Submission to the President of RDTL

from La’o Hamutuk

regarding the Rectification of the 2016 State Budget

28 July 2016

With respect to His Excellency Taur Matan Ruak, President of the Republic,

As you know, on 13 July the National Parliament unanimously approved the mid-year budget rectification, authorizing the withdrawal of an additional $391 million from the Petroleum Fund. This increases the total 2016 state budget to $1.953 billion, the largest budget in Timor-Leste’s history. The money will be spent through the Infrastructure Fund to finance several large projects, including Tasi Mane and Tibar port. However, Decree Law No. 13/2016 on the Regulations of the Infrastructure Fund empowers the Ministers of Planning, Public Works and Finance to reallocate this money to other projects or other years.

La’o Hamutuk is extremely concerned about this budget, which will fund mega-projects with unclear social and economic returns, and which continues to violate the sustainability principle of the Petroleum Fund. We believe that the Government of Timor-Leste needs to focus on the future of our people, rather than simply pouring out money.

La’o Hamutuk greatly appreciates the President’s decision to veto the original 2016 State Budget at the end of 2015, which demonstrated his concern for Timor-Leste’s economic sustainability and his belief that the nation’s resources should be used to benefit the people. Although Parliament ultimately overruled the President’s decision, we encourage the President also to veto this 2016 Rectification Budget, even if Parliament might override his veto again and enact it anyway.

As the Head of State, the President should act as a model for the nation, and he should do what he believes is right, regardless of whether other politicians are making wise decisions in the public interest. The President is responsible only for his own actions, not for decisions made by others. This budget rectification was hastily enacted by Parliament, without adequate time for careful consideration of its content and implications – even the recommendations from Committees C and E are not reflected in the law.

However, Parliament is now in recess, and they will have two more months to reflect and reconsider this rectification budget if the President sends it back to them with suggestions. We hope that this additional time will allow the public and Members of Parliament to realize how much the rectification goes against the public interest. The President has both the Constitutional power and the moral responsibility to provide this opportunity for revision, and we encourage him to carry out his duties.

In order to assist the President in fulfilling his obligation to the people of Timor-Leste, La’o Hamutuk will describe a few reasons why the President should veto this rectification:
Megaprojects need to be analyzed and planned more seriously.

Most of the additional spending in the proposed rectification budget will finance megaprojects such as Tibar port and Tasi Mane. La’o Hamutuk is concerned that this budget exemplifies the Government’s lack of realistic fiscal discipline or planning – for example, the Ministry of Finance and Ministry of Public Works already knew that they would have to pay Bolloré $131 million during 2016 for the State’s part of building Tibar port, but they did not include it in the original 2016 budget.¹ On the other hand, the Government wants to allocate $136 million more for the Tasi Mane project this year, including $96 million for the ‘highway’ between Suai and Beaçu, $30 million for the Suai Supply Base and $9 million for Suai airport. However, the contract for the Suai Supply Base was rejected by the Tribunal Rekursu, and the company has pulled out of the project, so there is no way that a legitimate new tender can be held in time for construction to start this year.² With this budget rectification, the total allocation for the Tasi Mane project during 2016 has increased to $192.9 million, and the allocation for Tibar port is $131.3 million.

In addition to the $391 million net increase, the rectification budget will cut around $25 million in appropriations from maintenance, management and some projects, reallocating that money to others and to pay debts from previous projects.

We are sad that the National Parliament did not consider these key issues when they rapidly approved the budget rectification in only one week. We hope that the President’s decision will address these concerns, in order to encourage more disciplined spending and guarantee that all of Timor-Leste’s people will benefit from the state’s resources.

During the plenary debate, Parliament Committee C presented their analysis, asking the Government to provide updated and detailed information on viability studies for the Tibar port and Tasi Mane projects before Parliament started to debate the proposed budget rectification. The Committee asked the Government to provide estimates of future shipping and container traffic during port operation, as well as projections of returns to the state from the large public investments for these two projects, as required by the Budget and Financial Management Law.

We greatly appreciate that Committee C brought this issue to the Government, as La’o Hamutuk has often encouraged the Parliament to insist that the Government’s projects be planned better, with cost-benefit-risk analyses to determine if the advantages outweigh the financial, social and environmental impacts.³ Unfortunately, the Government has still not provided detailed information or economic data on these two projects.

