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Dili, 25 November 2014

Your Excellency Sr. Virgilio Dias Marcal
President, Committee C, RDTL National Parliament

Dili, Timor-Leste

Regarding: La'ó Hamutuk's views on the proposed 2015 General State Budget

- CC :
- Excellencies, Members of National Parliament
 - Media

With respect,

Although La'ó Hamutuk was not invited by Parliament Committee C to testify in a public hearing about the proposed General State Budget (GSB) for 2015, as an organization which was founded to analyze and monitor the development process in Timor-Leste, we are always ready to continue to share our thoughts through this letter, to help assist Parliament in making wise decisions to benefit Timor-Leste's people, both today and in the future. Our observations follow.

Contents

Oil really will run out.	2
Education and health are people's rights, not business for the rich.....	3
Money for veterans is doubled!.....	5
The Tasi Mane Project continues to bleed dollars.	5
Don't spend money on a highway with unknown return.....	6
The Dili Airport project is unclear.	7
Public-Private Partnerships require income.	7
Petroleum House.....	7
The Tibar Port project needs deeper evaluation.....	8
It would be better to learn good practices than to borrow money.....	8
We need more transparency and accountability in the petroleum sector.	10

Oil really will run out.

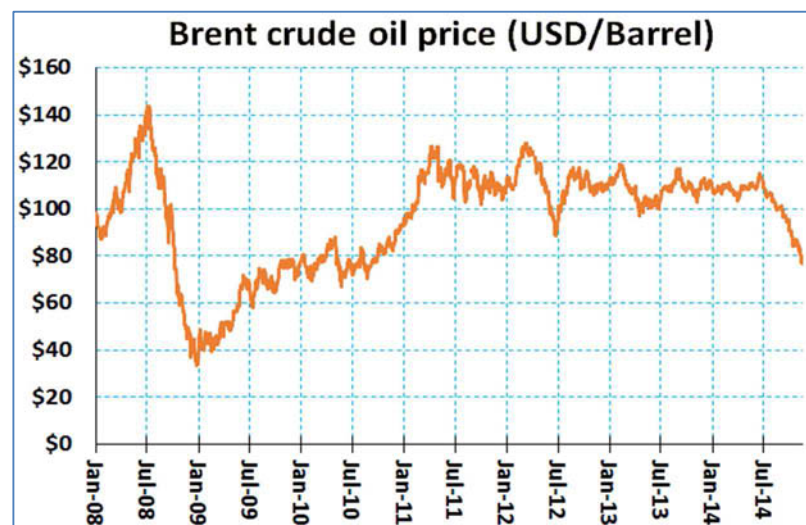
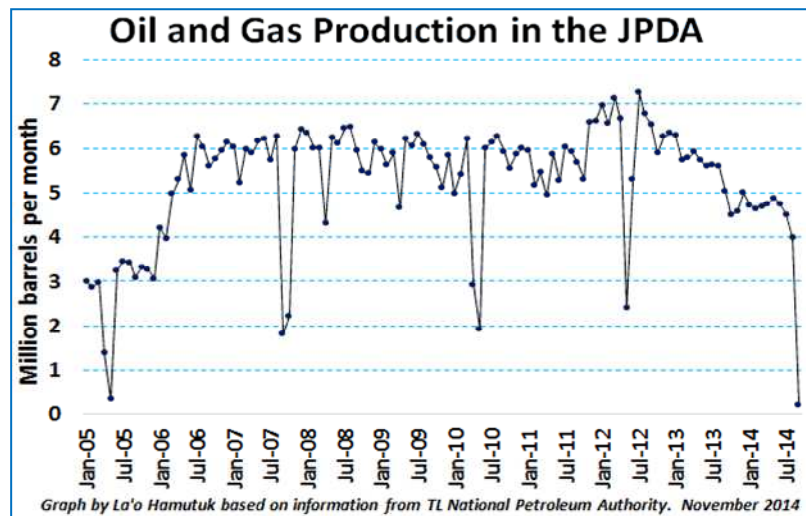
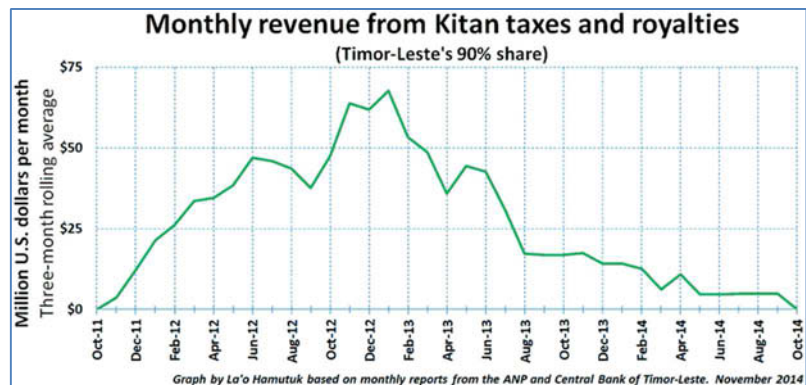
Timor-Leste's oil and gas resources are very limited and have already begun to fall. The Bayu-Undan and Kitan fields have provided money to Timor-Leste to date, but they have passed their peak production since 2012. Kitan will be dry in 2016, and already it only produces one tanker load of oil every three or four months. Bayu-Undan has already dropped significantly, and could be empty by 2020.

