



República Democrática de Timor-Leste

State Budget 2022

Budget Overview

Book 1



Book 1 – Budget Overview

Preface

The Organic Law of the Ministry of Finance specifies the responsibility of the National Directorate of Budget to collect and manage financial information relating to the public sector and publish the statistical results.

In accordance with this provision and to promote the transparency of the public finances, the Ministry of Finance is publishing the final version of the documents relating to the 2022 State Budget, following the approval of the Council of Ministers.

The documentation for the 2022 State Budget consists of the Budget Law, plus various supporting budget books:

Book 1	: Budget Overview
Book 2	: Annual Action Plan
Book 3A	: Infrastructure Fund
Book 3B	: Municipalities
Book 3C	: RAEOA & ZEESM
Book 3D	: Social Security
Book 4a and 4b	: Budget Line Items
Book 5	: Development Partners
Book 6	: Special Fund - FDCH

Book 1 *Budget Overview* describes the overall budget strategy of the Government. It provides information on the international and domestic economic outlook, expected domestic and oil based revenue including expected sustainable income, and overall expenditure in the medium term and the main new initiatives in the coming year.

Budget documentation is available on the budget transparency portal of the Ministry of the Finance, www.mof.gov.tl Inquiries relating to this publication should be directed to the General Directorate of Planning and Budget on email jcarvalho@mof.gov.tl, phone (+67077304362), epmartins@mof.gov.tl (+67077879183) and syaquim@mof.gov.tl (+67077305809).

I consider that this document will increase awareness and understanding of the Government's finances and help people to become good citizens and heroes to our nation.



Rui A. Gomes
Minister of Finance

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Abbreviations

Appropriation Category	AppCat
Asian Development Bank	ADB
Autonomous Agencies	AA
Autonomous Service Of Medicines And Health Equipment	SAMES
Capital Development	CD
Classification of the Functions of Government	COFOG
Council of Administration for the Infrastructure Fund	CAFI
Consolidated Fund of Timor-Leste	CFTL
Consumer Price Index	CPI
Dalan Ba Futuru (Timor- Leste)	DBF(TL)
Democractic Republic of Timor-Leste	RDTL
Development Partner	DP
Direct Budget Support	DBS
Timor-Leste National Police	ETNP
Economic Recovery Plan	ERP
European Union	EU
Falintil - Defense Force of East Timor	F-DFTL
Financial Management Information System	FMIS
General State Budget/ Orsamentu Jerál Estadu	GSB/ OJE
Goods and Services	GS
Government of Timor-Leste	GoTL / GovTL
Government Resource Planning	GRP
Gross Domestic Product	GDP
Gross National Income	GNI
Human Capital Development Fund	FDCH
Human Capital Index	HCI
Human Development Index	HDI
Infrastructure Fund	IF / FI
Integrated Financial Management Information System Unit	IFMISU
Integrated Municipal Development Program	IMDP (PDIM)
National Institute for Health	INS
International Development Agency	IDA
Laboratory National	LABNAS
Line Ministries	LM
Ministry of Agriculture and Fisheries	MAP
Ministry of Defence	MD
Minor Capital	MC
Ministry of Education including SEJD	MEJD
Ministry of Finance	MoF
Ministry of Health	MoH
Ministry of Interior	MI
Ministry of National Liberation Combatant Affairs	MACLAN

Ministry of Planning and Strategic Investment	MPIE
Ministry of Public Works	MoP
Ministry of Social Solidarity and Inclusion	MSSI
Ministry of Tourism, Commerce and Industry	MTCI
Ministry of Transport and Communications	MTC
National Communication Agency	ANC
National Development Agency	ADN
National Directorate of Budget	DNO
National Intelligence Agency	SNI
National Police of Timor-Leste	PNTL
Nominal Effective Exchange Rate	NEER
Organization of the Petroleum Exporting Countries	OPEC
Petroleum Fund	PF
Planning, Monitoring and Evaluation Unit	UPMA
Programme Budgeting	PB
Public Financial Management	PFM
Public Service Commission	PSC/CFP
Public Private Partnerships Unit	PPPU
Public Transfers	TP
Quarter 1	Q1
Quarter 2	Q2
Real Effective Exchange Rate	REER
Self-Funded Agency	SFA
Salaries and Wages	SW
Secretariat of State for Art and Culture	SEAC
Secretariat of State for Environment	SSE/SEA
Secretariat of State for Youth and Sport	SEJD
Social Security Fund	SSF
Special Administrative Region of Oé-Cusse Ambeno - Special Zones of Social Market Economy	RAEOA-ZEESM
Strategic Development Plan	SDP/PDE
United Nations Development Program	UNDP
World Bank	WB

1 Executive Summary

Government Policy

Timor-Leste's Strategic Development Plan 2011 - 2030 is organized around four pillars: Institutional Framework, Social Capital, Economic Development and Infrastructure Development, all of which are priorities in the VIII Constitutional Government's mandate.

