Fiscal Strategies and their Implications for Wealth Distribution

By Charles Scheiner, La’o Hamutuk
ANU 2015 Timor-Leste Update Conference
Canberra, 20 November 2015

Topics to discuss

1. Current poverty, inequality and negligible progress (and the lack of good, current data)
2. Where the state gets its money
3. What the 2016 budget will pay for, and who benefits?
4. Implications for the future of the half of Timor-Leste’s people who are less than 17 years old.

Basic Statistics

- More than half of Timor-Leste’s people live in poverty, and the number is growing.
- Two-thirds of our people live in rural areas, largely by subsistence farming.
- About 1,200 Timorese children under 5 years old die from preventable conditions every year ... 20 times the number of people who die from physical violence.
- Poor sanitation and malnutrition are endemic.

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- Poor sanitation and malnutrition are endemic.
By 2021, 200,000 more babies will have been born, and the only producing oil and gas fields will be used up.

How will they survive?

Agriculture will get 1.9% of state expenditures in 2016, although it is the livelihood of 65% of the population.

Most people live in rural areas by subsistence agriculture.

A malnourished child may be permanently damaged.

An undereducated child will not be a productive worker.

Half of Timor-Leste’s population is less than 17 years old, and the largest group is still in primary school.
More than 70% of Dili’s population are among the wealthiest 20% of Timorese, while only 2% are below the poverty line.

More than half of families outside Dili live in poverty.
Real growth in total GDP

<table>
<thead>
<tr>
<th>Source</th>
<th>Date used</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014 (proj)</th>
</tr>
</thead>
<tbody>
<tr>
<td>RDTL National Accounts (2013)</td>
<td>Jun-15</td>
<td>12.6%</td>
<td>5.2%</td>
<td>-13.9%</td>
<td></td>
</tr>
<tr>
<td>IMF Article IV Consultation (2014)</td>
<td>Oct-14</td>
<td>7.9%</td>
<td>-10.4%</td>
<td>-10.7%</td>
<td>-10.2%</td>
</tr>
<tr>
<td>RDTL 2015 State Budget</td>
<td>Oct-14</td>
<td>9.8%</td>
<td>5.6%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>World Bank EAP Economic Update</td>
<td>Oct-14</td>
<td>5.7%</td>
<td>-3.2%</td>
<td>-6.9%</td>
<td></td>
</tr>
<tr>
<td>IMF Article IV Report (2013)</td>
<td>Dec-13</td>
<td>7.3%</td>
<td>5.7%</td>
<td>-3.2%</td>
<td>-6.9%</td>
</tr>
</tbody>
</table>

Non-oil GDP per capita also fell in 2013, as the population grew faster than the economy.

The non-oil, non-state GDP per capita is stagnant.

Businesses don’t invest in themselves.

<table>
<thead>
<tr>
<th>Sector</th>
<th>Million USD spent</th>
<th>Million USD earned</th>
<th>Million USD taken out</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>$200</td>
<td>$400</td>
<td>$200</td>
</tr>
<tr>
<td>Construction</td>
<td>$100</td>
<td>$200</td>
<td>$100</td>
</tr>
<tr>
<td>Hospitality</td>
<td>$50</td>
<td>$100</td>
<td>$50</td>
</tr>
<tr>
<td>Financial</td>
<td>$500</td>
<td>$500</td>
<td>$500</td>
</tr>
<tr>
<td>Other expenses</td>
<td>$50</td>
<td>$200</td>
<td>$50</td>
</tr>
<tr>
<td>Buy supplies &amp; materials</td>
<td>$500</td>
<td>$500</td>
<td>$500</td>
</tr>
<tr>
<td>Labor costs</td>
<td>$200</td>
<td>$200</td>
<td>$200</td>
</tr>
<tr>
<td>Agriculture</td>
<td>$200</td>
<td>$400</td>
<td>$200</td>
</tr>
</tbody>
</table>
1. Current poverty, inequality and negligible progress

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Petroleum Dependency

- Petroleum GDP in 2013: $4,276 million (76%)
  Non-oil GDP in 2013: $1,319 million (24%)
  Productive sectors (agric. & manufacturing) $165 million (9%)

- Projected state revenues in 2015: $1,594 million
  $1,394 million (87%) will be from oil (incl. $916m investment return)
  $171 million (11%) will be from non-petroleum sources

- 2016 Proposed State Budget: $1,562 million
  $1,184 million (82%) will come from the Petroleum Fund in 2016.
  $107 million (7%) more is from the Petroleum Fund in the past and future.

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

- Balance of trade (2013):
  
  | Imports | $1,536m | $523m | $550m |
  | Exports | $78m | $16m | $14m (coffee) |
  | Deficit | $1,458m | $507m | $536m |

- Petroleum “income” goes to the government, not the people.