This will have a huge impact on our domestic economy, as Bayu-Undan so far has provided nearly all of Timor-Leste's income. From January-September 2014, oil and gas production from the Joint Petroleum

Development Area (JPDA) averaged 4.1 million barrels/month, 33% less than the average during 2012, and the lowest level since production began in 2006.

Coincidentally, from July 2014 until today, the world market price for Brent crude oil fell by 30%, to \$76.86 (17 Nov.), the lowest price in four years. Although the price of oil will rise and fall in the future, the most important reality is that production from Timor-Leste's reserves will continue to decline. Each year, the Ministry of Finance projects lower future revenues from Bayu-Undan, which will critically affect Timor-Leste's state finances and economy.

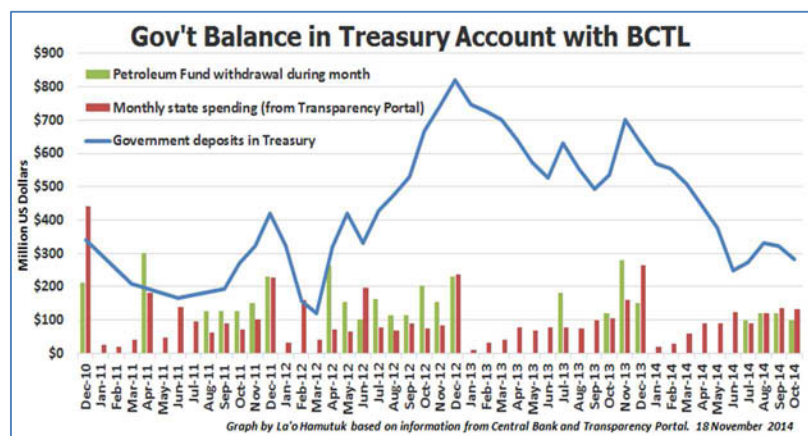
Some oil and gas regulators and promoters are more optimistic -- that Bayu-Undan will last until 2022, not 2020. However, adding only two years is not significant when we consider



the future of our entire nation. Parliament should understand the uncomfortable reality that people who work in oil and gas will always defend the sector for which they are responsible.

We are already in a phase where we urgently need to diversify our domestic economy, to make it sustainable. Money from our very limited petroleum reserves must be used wisely, not wasted on large, expensive things or projects that cannot benefit Timor-Leste's people.

