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Submission to
Committee C: Economy, Finances and Anti-Corruption
National Parliament, Democratic Republic of Timor-Leste

From
La'o Hamutuk

Regarding the
Proposed General State Budget for 2012

21 October 2011

Contents

La'o Hamutuk appreciates the invitation from Committee C to your hearing today. As in the past, we are confident that Committee C will do a good job in analyzing and reporting on the complex State Budget for 2012, in spite of the difficulties in obtaining complete information. We hope that our observations will help in that challenging task, and are glad to provide more information or answer questions.[1]

Throughout 2011, La'o Hamutuk has tried to help Parliament and other stakeholders in their understanding and decision-making regarding Timor-Leste's budgetary processes and economy, and many of the materials we have published may be helpful to Members of Parliament as you consider the proposed $1.8 billion State Budget for the upcoming election year:

- Submissions to processes on Aid Effectiveness[2], Transparency[3] and Development Partners.[4]
- Training the Parliamentary Research Center[5] and civil society organizations on state budget issues.
- Comments on the UNDP National Human Development Report, which encourages Timor-Leste to develop non-oil sectors of our economy.[6]
- Initial analysis of the National Strategic Development Plan for the National Parliament.[7]
- Submissions and testimony on legislation, including the revision to the Petroleum Fund Law[8] and the TimorGAP National Oil Company[9] which have already been enacted, and the draft Anti-Corruption Law,[10] Basic Law on Environment,[11] Land Law[12] and Expropriation Law.[13]
- Information and analysis on the national electricity project,[14] the Tasi Mane projects,[15] the Greater Sunrise oil and gas field[16] and the implications of Timor-Leste taking out loans.[17]

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1 Budget documents, this submission, and other materials on the State Budget for 2012 and previous years is available on La'o Hamutuk's website: http://www.laohamutuk.org/econ/OGE12/10OJE2012En.htm (English) or http://www.laohamutuk.org/econ/OGE12/10OJE2012Te.htm (Tetum)

2 http://www.laohamutuk.org/econ/fragile/LHSubFSP6May2011.pdf (English)

3 http://www.laohamutuk.org/Oil/EITI/2011/LHEITI26Aug2011En.pdf (English) or http://www.laohamutuk.org/Oil/EITI/2011/LHEITI26Aug2011Te.pdf (Tetum)

4 http://www.laohamutuk.org/econ/11TLDPM/LHtoTLDPM12July2011.pdf (English)

5 This training was supported by The Asia Foundation. The Tetum Powerpoint is at http://www.laohamutuk.org/econ/training/PRCBudgetTraining27Jun2011Te.pdf

6 http://www.laohamutuk.org/econ/HDI10/11NHDREn.htm (English) or http://www.laohamutuk.org/econ/HDI10/11NHDRTe.htm (Tetum)

7 http://www.laohamutuk.org/econ/SDP/2011/LHSubSDP11Jul2011En.pdf (English) or http://www.laohamutuk.org/econ/SDP/2011/LHSubSDP11Jul2011Te.pdf (Tetum).
More comprehensive information about the SDP is at http://www.laohamutuk.org/econ/SDP/10SDPindex.htm or http://www.laohamutuk.org/econ/SDP/10SDPindexTe.htm

8 http://www.laohamutuk.org/Oil/PetFund/revision/10PFRevision.htm (English) or http://www.laohamutuk.org/Oil/PetFund/revision/10PFRevisionTe.htm (Tetum)

9 http://www.laohamutuk.org/Oil/PetRegime/NOC/2011/LHSubTimorGAP14June2011.pdf (English).
For more information see http://www.laohamutuk.org/Oil/PetRegime/NOC/10Petronatil.htm (English)

10 http://www.laohamutuk.org/econ/corruption/SubLHLeiAntiKorupsaun16Junhu2011Te.pdf (Tetum)

11 We made submissions on two drafts, see http://www.laohamutuk.org/Agri/EnvLaw/11EnvBasicLaw.htm (English)

12 http://www.laohamutuk.org/Agri/land/SubmisaunLeiRai19Sep2011Te.pdf (Tetum)

13 http://www.laohamutuk.org/Agri/land/SumisaunLeiExpropriasaun19Sep2011.pdf (Tetum)

14 http://www.laohamutuk.org/Oil/Power/HeavyOilPowerPlant.htm (English and Tetum)

15 http://www.laohamutuk.org/Oil/TasiMane/11TasiMane.htm (English) or http://www.laohamutuk.org/Oil/TasiMane/11TasiManeTe.htm (Tetum)

16 http://www.laohamutuk.org/Oil/Sunrise/10Sunrise.htm (English) or http://www.laohamutuk.org/Oil/Sunrise/10SunriseTe.htm (Tetum)

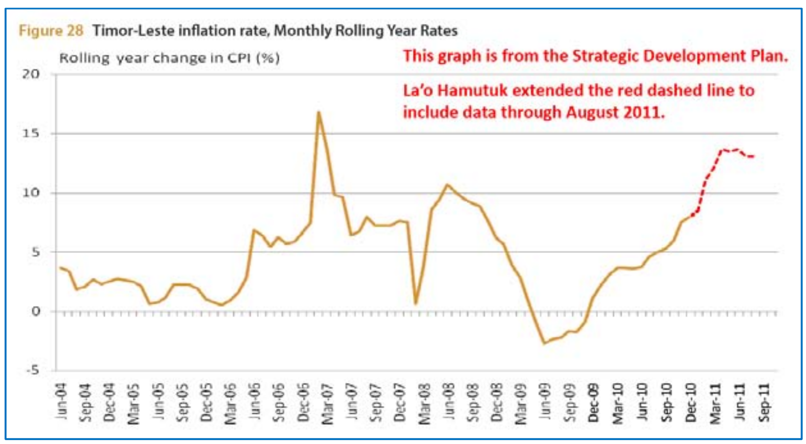
The Resource Curse is truly here.

La'o Hamutuk and others have long warned about the experiences of countries rich in natural resources but poor in other aspects of economic and social development. In such cases, non-renewable resources like petroleum, diamonds or gold are usually a curse, rather than a blessing. In our 2004 submission on the proposed Petroleum Fund, we wrote "Nearly all petroleum-revenue dependent countries experience artificially high prices, substitution of imports for locally produced items, and neglect of non-oil sectors of the economy."[18] For seven years, we have repeated this warning in our articles, policy submissions and presentations – as we have sadly watched it engulf our country. A few months ago, we commented that "the resource curse is already here, manifesting itself in a range of symptoms including inflation ('Dutch disease'), extreme import dependency, neglect of non-oil sectors and revenue sources, ineffective public expenditures, credible rumors of corruption and failure to plan for the long term."[19]

These problems are not God-given or made by supernatural forces. They are usual, but avoidable, consequences of our political and economic situation, enabled by government decisions. With longer-term planning, better control and oversight mechanisms and more prudent analysis, Timor-Leste can overcome them. We will need wise leaders, with the perspective and knowledge to place the interests of current and future generations of all our people ahead of short-term political or personal priorities.