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

But we don’t have very much oil.

<table>
<thead>
<tr>
<th>Known oil and gas reserves per person</th>
<th>TL without Sunrise</th>
<th>Australia</th>
<th>Brunei</th>
</tr>
</thead>
<tbody>
<tr>
<td>605 barrels</td>
<td>160 barrels</td>
<td>1,170 barrels+ (1,150 without Sunrise)</td>
<td>6,438 barrels</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>How long reserves will last at 2014 production rates</th>
<th>TL without Sunrise</th>
<th>Australia</th>
<th>Brunei</th>
</tr>
</thead>
<tbody>
<tr>
<td>16 years</td>
<td>4 years</td>
<td>51 years+</td>
<td>23 years</td>
</tr>
</tbody>
</table>
Timor-Leste has already received 80% of the revenues from Bayu-Undan and Kitan, and they could end in five years.

Production is falling faster than the oil price, and will not go back up. The price will be irrelevant when we have nothing left to sell.

Where TL’s oil income comes from

The Petroleum Fund balance is already starting to drop.

The balance at the end of September 2015 was the lowest since May 2014. We have entered a new phase of Timor-Leste’s petroleum dependency.
Australian companies began exploring Sunrise in the early 1970s, after Australia and Indonesia divided our maritime resources without involving Portugal. In 1989, they closed the “Timor Gap” to share illegally occupied resources in the Joint Development Area.

The 2006 CMATS treaty bans maritime boundaries discussion for 50 years. It divides Sunrise upstream revenues 50-50.

Australia put its greed for oil before respect for its sovereign neighbors or international law.

Based on UNCLOS, TL owns everything north of the median line.

This graph includes known fields which would belong to Timor-Leste under the international law median line principle: Bayu-Undan, Elang-Kakatua, Greater Sunrise, Kitan, Laminaria-Corallina and Buffalo.

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The Greater Sunrise stalemate

- The project is stalled because Timor-Leste and the companies do not agree on how it should be developed.
- Woodside and its partners Shell, ConocoPhillips and Osaka Gas believe a floating LNG plant in the sea is the most profitable.
- Timor-Leste wants a pipeline from Sunrise to Beaçu, to get more tax revenues and anchor the Tasi Mane project.
- Under contracts and treaties, the companies can choose the path, but both governments need to approve it.
- TL can withdraw from most of CMATS any time before a development plan is approved.
- Because of Australian spying, TL is trying to invalidate CMATS.

State Budgets 2002-2016

- The narrow bars show revenues from various sources.
- The yellow and red striped area is loans which must be repaid in the future.
- The blue part shows unspent money carried over from the previous year to be spent this year.
- The green part is unspent revenues from taxes/royalties and autonomous agencies.
- Most financing is from the Petroleum Fund (pink and purple), with the darker purple showing the Estimated Sustainable Income (ESI).
PLANEAMENTU NO PANORAMA EKONOMIKA
5 Fatores Prinsipais

1. Prioridade Nasional ba 2016: (1) Edukasaun (2) Saude (3) Agrikultura (4) Infrastrutura Bazika (inklui Bee mos no saneamentu no Operasaun no Manutensaun)

2. Kapasidade Ezekusaun - $1.570 miliaun
   Taxa Ezekusaun to'o dia 9 Novembro 2015 = Real=57%, Obligasaun = 14%, Komitmentu = 8%. Balansu = 21%

3. Sustentabilidade Fiskal:
   Despezas =< Reseitas

4. Kualidade Orsamentu
   – Ligasaun entre Planeamentu, Orsamentu no Monitorizasaun
   – Despezas Rekorentes vs Kapital

5. Kapasidade Ekonomika hodi Absorve
   Inflasaun no despezas ne'ebe saí ba rai-liur

The 2016 Budget still neglects farmers, students, and health care.

Allocation of the proposed 2016 State Budget (US $1,562 million)

Appropriations for “prioritized” sectors in annual State Budgets.

The 2016 budget increases infrastructure and cuts everything else.

Appropriated spending in RDTL annual budgets
La'o Hamutuk for TL Update

Sectoral allocation of the 2016 budget

Building physical infrastructure gets $589m in 2016, 38% of the budget.

To each according to her needs?
Spending is not equitable.

![Graph showing executed state expenditures per person by district for 2013, 2014, and 2015 through 4 Dec.](image)

Donor support is less important now.

![Graph showing percentage of donor support in Timor-Leste's combined sources budget](image)

Spending peaks at year-end.

![Graph showing government executed spending during 2014 and 2015, showing different categories of spending](image)

The Tasi Mane Project includes the Suai supply base, Betano refinery, Beaçu LNG plant, 150-km highway, onshore and offshore pipelines, 2 airports and 2 seaports.
In 2010, Timor-Leste began the South Coast Petroleum Corridor.