In the proposed General State Budget for 2015, Government will spend \$1.57 billion, of which \$1.33 billion will come from the Petroleum Fund. High withdrawals from the Fund will continue in 2015 because Government promised to spend all the money approved in the 2014 GSB by the end of the year, and will roll over only \$2.1 million from 2014 to 2015. This is less than last year, because Government followed the suggestion from La'o Hamutuk and others to reduce the balance in the Treasury operating account, rather than taking more than they need from the Petroleum Fund. We appreciate this effort, which leaves a Treasury Balance of around \$300 million, which is what the Prime Minister requested during the revision of the 2014 GSB law. Keeping money in the Petroleum Fund will probably increase future investment returns.



Although we don't yet know how much money will be taken from the Petroleum Fund in 2014, the Central Bank has said that the Government will withdraw \$540 million from the Petroleum Fund through the end of November. We hope that by the end of 2014, total withdrawals will be no more than the 2014 Estimated Sustainable Income (ESI) of \$632.3 million, leaving more in the Petroleum Fund for the future. We support the Government in keeping withdrawals under ESI in 2014, and we encourage Parliament to authorize PF withdrawals during 2015 as no more than the 2015 ESI of \$638.5 million.

We would also like to recall that, although we don't yet know the final results of all the petroleum tax cases under arbitration in Singapore, if Timor-Leste loses some of these cases, our Petroleum Fund will be further depleted, as we may have to repay the companies for taxes they overpaid pending appeal, either by direct payment or through reduced receipts of oil revenues for several months, as well as possible interest and legal costs.

Education and health are people's rights, not business for the rich.

Since independence in 2002, the RDTL Constitution has guaranteed access to public health and education which is free or inexpensive (for public universities). As the 2011-2030 National Strategic Development Plan says "We will invest in education and training to ensure that by 2030, the people of Timor-Leste are living in a nation where people are educated and knowledgeable, able to live long and productive lives, and have opportunities

to access a quality education that will allow them to participate in the economic, social and political development of our nation.”

To the contrary, in the 2015 budget year, Government will invest less in the health and education sectors than in the 2014 budget. Government allocates only 4.7% of the total budget for health and 9.2% for education. This inadequate investment in these social sectors will damage poor people’s lives, preventing people living in rural areas from accessing appropriate health and education. Today, the many children born after the end of the occupation need these social services. Depriving these children of adequate health care, education and nutrition permanently damages the nation’s future, as well as the quality of their own lives.

We are also saddened that the proposed 2015 GSB includes planning to develop the health and education sectors with private companies through Public-Private Partnerships (PPP), a business mechanism to share profit and risk between the state and the private sector. Although this is only a preliminary discussion, we think that it is not good policy to involve for-profit companies in providing essential public services, as they will not prioritize our people’s needs. Such a policy will break the promises of Article 57.2 of the RDTL Constitution: “The State shall promote the establishment of a national health service that is universal and general. The national health service shall be free of charge in accordance with the possibilities of the State and in conformity with the law.” and Article 59.1 “The State shall recognize and guarantee that every citizen has the right to education and culture, and it is incumbent upon it to promote the establishment of a public system of universal and compulsory basic education that is free of charge in accordance with its possibilities and in conformity with the law.”

We see this as very dangerous. When the state neglects its responsibility to work hard in these sectors, to identify and fix failures which occur, we should be embarrassed to expect private companies to effectively repair our health and education systems, when we ourselves have not deeply analyzed our own problems and taken serious efforts to address them.