However, the 2012 budget continues to deny or ignore these challenges, and we believe it will worsen the Resource Curse, embedding it deeper and wider in our society, making it more difficult to exorcise.

The "Dutch disease" of inflation exacerbates poverty in Timor-Leste.



One main characteristic of the resource curse is inflation, which is currently 13.1%.[20] Although the government blames this on external factors, such as rising international prices and the falling U.S. dollar, this explains only part of the problem. Our fiscal policy and lack of domestic productivity are a significant element. Even though most of our State Budget is spent outside Timor-Leste, what stays inside the country is more than our local economy can absorb, driving prices upwards.

Unfortunately, the 2012 budget will increase inflation, especially the prices of basic necessities. This budget has no effective measures to increase domestic productivity, but will increase the money in circulation, raising prices. Poor people will be hit hardest –people with very low incomes or without permanent jobs are already unable to pay for basic needs. Inflation reduces the purchasing power of the poor, and will increase

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17 http://www.laohamutuk.org/econ/debt/09Borrowing.htm (English) or http://www.laohamutuk.org/econ/debt/09BorrowingTe.htm (Tetum)

18 http://www.laohamutuk.org/Oil/PetFund/Consult/LH PetFund submission.htm

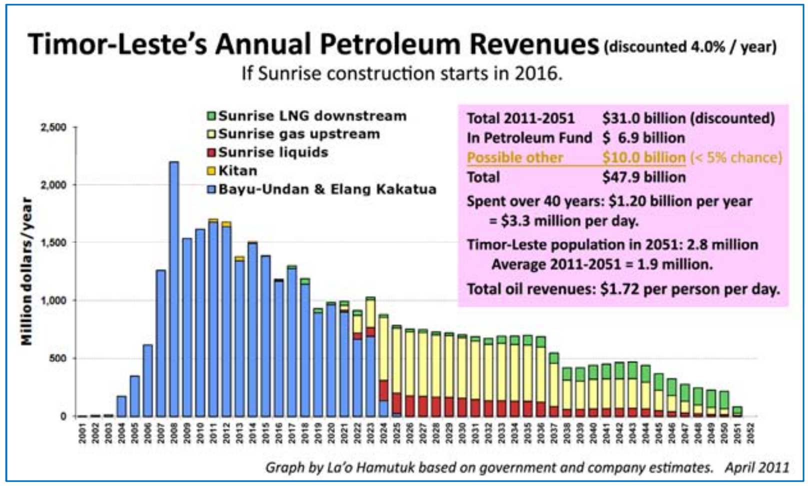
19 http://www.laohamutuk.org/econ/HDI10/11NHDREn.htm (English) or http://www.laohamutuk.org/econ/HDI10/11NHDRTe.htm (Tetum)

20 Dili Region Consumer Price Index monthly report, RDTL National Statistics Directorate, August 2011 http://dne.mof.gov.tl/cpi/Monthly%20Report/documents/CPI%20Monthly%202011/August%202011/FINAL_CPI_monthly_%20Agustus%202011%20English.pdf

the breadth and depth of poverty in Timor-Leste. High inflation will also discourage people from investing in Timor-Leste, since the costs for labor will also increase.

We continue to neglect non-oil development.

Timor-Leste does not have much oil and gas. Bayu Undan will be empty by 2024, and if Greater Sunrise is eventually developed, it will be empty by 2051, and could provide less total revenues than Bayu-Undan, even with an LNG plant in Beaçu.



The graph at right is an optimistic prediction of our oil wealth, which will enable Timor-Leste to spend $1.72 per citizen per day for the next 40 years. The proposed 2012 budget will spend $3.96 per citizen per day, an increase from $3.11 in 2011. Our oil and gas wealth aren't enough to continue even today's limited level of public services.

Our population continues to grow rapidly, with more than 30,000 babies born every year. Therefore, the cost of education and health goes up, as our nonrenewable resource wealth is being spent. Timor-Leste must quickly develop sustainable sectors, like agriculture, tourism and small business, to increase productivity and add value to our products. As the UNDP recently pointed out, "Timor-Leste currently is in a challenging situation. Despite recent progress, many of its population remain poor, and there is considerable scope for improvements in levels of human development. To meet present and future needs the wealth from its oil must be utilized effectively to promote sustainable development of the non-oil economy."[21]

Unfortunately, the proposed 2012 budget does not seriously address this crucial issue. It continues to neglect investment in productive, sustainable sectors. Instead, this budget allocates more money to physical infrastructure, especially electricity, Tasi Mane projects and the Timor-Leste Investment Corporation, most of which will not reduce our dependence on petroleum.

As a consequence of neglecting productive sectors, we continue to depend on imported goods and services, even for products like water, chickens, rice, fruit juice, fish and vegetables that could easily be produced here. Our non-oil trade deficit is around a billion dollars, made possible by oil exports which will end in less than a generation.

Timor-Leste Balance of Trade, 2010 (millions of US Dollars)

Category	Imports	Exports	Balance
Goods	$289 (DNE reports)	$17 (96% coffee)	($272)
Other goods (extra-legal)	$200 (LH estimate)	$0.3 (LH estimate)	($200)
Services	$505 (2009, from BPA)	$3 (LH est. remittances)	($502)
Total excluding oil & gas	$994	$20	($974)
Petroleum receipts (to state)	--	$2,016 (incl. $294 Petrol. Fund interest)	$2,016
Total	$994	$2,036	$1,042

Although the action plans of the Ministry of Economic Development and the Ministry of Tourism, Trade and Industry say that they want to grow local business, most of their programs will not increase domestic production because they focus on retail rather than productive sectors. This means that our dependency on imported goods will get worse, as our wealth flows out to Indonesia, Australia, Singapore and China.