Total project costs could be at least $15 billion (much more if Timor-Leste pays for the refinery, gas pipeline or LNG plant).

The state has already spent $94 million on TMP.

The proposed budget allocates $97 million in 2016 and $1.6 billion in 2017-2020, but leaves out the largest items.

The most expensive contract in the nation’s history was signed in August: $719 million to build the Suai Supply Base.

RDTL just signed a $719,212,000 contract with Hyundai Engineering and Construction to build the Suai seawall and Supply Base.

This is more than Timor-Leste has spent on education since independence in 2002.

The Audit Court has rejected the contract, but Government is appealing.

Other TMP contracts for Suai will cost at least $100 million more.

The Suai Supply Base is being built with a $719 million contract to Hyundai Engineering and Construction. This is more than Timor-Leste has spent on education since independence in 2002. The Audit Court has rejected the contract, but Government is appealing.

Other TMP contracts for Suai will cost at least $100 million more.
• It makes TL more dependent on the oil and gas sector.
• Dubious concepts and planning; it is unlikely to provide a reasonable return on the multi-billion-dollar investment.
• It neglects sustainable development (agriculture, tourism, small industries etc.), exemplifying the obsession with oil.
• Nearly all the money will go to foreign companies, providing hardly any local jobs or subcontracts.
• It will create social conflict, take up land, displace people, worsen health and degrade and endanger the environment.
• Cost projections leave out most expenditures, including nearly all of the highway, LNG plant and refinery.
• What if Sunrise gas doesn’t come to Timor-Leste?

Problems with the Tasi Mane project

The Government has made many unrealistic promises to local communities about profit-sharing, jobs and other benefits.

For 2016, ZEESM has $218 million with no accountability.
What are Oecusse’s competitive advantages?
Can ZEESM recover a $4 billion investment?

Who benefits: residents of Oecusse or political ex-opposition?
Overbuilding ports and airports

- IFC is encouraging Timor-Leste to build Tibar port and Dili airport far beyond realistic traffic expectations.
- How will the country pay for a $6 billion annual trade deficit after the oil is gone?

Timor-Leste changes every year.

- Population
  Increases 1.8% every year, slower than 5.3% in 2004 and 2.4% in 2010. The post-war “baby boom” will start having children in the next few years.

- Inflation
  Consumer prices went up 11% during 2012, but rose only slightly in 2013-15 due to slower state spending and the rising US dollar.

Many children will become youth.

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People’s needs and desires will increase as the nation develops.
Timor-Leste is going deeper into debt.

- Laws since 2009 paved the way for foreign loans.
- Between 2012 and 2015, Timor-Leste signed contracts to borrow $211 million from Japan, the ADB and the World Bank to build roads.
- During 2016-2020, TL plans to borrow more than a billion dollars for physical infrastructure:

<table>
<thead>
<tr>
<th>Year</th>
<th>Loans (millions USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>$107m</td>
</tr>
<tr>
<td>2017</td>
<td>$348m</td>
</tr>
<tr>
<td>2018</td>
<td>$366m</td>
</tr>
<tr>
<td>2019</td>
<td>$160m</td>
</tr>
<tr>
<td>2020</td>
<td>$39m</td>
</tr>
</tbody>
</table>

But the 2015 State Budget had different numbers:

<table>
<thead>
<tr>
<th>Year</th>
<th>Loans (millions USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>$194m</td>
</tr>
<tr>
<td>2017</td>
<td>$135m</td>
</tr>
<tr>
<td>2018</td>
<td>$160m</td>
</tr>
<tr>
<td>2019</td>
<td>$50m</td>
</tr>
</tbody>
</table>

Borrowing in GSB 2016. Many projects after 2018 are left out.

<table>
<thead>
<tr>
<th>Project Description</th>
<th>Budgeted Amount (millions USD)</th>
<th>Contracts Awarded (millions USD)</th>
<th>Progress (millions USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Most loans will pay for roads.

Loans will have to be paid back.
Implementing the SDP will require billions of dollars in loans, probably at commercial rates.

Even at concessional rates, repaying a loan will permanently reduce money in the Petroleum Fund. The yen loan makes us hostage to a strong dollar.

TL’s oil and gas reserves are limited, non-renewable, and 75% depleted already.

TL will have to make loan repayments before spending money on people’s needs or developing other sectors.

Our children and grandchildren will inherit the debt after the oil wells have run dry.
La’o Hamutuk for TL Update

Spending

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Thank you.

You will find more and updated information at
- La’o Hamutuk’s website http://www.laohamutuk.org
- La’o Hamutuk’s blog http://laohamutuk.blogspot.com/

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