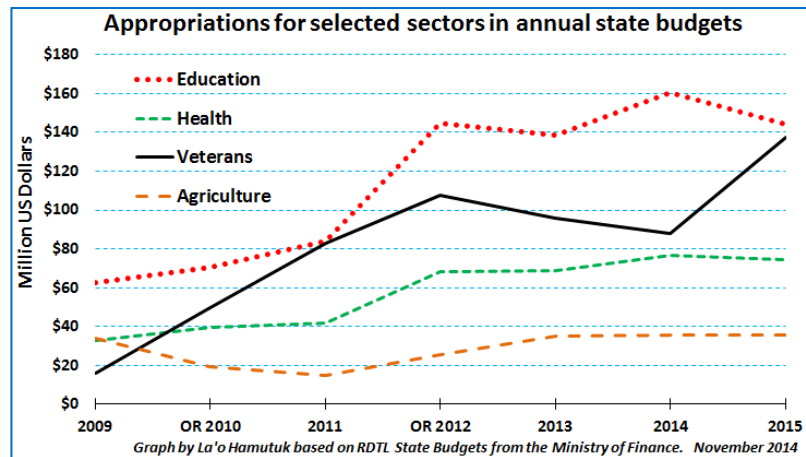
If Government does go ahead with studies for PPPs, we suggest that these studies must involve, consult with and truly listen to concerns from the public, civil society, and professionals in these sectors, as well as the recipients of these services. Furthermore, the record of privatization of health and education in other countries shows that poor and marginalized people, with little political influence, rarely benefit, but that such systems often work best for an already privileged minority. Timor-Leste should learn from these experiences, and ensure that we do not repeat their mistakes.

Money for veterans is doubled!

Timor-Leste allocates money from our limited petroleum resources to finance state activities, including paying the veterans of our struggle for national liberation. For nearly a decade, veterans have received special privileges from the state, including money and infrastructure projects.

Although Ministry of Finance

officials have said that this money is keeping a “promise,” we are not clear what promise was made and by whom.



According to Book 4 of GSB 2014, appropriations for personal transfers to veterans during 2014 were \$79 million, although the Transparency Portal says \$69 million, of which \$56 million has been spent to date. During 2013, we spent \$73 million on veterans.

For 2015, Government has requested \$130.5 million, more than double last year, with no explanation in the budget documents. This is a huge increase, especially when compared with cuts in education and health.

The Tasi Mane Project continues to bleed dollars.

The Tasi Mane Project is still in the 2015 GSB, although in each fiscal year the appropriations for this project gradually fall. If these budget changes are because leaders have agreed that this project is not a good idea, it would be better not to continue to pour good money after bad, and to stop wasting financial and human resources on more studies. These could be reallocated to sectors which are more promising for the nation's future. La'o Hamutuk has expressed doubts about this project's economic viability, social impacts (including taking people's land) and environmental risk since its beginning, as it prolongs our dependency on petroleum and squanders time, resources and opportunity cost that could be used to develop a more productive, sustainable economy.

The proposed 2015 General State Budget allocates \$37.6 million for the Tasi Mane Project (TMP), as well as \$18 million for Suai airport. Book 6 of GSB 2015 projects that between 2016 and 2019, Government plans to spend more than \$400 million for parts of the Tasi Mane Project. Unfortunately, the proposed Budget continues to leave out the total cost of the TMP. It has no information about construction costs of other components such as the highway, the LNG plant in Beaçu, or the refinery and petrochemical plant in Betano, but only includes amounts for studies. For the Betano refinery, TimorGAP signed an agreement a few years ago with PTT (Thailand's national oil company) and other partners, but the 2015 Budget Books and TimorGAP's testimony to Parliament say nothing about what obligations they have committed Timor-Leste to, or how the project will be financed. In addition, TimorGAP will become the owner of this Tasi Mane Project, and has allocated \$1.25 million

to TMP from the \$6.7 million subsidy it will receive from the 2015 GSB through the Ministry of Petroleum and Mineral Resources.¹

During the hearing with MPRM, several Members of Parliament asked about the controversy over land for the Suai Supply Base, and MPRM explained that the land disputes between the community and MPRM occurred because there is not yet an Expropriation Law. Because the *lia na'in* (traditional leader) is not the *rai na'in* (land owner), he/she doesn't have the authority to give people's land to the state. Therefore, we suggest that Parliament should tell TimorGAP to stop taking community land for the Tasi Mane Project until the Expropriation Law has been enacted, and we urge Parliament to protect local people's rights when you approve this law.