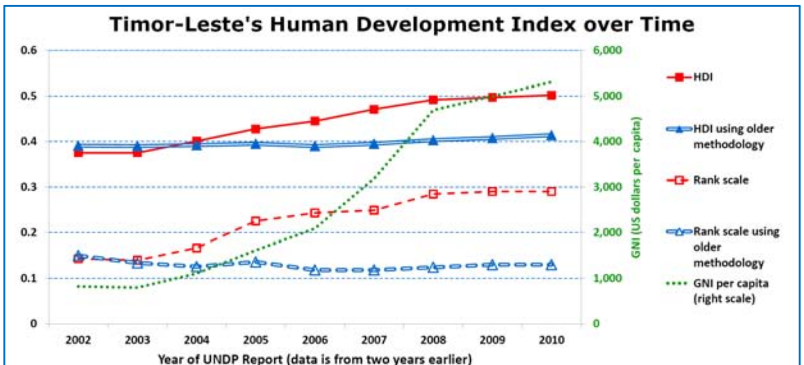
21 United Nations Development Program 2011 National Human Development Report for Timor-Leste, at http://hdr.undp.org/en/reports/national/asiathepacific/timorleste/Timor-Leste_NHDR_2011_EN.pdf

In Timor-Leste, as in many petroleum-export-dependent countries, the oil and gas sector gets disproportionate attention from visionary and influential policy makers. Given our very limited petroleum reserves, there is no logical reason to base our economic development strategy on this capital-intensive, high-technology industry, which provides very few jobs and relies primarily on imported goods, materials and expertise. A realistic development policy would focus on food sovereignty, import substitution, eco-tourism, agriculture, value-added to farming and fishing, and light industry for local production. But nobody has come up with pretty pictures of Timor-Leste's future based on these less glamorous sectors, and we are left with the mirages of Tasi Mane, five-star hotels, and Timor-Leste Investment Company fantasies of luxury shopping centers, high-rise office buildings and world-leading internet access.

The Resource Curse often causes governments to prioritize physical infrastructure, especially large showpiece projects, over human infrastructure. Our people's development is neglected in favor of huge infrastructure projects with little benefit for most of our population, as discussed below regarding the electricity project, the Tasi Mane petroleum project, and the Suai-Beaçu highway. These capital-intensive boondoggles will generate few spillover benefits for the rest of the economy, especially in terms of job creation. In many developing countries, such mega-projects have boosted economic growth statistics while severely damaging the environment, destroying peasants' and fisherfolk's livelihoods, leading to social and cultural deprivation and increasing suffering among poor, displaced and marginalized people.

Our people are our most important resource.

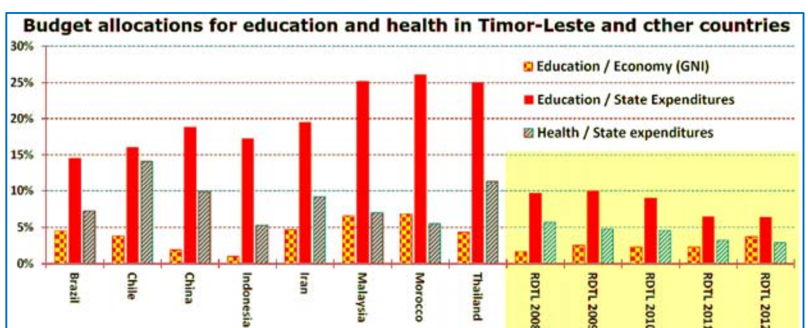
As the 2012 State Budget Overview reiterates, the Strategic Development Plan aims to transform Timor-Leste into an upper middle income country with a healthy, educated and secure population by 2030. Nevertheless, without proper allocation of funds and wise policies, this dream will never come true.



The red single lines are the new methodology of calculating HDI instituted in 2010, based on GNI, while the blue double lines are using the older method (in which Timor-Leste has scarcely improved).
Rank scale is the fraction of countries with HDI scores lower than Timor-Leste. A rank of 120 out of 169 gives a scale of 0.29.

Timor-Leste's human resources, which are the foundation of our economic development, should be at the top of the government's priorities. But unfortunately, Timorese people are neglected, as reflected in the stagnant Timor-Leste's Human Development Index (according to the more relevant methodology used by UNDP before 2010, which doesn't use oil revenues to measure human development) and the continuously decreasing percentage of public funds allocated to social services.

In this 2012 State Budget, only 6.3% of state expenditures will go for education, and only 2.9% for health, which is slightly less than last year's percentage (9.6%) and much less than other developing countries. By comparison, the 2011 UNDP National Human Development Report points out that countries making progress toward the MDGs spend about 28% of their budgets on education and health, concluding that in Timor-Leste, "not enough priority is being accorded to education and health. If Timor-Leste is to move faster in achieving the MDGs in these areas,



Graph by La'o Hamutuk based on information in UNDP Human Development Report and RDTL State Budgets.

then the share of social services in the budget will have to be virtually doubled." The 2012 budget moves in the opposite direction, reducing the budget allocation for these social services.

This is very sad, as most Timorese receive substandard education and health care. As we see in local media, many schools lack basic furniture. More importantly, there are few books, low standards, poor quality of instruction and little value given to improving students' knowledge and capacity for independent thinking. The contradictory and misleading figures for school enrollment in the SDP conceal a much more important weakness – what are our children learning? In addition, many children suffer from malnutrition, diarrhea, malaria and other preventable diseases, endangering their lives and reducing their capacity to learn. We need more social investment to prepare our children and our nation for a better future.

The Human Capital Development Fund will increase 20% in 2012 even though only 43% of its 2011 allocation has been spent to date. This Fund is mainly intended to increase civil servants' capacities, rather than educating our children and young people. We are glad to see that the allocation for the National University has increased, but remain concerned that overseas scholarships receive a larger share of state funds.

The MDG-Suco program exemplifies careless budget practices.

Another characteristic of the Resource Curse in Timor-Leste is that easy money leads to easy spending, with poor planning, project design and quality control. Our leaders justify huge annual budget increases as meeting people's needs, but more of the money goes to mega-projects than to direct benefits for our population. Programs like the Heavy Oil Project, MDG Suco, PDD, PDL and Tasi Mane mirror difficulties faced by other oil-rich countries which spend unwisely.

The 2011 State Budget appropriated $44.6 million for the MDG-Suco program, to build five houses in every aldeia in 2011, which is to be repeated every year through 2015. In June, the National Procurement Commission issued a tender to import and build 11,855 prefabricated houses, allocating $4,000 per house as Parliament had approved.

However, no suppliers could be found at that price, and last month the NPC announced its intention to award the contract to Carya Timor Leste and Jonize Construction for more than double the budget allocation. At $10,800 per house, the bidder asked for $144 million to build the requested number of houses, but the Procurement Commission limited the contract to $100 million, reducing the number of houses to 9,237 "due to a budget shortfall faced by the Government."

Unfortunately, the proposed 2012 budget ignores the $55 million cost overrun for this project during 2011, reporting expected 2011 budget execution for this project at $50 million. The Government asks to spend $54.6 million in 2012 and $44.6 million annually from 2013-2015, but still plans to build 11,145 houses per year for this money, even though actual costs will be much higher.

La'o Hamutuk thinks the MDG-Suco program is well-meant to support poor people in rural areas, reducing their vulnerability. But we are concerned about the sloppy budgeting and cost overruns, and that Parliament is not being told the truth about the program. Before you approve additional money for it, you should know how much it will really cost, and how many houses will be built.