We also appreciate Committee E’s report, which focused on the weak management of infrastructure projects and urged the Government to pay more attention to maintaining public works. The rectification will reduce the budget for infrastructure maintenance by two-thirds – from $16 million to $5 million – while at the same time allocating more money to rebuild roads which were poorly designed and constructed from the beginning. The rectification also cuts funding for new project design and monitoring in half – from $6 million to $3 million.

La’o Hamutuk observes that the budget does not reflect another of the stated intentions of the rectification: to improve currently weak project planning and monitoring. The rectification budget contradicts the recommendations Parliament made when they approved the original 2016 State

¹ http://www.laohamutuk.org/econ/PPP/Tibar/TibarIndexEnTe.htm#cost
² http://laohamutuk.blogspot.com/2016/06/suai-supply-base-contract-cancelled-its.html
³ La’o Hamutuk’s submission to Parliament about the proposed 2016 Budget rectification, translated at http://www.laohamutuk.org/econ/OGE16/Ret/LHSubmissionPNOR12Jul2016En.pdf
Budget, which asked for stronger investment in project maintenance, design and supervision in order to improve the quality of works for the benefit of the people.

The Government’s position also increases our doubts about the viability and sustainability of these major infrastructure projects. We share the perspective expressed by the President when he vetoed the 2016 State Budget – that it would use the people’s resources in a way that does not benefit current or future generations of Timorese people, undermining the principal objective of the Petroleum Fund according to the law.

**Timor-Leste cannot continue to violate the principle of sustainability.**

The proposed budget increase will be entirely funded by withdrawals from the Petroleum Fund. It will spend 9.2% of Timor-Leste’s entire petroleum wealth this year, more than three times the Estimated Sustainable Income (ESI).

Last June, the IMF published its latest Article IV report on Timor-Leste, announcing that:

> “While prudent saving of its oil wealth in the Petroleum Fund (PF) has provided Timor-Leste with a financial cushion to help offset revenue losses related to the recent fall in global oil prices, fiscal trends under existing capital expenditure plans are unsustainable as the PF will be depleted in the long term at the current rate of withdrawals.”

This report was published with consent from the RDTL Ministry of Finance. The IMF and World Bank economists who wrote it did not imagine that capital expenditure plans would become even more unsustainable a month or two later.

This rectification will increase Timor-Leste’s dependency on petroleum income, which currently funds 90% of the State’s activities. Reflecting La’o Hamutuk’s concern, Committee C recognized that the withdrawing more than ESI from the Petroleum Fund this year will impact the ESI in 2017 and the following years, as well as immediately reducing the balance in the Fund. La’o Hamutuk had previously projected that Timor-Leste’s Petroleum Fund could be entirely spent within ten years. However, if the unthinking overspending proposed in this rectification is a precedent, the Fund could be used up even sooner.

The Central Bank has reported that between January and May 2016, the return on Timor-Leste’s Petroleum Fund investments totaled $429 million. During the first half of this year, $440 million was transferred from the Fund to the State Budget, and the original state budget authorizes $844 million more in transfers before the end of 2016. However, the rectification will increase withdrawals from the Fund by $391 million, which will oblige Timor-Leste to sell more of its financial assets.

The path which the Government is taking does not uphold the sustainability of the Petroleum Fund for current or future generations. We regret that the Government and Parliament have not learned from concerns expressed by many people, including the President,⁵ that we must increase non-oil revenues and withdraw no more than the Estimated Sustainable Income from the Petroleum Fund. Through this letter, La’o Hamutuk encourages the President to continue to urge the Government to respect sustainability.

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In addition to increasing spending on infrastructure this year by $391 million, the rectification increases infrastructure spending by $786 million over the next four years, including $15 million in 2017, $207 million in 2018, $331 million in 2019 and $233 million in 2020.

The Government should prioritize investment in human resources.

We agree with the President’s frequent recommendation that the Government not reduce spending on health, education and agriculture, and we also call for a clear policy to invest in water and sanitation in order to improve the quality of people’s lives.

Unfortunately, the rectification budget which Parliament just approved continues to increase allocations for dubious physical infrastructure, but fails to invest adequately in human resources, basic services and developing the non-oil economy. In fact, total budget allocations for health, education and agriculture have fallen over the last two years.

