TIMOR-LESTE

The 2011 budget contains plans for a huge rise in spending

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The government has again courted controversy over its determination to ramp up public spending and withdraw even greater amounts from the Petroleum Fund (the state fund that receives all of the tax and royalty revenue from hydrocarbon projects in the Timor Sea). After much debate followed by amendments to further increase planned spending for 2011, the government's budget for the year was finally passed by parliament in late January, with 42 members of parliament voting in favour and 21 against. The budget was ratified on February 1st. Mr Gusmão had presented the government's draft budget to parliament on January 12th: it involved total expenditure of US$985m, with total non-petroleum revenue projected to reach US$110m. The resulting non-petroleum deficit was thus set at US$875m, to be financed by a withdrawal of US$734m from the Petroleum Fund and US$141m from the Consolidated Fund (which consists of money previously withdrawn from the Petroleum Fund but not spent). Following ten days of deliberations in parliament, the total expenditure budget for 2011 was pushed up to more than US$1.3bn, with much of the additional spending being allocated to one of two "special funds", the Infrastructure Fund (for multi-year projects valued at over US$1m each). This fund, which will be mainly used in 2011 to finance a project to establish a national electricity-transmission grid, has now been allocated US$599.3m, up from US$342.2m in the first draft of the budget. The allocation to the other special fund, the Human Capital Development Fund, remained unchanged at US$25m. Planned spending for 2011 in the recurrent budget is now set at US$563.4m (up from US$525.9m in the initial draft budget), while that in the capital budget has been set at US$118.3m (up from US$116.8m initially).

Budgeted expenditure in 2011 is now much higher than that for 2010: the original budget for 2010 stood at US$600m, and was pushed up by a mid-year supplementary budget to US$838m. The sharp increase in the budget in 2011 has been criticised in some quarters, with La'o Hamutuk, an influential local non-governmental organisation (NGO) that monitors the activities of government agencies, claiming that the elevated levels of planned spending are "unwise and unsustainable". Controversially, the revised budget for 2011 is being financed in part by an "excess withdrawal" of US$321m from the Petroleum Fund. Under the 2005 Petroleum Fund law, in any given year the government is limited to withdrawing an amount from the fund that is equivalent to the estimated sustainable income (ESI). (The ESI is an estimate of the annual amount that the government can withdraw indefinitely without depleting the Petroleum Fund. It is set at the equivalent of 3% of the current value of the fund plus the net present value of future revenue.) The government had already managed to engineer a higher ESI for future years by approving in late 2010 a change in the methodology used to calculate the ESI, mainly by switching the oil price assumption from the "low case" forecast produced by the US Energy Information Administration (EIA), which the government believes to be overly prudent, to the average of the EIA's low and less conservative "reference case" forecasts. In part because of this change, the ESI rises to US$734m in 2011, from US$502m in the 2010 budget.

La'o Hamutuk restated its concerns over the creation of the two special funds, and also questioned whether proper procedures had been followed by the government in terms of making a case that it is in the long-term interests of the country to make a withdrawal from the Petroleum Fund in excess of the ESI. The NGO called on Mr Ramos Horta to veto the budget or seek advice from the Court of Appeals. The president chose the latter course of action, and the court subsequently ruled in the government's favour. Mr Gusmão has long been expressing frustration over the constraints placed on the government in terms of access to the country’s petroleum wealth. In his budget speech in January 2011 he reiterated his claim that his government did not want Timor-Leste to become “a country that is poor with people who live in misery, but proud to have lots of money in the banks of rich countries”. He added that it was his government’s intention to use its petroleum wealth “now and in the future” to build the nation and invest in its people.

Following its Article IV consultations with the government in January, the IMF praised the government’s policy performance but suggested that a more cautious approach to investment spending might be warranted. In its report following the consultations, published in March, the Fund stated that its directors welcomed the government’s determination to pursue development policies. They also said that infrastructure investment projects with “sufficiently high returns” would justify temporary withdrawals from the Petroleum Fund in excess of the ESI. However, in a note of caution, the IMF's directors said that “spending at a slower than planned pace, consistent with the absorptive capacity of the economy, would stand a better chance of realising high-quality projects and crowding in private investment”.