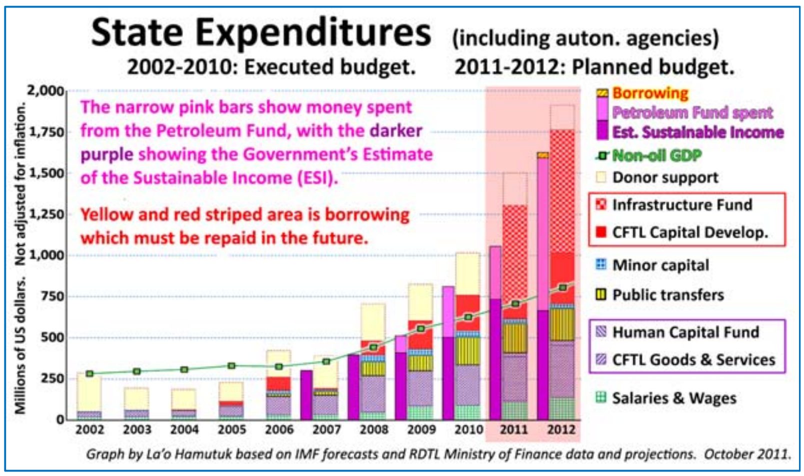
In addition, we are concerned that the plan to import prefabricated houses continues our dependence on foreign suppliers and sends our money overseas. This program could be a good opportunity to support local small businesses, employ Timorese construction workers, use local materials and develop our domestic private sector. However, a single contract to import more than 10,000 houses excludes all but the largest Timorese companies, and will produce houses which will be difficult and expensive to maintain if all replacement parts need to be shipped in from overseas.

We should learn from Timor-Leste's past experiences.

Our submission to Committee C on the 2011 State Budget[22] raised many concerns, and Committee C included several of them in its report to Parliament. Unfortunately, the final 2011 budget was mainly decided by party politics rather than by sound judgment. The proposed budget for 2012 continues many of the same mistakes, with even larger deviations from caution and practicality.

Timor-Leste is a world leader in budget escalation.

The proposed 2012 budget is 35% larger than last year's budget, which was 56% larger than the enacted budget for 2010. Actual expenditures are growing even more rapidly as budget execution rates improve.[23] Without adjusting for inflation, Timor-Leste's 2012 State Budget is more than five times larger than the original 2008 budget, a 407% increase. Timor-Leste places second in this global race to squander state resources, behind Zimbabwe (which increased 1034% during the last four years) and ahead of the Democratic Republic of Congo (267%).[24] After adjusting for inflation, Timor-Leste's 2012 budget is 25% larger than last year and has nearly quadrupled since 2006.



The Government's budget documents include revenue and expenditure projections through 2016 as required by Law No. 12/2009. We omitted them from this graph because Government promises about future budgets have not been kept.[25] Two years ago, the Government projected that expenditures in 2012 would be $441 million, but now they are asking for $1,763 million -- four times as much.

Don't spend twice the Sustainable Income from the Petroleum Fund.

We appreciate that the lower Estimated Sustainable Income for 2012 reflects revised Bayu-Undan production and cost projections from ConocoPhillips, although it is unfortunate that our total income from this field will be less than was previously expected. We are disappointed that this reduction in ESI from last year's imprudent $734 million to $665 million gave no pause to the Government's budget designers. The proposed 2012 budget will withdraw 7.2% ($1,594 million) of our total Petroleum Wealth from the Petroleum Fund, far above the 3% guideline which underlies the Sustainable Income calculation. Although much of the discussion of the recent revisions to the Petroleum Fund Law focused on the danger to future

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22 http://www.laohamutuk.org/econ/OGE11/LHSubComCPNOGE15Dec2010En.pdf (English) or http://www.laohamutuk.org/econ/OGE11/LHSubComCPNOGE15Dec2010Te.pdf (Tetum)

23 La'o Hamutuk does not consider budget execution to be a meaningful measure of state performance. The objective of the state should be to provide services and develop the nation, rather than to spend money.

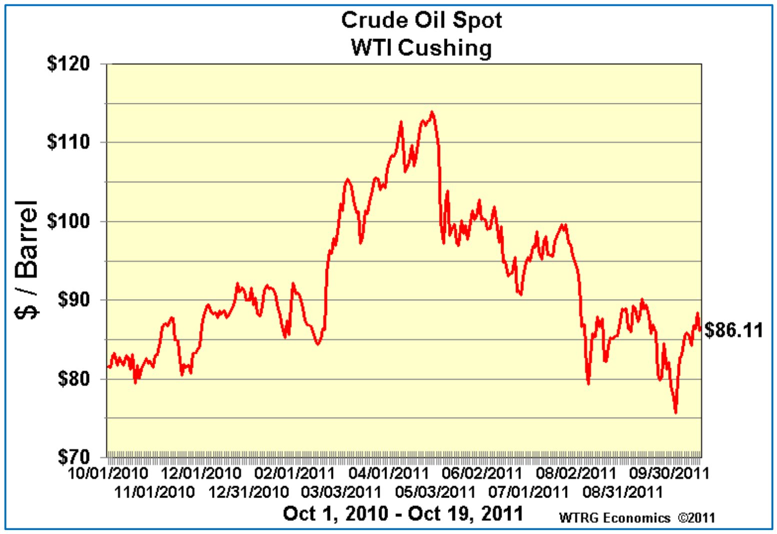
24 According the September 2011 IMF World Economic Outlook, with economic and budget data for most countries.

25 A graph displaying how projected future expenditures have changed over the years is at http://www.laohamutuk.org/econ/OGE12/ChangingEstimatesEn.gif (English) and http://www.laohamutuk.org/econ/OGE12/ChangingEstimatesTe.gif (Tetum).

generations from weakening the 3% spending rule, in fact the Government has broken that rule every year since 2008, rendering it essentially meaningless.

The Ministry of Finance projects even larger withdrawals from the Petroleum Fund in 2013 (7.3%) and 2014 (7.7%). During 2014, they plan to withdraw $180 million more than will be deposited into the Fund from oil revenues, marking the beginning of the end of Timor-Leste's petroleum-fueled illusions.

The Budget assumes imprudently optimistic future oil prices – which have the biggest effect on the ESI – as we discussed last year. The Ministry calculated the ESI in July, expecting a 2011 price of $88/barrel. Since mid-year, prices fell more than $20/barrel (they were below $76 in early October, and have rebounded slightly).