In addition to problems with land and economic viability, this project will degrade our environment. For the Beaçu port for LNG tankers, TimorGAP has changed its plan to build the port from a breakwater to making a harbor where Beaçu village is currently located, greatly increasing the negative consequences on local people. We are also concerned that the environmental license for Suai Supply Base and Airport did not include free and informed community consultation to receive consent, and that the Environmental Impact Evaluation only looked at the construction phase, although it is clear that toxic chemicals and other dangerous materials will be involved during project operation. Timor-Leste's environmental authorities have told La'o Hamutuk that they issued the environmental license for the Suai projects due to political pressure, and were not allowed to follow the law or their own procedures for proper environmental assessment and planning.

Therefore, we suggest that Parliament should not approve any more money for the Tasi Mane Project until you receive information about its total cost and economic and social return, so that you can assess whether it is worth building. Without a decision on the Sunrise pipeline or the discovery of new commercially-profitable oil fields in the Timor Sea, it makes no sense to spend more money on studies, especially when Parliament and the public have not been allowed to see the studies already completed with millions of public dollars.

Don't spend money on a highway with unknown return.

GSB 2014 did not appropriate any money for the South Coast highway project, although the Government had opened a tender in 2013 for international companies to start its construction. In our letter to Parliament last year about the proposed GSB 2014, La'o Hamutuk "welcome(d) the removal of funding for the South Coast Highway in OJE 2014 and hope(d) that the tenders in process will be cancelled and the project will be permanently stopped." Unfortunately, the Government wants to spend \$15 million in the 2015 budget, of which \$10 million will come from loans.

The 2015 General State Budget contains no information about the total cost of this project, although several years ago, the Government hired the Indonesian company Vikrama Karya to study this highway, and they estimated a total cost of \$1.2 billion based on costs in Indonesia, which are usually less than half those in Timor-Leste. However, Book 6 of GSB

¹ TimorGAP presentation to 7 November 2014 hearing of Parliament Committee C on proposed GSB 2015 <http://www.laohamutuk.org/econ/OGE15/MPRM/TimorGAP.pdf>

2015 shows zero expenditure for the highway project between 2016 and 2019. Therefore, if Government is thinking not to build this highway, it would be better not to throw any more money at it.

Although we agree that South Coast communities should have access to good roads, we think that they don't need a very expensive highway, whose principal objective is to facilitate petroleum projects whose future and viability remain unclear. We suggest that Parliament should not approve money for this project, especially borrowing, when you have not yet seen the studies TimorGAP has already done. Furthermore, we think it is important for Parliament to give the highway project the go-ahead only after you have received comprehensive information on its total cost, loan conditions, who will give the loan, and the project's economic and social returns.

The Dili Airport project is unclear.

Since 2011, Government has been supported by IFC (International Finance Corporation, part of the World Bank Group) to develop a Public-Private Partnership (PPP) to expand Nicolau Lobato airport in Dili. After spending money on studies, IFC and Government decided a few months ago not to continue to work together on Dili Airport, because the Government wanted to build a bigger, more expensive project than IFC and private investors believe is justified.

In spite of this, Government will continue this airport project without a PPP. Although GSB 2015 appropriates only one million dollars for 2015, it projects to spend \$245 million more from 2016-2019, and we believe that outlays will be even higher after that because peak spending is in the last year listed. It is important for Parliament to consider how the "investment" in the airport will be recovered, as ANATL's revenues are only \$1.2 million per year. In addition, we need solid analysis and projections for airport traffic, including numbers and destinations of daily flights.

Public-Private Partnerships require income.

Petroleum House

In 2014, Government allocated \$500,000 to build an office for the Ministry of Petroleum and Mineral Resources (of which \$330,000 will be spent), and another \$500,000 for the office of the Institute of Petroleum and Geology (IPG) (which has not been spent). For 2015, Government plans to include these offices in a PPP project called Petroleum House, together with an office for TimorGAP. (This does not include ANP, which will get space in the new Ministry of Finance office tower.)

