012 to 2013

Figure 2.5.3.2.2 shows the key incremental changes in 2013 ESI since the Budget 2012. Main driving factors include oil price, price differentials, petroleum production and costs.

#### Actual data 2011

The current ESI for 2013 incorporates the actual development in 2011, which increases the 2013 ESI by \$28.0 million. The change is mostly due to higher than expected oil prices.

#### Actual 2012 withdrawals from the Petroleum Fund

The 2013 ESI as estimated in Budget 2012 is based on the assumption that the Government would only withdraw the ESI from the Petroleum Fund in 2012. In 2012, the Parliament approved withdrawing \$1,495.0 million from the Fund, which is \$829.7 in excess of the ESI. This higher withdrawal in 2012 reduces the 2013 ESI by \$24.5 million.

#### Liquids production

The difference in the production forecasts used in this material and Budget 2012 is small and results in an \$11.2 million increase in ESI for 2013.

#### Oil prices

The current ESI for 2013 assumes an average oil price of \$91 per barrel in 2012, based on the actual development for the first half of the year and EIA's forecasts going forward.<sup>19</sup> The Budget 2012 assumed an oil price of \$74 per barrel for 2012. Moreover, the EIA's oil price

<sup>19</sup> These forecasts are reported by the EIA and also available from Annual Energy Outlook 2012: <http://www.eia.doe.gov/oiaf/aeo/index.html>.

forecast over the projected life of Bayu-Undan and Kitan are 14% higher than projected at the same time last year. These changes increase 2013 ESI by \$98.4 million.

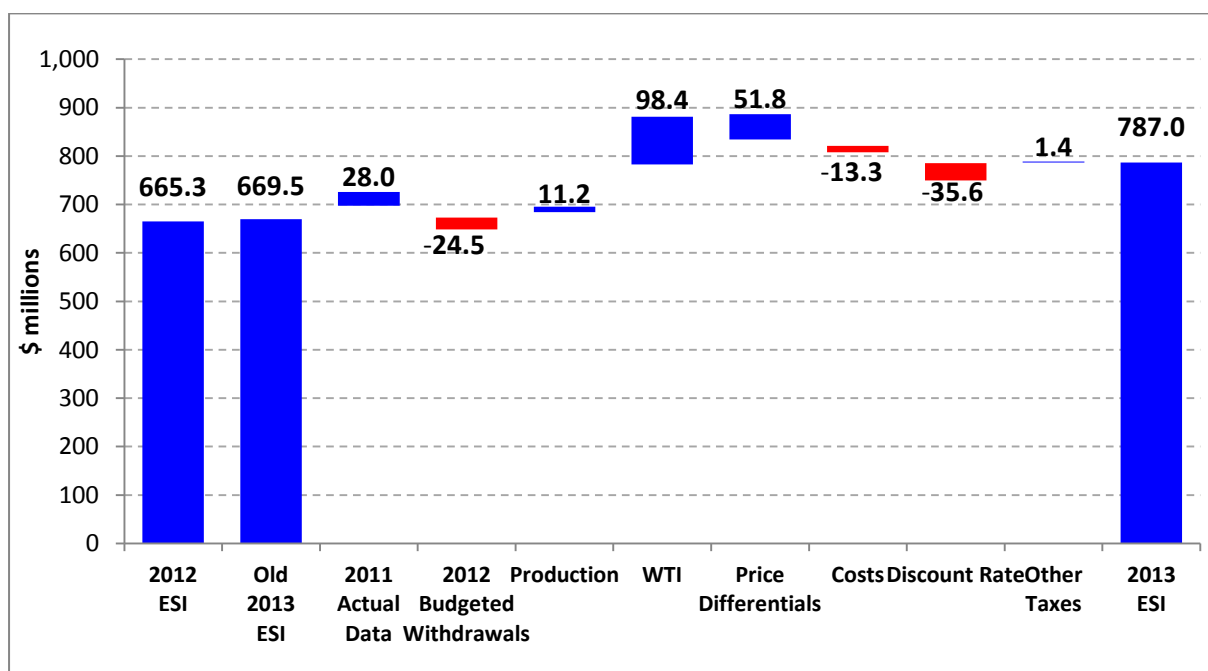
Liquids price differentials (condensate and LPG)

As in previous years, the price for Bayu-Undan condensate products is forecasted based on the relationship with the WTI benchmark price. The development in this relationship implies a higher price on the Bayu-Undan products than previously assumed. The relationship between WTI and LPG has changed only slightly. The updated price differentials increase the 2013 ESI by \$51.8 million. See the below paragraph on methodology review for further discussion of the price differential.

Cost

Production costs from the two operators (COP and ENI) are forecasted slightly higher in this material than in Budget 2012. The increase in the cost forecasts reduces 2013 ESI by \$13.3 million.