The revised Petroleum Fund law allows half the Petroleum Fund to be invested in the stock market (international equities), up from 10% in the previous law. The Ministry of Finance hopes that more risky investments will increase the Fund's return (which, corrected for inflation has been less than 3% due to global financial conditions). However, our brief experience to date is not encouraging – From June through August 2011, the equities investments of our Petroleum Fund lost 9.8% (annualized) in value, while the part invested in bonds grew by 1.5% (annualized).[26]

Special Funds continue to erode Parliamentary authority.

The creation of the Infrastructure Fund and the much smaller Human Capital Development Fund crippled Parliament's ability to approve and oversee the State Budget, which we believe violates the intent of Timor-Leste's Constitution. Sadly, much of what we warned against last year has come to pass, such as the unreported doubling of the money spent on the MDG-Suco program in 2011.

Similarly, although the 2011 State Budget didn't authorize Infrastructure Fund money for EDTL (the national electricity project is outside EDTL's budget), the Transparency Portal shows that $4 million has already been spent for this unforeseen purpose. Before authorizing additional state money for Special Funds, Parliament should know how the $599.3 million the Infrastructure Fund received last year has been used, and what was changed from Budget Book 6 given to Parliament as part of the 2011 budget proposal.

Although this year's Book 6 includes "estimated expenditures through December 2011," it is inaccurate and incomplete. In addition to the examples above, the $31 million being spent to upgrade the Comoro power station does not appear on the list of projects, and the $261 million line for "Geradores da Central Eléctrica de Hera + linhas de Distribuição e Transmição" fails to mention the heavy oil power plant in Betano.

Parliament needs complete information on expected project costs.

Unfortunately the Government continues to hide the full costs of multi-year projects, such as the Heavy Oil electricity project (according to the 2012 Budget, this will be more than $950 million), the South Coast Highway (the budget shows $767 million, but the preliminary design estimates the project cost at $1.39 billion), and south coast infrastructure (only design costs are shown, and nothing after 2012). The Suai supply base is listed as costing $329 million total between 2011 and 2015, while Government Resolution

[26] Data from the most recent (August 2011) monthly Petroleum Fund financial report issued by the BPA/Central Bank.

26/2011 of 14 September says that "the cost of Phase 1 – Construction of fixed assets" for the Supply Base will be between $273 and $347 million.

In July, Parliament hastily approved the Prime Minister's National Strategic Development Plan, with no information about costs, borrowing, debt service or rates of return. This enticing dream may cost tens of billions of dollars to attain – money that Timor-Leste does not have. Before Parliament approves money to begin its implementation, you need to be told what it will cost and how it will be paid for.

Electricity continues to dominate, with results lower than expectations.

More than three years after the Government embarked on the Heavy Oil electricity project, it still gets the largest piece of the annual budget. However, our people don't get information about the true project costs, which constantly increase.

In the 2008 mid-year budget, Parliament approved $10 million for the Heavy Oil power plants and national distribution grid, a down payment on the estimated project cost of $390 million, which was repeated in the 2009 and 2010 budgets. More than $442 million has already been spent, and the 2011 and 2012 budgets price this project at over $950 million, not counting temporary ports, recovery from transport accidents, and other unplanned expenditures.

Last year's 2011 state budget allocated $497 million for electricity, including $447 for the national electricity project, nearly 40% of the entire budget. Most of this is partial payment on the three largest contracts in Timor-Leste history, $406 million for Puri Akraya Engineering (PAE) to build the power plants, $298 million to Chinese Nuclear Industry Construction Company #22 (CNI22) to build the national high-voltage distribution grid, and $31 million to China Shandong International (CSI) to upgrade the Comoro power station.

Unhappily, the electricity sector is still problematic, even though it is the Government's first priority. A lot of money has been spent, but the quality of construction work on the power stations and transmission lines is below expectations, and daily power cuts afflict EDTL customers.

The EDTL audit report from Deloitte[27] and the monthly reports from project supervisor ELC-Bonifica S.P.A[28] point out continuing poor-quality work and inadequate preparation for EDTL to operate the two new power stations. We will be pleasantly surprised if the Government achieves its goal of electrifying the north coast at the end of next month.

In the 2012 budget, capital expenditures for electricity are $282 million, while running the new power plants will increase expenditures for generator fuel from $46 to $89 million. However, the proposed 2012 budget shows no increase in salary allocation for EDTL staff to learn, operate and maintain this new infrastructure, (although they plan to begin installing prepaid meters in the districts), and a reduced allocation for equipment maintenance. No money is foreseen to build or rehabilitate medium and low-voltage power lines after 2012, and EDTL fuel usage (budget allocation divided by expected oil price) is projected as constant from 2012 through 2016. Although generating capacity and paying customers will increase greatly, EDTL

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27 http://laohamutuk.org/Oil/Power/2011/DeloitteEDTLExecSummApril2011En.pdf

28 http://laohamutuk.org/Oil/Power/Bonifica/BonificaMonthlyReportApr2011.pdf or http://laohamutuk.org/Oil/Power/Bonifica/BonificaMonthlyReportJun2011.pdf

gross revenues are projected to go up only slightly, from $14.5 million in 2011 to $16.1 million in 2012. By 2016, EDTL projects revenues of $41.6 million, for which it will spend $102 million on fuel.

In 2012, the budget requests a $73 million subsidy (not including hundreds of millions of dollars in capital costs) for this autonomous agency. Why spend nearly a billion dollars on generating capacity if it's not going to be used?

La'o Hamutuk wishes that the subsidies for EDTL were an investment which would generate returns for the state. Unfortunately, it is a losing proposition, and the required subsidies increase as generating capacity grows, more customers are reached by power lines, and fuel and maintenance expenses mount. Few Timor-Leste consumers can afford the actual costs of the electricity they use (about five times higher than current meter rates), and we regret that so much of the state's resources are directed to furnishing many kilowatt-hours for wealthy users with air conditioners and many appliances. Although some policy-makers believe otherwise, we doubt that large industrial users who require 24-hour power (such as an LNG plant or oil refinery) will rely on EDTL-produced power, and expect them to generate their own.

This is bad news for Timor-Leste's economy. When our petroleum reserves are used up and revenues drop, we will not be able to provide electricity for our people, with no money for maintenance, fuel and other operational costs. The high price of electricity will fall heaviest on poor people.

Several recent reports have revealed that some large customers are not paying for electricity. The 2012 budget timidly hints that this might change: "It is also possible that the rates charged, which were revised in August of 2011, may be further modified as better-off clients could be asked to accept less of a subsidy for their electricity, and such changes could boost these revenues further."

Therefore, we suggest that Parliament request a detailed explanation from the Government about the total project costs and expected returns and consumer payments from the national electricity project. The Government should publish a cost/benefit study, and Parliament should increase its oversight to ensure that these huge expenditures can provide benefits for all our people.

Agriculture deserves more attention.