The 2015 GSB has no budget line for this PPP project in 2015, although it includes a projection to spend \$17.7 million on it during 2016-2019. Although the IPG office is discussed a little in Budget Book 2, IPG did not mention it when it presented to Committee C. TimorGAP's presentation also left this project out of their projected budget.

La'o Hamutuk is concerned when state agencies do not provide adequate information, especially in terms of total project costs, how companies and the state will share risks and

profits, how companies will receive revenues, and who will pay for investment costs. Is this office to follow the Timor Plaza standard that TimorGAP has become accustomed to? We suggest that Parliament ask for and receive more information before approving this project, to avoid people's money from being used for personal or private interests.

The Tibar Port project needs deeper evaluation.

The 2015 Budget continues Tibar Port with a 2015 appropriation of \$4.6 million, with plans to spend \$84 million from 2016-2019, a figure which rises and falls every year – in 2013 Government estimated the capital investment in this project at \$300-400 million.

For several years, La'o Hamutuk has been concerned that IFC's studies for Tibar Port expect Timor-Leste to continue extreme import dependency, providing profit for the private partner in the port. According to IFC's project, the tonnage of imported containers will increase by 4.8 times from 2013 to 2030, while full container exports will increase by a factor of five. If the value of goods per ton remains unchanged, Timor-Leste's annual trade deficit in 2030 will be \$2.4 billion according to these projections, increasing to nearly \$4 billion by 2040.

According to the Directorate-General for Statistics, Timor-Leste imported \$523 million in goods in 2013, with non-oil exports of \$18 million. This deficit is covered by oil and gas money from Bayu-Undan and Kitan, which will stop coming in six years, and the Petroleum Fund may be empty five to eight years after that. IFC expects Timor-Leste's exports to be only \$90 million in 2030, and Parliament and Government need to develop reasonable forecasts based on Timor-Leste's economic context today and tomorrow. If not, Timor-Leste will spend money on a huge project from which we will never be able recover the capital investment. Even if a private partner pays for some of the construction costs, Timor-Leste's people will likely be obligated to reimburse the difference between the investor's expected profits and the project's actual return.

It would be better to learn good practices than to borrow money.

Timor-Leste created the legal foundation for borrowing in 2009, and most loans so far have been for rehabilitating roads. Although La'o Hamutuk has called attention to the dangers of borrowing for several years, Government continues to put new loans in the budget and to sign new contracts.

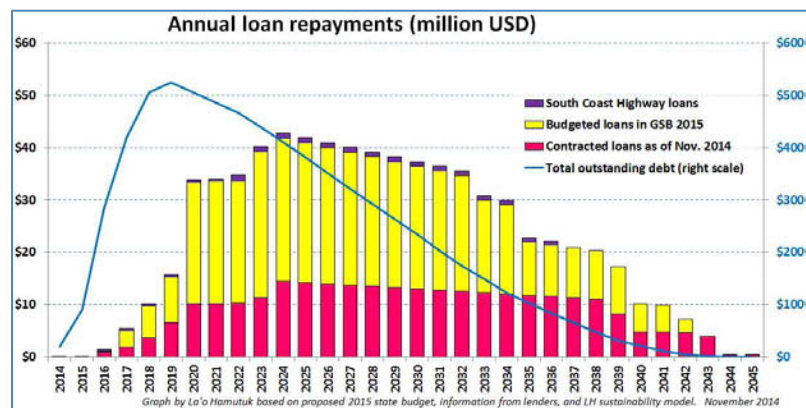
However, we are glad to see that the amount of borrowing is less than in previous projections. For example, GSB 2013 expected that we would have borrowed \$190 million by the end of 2015, but GSB 2015 says that the total outstanding loans at the end of 2015 will be \$105 million. We appreciate the smaller burden these debts will impose on future generations, although we fear that the low debt to date may be only because some projects are behind schedule, and could increase greatly when all currently approved projects begin to be built.

