



VIII CONSTITUTIONAL GOVERNMENT

Proposed Law approving the General State Budget for 2020

Explanatory Memorandum

Introduction

Pursuant to Article 97.1(c) and Article 115.2(a) of the Constitution of the Democratic Republic of Timor-Leste, the Government proposes to the National Parliament the present Proposal of the General State Budget (GSB) for 2020.

The present GSB Bill for 2020 covers all State and Social Security revenue and expenditure of the Democratic Republic of Timor-Leste for the period from 1 January to 31 December 2020.

Grounds for the proposal

The General State Budget (GSB) is the main instrument of Timor-Leste's economic and financial policy, providing for the income and expenses that will create the conditions for the country's economic development.

The State Budget is also the main instrument for implementing the measures proposed by the VIII Constitutional Government and set out in its Program, which aims to prepare the country for the short, medium and long term challenges, which are expressed in the Strategic Development Plan 2011-2030 and in the Sustainable Development Goals.

Currently, the state remains the main driver for promotion of development in Timor-Leste. This is not surprising given the level of economic development in our country, in which the foundations for the development of an active and resilient private sector are still being laid.

To this end, the VIII Constitutional Government proposes to make profound improvements in the various sectors of governance, with particular focus on the implementation of activities that enable the development of basic infrastructure, as well as in the areas of tourism, health, education, agriculture, drinking water, investment in human capital, institutional strengthening, the devolution and administrative decentralization and promotion of private sector investment.

It is worth noting in particular the impact of the entry into force of the Treaty between the Democratic Republic of Timor-Leste and Australia establishing their respective maritime borders in the Timor Sea, which creates a stable legal framework for the exploitation of oil and gas resources industry in the Timor Sea. We will therefore continue, as a major national project, with the development of the Tasi Mane project, which includes the Suai supply base, a Betano refinery and the Liquefied Natural Gas (LNG) plant in Beaçó, creating the necessary conditions for the exploitation of the *Greater Sunrise fields* and benefiting from the opportunities offered by the development of the oil and gas industry.

Also noteworthy is the purchase of the Nakroma II ferry, which will make it possible to substantially improve passenger and freight connections between Dili and the other municipalities, and will naturally have a positive impact on domestic economic activity.

The present State Budget Bill contains the budget allocations required to implement the above policies, which should be done through demanding, efficient and effective public financial management.

Macroeconomic scenario

By the end of 2019, the world economy is approaching a period of uncertainty after several years of substantial growth, which is due in particular to threats looming over international trade. However, Timor-Leste should, after an unfavorable economic period, return to robust growth, and should be relatively immune to the global slowdown.

It is expected that the real growth of non-oil GDP to accelerate, with an increase of 5.1% in 2019 and of 7.2% in 2020. This return to growth is driven by political stability and the substantial increase in public spending. It is expected that living standards will improve, with household consumption to grow 3% in 2020, augmenting investment by the private sector. These investments are consistent with the Government's economic strategy to attract investors and create jobs in the domestic market, coupled with continuous public investment in human capital and education.

Consistent growth in consumption is driven by a low inflationary environment. Inflation is expected to remain low and stable at 1.1% in 2019 and 2.7% in 2020. This will contribute positively to Timor-Leste's competitiveness, with inflation expected to be below the regional average.

Petroleum Revenue

In preparing the state budget for 2020 the petroleum wealth was estimated at \$17,891.8 million. Therefore, the Estimated Sustainable Income (ESI) of 3% is estimated at \$536.8 million. This amount is \$7.8 million higher than estimated in last year's budget.

Revenues to the Petroleum Fund for 2020 are estimated at \$1,226.7 million. The return on investment is 3.8%, which translates into an investment result of \$632 million.

It is expected that the balance in the Fund will be \$16,828.4 million at the end of 2020 after deducting the withdrawal of \$1,466.5 million in 2020 to be approved by the National Parliament. The transfer of the Petroleum Fund to be made during 2020 is \$929.7 million higher than the ESI.

The investment policy of the Petroleum Fund is based on an asset allocation and risk limits as defined in the Petroleum Fund Law as revised in August 2011. It presents a portfolio for investing the Petroleum Fund around 35% in equities, around 55% in government bonds and 5% in petroleum operations, with 5% available in cash.