Based on these pillars, the VIII Government has set out 6 key areas for 2022. These are:

- Development of Human Capital (Education, Training and Health)
- Housing and Social Inclusion
- Productive Sectors (Agriculture, Tourism), Environment and Connectivity
- Private Sector Development
- Rural Development
- Good Governance

The proposed 2022 budget ceiling is set at \$1.84bn (including development partner commitments) and its split across the funding sources as set in the table below.

Table 1: Combined Sources Budget 2020-2026, \$millions

	2020 Actual	2021 Rectified Budget	2022 Budget Proposal	2023	2024	2025	2026
Combined Sources Budget	1,339.1	2,185.4	1,842.5	2,795.0	2,664.4	2,093.2	1,782.2
Government Expenditures by Fund (including loans)	1,156.0	2,030.3	1,675.0	2,670.9	2,579.1	2,088.6	1,777.6
CFTL (including DBS, excluding IF, HCDF, SS, COVID-19 and RAEOA)	748.5	1,237.6	1,165.5	1,220.6	1,277.6	1,329.6	1,387.4
<i>Direct Budget Support</i>	<i>10.1*</i>	<i>9.1</i>	15.6	6.6	2.8	3.8	0.0
Infrastructure Fund (IF)	108.6	280.9	281.7	1,231.5	1,096.1	510.2	160.5
Human Capital Development Fund (HCDF)	8.8	13.0	12.0	12.5	13.0	13.4	14.0
COVID-19 Fund	194.3	287.6	37.6	28.2	21.2	15.9	11.9
Social Security Fund (SSF)	41.7	42.7	43.0	44.6	46.4	48.1	50.0
RAEOA	23.8	97.8	84.4	87.6	91.2	94.4	98.2
Borrowing/Loans (disbursements)	30.1	70.7	50.8	45.9	33.8	77.0	55.6
Development Partner Commitments	183.1	155.1	167.5	124.1	85.3	4.6	4.6

Source: Ministry of Finance, 2021.

* International Labour Organization also provided \$0.7 million in one-off support in 2020

Future year spending is forecast to maintain increase in line with inflation and population forecasts In 2021, Timor-Leste was hit by the twin shocks of COVID-19 and Cyclone Seroja.

Impact of COVID-19

Timor-Leste recorded its first COVID-19 case on 21st March 2020. As of 10th October 2021, there have been a total of 19,673 confirmed cases of COVID-19 detected in the country and 119 deaths.

Following the first confirmed case in the country, President Lu-Olo declared a State of Emergency to run from 28th March which has subsequently been extended numerous times and is still in place currently. In March 2020, the Government asked National Parliament to approve a \$250 million extraordinary transfer to reinforce the Treasury account during the duo-decimal regime and establish the COVID-19 Fund. This new law was promulgated by President Lu-Olo on April 6th. The first \$150 million transfer was made in April with the second \$100 million transfer made in May. Of the \$250 million transfer, \$150 million was assigned to the COVID-19 Fund, with broad spending on programs and sub-programs related to the COVID-19 response. This included funding for prevention and combating COVID-19 which focused on the acquisition of essential medical equipment and goods, the creation and maintenance of isolation centres and training for key staff. The remainder of the extraordinary withdrawal, totalling \$100 million, was used to finance the Treasury account. In June 2020, through enactment of Law No 5/2020, the Parliament approved a second round of the extraordinary withdrawal from the Petroleum Fund totalling \$286.3 million. This amount was to be split between the COVID-19 Fund (\$69.5 million) and supporting the Treasury account (\$216.8 million). It was withdrawn in two parts, one in August (\$169.5 million) and the other in October (\$116.8 million). Following the approval of Budget 2020 in October, another withdrawal was done in December (\$350 million). Hence, the total withdrawal from the Petroleum Fund in 2020 was \$886.3 million out of the \$963.9 million approved by the Parliament.

In the final 2020 budget (approved in October 2020), the COVID-19 Fund received a total allocation of \$333.2 million. This was divided with \$151.1 million to Goods and Services, \$165.9 million to Public Transfers, \$4.1 million to Minor Capital and the final \$10.2 million to Capital and Development. By the end of Q4 2020, it had executed \$194.7 million, giving an execution of 58.4%. In the original 2021 Budget, the COVID-19 Fund was due to receive \$31.0 million to focus on risk mitigation and recovery measures. \$23.9 million was allocated to Goods and Services, \$3.5 million to Public Transfers and \$3.6 million to Capital Development.