The proposed 2015 budget includes \$70 million in borrowing in 2015, and Book 1 says that loans during 2016-2019 will total \$539.8 million, but there is no information about how much of this money will be used for what. Government projects borrowing \$194.4 million in

2016 and less per year after that, but we believe that they intend to borrow more from 2017 on which is not shown in the Budget Books. Therefore, we suggest that Parliament and the public need to know what the Government plans to do with borrowed money during the next few years.

Since 2009, we have been told that borrowing is good for Timor-Leste because of low interest rates and grace periods, but the reality is that not every loan the same. Some loans have fixed concessional interest rates, some are at commercial rates, and some are tied to the unpredictable global loan market.

Another problem is that borrowing encourages more spending now on physical infrastructure, with less analysis and attention to the costs and benefits for each project, rather than using money more wisely in the future. Even if the debt service costs are lower than the return on Petroleum Fund investments, borrowing undercuts the principle of sustainability which is the foundation of the Petroleum Fund, because it commits Timor-Leste to take more money from the Fund in the future (for as long as it exists), in order to pay for projects we are building today. Even with low interest, we will have to repay the principal, and 95% of Timor-Leste's income is from temporary oil and gas.



We suggest that Parliament not only look at low interest rates and grace periods, but relate borrowing policies with the nation's social and economic conditions ten years from now, when Kitan and Bayu-Undan have been used up. Our many children born after 1999 will be finished with school and looking for jobs, adding to the state's burden to provide work and development for our people. But at the same time, we will be seeking money to repay the loans we are taking out today. What will Timor-Leste use to repay the debt obligations we are creating today?

Today, many people feel good about some results from the road projects managed by ADB, JICA and the World Bank, and would like these agencies to build other infrastructure. La'o Hamutuk believes that if this technical assistance from the World Bank, ADB and JICA is truly valuable, it would be better for Timor-Leste to purchase this assistance directly, or ask for donors to provide it free, rather than receiving it as part of a project loan which we will eventually have to repay. If we receive technical assistance directly, we can better control and manage it, and apply it to other projects in addition to those financed by loans, as well as using it to enhance the Government's own project management capabilities.

In addition, the proposed 2015 General State Budget does not mention the money that Timor-Leste will have to pay back to lenders during 2015-2019. La'o Hamutuk estimates that this will be a few hundred thousand dollars in 2015, but could be as much as \$10 million by

2018. Article 6 of Law no. 13/2011 on Public Debt states that “The payment of interest and capital depreciation on government debt are ensured by non-earmarked revenues included annually in the State Budget.” Unfortunately, this is not included in the proposed 2015 GSB, and we suggest that Parliament ask Government to provide this information before approving the budget.

TimorGAP’s submission to Committee C mentions its involvement with around ten consortia or joint ventures, many of which will require capital investment far beyond TimorGAP’s own resources. Article 9(h) of TimorGAP’s Statute (Annex to Decree-Law 31/2011) allows the national oil company to take out loans without approval of Parliament or Government. If TimorGAP borrows from its joint venture partners or other sources to pay for its share of such investments, this will impose another debt burden on the state of Timor-Leste. Therefore, we urge Parliament to carefully monitor this, and, if it happens, Parliament and Government must ensure that this process follows the investment policy and strategy of the state, and is fully transparent.

We need more transparency and accountability in the petroleum sector.

Since 2010, Timor-Leste has been proud to be the third nation in the world to comply with the Extractive Industries Transparency Initiative (EITI) standard. La’o Hamutuk appreciates the hard work to ensure transparency and accountability in extractive industries, but on the other hand, we continue to encourage state institutions, especially those which work in the petroleum sector, to guarantee transparency and accountability in their own practices. This is essential because the petroleum sector involves a lot of money and often comes with corruption, conflicts of interest, tax evasion and other maladministration and crime.