The Human Capital Development Fund

The Human Capital Development Fund, established under Article 32 of Law No. 13/2009 of 21 October on Budget and Financial Management, and Article 9 of Law No. 1/2011 of 14 February, which approved the State Budget for 2011, is regulated by Decree-Law No 12/2011 of 23 March.

The Fund allows the State to invest in the qualification of our people through a specific and targeted instrument, with budgetary and accounting autonomy, and greater transparency and accountability.

Is an ongoing review of Decree-Law No 12/2011 of 23 March, to revise the management model Fund and to develop and deepen the rules on financing programs and projects, central to the Fund's activity in the financing of technical and/or vocational training programs and scholarships and expressly establishing the preferential criteria which the programs must meet.

It is expected that the investments made are the fund will have a substantial impact on economic development of the country, since it depends on technical and academic qualification of national human resources.

Non-Oil Revenue

For 2020, projected to increase non-oil revenues, with an expected recovery of 210.5 million dollars, with taxes to reach 133.4 million. This forecast stems from the improved macroeconomic outlook and the improvement of private sector conditions.

Nonetheless, there is a diverging trend between direct and indirect taxes, with the former declining from last year to \$50.4 million and the latter increasing to \$83 million.

Domestic revenues continue to constitute only a small part of the overall revenues and its percentage weight in total revenues is expected to be slightly below the previous year.

However, recent legal changes to the structure of the Ministry of Finance, the Tax Authority and the Customs Authority should allow for an improvement in public revenue collection, which should be complemented by the revision of the Tax Law in the short term to match the Timor-Leste's fiscal framework to international best practice.

Public debt

Article 20 of Law No. 13/2009 of 21 October on Budget and Financial Management, as well as Law No. 13/2011 of 21 February on the Regime of the Public Debt, provide for the possibility of borrowing by the state.

It is on this legal basis that the Government submits to the National Parliament a proposal for authorization to contract additional concessional loans of up to \$750 million with a maximum maturity of 40 years, as well as mobilization and disbursements of up to \$73 million, which for legal obligation should be intended only for the construction of strategic infrastructures for the development of the country.

Still, Timor-Leste's public debt level is expected to remain very low, not substantially encumbering the State Budget.

Treasury Account Balance

According to the best international accounting practices, funds not used in the State Budget for 2019 and carried over into the State Budget 2020 as revenue are entered in the source of funding as "Treasury Account Balance," in order to finance budgetary appropriations in the state budget this year.

A carry-over balance of \$200 million is expected for 2020, which is a significant increase from the year 2019, when no amount has been entered for this source of funding.

Expenditure entered in the State Budget 2020

Salaries and Benefits

The total budget for salaries and benefits is \$241,271 million. This amount increased by 12.6% in the State Budget for 2020 compared to the allocation to 2019. This is due to cost increases caused by changes in the governance structure and the payment structure.

Key measures in this category include, among others:

- \$6.5 million for all municipalities, intended to fill positions in the structures of the local administration.
- \$2.0 million to the Ministry of Finance for payments to its employees under the Special Regime.
- \$1.6 million to the Ministry of Foreign Affairs and Cooperation for the recruitment of new diplomats.

Unofficial translation by La'o Hamutuk.

- \$936,000 for the F-FDTL for the recruitment of 600 new members.
- \$730,000 to the Civil Service Commission for internal promotion of civil servants.
- The remaining increases the wage level are due to the enactment of new organic laws, which caused internal restructuring and created new positions which will be filled through it the State Budget for 2020.

Goods and services

The total of the budget for Goods and Services category is \$727,587 million, which is in 2020 an increase of 53.8% compared to the allocation in the State Budget for 2019. These funds will be used to properly execute the plans of the line ministries, including the carrying out of maintenance to ensure optimal continued use of the assets infrastructure resulting from previous investment.