The first cases of community transmission were declared on 26th February as an outcome of the mass testing. On 7th March 2021, the first cases of community transmission in Dili were announced. On the 24th March, the Council of Ministers approved the draft for the first amendment to Law No. 14/2020 of December 29th, which approved the 2021 General State Budget. The amendment increased the budget by a further \$198.4 million (excluding donor funded spending). However due to internal budget reallocations, additional spending to cover these new activities totalled \$135.3 million.

The amendment focused on 6 key areas:

1. Employment support
2. Moratorium on credit
3. Exemption from tuition fees
4. Food acquisition

5. Support to frontline professionals
6. COVID-19 prevention and mitigation measures

The final rectified budget was approved by Parliament on the 27th April 2021. There was no changes to the total government expenditure but some additional adjustments to the appropriation category allocations. The approved budget had additional spending of \$317.1 million, with \$182.4 million in budget reallocations, meaning the overall increase remained \$135.3 million. This did not include the additional \$39.1 million rebalancing from line ministry's virements towards Cesta Basica between January to March 2021. The proposal was passed unanimously (with 20 abstentions). The largest economic recovery measure, \$45.3 million, was assigned to National Institute of Social Security to implement employment support initiatives. \$34.5 million was allocated to Ministry of Health to implement the COVID-19 vaccination program, increasing quarantine facilities, purchasing personal protective equipment (PPE) equipment and extending contact tracing initiatives. Funds were also given to the National Centre of Logistics and the Integrated Center for Crisis Management, as well as to provide subsidies for frontline workers and support the conclusion of the Cesta Basica Programme.

Impact of Cyclone Seroja

On Easter Sunday 4th April, Timor-Leste was impacted by a severe natural disaster known as cyclone Seroja which caused the largest amount of rainfall in 30 years and devastating flooding and landslides. The disaster caused great devastation including material loss and deaths. In total, 48 people lost their life and 30,350 people were dislocated across 6 different shelters across Dili (São Tiago Church Hera, Canossiana Convent Hera, Dom Bosco Comoro Dili, Ex Metiaut Restaurant, Rate-Ain near Canossa Comoro, and Manleuana Suco Centre). The most severely impacted areas were Dili, RAEOA (Oé-Cusse), Manatuto, Ainaro, and Viqueque. Dili, Ainaro and Manatuto experienced most of the fatalities.

In response, on April 9th 2021 the State declared the situation a national calamity as per Government Resolution No. 32/2021. The government originally allocated \$2,247,064 in response. The fund was for clean water and food, construction materials, temporary wall protection for water and rivers. A total number of 3,710 people benefitted with 3,138 people receiving non-food support and 2,093 people receiving construction materials. Apart from the government aid, victims also received support from local support groups and the international community.

To ensure that the state is well prepared for responding similar event in the future, the Ministry of State Administration through Unit for Civil Protection Mission and Management of Natural Disaster has established a number of policies and initiatives including: identifying risk areas and banning communities to construct houses in risk areas, improving knowledge and infrastructure to mitigate risk from natural disaster, preparing and informing to the community to have culture of risk prevention and developing an efficient alert system. Moreover, a working group looking at implementation, measurement and prioritisation of natural disaster risk mitigation has been developed. A pilot multi-functional accommodation centre will be established with the objective to respond to natural disasters across the territory and contribute to urban reorganization, decentralization policy and local power. \$57.3 million from the 2021 Rectified Budget was to be used to fund infrastructure maintenance and rehabilitation following the impacts of cyclone Seroja (including an extra \$54 million in reallocations within the Infrastructure Fund).

Macro-Fiscal Overview

Economic growth contracted by -8.6% in 2020 due the combined effect of the delayed budget, COVID-19 and the State of Emergency. However it is expected to return to positive growth of 1.6% in 2021. This return to growth is driven by an end to political uncertainty and return to strong government expenditure. Although this has been revised down due to COVID-19 confinement, the recent floods and poor execution of the large state budget by Q3 2021. Meanwhile, inflation is expected to rise in 2021 to 2.7%, remaining steady in 2022 at 2.0%. This is due to a rebound in oil prices following the dramatic fall in 2020.

