



## **Submission to Committee C National Parliament, Democratic Republic of Timor-Leste**

**From La'o Hamutuk**

**regarding the**

### **Proposed RDTL Budget Rectification for 2010**

**15 June 2010**

As in the past, La'o Hamutuk would like to offer some information and perspectives to help Committee C, the National Parliament and the Government make wise decisions for Timor-Leste's people. We hope that this submission will be useful to your deliberations, and we are always ready to provide additional information or respond to questions. Our submission will address the following topics:

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#### **Timor-Leste is getting closer to the "Resource Curse"**

Timor-Leste is the most petroleum-dependent country in the world, with 95% of state revenues coming from petroleum receipts.<sup>1</sup> Our oil and gas economy is several times larger than the non-oil economy. In La'o Hamutuk's November 2009 submission to Committee C about the 2010 General State Budget,<sup>2</sup> we described how petroleum export dependency threatens our future economy. If our leaders don't think carefully about the long term, Timor-Leste will suffer greatly when our nonrenewable resources are exhausted.

The Government's Budget Rectification proposes a 27% increase to the original 2010 budget, adding \$178 million to \$660 million already appropriated, for a total of \$838 million. The Budget Rectification proposes to take more money from the Petroleum Fund, adding \$309 million to the \$502 million withdrawal in the original 2010 state budget.

<sup>1</sup> Annex I, proposed 2010 Budget Rectification.

<sup>2</sup> Available at <http://www.laohamutuk.org/econ/OGE10/sub/09LHSubOJE10En.htm> (English) or <http://www.laohamutuk.org/econ/OGE10/sub/LHSubPNComCOGE10En.pdf> (Tetum).

We notice a tendency from the Government to make quick decisions about spending, without careful thought. The planned expenditure increase is larger than the entire state budget a few years ago. More money is allocated for public transfers than for capital investment. If the budget doesn't prioritize long-term capital investment while oil and gas revenues are still high, Timor-Leste will fall into the resource curse in the future, when petroleum revenues drop or our oil and gas runs dry.

### **Unsustainable, illegal spending from the Petroleum Fund**

The proposed Budget Rectification asks Parliament to approve transferring \$811 million from the Petroleum Fund to the Government's operating account, which is \$309 million more than the Estimated Sustainable Income for 2010. La'o Hamutuk believes that this is prohibited by the Petroleum Fund Law, as the reasons given do not meet the legal requirement. We also believe it is unwise and exemplifies a policy which will bring the resource curse to Timor-Leste.

The Rectified Budget increases State Expenditures by \$178 million, yet it proposes to increase withdrawals from the Petroleum Fund by \$309 million, \$131 million more than the additional expenditures. Although the non-oil fiscal deficit in the proposed rectification is \$743.2 million, the government has requested to withdraw \$68 million more than that.

Article 9(d) of the Petroleum Fund Act states that transfers exceeding the Estimated Sustainable Income can only be made after Government provides Parliament with "a detailed explanation of why it is in the long-term interests of Timor-Leste to transfer from the Petroleum Fund an amount in excess of the Estimated Sustainable Income

The Prime Minister's letter to the President of Parliament does not meet that requirement. It describes measures the Government has already taken, along with a heartfelt argument that people need economic support and that spending money now can be considered an "investment" which will produce economic returns in the future. There are no specific projects or amounts mentioned in the letter, and no explanation of why it is in Timor-Leste's long-term interests to spend so much money during the next six months to "quickly provide better living conditions" for the people of this country."

The original 2010 budget would have expended \$70.6 million which had accumulated in the Treasury's operating account from past shortfalls in budget execution (at the end of 2009, the Government had \$163 million on deposit in the BPA<sup>3</sup>), but the rectification not only fails to spend down that balance, but adds \$67.7 million to it.<sup>4</sup> We do not understand how increasing the treasury balance is "in the long-term interests of Timor-Leste."