Key measures in this category include, but are not limited to:

- \$173.9 million to the Ministry of Public Works to pay for fuel and maintenance for the electric generators in Hera and Betano. This includes the maintenance of electrical transmission towers (150KW) and substations (20KW) in seven key locations (N117, N31, N71, N72, N15, N24, N34 and N76). Electricity supply throughout the country is essential for generating growth and development in the country.
- \$92.0 million for Whole of Government, for Counterpart Fund. This will contribute to the further implementation of major co-financing projects, including among others the purchase of a fleet to patrol maritime borders and the purchase of the ferry Nakroma II.
- \$15.0 million for Whole of Government for legal services. This money will allow the state to defend itself from various lawsuits.
- \$5.5 million for Whole of Government, for the repayment of loans relating to Electricity of Timor-Leste (EDTL).
- \$5.0 million for Whole of Government for new civil aviation provisions.
- \$5.0 million for Whole of Government to pay dues to international institutions. This will ensure Timor-Leste's continued participation in regional and international activities.
- \$4.9 million for SAMES to purchase medicines to improve the quality of health services provided in the country.
- \$3.5 million to the Ministry of Public Works for water and sanitation projects in rural and urban areas. The development of water and sanitation infrastructure is one of the government's top priorities for 2019 and for the next five years.
- \$3.0 million for Whole of Government for the population and housing census. This will help to define future socio-economic development programs.
- \$2.7 million to the Ministry of Finance to support Tax Reform and Public Financial Management (PFM). The Tax Reform and PFM includes tax reform and customs, budgeting programs, the spending reform (public accounting and procurement systems) and the reform of management performance. These reforms are crucial for strengthening fiscal sustainability and Public Financial Management across government.
- \$2.4 million for Whole of Government for the international tournament of the Community of Portuguese Speaking Countries (CPLP) in Timor-Leste.
- \$2.1 million for the Office of the Prime-Minister, for participation of Timor-Leste at the Dubai Expo.
- \$1.0 million to the Ministry of Agriculture and Fisheries for the transport of local produce, which will help farmers move their produce from the farm to the market.

Unofficial translation by La'o Hamutuk.

- \$600,000 to the Ministry of Higher Education, Science and Culture to raise awareness about malnutrition, poverty alleviation and environmental diversification.

Public Transfers

The total budget for the category Public Transfers is \$469,773 million, which represents an increase of 29.5% compared to the 2019 state budget.

The main budgeted measures in this category are as follows:

- \$93.0 million to the Ministry of National Liberation Combatants Affairs, for pensions and housing for veterans.
- \$70.0 million for the Ministry of State Administration, namely \$50.0 million for housing construction for economically vulnerable Timorese citizens, \$3.0 million for water reservoirs, \$15.0 million for the National Suco Development Program (PNDS) and \$2.0 million for cattle raising.
- \$63.8 million to the Ministry of Petroleum and Minerals, intended to invest in the Timor Gap development.
- \$40.2 million to the National Institute of Social Security (INSS), for the contributory and non-contributory regime.
- \$23.1 million to the Ministry of Petroleum and Minerals, intended to support the National Petroleum and Minerals Authority (ANPM), the TIMOR GAP and the Institute of Petroleum and Geology (IPG), to ensure that Timor-Leste benefits the most of its natural resources.
- \$21.6 million to the Ministry of Education, Youth and Sport for the construction of classrooms and schools to ensure that each child has access to a good study environment in which to learn and grow.
- \$17.2 million to Whole of Government, for the provision of pensions to permanent civil servants under the contributory regime.
- \$11.3 million to the Ministry of Health for treatment abroad, primary health care and subsidies for Cuban doctors in Timor-Leste. These investments are important to further improve the quality of services and health provided to the population.
- \$11.0 million to Whole of Government to recapitalize the Timor-Leste National Commercial Bank (BNCTL).
- \$10.2 million to Whole of Government to cover loan repayments.
- \$10.0 million to Whole of Government, intended to support church activities through the Episcopal Conference.
- \$8.0 million to Whole of Government to provide new health diagnostics assistants. This will help to improve health care in the country, as envisaged in the SDG goal of universal health care.
- \$7.2 million to the Office of the Prime-Minister, to support NGOs and activities of various civil society organizations.
- \$7.0 million to Whole of Government to recapitalize the Central Bank of Timor-Leste (BCTL) and pay service fees.
- \$6.7 million to the Ministry of Education, Youth and Sport to support various sporting events and youth activities throughout the year.
- \$6.0 million for Whole of Government, aimed at pension payments to ex-leaders and ex-members of the organs of sovereignty.

Unofficial translation by La'o Hamutuk.