Domestic revenues reached \$106.67 million by the end of September 2021, a decline of \$25.5 million on collections at the same time the year before. This is a fall of 19.3%. The main factor for this is that from the start of 2021, Electricidade de Timor-Leste E.P. (EDTL) and BEE Timor-Leste E.P. became Public Enterprises. This means that while they remain in the public sector, their revenues are no longer counted in in the Treasury account as they are not included as part of the General Government. Public Enterprises are the most autonomous of all public entities. However even when including these new public enterprises back into the total, to allow a like-for-like comparison, revenues are still below those at the same point last year. This is largely due to a rapid decline in tax revenues due to the impact of the global COVID-19 pandemic and the associated state of emergency enacted in Timor-Leste, as well as the knock-on effects of cyclone Seroja to business activity.

Preliminary forecasts see domestic revenue set to equal \$150.9 million by the end of 2021 and \$159.1 million by the end of 2022. Following a fall in 2021, non-oil receipts are set to be on a consistent growth trend for the next 5 years; nearing \$184.6 million by 2026 provided that positive macro-economic conditions hold. Enacting further key fiscal policy reforms, such as the approval of a VAT Law, could help to increase this growth even further.

Petroleum Fund Revenue

The Petroleum Fund remains the main source of funding for the state budget. The amount withdrawn is categorised into the ESI amount and any excess withdrawal that is justified by the Government to be in the long-term interests of Timor-Leste. Calculating the ESI requires projecting the Fund's value at the beginning of the budget year along with the present value of future petroleum revenue. The assumptions for Budget Book 2022 are updated with the latest information available to date.

The Fund's actual closing balance at the end of 2020 was adjusted for potential devaluation of the Fund's loan to Timor Gap E.P. This followed Timor Gap's write-down in its financial statements of the value of its participating interest in Greater Sunrise from \$673.3 million to zero as at 31 December 2020. The fair value of the Fund's loan is being assessed by an independent expert and the valuation will be incorporated in the Fund's final 2020 financial statements. For ESI calculation, it is assumed nil. As a result, the expected value of the Fund at the beginning of 2021 was revised down to \$18,289.3 million. Excluding the loan's value which is currently being assessed, the Fund is expected to end 2021 at \$18,323.8 million after accounting for the revenue estimates of \$228.1 million, a \$1,184.0 million in investment income, and the \$1,377.6 million withdrawal in 2021 approved by Parliament. The end of year balance is uncertain and depends largely on the performance of equity markets in the final quarter and the valuation of the loan.

Total Petroleum Wealth is estimated to be \$18,469.3 million on 1 January 2022. This is \$206.8 million higher than the figure previously calculated for ESI 2021. Thus, the ESI for 2022 is \$554.1

million, an increase of \$27.5 million from previously estimated in Budget 2021. In terms of the projections for 2022, petroleum revenues is estimated at \$45.6 million and expected investment return is \$445.6 million due to lower expected long-term investment return. Withdrawals to fund the 2022 Budget are projected to be \$1,042.1 million or 5.6% of Petroleum Wealth, exceeding the 2022 ESI by \$488.4 million.

The Fund's investment strategy needs to account for fiscal policy and the Fund's sustainability faces three substantial challenges, namely, 1) continued withdrawals in excess of the ESI since 2009, 2) declining petroleum revenues, and 3) expected investment returns well below the implied 3% real return target. On this basis, following the advice from the Investment Advisory Board (IAB), the Ministry of Finance decided to segment the Petroleum Fund's financial assets into 1) a liquidity portfolio and 2) a growth portfolio to better manage the Fund's risk and align its investments with the projections for fiscal policy.

Section 2.4.8 of this budget book describes in detail of the all changes impacting the Petroleum Fund.

Proposed Expenditure

The total proposed expenditure for the 2022 budget is \$1,675.0 million (excluding donor funded activities of \$167.5million). The total 2022 State Budget (excluding donor funded activities) is 17.5% reduction compared to the final budget allocation for 2021.

This table is still presented at the appropriation category level, despite Timor-Leste's move to programme based budgeting, to allow comparisons with previous years.