When the Government presented the 2010 budget to Parliament, they promised that withdrawals from the Petroleum Fund during 2009 would be less than the ESI of \$408 million.<sup>5</sup> However, within two weeks the Ministry of Finance told the BPA to transfer a total of \$512 million during 2009, exceeding the ESI by \$104 million.<sup>6</sup> Although this amount had

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<sup>3</sup> See BPA, *Quarterly Summary Financial Statements as of 31 December 2009*.

<sup>4</sup> See Annex B (Table 5) in the budget document package.

<sup>5</sup> General Budget of the State 2010 as proposed to Parliament on 15 October 2009, Book 1, page 16 (English version, page 34 in final version): "actual expenditures in 2009 would not exceed the sustainable spending level."

<sup>6</sup> See La'o Hamutuk's 10 November 2009 letter to Committee C, <http://www.laohamutuk.org/econ/OGE10/sub/KartaLHTilman10Nov09te.pdf> (Tetum) or <http://www.laohamutuk.org/econ/OGE10/sub/KartaLHTilman10Nov09en.pdf> (English).

been authorized by the 2009 Budget Law enacted ten months earlier, it violated the Government's promises to the Parliament in both the 2009 and 2010 budget documents.

Spending more than the ESI was authorized in the 2009 budget because building heavy oil power plants and a national electric grid was a long-term capital investment which would help develop the economy. However, when that project ran into problems, its funding was reallocated to Pakote Referendum, a collection of small projects which, even if executed flawlessly, clearly do not provide long-term benefits to the people.

When the original 2010 budget was approved late last year, it seemed that Government and Parliament had learned a lesson, keeping spending and Petroleum Fund withdrawals within sustainable levels. This proposed Rectification, unfortunately, shows that Government has already forgotten the lesson.

Overspending the ESI by \$309 million this year will lower the ESI by \$9.3 million per year in every budget from 2011 on. By 2050, this extravagance will have cost the state of Timor-Leste \$373.2 million, and the price will continue to be paid every year. Future governments and future generations may not agree that this rectification provided for their long-term interests, as it violates the principle of intergenerational equity enshrined in the Preamble of the Petroleum Fund Law and Article 9 of the Budget and Financial Management Law.

The explanations accompanying the proposed rectified budget give the impression that the Government is trying to circumvent the principles underlying the Petroleum Fund Law which Parliament passed unanimously five years ago. If the Government intends to alter or abolish the Petroleum Fund, they should amend or repeal the Petroleum Fund law, not evade the law in a hasty, politicized mid-year budget adjustment. La'o Hamutuk understands that the Government will submit such a revision to Parliament later this year, and we hope that the people's representatives will make careful decisions based on Timor-Leste's long-term interests, rather than on "expert" advice from people promoting risky or impractical spending and investment strategies. Until the law is revised, it should be obeyed.

### **Timor-Leste should only have one budget cycle each year**

According to the Budget and Financial Management Law,<sup>7</sup> a budget rectification may be presented "when the circumstances justify it." We do not believe that this budget rectification is being proposed to adapt to new circumstances, but rather that it is a grab-bag of supplemental appropriations to correct the 2010 budget, enact impulsive new projects and withdraw money rapidly from the Petroleum Fund.

If Timor-Leste is to undertake two budgeting cycles in a year, both should contain enough detail and allow enough time for Parliament to fully discuss, analyze, amend and decide on the proposals. We believe this is a bad idea, as Parliament and the Ministry of Finance would have little time for other activities.

The Government must submit the Annual Budget to Parliament by 15 October, ten weeks before it is to take effect. It is unreasonable to expect this large budget rectification to become effective on 1 July, only one month after Parliament received it. Dozens of new multi-million-dollar expenditure items are each reduced to less than ten words, not nearly enough information for Parliament to thoughtfully consider them or to effectively oversee their implementation.

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<sup>7</sup> Law No. 13/2009, Article 34.