**Figure 2.5.3.2.2 Changes in the 2013 ESI (from Budget 2012 to Budget 2013), \$ millions**



Source: Petroleum Fund Administration Unit, Ministry of Finance, 2012

Discount rate

Under Timor-Leste law, the discount rate used in the Net Present Value (NPV) calculation of future petroleum revenues must equal the expected rate of return of the Petroleum Fund portfolio. The expected long-term nominal portfolio return has increased from 3.7% to 5.7% due to higher allocation to equities. By definition, an increase in the NPV discount rate

decreases the NPV. The increase in the NPV discount rate results in a decrease in 2013 ESI of \$35.6 million.

### Other Taxes

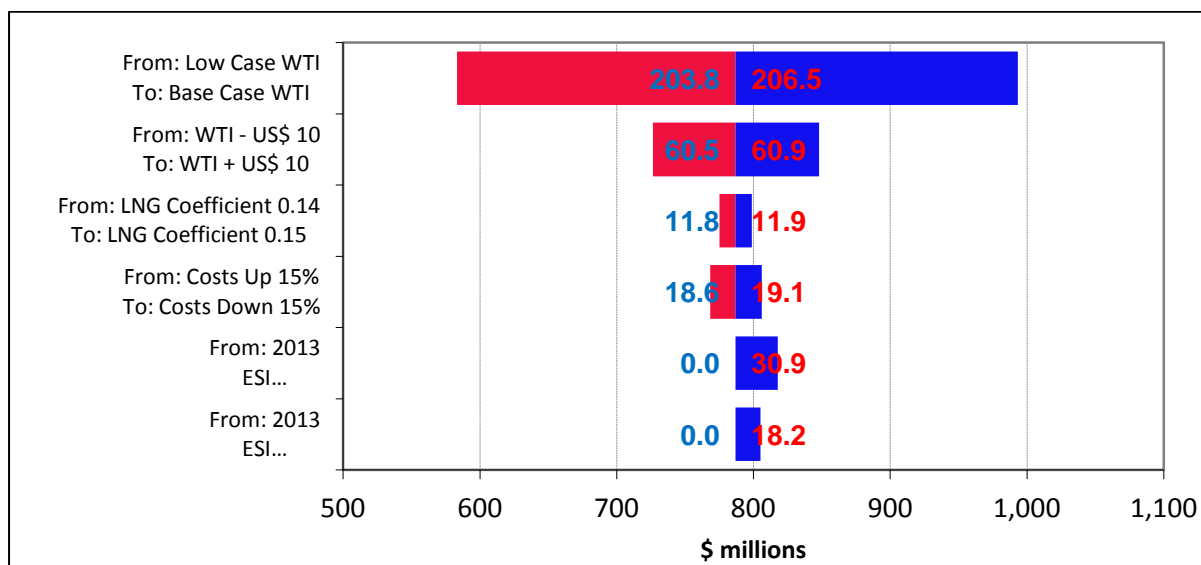
Other taxes include wage taxes, tax collections from subcontractors and exploration drilling. These taxes are forecast for Budget 2013 based on an analysis of recent collections and taking into account exploration work commitments as advised by Autoridade Nacional do Petroleo (ANP). The change in the forecast of other taxes increases 2013 ESI by \$1.4 million.

### **Sensitivity analysis**

The Government’s objective is to prepare an ESI that is prudent overall, as required by the Petroleum Fund Law. Although the calculations are based on the best information available and advice from experts, each input is inherently subject to significant uncertainty. Figure 2.5.3.2.3 shows how 2013 ESI changes when key assumptions are changed individually.

The sensitivity analysis starts with the 2013 ESI of \$787.0 million and shows by how much the ESI would change if a different assumption for each key variable were used. The analysis shows that the oil price has by far the biggest impact on the ESI.