The Ministry of Agriculture and Fisheries (MAP) says that 87% of Timor-Leste's population – 972,000 people – live by the agricultural sector. To develop this sector, the 2012 budget appropriates $20.1 million, about 1% of state expenditures. As this tiny allocation shows, the State gives little attention to the sector which includes most of our citizens, and the MAP Annual Action Plan leaves out important points. Unfortunately, MAP has no integrated plan to increase farmer's capabilities to extend and intensify agricultural production, reducing their reliance on inputs like tractors and chemical fertilizers which force them to give their money to foreign companies. We encourage MAP to believe that Timor-Leste's farmers can be independent, and to work to make that happen.

So far, MAP doesn't have a clear program or system in prepare farmers' capacity for the future, especially in relation to their lives. They haven't received necessary training on topics like organic fertilizer, organic pest control, processing their products, negotiations, managing their income, developing household industries and market principles. Farmers' limited knowledge continues to obstruct significant improvements in their production, maintaining their dependency on the state and on chemical products.

The 2012 MAP Action Plan has three programs to train farmers: The Farmer Field School (FFS) to train 600 farmers, visiting training for 1,524 groups of 15 farmers, and training 5,588 farmers in Agricultural Production Centers. MAP hopes to train 29,000 farmers, about 18% of agricultural households.

Many developing countries have high agricultural expenses. In Thailand, many agricultural workers have lost their land to companies, becoming slaves instead of farmers. In the Philippines, farmers move to the city when their farms are forfeited because they cannot pay back what they had to borrow to support high-input agriculture, which requires chemicals, fuel and machines.

Sustainable agriculture and diversified income is a better way for Timor-Leste. Although the government has big dreams to export our agricultural products, a more realistic goal would be Food Sovereignty, reducing the need to import rice and other products, enabling our farmers to feed their families from their own labor. Instead, the Government plans to take land away from farmers for projects like Tasi Mane, undercutting this important objective. Food Sovereignty will be based on Timor-Leste's own wisdom and resources, not on foreign companies. Our farmers will produce a variety of crops, promoting diversification and healthier diets. This approach doesn't reject technology, but looks for sustainable, appropriate technology which is good for the land, the environment and people's health.

Some new developments give more reason for concern.

Parliament needs more information before you can approve borrowing.

This year's budget asks Parliament to approve expenditures of $33 million borrowed from overseas, for Dili sanitation and drainage, and for roads between Dili, Liquiçá, Ermera, Manatuto, Natarbora and Baucau.

Table 6.1. Financing needs and Co-financing from the Government, 2012 - 2016

Roads	2012	2013	2014	2015	2016	Total
Dili-Liquica, Tibar-Ermera	5,260	10,700	10,700			26,660
Manatuto-Natarbora	2,840	2,880	2,280	5,340	30,000	43,340
Dili-Manatutu-Baucau	5,000	6,600	8,100	27,500	50,000	97,200
Maubise-Ainaro/Same		10,000	20,000	20,000		50,000
South Coast Highway		30,000	40,000	50,000	100,000	220,000
Dili Sanitation/drainage	20,000	20,000				40,000
Loans	**33,100**	**80,180**	**81,080**	**102,840**	**180,000**	**477,200**
Government Co-Financing	9,930	24,054	24,324	30,852	54,000	143,160
	43,030	**104,234**	**105,404**	**133,692**	**234,000**	**620,360**

Source: Major Project Secretariat, Ministry of Finance, 2011

This is the first time the Government has asked Parliament to approve actual borrowing, since Parliament and the Council of Ministers recently approved the required legislation. Unfortunately the Budget package includes less than a page about borrowing, without identifying the lenders or the terms of the loans, and "does not show repayment because most of the loans have a ten year grace period." The memorandum explaining the Budget Law explains that for "the first time in the history of Timor-Leste, the Government is proposing to National Parliament a ceiling that the Government is authorized to contract loans, by a legal obligation which must only intended for the construction of strategic infrastructure development the country."

Borrowing is not just about spending but about repayment – even "concessional" loans require the principal to be paid back. Lenders also require guarantees and impose conditions; Timor-Leste will surrender some of its hard-won independence to receive this financing.

Before you approve this budget, you need information about the total amounts to be borrowed (not just how much loan money will be spent each year), who the lenders are, interest rates, grace periods, terms of repayment and conditions on the loan. You need to know how each loan relates to a specific project, and to see the terms of the loan agreements. What will be offered as collateral (now that 10% of the Petroleum Fund can be risked in this way), what happens if Timor-Leste defaults, and do we legally have to repay the loan before providing essential services for our people? The Government needs to tell Parliament how Timor-Leste will repay the money.

In recent months, the Government has moved rapidly and alone, ignoring concerns from Parliament, other leaders, and civil society organizations. Parliament approved the Public Debt Law two months ago with rushed and inadequate debate. This process has serious implications for future generations of our citizens, and deserves more attention.

According to Article 20.1 of Law No. 13/2009 on Budget and Financial Management, the Government is required to "specify the amount it expects to receive from borrowings and grants during the financial year" as part of the budget proposal submitted to Parliament. But the Budget documents only say how much borrowed money will be spent each year. Most loans pay for multi-year projects, and the contracts and repayments are for much more than the first year's expenditure.

Creditors know that oil and gas is Timor-Leste's only significant resource which can easily be converted to cash, and our petroleum wealth is what makes us credit-worthy in their eyes. By the time the 10-year grace period has ended, Bayu-Undan will be almost empty, and the next generation will struggle to pay back interest and principal from uncertain domestic revenues, in an unpredictable international economic climate. At this stage, we cannot expect that non-oil income will be able to repay loans – so Timor-Leste should think before we leap.

Last month, La'o Hamutuk and more than 100 organizations from all over the world wrote "Rather than repeat the mistakes of other developing countries that have struggled with debt during recent decades, Timor-Leste should learn from their experiences, which often inflicted great hardships on their people. This is especially important because of Timor-Leste's high dependence on exporting non-renewable oil and gas wealth, a resource which will run out soon."[29] We urge Parliament to heed this advice and exercise its Constitutional power to reject borrowing at this time, until the specific loan agreements and projects to be financed are transparent and thoroughly discussed.

As we have seen with the national electricity project, poor planning, oversight and management lead to wasted money, delays and unreliable results. Corruption is likely, and maladministration dominates. Most public investment goes abroad, as our local economy cannot absorb it. As other countries have sadly learned, these problems can be made worse by borrowing. Loan money benefits high-level officials and foreign companies, but poor people suffer the burden of repayment. This money will flee Timor-Leste, yet we are the ones who will have to pay it back.