Sadly, this Budget Rectification begins a process which would spend all our nation's nonrenewable resource birthright in one generation. It would be better to improve people's lives not only today, but also to provide a brighter future for our grandchildren.

The Council of Ministers 31 May 2010 press release says that this Budget Rectification will "take advantage of new opportunities to achieve government priorities, especially for faster national economic development," but we see that many items in this budget are not new opportunities.

Although the Budget Rectification spends a lot of money, it prioritizes big projects and many activities, but doesn't include planning or consideration of the pre-conditions required to implement them. For example, the original 2010 budget didn't include a Naval Port to accommodate the F-FDTL patrol boats which were ordered years ago, and now money will be spent on both a temporary and a permanent port. The \$7.1 million for the temporary port is included as "Capital Development" in the rectification, but it should be categorized as Minor Capital or Goods and Services, as it is not an investment with a long-term result.

Many of the new items in the rectification – such as 13<sup>th</sup> month salaries for several ministries, veterans pensions (\$25.5m), medical treatment overseas (\$2.0m), additional funding for the national electricity grid (\$17m) and computer systems for the Ministry of Finance (\$7.3m) are predictable continuations of prior policies and should have been included in the original 2010 budget.

Other large items, including rice imports (\$17m added to \$25m already appropriated, with large amounts of rice already in storage), demolishing buildings which Indonesia wrecked a decade ago (\$5.5m), rehabilitating church buildings (\$3.5m) and upgrading the airport runway (\$2m now, \$5m more in the future) are not urgent and could be put off until the annual 2011 budget cycle, when they can be integrated better with other activities and when Government will provide Parliament with more complete information.

### **Package of Decentralized Development (PDD) a little better**

We appreciate that the Pakote Dezenvolvimentu Desentralizadu (PDD) is better than the Pakote Referendum (PR) from last year, when the Government reassigned money from the heavy oil project in the 2009 State Budget to a local business association to manage many small infrastructure projects throughout the country.

The allocation for Pakote Referendum was not approved by the National Parliament and not continued in the State Budget for 2010. However the PDD is better at following legal procedures, based on already enacted revisions to procurement processes, being incorporated in the rectified 2010 State Budget, and requiring Parliamentary approval of the budget before projects can start. The Government has learned from the weaknesses of Pakote Referendum, and we hope that its mistakes, which resulted in corruption, poor planning, and intermittent implementation, will not be repeated.

However, the PDD itself raises a number of questions:

- With money and responsibility being shifted from capital expenditures in the Ministry of Infrastructure and others to transfers under the Ministry of State Administration, how will these projects be coordinated with other government planning?
- Does the Ministry of State Administration, even with support from hundreds of Chefes do Sucos, have the legal authority, personnel and capacity to manage large numbers of local infrastructure projects?

- Do other Ministries have the authority to turn over their budgets to the Ministry of State Administration, and the interest to provide technical support for projects they specified which are now being managed by another ministry through a decentralized mechanism?

Therefore, we urge the members of the National Parliament, with your responsibility to oversee the implementation of the budget, to develop effective mechanisms to insure that the people's money is used effectively, providing benefits for our citizens, not only for businesses.

Some have suggested shifting funds from the PDD to the Local Development Program (PDL), but they do not provide the same function. The PDL gives local authorities power to decide what projects to do, while PDD merely gives them responsibility to administer projects which have already been decided by the national Government. Nevertheless, we are concerned about the many changes and alternative mechanisms for procurement and project implementation which have occurred in recent years. It would better to have one efficient, well-functioning mechanism, with clear lines of responsibility, than to continually invent new ways to expend state money without effective controls and oversight.