**Figure 2.5.3.2.3 Sensitivity Analysis – Estimated Sustainable Income, \$ millions**



Source: Petroleum Fund Administration Unit, Ministry of Finance, 2012

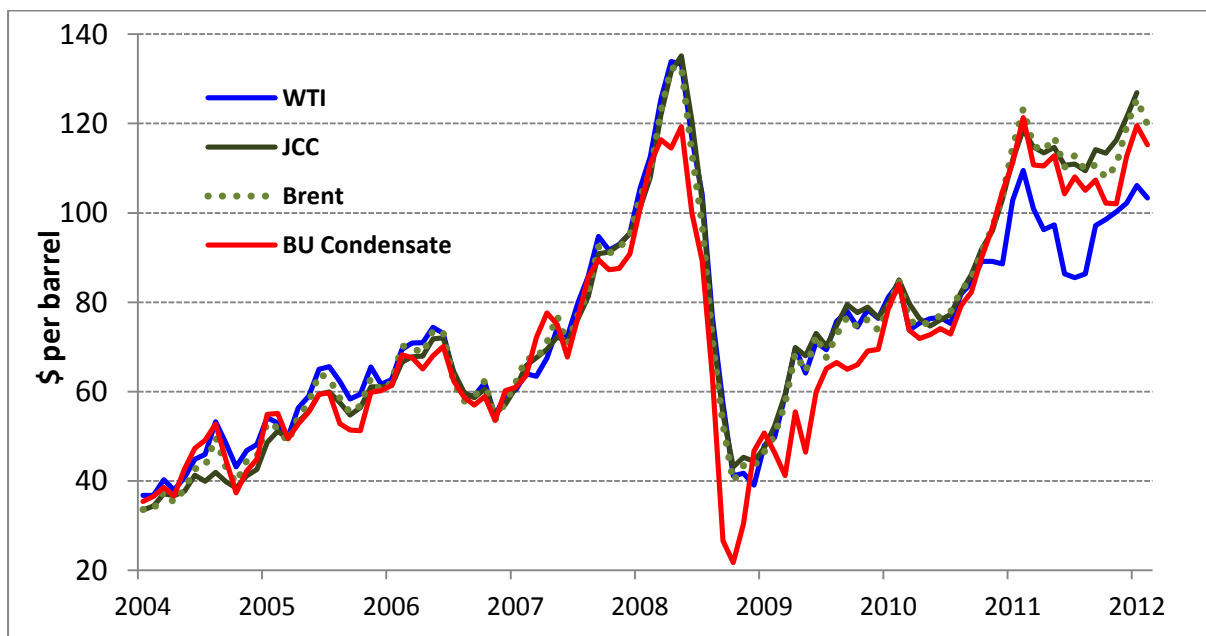
### **Review of methodology**

Schedule 1 of the Petroleum Fund Law requires the ESI to be estimated using prudent assumptions reflecting international best practice and based upon recognised international standards. The Ministry of Finance undertook a comprehensive review of the methodology for the ESI prepared for Budget 2011 with technical assistance from the IMF. No material changes in methodology have been implemented since then. Minor adjustments include:

Production forecast methodology for Liquefied Natural Gas (LNG) has been changed back to the previous methodology. The ConocoPhillips (COP) low case LNG forecast has usually mirrored the base case for most of the project life. In 2011, however, COP low case LNG forecast was limited to the Annual Contract Quantity (ACQ) with the buyers. COP confirmed they would always choose to produce the maximum possible LNG amount, that there was limited risk of the production capacity of the LNG plant being below that reflected in the base/P50 case and that there was sufficient gas to produce the base case volume until at least 2022. The Ministry of Finance therefore took the view in 2011 that a prudent LNG forecast is one consistent with a P50 case, but with a cut-off in 2022 consistent with the low case liquids forecasts. In 2012, the COP LNG forecast again follows the methodology used in years prior to 2011. The ESI methodology has therefore been changed accordingly, using low case production as the prudent forecast.

*Discounting principles.* Under Schedule 1 of the Petroleum Fund Law, the interest rate used to discount future petroleum revenue is the expected rate of return on the portfolio of financial assets held in the Fund. In previous years, the expected return has been set equal to the 10 years rolling average of the nominal yield on US bonds with various maturities. Further to the new investment strategy of the Petroleum Fund with a higher portion of growth assets, the long-term real return of the portfolio is expected to be 3.6% per year. The nominal return is arrived at by using the official US inflation forecast from the US Congressional Budget Office (CBO, since the assets are denominated in US\$).<sup>20</sup>

**Figure 2.5.3.2.4 BU Condensate Price vs. World Oil Prices**



Source: Petroleum Fund Administration Unit, Ministry of Finance, 2012

<sup>20</sup> Budget and Economic Outlook: Fiscal Years 2011 to 2021, <http://www.cbo.gov/publication/21999>. Nominal ROI equals (1 + real ROI) times (1 + inflation rate).

While the inflation forecast varies slightly year by year, the average discount rate is about 5.7% for the forecast period. In Budget 2012, the interest rate used for discounting future revenue was 3.7%.

*Methodology to forecast Timor condensate prices has been updated.* Over the last two years, the relationship between condensate prices and WTI prices has changed materially, as can be seen in Figure 2.5.3.2.4.

The graph shows Bayu-Undan condensate price and the price of WTI and prices for two other important international oil benchmarks, Brent (which is North Sea oil) and JCC, Japanese Crude Cocktail, which is the average price of the crude being imported into Japan.

Until 2010, the price of Bayu-Undan (BU) condensate was consistently tracking somewhat below the price of WTI. Since 2010 the price of BU condensate has exceeded the price of WTI, and the co-development has been weaker. It is true that BU condensate tracks Brent and JCC fairly well, but low/reference/high case forecasts are not available for these benchmarks. The ESI methodology will therefore continue to be based on WTI, with updated adjustment factors that take into account the new relationship. In this assessment it is assumed that the relationship between WTI and BU condensate will “normalise” over time. In particular, the differential starts with BU condensate exceeding WTI by 4.9% in 2012 and declining to 3.5% by 2020.