- \$6.0 million to the National Election Commission, intended to subsidize political parties and thus continue to strengthen the democratic process in Timor-Leste.
- \$5.3 million to the Ministry of Health for the construction of clinics.
- \$3.0 million to Whole of Government to pay contributions for international financial support. This will help the international community and enable Timor-Leste to further influence the global community.
- \$2.6 million to the Secretariat of State for Vocational Training and Employment (SEFOPE) for the self-employment program. This will help to promote job creation and economic growth.
- \$2.5 million to the Ministry of Higher Education, Science and Culture, intended for traditional dwellings (uma lulik) and to preserve the cultural identity and heritage of the Timorese people.
- \$2.0 million to the Secretary of State for Cooperatives, intended to subsidize groups of cooperatives.
- \$1.9 million for the Ministry of Education, Youth and Sports, for the concessions to private and CAFE schools.
- \$1.9 million for the Ministry of Social Communication, to subsidize the Radio and Television of Timor-Leste (RTTL) and the Tatoli-state news agency of Timor-Leste.
- \$1.5 million to the Secretariat of State for Youth and Sport for the Community Police Initiative (KPK) and to be disbursed jointly with the Ministry of Interior.
- \$1.5 million to the Secretariat for Equality and Inclusion to provide capital to rural women to promote female entrepreneurship.
- \$1.5 million to Whole of Government, for the g7 + secretariat. The work of this secretariat ensures that the voice of fragile states (including Timor-Leste) is heard by the international community and deserves action on its part.
- \$1.0 million for the Interior Ministry, for assistance during natural disasters.
- \$1.0 million for the Ministry of Transport and Communications, for a grant to the Timor-Leste Aviation Authority.

Minor Capital

The total budget for this expense category is \$53,167 million, which represents an increase of 68.9% from the State Budget for 2019. Expenses under the minor capital category are used for the purchase of capital equipment such as vehicles and machinery, which is expected to last for several years and need no longer be purchased in the near future.

The main measures in this expense category are as follows:

- \$8.1 million to the Ministry of Finance for the purchase of computer equipment for an additional backup center and x-ray equipment, etc.
- \$5.3 million to the Ministry of Public Works for the purchase of heavy vehicles.
- \$5.0 million to the Ministry of Transport and Communications for the purchase of a passenger boat.
- \$4.0 million to the Ministry of Interior for the purchase of fire trucks.
- \$2.9 million to the Ministry of Defense for the purchase of military vehicles and protective and communications equipment.
- \$2.5 million to the Ministry of State Administration, for the purchase of 31 vehicles for administrative posts and municipalities, as well as computer equipment to be used in elections and in PNDS.

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- \$2.4 million to the Ministry of Education, Youth and Sport for the purchase of school desks and chairs.
- \$2.0 million to the Equipment Management Institute for the purchase of heavy vehicles.
- \$1.7 million to the Ministry of Health for the purchase of ambulances and multi-purpose vehicles for monitoring and evaluation.
- \$1.5 million to the Timor-Leste National Police (PNTL) for the purchase of protective equipment, vehicles for the community policing initiative and traffic motorcycles.
- \$1.0 million for the Ministry of Transport and Communications, for the purchase of buses to transport passengers in Dili.

Development Capital

The budgeted amount for the category of expense development capital (excluding loans) amounted to \$385,202 million. This represents an increase of 22.8% compared to the allocation for 2019.

Social Security

By Law No. 12/2017 of 14 November, the National Parliament approved the establishment of contributory social security scheme, which is characterized by being a single regime for all citizens and integrating the beneficiaries of the transitional arrangements, of the compulsory regime and the self-financed regime, with financial autonomy in relation to the State Budget.

The Social Security Budget (OSS), which has a range of control and approval mechanisms similar to those provided for in the State Budget, and is considered and approved separately in equally annual cycles, is the central instrument for control and monitoring of the evolution and planning of the system by the sovereign bodies.

The National Social Security Institute (INSS), created by Decree-Law 47/2016 of 14 December, responsible for the management and administration of the entire social security system, and the whole process inherent to the same, is now fully operational and 2020 will be the first social security budget year fully managed by this entity.

Thus, and unlike in previous years, when the INSS was not fully operational, by 2020 the Social Security Budget will include all components of social security schemes, in particular:

- i) The budget for the contributory social security scheme in its distribution component (including sub-components of the overall system and the transitional arrangements for social security)
- ii) The budget for the contributory social security scheme in its capitalization component (Reserve Fund of Social Security)
- iii) The budget for non-contributory social security scheme, and
- iv) The budget of the Social Security Administration.