### **Waiting for the Strategic Development Plan**

The Prime Minister is currently socializing a draft national Strategic Development Plan 2011-2030 (SDP), which will be presented to Parliament later this year. This is likely to result in major changes to projects and priorities included in the State Budget. Therefore, it would be advisable to defer as many budget decisions as possible to the 2011 budget, after the Strategic Plan is finalized and approved. The annual budgeting process provides more information and time to explain and analyze the expenditures, rather than the short, uninformative descriptions in this Rectification.

We cannot tell if the Budget Rectification reflects the Strategic Development Plan, because neither contains detailed explanations. However both the SDP and the Rectification intend to spend more than the Estimated Sustainable Income from the Petroleum Fund, \$811 million in 2010 and at least a billion dollars every year after that. This is a big concern for us, as neither this rectification nor the SDP includes realistic, well-planned investment in physical and human capital which will provide returns to make it possible implement the dreams in the SDP.

The Prime Minister and his staff have focused on the draft SDP for several months already, although they have released only a summary with the public.<sup>8</sup> Although nothing about this plan was included in the original 2010 State Budget, the rectification includes \$3.5 million for writing the plan, and another \$7.4 million to design unspecified large future public investment projects.

Like everyone else in Timor-Leste, we wish that the lofty objectives of the SDP were achievable. If they were possible, \$11 million would be a small price for the initial steps toward those goals. Unfortunately, as La'o Hamutuk has explained elsewhere,<sup>9</sup> Timor-Leste's oil and gas reserves cannot provide enough revenues to achieve these dreams, and a more realistic, better-coordinated, less politicized, more concrete development strategy would serve the nation better. We suggest that further spending to "implement" the plan be

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<sup>8</sup> Although the Government has not released the draft Strategic Development Plan, La'o Hamutuk has posted an unofficial copy of the 400-page document in English at <http://www.laohamutuk.org/econ/SDP/SDPDraft.htm>

<sup>9</sup> See <http://www.laohamutuk.org/econ/SDP/10SDPindex.htm>

incorporated in the normal 2011 budget process, and be delayed until the fundamental outlines of the plan have been approved by Parliament.

### **Spending double on electricity**

The Government expects that the heavy oil power plant at Hera, together with the new national electric grid, will provide electricity to the entire nation by the end of next year. This project was under-budgeted in the 2010 state budget at \$50 million (total project costs will probably be well over \$500 million), and the \$17 million added to it in the rectification budget is still far from enough, even after considering the \$23 million spent on this project in 2008 and 2009.

Annex II of the rectification budget says that \$60 million will be allocated to this project during 2010. With \$50m in the original budget and \$17m added in rectification (Annex A), \$7 million is unaccounted for.

Furthermore, we doubt it is wise to spend \$10m more to upgrade the Comoro power station, which will soon be replaced by the Hera one. For many years, the Comoro station has suffered from mismanagement and neglect, with resulting high maintenance costs and unreliable operation. If the Hera heavy oil project is indeed being implemented, it seems wasteful to throw good money after bad for the Comoro station.

However, if the heavy oil project has encountered difficulties similar to those which prompted a redesign last year, the additional \$17 million requested for it in this budget rectification should not be approved, but should wait for the 2011 budget when the project status and costs should be clearer. We urge the Government to include the construction and operation costs of this entire multi-year project in the budget, as such transparency is essential for Parliament to perform its budgetary responsibilities.

EDTL continues to receive massive government subsidies, which are shown as \$31 million in the rectification budget. These are actually more than twice this amount, with additional subsidies for fuel under Whole of Government and capital construction under the Ministry of Infrastructure. The principal beneficiaries of these subsidies are EDTL's largest customers – embassies, the UN, the World Bank and other international agencies, most of whom do not pay taxes to Timor-Leste.

If Hera and Comoro increase their power generation capacity, distributing more subsidized electricity will increase government expenditures. We encourage Parliament to ask the Government to provide a complete, public accounting of EDTL's expenditures, plans, customers and revenues, so that you can adequately oversee its operations and anticipate future costs.