### **2.5.3.3 Managing the Petroleum Fund**

#### **The Petroleum Fund Model**

The Petroleum Fund Law is designed to contribute to a wise management of Timor-Leste’s petroleum resources for the benefit of both current and future generations. The Petroleum Fund is a tool that contributes to sound fiscal policy, where appropriate consideration and weight is given to the long-term interest of Timor-Leste’s citizens. The Petroleum Fund helps policymakers to make well-informed budget decisions in an environment of temporarily high and very fluctuating petroleum incomes. The decision on *how much to spend and how much to save* (i.e. spend later) is done in the state budget where all the Government’s priorities are weighed against each other.

The petroleum fund mechanism implies that petroleum revenues are transferred in their entirety to the Fund and invested abroad in financial assets. The investment policy of the Fund aims at maximising the risk-adjusted return. The Fund’s only outflow is transfers to the central government budget, pursuant to parliamentary approval. The amount that may be transferred to the budget is guided by the Estimated Sustainable Income (ESI), which is defined as 3.0% of the petroleum wealth. Assuming the investments of the Fund as well as the reserves under the sea bed actually earns 3.0% real return; ESI is the level of spending that will maintain the purchasing power of the petroleum wealth.

## **Governing the Petroleum Fund**

Based on the “Santiago principles”<sup>21</sup>, the Petroleum Fund governance model is one of high degree of transparency and disclosure of information. This helps build public support for wise management of petroleum revenues and reduces the risk of bad governance. Transparency ensures that information can be used to measure the authorities' performance and also guards against any possible misuse of powers. One of the fundamental elements of the Fund's governance structure is that no one person or institution is responsible for making and implementing investment decisions because each party is formally accountable to another for their role in the decision-making process. This degree of transparency serves to encourage consensus and enable accountability, which means authorities and whoever handles public money can be held responsible for their actions.

As the Executive, the Government through the Ministry of Finance is responsible for the overall management of the Petroleum Fund, on behalf of the people of Timor-Leste. The Petroleum Fund Law makes the Government accountable to Parliament through various reporting requirements. The operational management is carried out by the Central Bank, which invests the Fund's capital according to guidelines established by the Ministry of Finance and mandates developed by the Investment Advisory Board (IAB). The Ministry of Finance is required to seek advice from the IAB before making decisions on any matter relating to the investment strategy or management of the Petroleum Fund.

## **Petroleum Fund Investment Policy**

The Petroleum Fund investment policy is based on the asset allocation and risk limits as defined in the Petroleum Fund Law as amended in August 2011. The new investment policy states that no more than 50% of the Fund may be invested in equities, no less than 50% should be invested in investment grade fixed income, and no more than 5% can be invested in alternative instruments such as real estate, private equities and hedge funds.

The investment policy emphasises the principle of diversification. Diversification is the process of exposing an investment portfolio to a number of different asset classes (for example bonds and equity) and individual financial assets, rather than being concentrated in any one of these singularly. Diversification is the antidote to many avoidable risks. The key to the diversification process is that different asset classes and other portfolio risk factors will usually not move in unison. Combining assets with returns that are less than perfectly correlated mitigate risks and volatility.

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<sup>21</sup> International Working Group's “Sovereign Wealth Funds: Generally Accepted Principles and Practices”, otherwise known as the Santiago Principles. The Principles identify a framework of generally accepted principles and practices that properly reflect appropriate governance and accountability arrangements as well as the conduct of investment practices by Sovereign Wealth Funds (SWFs) on a prudent and sound basis.

The Government appreciates that obtaining financial returns involves taking risks in terms of higher short-term volatility. Being a long-term investor, higher short-term volatility is of less economic significance. The Petroleum Fund law amendments give room for the Fund's portfolio to achieve 3% real return over time (although the return is not guaranteed), which would enable the sustainability of public spending.

As a first step to implement the investment policy, taking the advice from the Investment Advisory Board (IAB), the Minister of Finance instructed the Central Bank to progressively invest up to 20% of the Petroleum Fund in global equities by June 2012. As of September, 5% of the Fund was managed by Schroders and 18% by State Street Global Advisors. The remaining 77% of the Fund was still invested in US Treasuries, of which 20% was managed by BIS and 57% was managed internally by BCTL. Table 2.5.3.3.1 shows the Petroleum Fund portfolio and manager structure as of September 2012.

As a second step, again taking the advice from the IAB, the Minister of Finance instructed the Central Bank to continue invest progressively up to 40% in global equities over the two next years, starting from July 2012.

Currently, the fixed income portfolio of the Petroleum Fund is invested in US Treasury only, while the equity portfolio is invested in more than 1,000 companies in 23 developed countries. The exposure to each of the company is required to be less than 3%.