This graph illustrates that physical infrastructure receives much more money than other sectors.
Timor-Leste will be faced with major economic, social and political problems if we continue to neglect human resources. Today, Timor-Leste could still use the money saved in our Petroleum Fund to improve the lives of our citizens. However, the Fund is threatened by excess withdrawals, and its balance of $16.465 billion at the end of last month is $398 million lower than it was twelve months earlier. If our Petroleum Fund – which depends on non-renewable resources – is used up rapidly, what will Timor-Leste have left to develop our people? Only brave political decisions and sustainable policies from our leaders can save the future of Timor-Leste’s people.

**Important facts to consider**

Since the information provided in the Budget Books about future petroleum revenues includes several omissions, errors and distortions, we would like to share a few important facts with the President of the Republic and hope that these will help the President decide how to respond to the proposed 2016 Budget Rectification:

- Oil revenues continue to fall due to the shutdown of the Kitan field, declining Bayu-Undan production and continued low global oil prices. The year-old “prudent” price projection that the Ministry still uses was that Brent crude oil prices in 2016 would average $64.70/barrel. So far this year, the actual Brent average has been $40.33, and the July 2016 U.S. Energy Information Administration projection is that Brent “reference” prices will average $43.73 during all of 2016. (A prudent price projection would be about $8 lower than the EIA “reference” price).

- However, as Bayu-Undan is more than 90% depleted, future oil prices will not make a large difference in Timor-Leste’s finances even if they go back up. During the first five months of 2016, the JPDA produced 5% fewer average barrels per month than it did during 2015, and 33% fewer than in 2012. Production will continue to decline as the field is nearly dry.

- ConocoPhillips and other oil companies will withhold about $125 million of what they would have paid Timor-Leste this year to recover overzealous assessments of back taxes which were collected in 2012.

- Petroleum revenues deposited into the Petroleum Fund during the first five months of 2016 totaled $146 million, and if they continue at this level Timor-Leste’s total oil and gas receipts this year will be $351 million. Yet the Budget continues to expect $719 million in revenues in 2016.

- The return on investing Timor-Leste’s Petroleum Fund during 2015 was less than zero, yet the Budget Books continue to use an optimistic, speculative prediction that they will earn 5.7% return every year. Global markets continue to be volatile.

- About $641 million of the Fund is invested in securities denominated in British Pounds, and the fall of the pound after the Brexit vote last month cost Timor-Leste about $63 million due to currency exchange rates.
The future ESI figures in the Minister of Finance’s 23 June letter to the Prime Minister are misleading, as they incorrectly assume that no more than ESI will be withdrawn from the Petroleum Fund after 2016, which is not what the Government plans to do. The following table is more compliant with Article 9(b) of the Petroleum Fund Law:

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount the ESI will be reduced each year because of the excess withdrawal during 2016, according to the 2016 Rectification Budget (Ministry of Finance data)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>$34.8 million</td>
</tr>
<tr>
<td>2018</td>
<td>$35.7 million</td>
</tr>
<tr>
<td>2019</td>
<td>$36.6 million</td>
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<tr>
<td>2020</td>
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<tr>
<td>2022</td>
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<tr>
<td>2023</td>
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<tr>
<td>2024</td>
<td>$41.9 million</td>
</tr>
<tr>
<td>2025</td>
<td>$43.1 million</td>
</tr>
</tbody>
</table>

We can see that the excess withdrawal this year will impact the ESI for every year in the future, reducing how much the state can withdraw sustainably by approximately as much as we will spend on the judicial system or on F-FDTL this year.

Therefore, in light of these important economic realities, La’o Hamutuk urges the President of the Republic not to promulgate this rectified budget. In Budget Book 1, the Government rationalizes the mid-year spending increase because “given that next year is an election year, it is expected that there will be a moderate budget that would be unable to accommodate these expenditures.” Unfortunately, this ignores Timor-Leste’s experience: the 2012 State Budget was the largest in the nation’s history … until now.

La’o Hamutuk believes that there is no need for the President to promulgate this rectification, which Parliament approved without public hearings or adequate analysis, consultation or debate. In conclusion, we sincerely hope that this letter will help your Excellency make wise decisions for the benefit of all of Timor-Leste’s people, maximizing the sustainability of our Petroleum Fund. We are ready glad to provide further information or testimony at your request.

Thank you very much.

Sincerely,

Juvinal Dias

Charles Scheiner

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Researchers on Economy and Natural Resources

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