### **Increasing imports and sale of rice**

During 2008 and 2009, the Government responded to a temporary escalation in market rice prices by spending almost \$100 million for imports, mainly rice, for people's daily needs. We are concerned that subsidized rice importation is becoming permanent. Although the original 2010 budget promised to phase this program out completely after this year,<sup>10</sup> the proposed Budget Rectification allocates another \$17 million for rice imports, adding to \$25 million in the original 2010 budget, for a total of \$42 million.

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<sup>10</sup> Note 1 to Table 2, "Economic Overview" chapter of 2010 Budget Book 1: "From 2011 onwards, rice sales will cease..."

Although rice market prices have dropped markedly during the last 12 months,<sup>11</sup> the rectification budget would spend more on rice imports than last year, when the Government spent \$38 million. However, much of the rice already purchased is still in warehouses, and distributing it has become a major headache.

During the Committee C hearing on 15 June, President Manuel Tilman asked La'o Hamutuk's to comment on information he recently received from the Minister of Trade, Commerce and Industry that Timor-Leste's rice consumption was 140,000 tons/year, with production of 60,000 tons/year, requiring imports of 80,000 tons, which would cost more than \$25 million. Our analysis, based on the draft Strategic Development Plan, is different. According to that document,<sup>12</sup> consumption is 90 kg/person/year, or 104,000 tons during 2010, and Timor-Leste's production of paddy was 121,000 tons during 2009, or approximately 73,000 tons of rice. The 31,000 ton deficit must be imported or supplied from existing stocks. If all of it were imported at the current \$505/ton price for "5% broken" Thai rice (which costs more than the "15% broken" imported by Timor-Leste), it would cost \$15.7 million.<sup>13</sup> Even after allowing for profit and shipping, the \$25 million allocated in the original 2010 budget should be more than enough.

Timor-Leste's economy is extremely import-dependent, partly because our agricultural and industrial sectors are not yet able to meet the needs of our people and private sector. During 2009, for example, our economy imported \$283 million worth of goods, while producing only \$8 million in non-oil exports, nearly all coffee. This trade imbalance is only possible because of oil revenues, and is not sustainable.

Subsidizing rice imports should be a temporary measure. If Timor-Leste doesn't give strong support to increasing local agricultural production, we will go hungry when the oil money runs out. Government should think about the long term, when declining oil revenues will no longer be able to subsidize imports for people's necessities. The state should strengthen our agriculture sector today, with the goal of food sovereignty: our people must be able to produce what we need to eat.

## Two brief observations

**The revenue aspect** of the rectification budget documents leaves out a great deal of information. For example, why did expected Direct Taxes in Annex I increase from \$12 million in the original 2010 budget to \$28 million, while Indirect Taxes dropped from \$48 million to less than \$20 million?

The budget includes \$3.1 million for **marine research in Beacu** under the State Secretariat for Natural Resources, which we believe is to develop further data to support construction of a natural gas pipeline and LNG plant in that area. However, Woodside and its joint venture partners are not receptive to Timor-Leste's wishes to bring Sunrise gas to our shores, and it seems likely that the gas will stay in the ground for future generations. In that case, it makes little sense to spend more money now on research for this project, especially since SERN's Sunrise Task Force Report has not been shared with Parliament or the public.

Thank you for your consideration, and we are always available for further discussions.

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<sup>11</sup> Chart 4 in the "Economic Overview" chapter of 2010 Budget Book 1 shows that by July 2009, Thai world market prices had fallen to the same level as the subsidized price in Dili. In the 11 months since then, world rice prices have dropped by 37% more.

<sup>12</sup> The draft document is available at <http://www.laohamutuk.org/econ/SDP/SDPdraft/Plan%204.21-4.65.pdf>. For consumption, see table 4.15, with reverse extrapolation to 2010. Production figures are in table 4.14.

<sup>13</sup> The price was outdated in an earlier version of this Submission, and was revised on 22 June.