**Table 2.5.3.3.1 Petroleum Fund Portfolio and Managers Structure**

Number	Managers and Mandates, as of Sep 2012	Weight	Market Values, \$ millions	Return since inception
<b>Total Petroleum Fund Portfolio</b>		<b>100.0%</b>	<b>11.1</b>	<b>4.1%</b>
<b>International Fixed Interest Portfolio (Bonds)</b>		<b>77.0%</b>	<b>8.5</b>	<b>3.9%</b>
1	Banco Central de Timor-Leste -BCTL			
	(1-3 years US Treasury bonds)	16.0%	1.8	0.4%
	(3-5 years US Treasury bonds)	41.0%	4.5	1.6%
2	Bank for International Settlement - BIS	20.0%	2.2	4.2%
	(5-10 years US Treasury bonds)			
<b>International Equity Portfolio</b>		<b>23.0%</b>	<b>2.5</b>	<b>7.7%</b>
3	Schroders Investment Management - Schroders	5.0%	0.6	7.9%
	(MSCI world)			
4	State Street Global Advisors - SSgA	18.0%	2.0	9.8%
	(MSCI world)			

Source: BCTL - Petroleum Fund Q3 2012 Report

### Projected Petroleum Fund Development

The Fund's balance is \$11,054.4 million as of September 2012. This is an increase of \$1,774.1 million from the start of the year. The Fund balance is expected to be \$10,776.7

million by the end of 2012 after deducting the estimated withdrawal of \$1,494.9 million in 2012 approved by Parliament.

The current forecast, as shown in Table 2.5.3.3.2, shows the total value of the Fund to be \$12,375.7 million by the end of 2013 and \$16,822.9 million by the end of 2017.

**Table 2.5.3.3.2 Estimated Petroleum Fund Savings 2011-2017, \$ millions**

	2011 Actual	2012 Estimate	2013 Budget	2014 Projection	2015 Projection	2016 Projection	2017 Projection
<b>Opening PF Balance</b>	<b>6,904.0</b>	<b>9,310.3</b>	<b>10,776.7</b>	<b>12,375.7</b>	<b>13,244.9</b>	<b>14,370.7</b>	<b>15,601.4</b>
Petroleum Revenue (excluding PF Interest)	3,240.1	2,753.4	2,309.1	1,971.9	2,176.7	2,144.7	2,058.5
Petroleum Fund Interest, Net*	221.2	207.8	487.7	614.3	692.1	778.3	874.3
Total Withdrawals	1,055.0	1,494.9	1,197.8	1,717.1	1,743.0	1,692.3	1,711.2
<b>Closing PF Balance</b>	<b>9,310.3</b>	<b>10,776.7</b>	<b>12,375.7</b>	<b>13,244.9</b>	<b>14,370.7</b>	<b>15,601.4</b>	<b>16,822.9</b>

*Source: Petroleum Fund Administration Unit, Ministry of Finance, 2012*

## 2.6: Financing

### 2.6.1 Definition of Financing

Table 2.6.1.1 shows financing of the 2013 State Budget. The financing items shown below equal the non-oil deficit (domestic revenue minus total expenditure). The Government is therefore clearly showing that all expenditures will be paid for either through domestic revenue or through financing from the ESI, excess withdrawals, loans or use of the cash balance.

There are important economic reasons for distinguishing between domestic revenue and financing items. Domestic revenue results from taxes borne by companies and individuals in Timor-Leste. An increase in domestic revenue allows for an increase in Government spending in Timor-Leste but is also likely to decrease spending by companies and individuals. The impact on the total amount of money and demand in the economy is therefore broadly neutral.

In contrast, financing expenditures by withdrawing money from the petroleum fund increases the overall level of demand within the economy. This increase in demand, if not matched by an increase in ability of the economy to produce goods, can lead to higher inflation.

As can be seen in Table 2.6.1.1, four financing items will be used in the 2013 budget. These are the ESI, excess withdraws from the petroleum fund, use of the cash balance and loans. The ESI and excess withdrawals are the two largest financing items; together these items equal \$1,197.8 million, equivalent to 66.6% of total expenditure.

**Table 2.6.1.1: Financing 2013 to 2017 \$ millions**

	2013	2014	2015	2016	2017
<b>Total Financing</b>	<b>1,651.2</b>	<b>1,787.7</b>	<b>1,865.9</b>	<b>1,814.0</b>	<b>1,834.2</b>
Estimated Sustainable Income (ESI)	787.0	785.3	771.6	757.9	746.5
Excess Withdrawals from PF	410.8	931.7	971.4	934.4	964.7
Use of Cash Balance	409.8	0.0	2.0	0.0	0.0
Borrowing /Loans	43.6	70.6	120.9	121.7	123.0

Sources: National Directorate of Budget, Petroleum Fund Administration Unit and Major Projects Secretariat, Ministry of Finance, 2012

The next three sections explain the ESI, excess withdraws, loans and use of the cash balance in more detail.