In the proposed GSB for 2015, the Ministry of Petroleum and Mineral Resources allocates \$11.5 million in public transfers: \$6.7 million for TimorGAP, \$2.8 million for ANP and \$2 million for IPG. Compared with 2014, this is a 34% increase for TimorGAP and 18% for IPG. Because ANP has millions of dollars in the bank, its subsidy should be reduced by more than the 7% cut MPRM proposes.

Between 2011 and 2014, TimorGAP alone received \$13.3 million through SERN and MPRM, and recently shared its Annual Reports for 2011-12 and 2013 with Committees C and D, even though they are not yet officially published.

Although we have not yet thoroughly analyzed these reports, our preliminary examination shows that they include negligible information about how TimorGAP has spent the money which Parliament has given it, with nothing about the investments, spending, revenues, profit and loss for each of TimorGAP’s business activities, including its partnership with Malaysian Helicopter Services (MHS), and the fuel port and supply at Hera which it failed to finalize. The reports say nothing about how much money it spent on salaries, travel and other things. In 2013 TimorGAP spent \$1.5 million on personnel for about 83 workers, an average of \$1,483 per person per month. This is almost five times as much as, for example, the \$324/month average the Ministry of Health spent on salaries for its 5,278 staffers, totaling \$20.5 million.

The National Petroleum Authority (ANP) is also challenged by transparency and accountability. The audit of ANP by the *Câmara de Contas* identified many significant weaknesses, including that ANP's reports for 2010-2012 often left out financial information, paid high salaries, and had many internal policies which had not been approved by their oversight agencies, MPRM and the Australia-Timor-Leste Joint Committee. ANP's procurement practices did not follow Timor-Leste procurement law.

In their 2013 Annual Report, ANP cites the "Otherways Golden Award" as its first "Major Achievement" during 2013. We hope that Parliament will ask how much of Timor-Leste's people's money ANP paid to the organization and the event which awarded this prize, and whether this expenditure benefited the Otherways Management & Consulting Association or the people of Timor-Leste.

We predicted some of these problems before ANP was established in 2008, and we often point out that in many nations affected by the "resource curse," people with the chance to access oil and gas money become a privilege, corrupt class. We do not think that this has yet happened in Timor-Leste, and hope that it never will. Therefore, we ask Parliament to approve ANP's money only after you are certain that they have implemented the recommendations of the *Câmara de Contas*. In addition, we suggest that the allocations for TimorGAP, ANP and IPG not be done as Public Transfers through MPRM, but as separate appropriations like nearly every other state agency, with complete information about what is appropriated and spent on salaries, goods and services, public transfers, minor capital and development capital, with their financial allocations and contracting spelled out in the State Budget Books and Transparency Portal.

On another topic, the Government of Timor-Leste has recently hired several international lawyers and law firms, including Arent Fox, Bernard Collaery and DLA Piper, to advocate for Timor-Leste in the International Court of Justice, tax arbitration, CMATS arbitration and other areas. However, the tens of millions of dollars paid to these attorneys is often left out of the proposed State Budget, financial reports, Transparency Portal and Procurement Portal. We encourage Parliament to ask Government to explain how much has been paid to each lawyer and law firm, and how this has been used for Timor-Leste's benefit. We see this as critically important to ensure that the people's money goes for people's needs, not to benefit others. We all need to reflect on the experience with Bobby Boye,² the petroleum tax advisor in the Ministry of Finance who was paid hundreds of thousands of dollars by Timor-Leste, stole \$3.5 million and whose "work" may cost Timor-Leste even more.

This concludes our open letter, and we are grateful for our collaboration with Parliament, and are always ready to share more information and thoughts with your Excellencies, Members of Parliament, at your wish and convenience.

Sincerely,



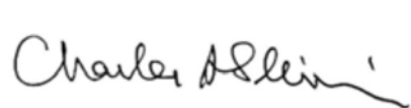
Juvinal Dias



Adilson da Costa Junior



Celestino Gusmão



Charles Scheiner

Researchers in Economy and Natural Resources at La'ó Hamutuk

² <http://laohamutuk.org/econ/corruption/Boye/14BoyeCaseTe.htm>