Ten years from now, as we are repaying our debt, our population will be larger, and our shrinking oil revenues will be stretched thin. Tomorrow's children will have less education and health care because today's leaders will have spent the money which would have paid for it on questionable mega-projects. This is another aspect of the resource curse, which we can still avoid. As you encourage sustainable development of our non-oil economy, please don't burden it with repayment costs for nonproductive loans.

The Tasi Mane project could be a multi-billion-dollar white elephant.

The 2012 State Budget will allocate $163 million for the Tasi Mane south coast petroleum infrastructure project, a huge increase over the $19 million spent this year but a small part of the total cost, which will be far more than a billion dollars.

Most of this year's allocation, $100 million, is to construct the Suai supply base for offshore petroleum operations, which has a total budgeted project cost of $329 million between 2011 and 2014. We remain dubious about the potential return on this "investment," which may have no offshore operations to supply. Bayu-Undan will probably be supplied from Australia until it runs dry in 2024, and Kitan – the small oil field which just began production – will be empty by 2016. At present, no oil companies plan to drill more wells in the nearby Timor Sea, although next year's bidding round could spark new interest.

The Supply Base is a hidden subsidy for Timor-Leste's new TimorGAP, E.P. national oil company, which also receives $2 million in state funds every year, buried in the SERN budget. In September, the Council of Ministers appointed the Singaporean company Eastlog Holdings PTE to direct construction of the supply base, and it will become the property of TimorGAP when it is built. We hope that Parliament will carefully evaluate the costs and benefits of this "investment" before approving a major expenditure which will primarily help Singaporeans. TimorGAP was established without any Parliamentary input or authorization, and has no legal obligation to report to Parliament or the public. Before approving additional money for TimorGAP or the Suai Supply Base, Parliament should request to provide a business plan, financial analysis, and regular reporting on how it will use the people's money.

The proposed Betano oil refinery and petrochemical plant, as well as the heavy oil power station there, have already provoked community opposition, as state officials have been dishonest about the total amounts of land required and insensitive toward the local community. Although 16 hectares have been cleared for the power plant (more than the four the community originally agreed to), Tasi Mane project maps show an 82-

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[29] See http://www.laohamutuk.org/econ/debt/2011/11ETANMKDStmt5Sep2011.htm (English and Tetum)

hectare power plant site, adjacent to a 282-hectare site for the planned refinery. Without free, prior and informed consent from local people, this project could lead to "Hello conflict, goodbye development." Budget Book 6 allocates $5 million (under Tasi Mane airports?) for a detailed geotechnical and marine survey for the Betano Petrochemical plant, with no information about total project costs.

Last year, we expressed concern that the 2011 budget allocated $9.3 million for the desired gas pipeline from Greater Sunrise and LNG plant in Beaçu, a project which may never happen as Woodside and its partners who hold the Sunrise contract continue to insist on a floating LNG plant. This year's budget reappropriates $1.5 million of the $3.5 million authorized during 2011 for pipeline route analysis, and adds $0.5 million to the $5 million spent in 2011 for detailed design for Beaçu infrastructure. As Budget Book 6 shows no spending for the Sunrise LNG plant after 2012, and SERN's Action Plan says that the Sunrise Task Force will have finished its studies by the end of 2012, we are glad to see that the Government may finally stop wasting the people's money on an impossible dream.

The National Procurement Office is tendering for an Environmental Impact Assessment for eleven components of the Tasi Mane project, to be done by nine technical specialists in four months. This process, which has not involved the National Directorate for Environment, seems intended to facilitate the petroleum industry rather than to protect our land, sea and communities. Parliament should not approve funding for this until a genuine EIS and extensive community consultation have been conducted, and you are certain that all practical steps are being taken to protect our people, agriculture, fisheries and environment from the kinds of destruction that accompanies petroleum industrial development all over the world.

The South Coast Highway will eat up another billion or more.

Another $45 million is allocated during 2011 for the Suai-Betano-Beaçu highway, which is budgeted to absorb $547 from the Infrastructure Fund and $220 million in loans between now and 2016. Cars and 10-ton trucks will speed along its two carriageways at 100 km/hour, making the 152-km trip in less than two hours.

Timor-Leste paid a million dollars to PT Virama Karya for a "Preliminary, Detailed Design and Environmental, Social and Economic Assessment, " which projects construction costs at $9.2 million/km, $1.39 billion total.

The proposed 2012 State Budget envisions only about half of this, which may be intended to pay for just one carriageway, as the Strategic Development Plan hints that the lanes may be built one at a time. La'o Hamutuk estimates that the cost of the road over its 30-year life (construction, loan interest, and maintenance) will be $1 billion for a single-carriageway road and $1.7 billion if both carriageways are built. Parliament should insist on full information about plans and costs, even if they extend beyond 2016.

Today, traffic along this route is less than 100 cars and trucks each day. If we optimistically assume tremendous regional growth, this could increase to 1,000 per day. If the Virama Karya design is built, each car or truck driving the length of the highway will benefit from a state subsidy of $156, more than a dollar per vehicle-kilometer. (Even if only one carriageway is ever built, Timor-Leste will have paid 60c for each vehicle-kilometer travelled, or $91 for a car which drives its length.)

The Timor-Leste Investment Company may squander people's money.

The 2012 state budget appropriates $200 million as seed money for the newly-established Timor-Leste Investment Company (TLIC) – more than the total allocated for education, health and law enforcement. TLIC was established last month by Decree Law 41/2011. The Government says that the TLIC will "promote the development of investment opportunities and national wealth growth, leading important strategic projects with significant commercial impact." Last June, the Government celebrated TLIC as being "born to attract foreign direct investment by providing commercial incentive, through which the Government and the People have ownership. Similar to Singapore's Temasek Holdings, a domestic, Government owned Investment Corporation, TLIC will target sector investment aligned to need and return and invest accordingly on a strictly commercial basis to accelerate development." Budget Book 1 expects TLIC to help "Timor-Leste develop a sustainable diversified economy by transferring the Petroleum Fund wealth into the non-oil economy, through economic growth and diversification of the economy from one dependent on oil and gas to non-oil and gas," but TLIC is not mentioned in the Action Plans of any Ministry.

TLIC was created without public or Parliamentary participation or oversight. Its structure, regulations, leadership and staff have not been defined or hired. It has nonexistent reporting requirements, no transparency, and little control on how public money will be used – even less than the Special Funds which are already cause for concern. Parliament needs more information before you hand over $200 million of our people's money to an entity "with administrative, financial and asset management autonomy." [30] Have we learned nothing from the cronyism and corruption of the Suharto era?