### 2.6.2 ESI and Excess Withdraws

The Estimated Sustainable Income (ESI) is calculated at \$787.0 million for 2013, which is an increase of \$142.8 million from the 2013 ESI estimate in last year's budget. The main reason

for this increase is that oil prices are expected to be higher over the forecasting period. Excess withdraws are budgeted at \$410.8 million; contributing to a lower future ESI.

### **2.6.3 Loans**

The Government's overall policy with regards to loans is to evaluate them with reference to the financing needed for strategic infrastructure development in the country. When financing from the ESI and domestic revenue falls below that needed for development, excess withdraws can impose high opportunity costs to the income from the petroleum fund's investments. Concessionary loans are, therefore, options to be considered. For a loan to represent good value for money, high quality projects need to be identified. These may include roads, bridges, water and sanitation, electricity, ports and airports as such projects normally have large economic and social returns.

The next table shows the two loan agreements the Government has already signed. The money from the JICA loan will be used to finance the construction of the Dili-Manatuto-Baucau road. The construction of this road is a priority and is in line with the Government's policies as described in the SDP. The value of this project including the Government's contribution is \$92.6 million. The JICA loan has a fixed interest rate that is less than 1.0% and a grace period of ten years. This loan is highly concessional; with its rate of interest being significantly lower than the likely rate of interest the Government would have to pay if it borrowed money from a private sector financial institution or issued its own gilts/treasury bills. The rate of interest on this loan is also less than the yield forecasted from Petroleum Fund investments; meaning that the opportunity cost of this loan is lower than withdrawing money from the petroleum fund. The only significant financial risk associated with this loan is that it is issued in Japanese Yen. This means that if the US\$ significantly depreciates against the Japanese Yen in future years, then the costs of repaying the loan in US\$ will increase.

The Government has also signed a loan agreement with the Asian Development Bank. This loan will be used to finance the Dili-Liquica and Tibar-Ermera roads which are estimated to have a high rate of economic and social return. The value of this project, including the Government's counterpart contribution is \$53.7 million. This loan has two components, one with a fixed interest rate (the SDR component) and one with a variable rate (OCR component). The SDR component's interest rate is fixed at 1.0% for the 8 year grace period and is then 1.5% for the remainder of the 32 year term of the loan. The OCR component has a five year grace period and a term of 25 years; with an interest rate based on the London Interbank Rate plus a small spread and a commitment charge of 0.15%. The fixed rate component of the loan can be regarded as concessionary and arguably has a lower opportunity cost than withdrawing money from the Petroleum Fund. The variable component of the loan can also be regarded as concessionary because the London Interbank Rate represents the rate of interest that leading banks are prepared to lend to each other at and this rate is probably less than that at which they would be prepared to

lend to Timor-Leste. The current London Interbank Rate is also significantly below the yield on petroleum fund investments and therefore the opportunity cost of this loan is currently lower than withdrawing an equivalent amount of money from the Infrastructure Fund. The main risk associated with the variable rate component of this loan is that the London Interbank Rate could increase in the future, leading to an increase in repayments.

**Table 2.6.3.1: Information on Signed Loan Agreements**

Information on Signed Loan Agreements	Loan 1: JICA	Loan 2: ADB
Date Signed	19-Mar-12	2-May-12
Organisation / Government providing Loan	JICA / Japan	Asian Development Bank
Amount of Loan in Dollars	\$68.7 million	\$40 million
Total Government Contribution	\$23.9 million	\$13.7 million
Total Project Value	\$92.6 million	\$53.7 million
Grace Period Years	10	SDR: 8 and OCR: 5
Maturity/Term	30	SDR: 32 and OCR: 25
Interest Rates Per Year	0.7% for construction works, 0.01% for consulting services and a commitment charge of 0.1%.	SDR: Fixed at 1.0% during grace period and then 1.5%  OCR Variable at LIBOR + spread; commitment charge of 0.15%.
Interest Rate Fixed or Variable	Fixed for Term	Fixed and Variable Components
Description of Project / Purpose of Loan	Construction and Supervision of Roads Dili-Manatuto-Baucau (L)	Construction and Supervision of Roads, Dili-Liquica e Tibar Ermera (L)

Sources: National Directorate of Budget and Major Projects Secretariat, Ministry of Finance, 2012

In addition to the two signed loan agreements, the Government is currently in negotiations with the World Bank and the Asian Development Bank regarding further loans. The World Bank loan will be used to finance the construction of the Aileu-Ainaro-Maubisse road. The Asian Development Bank loan, meanwhile, will be used to finance the construction of the Manatuto-Natarbora road. Both these projects are in line with the goals of the SDP and are expected to have a high rate of economic return.