Global Social Security Revenues amount to \$141.68 million, of which \$75.54 million is actual revenue for 2020 (including \$34.18 million from social security contributions and \$41.31 million from State Budget transfers to fund non-contributory social security schemes that are legally funded exclusively by the State Budget) and \$66.14 million (estimated) is the balance carried over from the previous year.

In compliance with the budget balance rule, total global social security expenditure is also \$141.68 million, of which \$42.95 million is actual expenditure for 2020 (including \$41.67 million in current transfers to pay social benefits to beneficiaries, from all social security

schemes) and \$98.73 million are expenses with financial assets, related to investment/investments of the accumulated amount, in 2020, in the Social Security.

Among the OSS estimates of actual revenues and expenses for 2020 there is, therefore, a foreseeable accounting balance of \$32.59 million, relative to the accounting balance of the Contributory Social Security Scheme-Breakdown Component, which will be transferred, by the end of 2020, to the Social Security Reserve Fund, in compliance with the law. Similarly, the amount of the balance carried over from 2019 will also revert to the Social Security Reserve Fund.

It is therefore foreseen that the Social Security Reserve Fund will accumulate a total of \$98.73 million in 2020, transferred from the Contributory Social Security Scheme-Breakdown Component, and that this amount will be applied to capitalize income. To this amount transferred in 2020 to the Social Security Reserve Fund, should be added the amount already accumulated in that Fund through the end of 2019.

The partial tables of revenue (Tables II to V of Annex II) and expenditure (Tables VII to X of Annex II) of social security schemes, which form part of the OSS 2020 budget perimeter, do not, of course, correspond to the consolidated totals in the overall tables of revenue (Table II of Annex II) and expenditure (Table VI of Annex II) of the OSS for 2020, since the latter do not include transfers between social security schemes (from the Breakdown and capitalization components).

Methodological Changes

The State Budget for 2020 presents a number of methodological changes that aim to bring to the budget the best international budget practices, improving the conceptual quality of the GSB, harmonizing the presentation of information and increasing transparency.

The changes made:

- a) Improve the definition of the budget perimeter by referring to the concepts of Administrative Law used in the definition of the State organization (Administrative Public Sector, Central Administration, Direct and Indirect Administration) and the concepts of Public Finance used in the definition of the financial regimes of the different services and bodies (SSAAF [Services without Administrative and Financial Autonomy], OASRP [Autonomous agencies without their own revenues] and SFA [Autonomous Funds and Services]), passing a direct relationship between the administrative nature of the various departments and agencies of the general government sector as defined in the organic law of the Government and sector organic laws and their inclusion in the budget perimeter;
- b) To clarify the difference between general state budget, state budget (OE) and Social Security Budget (OSS) and what rules apply to each of them, passing the general rules for Chapters I (GSB) and IV (Final and transitional provisions) and leave in Chapters II (OE) and III (OSS) only the specific rules of these budgets;
- c) Integrate all budgetary subjects into one of the three financial regimes provided for by law (SSAAF, OASRP and SFA), with the financial regime being defined by the GSB, even when the respective organic law does not define it or defines it differently, to that whereas there are no longer any services or bodies whose financial regime is undefined;
- d) To improve the definition and presentation of the budget classifications of revenue and expenses, which are now set out in the articles and its divisions are now identified and substantiated (organic classification, economic classification, source of financing and structuring of programs);

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- e) Remove from the GSB the rules on budget execution that should be integrated in the Government decree on budget execution.

Efforts are also being made to budget all public money, so that the State Budget is a faithful representation of the public financial flows in a given year. Therefore, all government financial resources are forecast as revenue, whether they are collected in the year 2020 (Petroleum Fund Transfers, Non-Petroleum Revenue, Donations and Loans) or from funds not used in 2019, and then pass as revenue to the 2020 State Budget (Treasury Account Balance, as well as SFA management balances, included in their own revenues).

Some modifications were also made to the annexes in order to improve the presentation of the information, namely in Table I of Annex I, which now correctly presents the OE revenues and not the Petroleum Fund revenues, which are now presented autonomously by reference.

These amendments aim to advance some of the most substantial changes that should be included in the forthcoming reform of the budgetary procedure.

Approved by the Council of Ministers on October 2, 2019.

The Prime Minister,

Taur Matan Ruak

The acting Minister of Finance,

Sara Lobo Brites