As an investor, Parliament should allocate money to only projects with a reasonable expected rate of return, and the examples in Budget Book 1 of TLIC investments are not promising:

- How can an undersea internet cable to another country make Timor-Leste a "world leader in internet access" when none of our neighbors are such leaders, and our internet will depend on theirs?
- How will our people benefit from a high-rise office building which will undercut the commercial real estate market, subsidizing foreign companies and government entities while reducing the attractiveness of private sector real estate investment?
- Will a high-quality, shopping center really be able to offer "the lowest cost prices in the region," attracting foreign tourists to shop here for imported luxury goods? Given our low, "nearly duty-free" import taxes, what benefits will our state and our citizens receive from subsidizing such a complex?

Projects like these undermine private sector development. Although public investment is essential in countries like Timor-Leste, the Government should fund more urgent, important sectors which benefit the majority of our people, such as education, health, agriculture, ecotourism, water and sanitation. Moreover, the TLIC projects do not reflect the needs of most Timorese who are struggling to keep one plate on the table. Students need chairs, books, libraries and teachers before they can take advantage of fiber optics internet, and people need healthy food and clean water before they can shop in a luxury mall.

Recommendations

Parliament cannot completely resolve all of these problems, as many of them result from misguided priorities, poor planning, unrealistic dreams and fascination with the petroleum sector. We hope that these recommendations will help you in improving the budget.

1. "Take context as the starting point" is the first Fragile States Aid Effectiveness Principle. Parliament and Government should recognize that Timor -Leste is experiencing the Resource Curse, and take effective actions to prevent it from getting worse. In particular, plan realistically for continuing inflation and improve domestic productive capacity so that our resource wealth stays in our country.
2. Give more attention to sustainable non-oil economic development which can benefit large numbers of people. This will be primarily based on agriculture, replacing import dependency and transient oil revenue, producing results which are equitably shared among our population.
3. Give more attention to human resource development, especially education and health, focusing on actual results rather than statistics for international agency scores.
4. Do not approve additional funding for the MDG-Suco housing project until you have accurate information about past and expected future expenditures and the number of houses to be constructed.
5. Pay more attention to the negative environmental, social and economic impacts of industrialization, especially on people living near industrial or large infrastructure projects.
6. Keep spending within sustainable levels, based on prudent projections of future oil prices, rather than the 7.2% of estimated petroleum wealth the Government is asking for. Avoid massive budget increases,

[30] Decree-Law 41/2011 of 21 September, Article 2.

keeping withdrawals from the Petroleum Fund within the 3% Estimated Sustainable Income. (If new investment strategies produce much higher returns, this could be revisited in future budgets.)

7. Exercise Parliamentary fiscal oversight over the implementation of the liberalized investments enabled by the recent revision of the Petroleum Fund Law. Evaluate the sustainability of the fund, given actual spending levels and realistic expectations of returns on Fund investments.
8. Before appropriating additional money for the Infrastructure Fund, demand a complete accounting of how the Fund was used during 2011, including what money was spent differently from the proposal in Budget Book 6 of the 2011 budget. Request more detail than one-line project descriptions on how the Government plans to use the $746 million it wants to add to the Infrastructure Fund in 2012.
9. Do not approve the budget until the Government provides expenditure projections based on actual plans, rather than econometric models, with full life cycle costs and projected rates of return on multi-year physical infrastructure projects. Request complete cost and financing information for the implementation of the National Strategic Development Plan before approving money to carry it out.
10. Request more information on the completion of construction and operation of the national electricity project, especially the heavy oil power plants. How much fuel will be required, what are operational and maintenance expenses, will this be contracted out or done by EDTL (or Manitoba), how much will ratepayers be expected to pay, what is the anticipated need for continuing subsidies from the state budget?
11. Encourage policies which support food sovereignty and sustainable agriculture, increasing Timorese farmer's human resources to enable them to enhance and diversify their production and add value to their products.
12. Taking into consideration the experiences of other indebted developing countries, require information on all prospective loans before approving borrowing, including the sources, interest rates, conditionalities, collateral, default provisions and repayment schedules. Ask the Government to provide the proposed loan agreements.
13. For projects which will be financed through loans, review the preliminary designs, financial analysis and projected rates of return.
14. Do not appropriate funding for Tasi Mane project construction, including the supply base until a solid economic cost/benefit analysis has been presented and discussed by Parliament. This needs to be more substantive and realistic than the glossy visions of the SDP, and should include accurate and detailed cost information and revenue and employment projections for the full project cycles.
15. Before spending more money on the South Coast Highway, request information on expected traffic, total project costs, maintenance expenditures, associated loans, and land use.
16. Before approving $100 million for the Suai Supply Base, review the plans, including expected customers and rates of return. Ask TimorGAP to provide a business and operational plan for this project, as well as a detailed design and economic spinoff projections, since they will be the eventual beneficiary of Parliament's appropriation of the money.
17. Do not approve funding for the Betano refinery and petrochemical plant until Parliament and the local community has had the opportunity for free, prior and informed consent over the actual amounts of land that will be used and the area affected.
18. Insist that a legitimate Environmental Impact Assessment and Environment Management Plan be conducted for every component of the Tasi Mane project, as well as for the Betano power and related infrastructure.
19. Implement Parliament's Constitutional responsibilities by enacting laws to bring the TimorGAP national oil company and the Timor-Leste Investment Company under Parliamentary oversight.

20. Do not approve investment capital for the Timor-Leste Investment Company until it has been established and presented its regulations to Parliament, with adequate transparency, checks and balances and oversight. Before significant capital is approved, request a well-thought-out business plan, including analysis of capital and operational costs and expected return for each project to be financed by TLIC.
21. Make budgetary decisions based on facts, rather than on political propaganda, and encourage the Government to provide accurate information about our economy rather than campaign promises.

Conclusion

As in past years, we appreciate Parliament's interest in hearing La'o Hamutuk's analysis, and we hope that our submission will help you make wise decisions as you carry out your essential Constitutional responsibilities to approve, oversee and audit the State Budget. We hope that you will receive all the information you need, as Budget documents and Ministerial presentations often omit necessary facts.

As the President of the Republic recently noted, 2012 will be an election year and it will be difficult for public officials to devote the attention and continuity required to implement major new programs and policy changes, yet this budget is a huge increase over 2011.

The election will also make it challenging for each Member of Parliament to take decisions in the current and future interests of all Timor-Leste's people, not only the electoral desires of his or her political party. We continue to encourage and support you to carry out your responsibilities under Article 92 of our Constitution: "The National Parliament is the organ of sovereignty of the Democratic Republic of Timor-Leste that represents all Timorese citizens and is vested with legislative, supervisory and political decision making powers."

We have attached our initial comments on the Strategic Development Plan, which we distributed last July, to this submission. It goes into more detail on aspects of the SDP, whose initial steps are included in the General State Budget for 2012.

Thank you very much for your attention and consideration, and we are happy to discuss these or other relevant concerns with anyone who is interested.

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