The Government has calculated the total ceiling required for loan financing in 2013 as being \$223.5 million.

The next table shows projected loan financing for all projects shown in Book 6 by year. Book 6 provides a detailed breakdown of loan financing and the Government's counterpart contribution by project.

**Table 2.6.3.3: Projected Total Loan Financing 2013-2017, \$ millions**

	Total	2013	2014	2015	2016	2017
Loans	479.7	43.6	70.6	120.9	121.7	123.0

Sources: National Directorate of Budget and Major Projects Secretariat, Ministry of Finance, 2012

## 2.6.4 Use of the Cash Balance

The Government is currently forecasting that actual expenditure in 2012 will be below that budgeted. This combined with strong domestic revenue collections and withdraws from the Petroleum Fund means that there is likely to be a cash balance held in the CFTL, Infrastructure Fund and Human Capital Development Fund accounts at the end of 2012. Holding large amounts of cash in these accounts is not optimal; because the rate of interest from these accounts is lower than the yield (amount earned) on Petroleum Fund Investments. The Government earns more money by holding \$500 million in the Petroleum Fund than it does by withdrawing this amount from the petroleum fund and holding it as cash in the CFTL fund. The Government will therefore use some of this cash balance to finance expenditures in 2013. This will allow the Government to make lower withdrawals from the Petroleum Fund and increase the overall rate of return from investments and cash. The amount of cash that will be used is shown in the next table.

**Table 2.6.4.1 Use of Cash Balance**

	2013	2014	2015	2016	2017
<b>Total</b>	<b>409.8</b>	<b>0.0</b>	<b>2.0</b>	<b>0.0</b>	<b>0.0</b>
CFTL	0.0	0.0	0.0	0.0	0.0
Infrastructure Fund	401.3	0.0	2.0	0.0	0.0
HCDF	8.5	0.0	0.0	0.0	0.0

Sources: National Directorate of Budget and General Directorate of Treasury, Ministry of Finance, 2012

## 2.6.5 Public Private Partnerships

The Government completed a Public-Private Partnership (PPP) policy and legal framework in 2012. PPPs normally involve a contract between a public sector authority and a private party, in which the private party provides a public service or project and assumes substantial financial, technical and operational risk in the project. Public-Private Partnerships in Timor-Leste will only be considered for projects that contribute to the Government's development objectives, have high rates of economic return and are likely to attract and benefit from private sector expertise. The potential advantage of PPP agreements is that by linking the rate of return received by the private sector contractor to the quality of services provided they lead to the provision of high quality services and value for money.

There are currently two Public Private Partnership projects which are ongoing in Timor-Leste. These are the project to expand the Presidente Nicolau Lobato International Airport and the construction of Tibar Port.

The Presidente Nicolau Lobato International Airport will, with private sector participation, be expanded to meet international standards of air travel and increase the efficiency of airport operations. The three major components of the project are the rehabilitation and upgrading of the runway; the rehabilitation and upgrading of the passenger terminal and

the operation and maintenance of the airport facilities after and during project implementation. The Government currently estimates that the project will cost in the region of \$27 million.

Tibar Bay port will be developed with private sector participation to meet international efficiency standards for container and other cargo operations. The major project components are the preparation of the port site conditions, the installation of port facilities and the operation and maintenance of the port facilities during and after the project's implementation. The total cost of the project is currently estimated to be in the region of \$442 million.

No major construction has yet started on either of these projects. The Government has, however, recently signed Financial Advisory Services Agreement with the International Finance Corporation (IFC) for both projects. Under these agreements the IFC will assist the Government cost the project and structure the Public Private Partnership agreement so that it attracts interests from the private sector, achieves the projects' goals and represents value for money for Timor-Leste citizens.

## **Part 3: 2013 General State Budget Law**

**To be inserted after the State Budget Law has been promulgated by the President.**

# Part 4: Supporting Documents

## 4.1: Petroleum Fund Law Article 8

### 4.1.1: Requirement for Transfers from the Petroleum Fund



República Democrática de Timor-Leste  
Ministério das Finanças  
Gabinete da Ministra



*"Adeus Conflito, Bemvindo Desenvolvimento"*

Ofício n.º: 2561/GMF/V/2012

Kay Rala Xanana Gusmao  
Prime Minister  
Democratic Republic of Timor-Leste

Dear Prime Minister,

**SUBJECT: REQUIREMENT FOR TRANSFERS FROM PETROLEUM FUND**

This report is provided in accordance with Article 8 a) and b) of the Petroleum Fund Law.  
The Estimated Sustainable Income is calculated in accordance with provisions outlined in Schedule 1 of the Petroleum Fund Law.

Estimated Sustainable Income For Financial Year: 2013	<b>Amount (USD)</b> \$787.0 million
Estimated Sustainable Income For preceding Financial Year: 2012	<b>Amount (USD)</b> \$665.3 million

A review of the methodology which the ESI-calculations are based on is included in the Budget 2013.

According to Art. 8 c) of the Petroleum Fund Law, the Independent Auditor, shall certify the amount of the Estimated Sustainable Income. The certification report is attached.

Yours sincerely

Emília Pires  
Minister of Finance

## 4.1.2: Independent Reassurance Report to the Ministry of Finance



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### INDEPENDENT ASSURANCE REPORT TO THE MINISTRY OF FINANCE, DEMOCRATIC REPUBLIC OF TIMOR-LESTE

We have been engaged by the Ministry of Finance in accordance with Article 8(c) of the Petroleum Fund Law (Law No. 9 /2005) of the Democratic Republic of Timor-Leste, ("The Law") relating to the Ministry of Finance's compliance with in the calculation of the Estimated Sustainable Income for the fiscal year 2013 in accordance with paragraphs II and III of Schedule 1 of The Law.

#### **The Ministry of Finance's Responsibility for the Estimated Sustainable Income Calculation**

The Ministry of Finance is responsible for the calculation of the Estimated Sustainable Income for the fiscal year 31 December 2013 in compliance with the amended Schedule 1 of Petroleum Fund Law (Law No. 9 /2005, Amendment 1, No. 12/2011) of the Democratic Republic of Timor-Leste, ("The Amended Law"). Additionally, the Ministry of Finance is responsible for ensuring that all assumptions comply with the provisions of Schedule 1 (IV) and (V).

#### **Our Responsibility**

Our responsibility is to express a conclusion whether the Estimated Sustainable Income Calculation for the fiscal year 31 December 2013 has been calculated, in all material respects, in accordance with the formula in Paragraphs II and III of Schedule 1 of the Amended Law. Our audit has been conducted in accordance with the International Standard on Assurance Engagements (ISAE) 3000 *Assurance Engagements Other than Audits or Reviews of Historical Financial Information* to provide reasonable assurance that the Ministry of Finance has complied with requirements in the Law. Our procedures consisted primarily of inquiries of relevant personnel, inspection of evidence including the Budget Book and obtaining and reviewing the Estimated Sustainable Income Calculation.

These procedures have been undertaken to form a conclusion as to whether the Ministry of Finance has complied, in all material respects, with the requirements of the Law.

#### **Conclusion**

In our opinion, the Ministry of Finance has complied, in all material respects, with Paragraphs II and III of Schedule 1 of the Petroleum Fund Law (Law No. 9 /2005, Amendment 1, No. 12/2011) of the Democratic Republic of Timor-Leste in calculating the Estimated Sustainable Income for the fiscal year ending 31 December 2013. The calculation shows an Estimated Sustainable Income of \$787 million United States Dollars.

DELOITTE TOUCHE TOHMATSU  
Chartered Accountants  
Darwin  
22 November 2012

Liability limited by a scheme approved under Professional Standards Legislation.  
Member of Deloitte Touche Tohmatsu Limited

## 4.2: Petroleum Fund Law Article 9

### 4.2.1: Requirement for Transfers from the Petroleum Fund



República Democrática de Timor-Leste  
Ministério das Finanças  
Gabinete da Ministra



*"Adens Confliato, Bemvindo Desenvolvimento"*

13th December 2012

Kay Rala Xanana Gusmao  
Prime Minister  
Democratic Republic of Timor-Leste

Dear Prime Minister,

**Subject:** Requirement for transfers from the Petroleum Fund

This report is provided in accordance with Article 9 b) of the Petroleum Fund Law.

As required in Article 9 b) the table below shows the reduction of Estimated Sustainable Income for Fiscal Years commencing after 2013, as a result of the proposed transfer from the Petroleum Fund of an amount in excess of the Estimated Sustainable Income in 2013:

Fiscal Year	Estimated Sustainable Income Withdrawals in 2013	
	\$787.0 million	\$1197.8 million
2014	797.9	785.3
2015	813.0	800.2
2016	830.1	817.0
2017	849.1	835.7
2018	870.1	856.4
2019	892.1	878.0
2020	914.8	900.4
2021	938.2	923.5
2022	962.3	947.2
2023	986.9	971.4
2024	1012.1	996.2
2025	1038.0	1021.6

According to Art. 9 c) the Independent Auditor shall certify the estimates of reduction in the Sustainable Income. The certification report will be submitted to Parliament once it is available.

All calculations have been carried out by technical experts in the Ministry of Finance and with external professional assistance.

Yours sincerely

Emilia Pires  
Minister of Finance

#### **4.2.2: Independent Reassurance Report to the Ministry of Finance**

- To be submitted to Parliament at a later date, prior to the preliminary debates.

#### **4.2.3: Justifications of the Excess Withdrawals from the Petroleum Fund**

- This will be submitted to Parliament separately