Table 2: Fiscal Table 2020 - 2026, \$millions

	2020 Actual	2021 Rectified Budget	2022 Proposed Budget	2023	2024	2025	2026
Total Expenditure by Appropriation Category (incl. loans)	1,156.0	2,030.3	1,675.0	2,670.9	2,579.1	2,088.6	1,777.6
Total Expenditure by Appropriation Category (excl. loans)	1,125.9	1,959.6	1,624.2	2,625.0	2,545.3	2,011.6	1,722.0
<i>Recurrent</i>	<i>972.2</i>	<i>1,539.4</i>	<i>1,170.4</i>	<i>1,214.9</i>	<i>1,263.5</i>	<i>1,309.0</i>	<i>1,361.3</i>
Salary and Wages	206.4	229.7	244.7	254.0	264.1	273.6	284.6
Goods and Services (inc. HCDF)	376.9	613.0	416.9	432.8	450.1	466.3	484.9
Public Transfers (inc. social security)	388.8	696.7	508.8	528.1	549.3	569.0	591.8
<i>Capital</i>	<i>44.1</i>	<i>393.2</i>	<i>420.2</i>	<i>1,368.3</i>	<i>1,224.5</i>	<i>685.2</i>	<i>318.1</i>
Minor Capital	8.9	55.1	31.4	32.6	33.9	35.1	36.5
Capital and Development (including loans)	35.2	338.1	388.8	1,335.8	1,190.6	650.1	281.6
<i>RAEOA/ZEESM</i>	<i>23.8</i>	<i>97.8</i>	<i>84.4</i>	<i>87.6</i>	<i>91.2</i>	<i>94.4</i>	<i>98.2</i>
Revenue	726.7	738.5	705.0	695.3	642.2	590.4	554.0
Domestic Revenue	182.4	190.6	150.9	159.1	167.2	175.7	184.6

	2020 Actual	2021 Rectified Budget	2022 Proposed Budget	2023	2024	2025	2026
Estimated Sustainable Income (ESI)	544.4	547.9	554.1	536.3	475.0	414.7	369.4
Fiscal Balance	(429.2)	(1,291.8)	(970.0)	(1,975.5)	(1,936.9)	(1,498.2)	(1,223.6)
Financing	429.2	1,291.8	970.0	1,975.5	1,936.9	1,498.2	1,223.6
Excess Withdrawals from the PF	342.0	829.7	488.4	1,923.1	1,900.3	1,417.4	1,168.0
Use of Cash Balance	47.1	382.3	415.1	-	-	-	-
<i>Treasury Cash Balance</i>	23.4	238.8	330.7	-	-	-	-
<i>RAEOA ZEESM Cash Balance</i>	23.8	97.0	84.4	-	-	-	-
<i>Use of INSS cash return</i>		35.0	-	-	-	-	-
<i>Use of Idosos cash subsidy return</i>		7.5	-	-	-	-	-
<i>Use of BCTL credit moratorium return</i>		4.0	-	-	-	-	-
Borrowing/Loans (disbursements)	30.1	70.7	50.8	45.9	33.8	77.0	55.6
DBS	10.1	9.1	15.6	6.6	2.8	3.8	-
<i>European Union Direct Budget Support</i>	10.1*	9.1	9.0	5.0	2.8	3.8	-
<i>Australian Direct Budget Support</i>			6.6	1.6	-	-	-

Source: Ministry of Finance, October 2021.

*Including a \$0.7 million contribution from International Labour Organization

Fiscal Sustainability Analysis

Timor-Leste is highly dependent on the Petroleum Fund to finance the fiscal deficit, therefore this is the main focus of any fiscal sustainability analysis. The long term sustainability of the Petroleum Fund is not dependent only on this year's choice of budget, but also the choices made for the subsequent years.

The analysis shows that if expenditure grows at the same rate as it has historically, the Petroleum Fund will run out in just 13 years. If the growth in expenditure is capped to keep real per capita spending the same (i.e. equal to the growth in the population and inflation), the Fund will be fully utilised within 18 years.

Loans and Public Private Partnerships (PPPs)

Loans – Government of Timor-Leste contracts concessional finance from multilateral and bilateral creditors. The main source of multilateral financing are international financial institutions such as: the World Bank and Asian Development Bank in which Timor-Leste is a member. The loans are highly concessional and cheaper than withdrawing money from the petroleum fund. By end of 2021, the external debt to GDP is expected to reach 18.9%. The figure

is the result of increase in disbursement and incremental growth in real GDP. Based on the IMF's article IV consultation report 2021, under the baseline scenario, the present value of total public and publicly guaranteed debt-to-GDP ratio remains below the threshold level for the next 20 years.

While national road development is still the predominant sector, in accordance with the priority of the VIII Constitutional Government programme, efforts have been taken to diversify and expand concessional sovereign borrowing into other key sectors especially for projects with high social benefits. These include water supply and sanitation service, expansion of Dili International Airport, education and energy, just to name a few. This would help unleash the growth potential of other key economic activities, leading to inclusive economic growth and poverty reduction. The Government is therefore proposing an estimated ceiling of \$410m for new concessional foreign loans to be negotiated in 2022.

PPPs – The PPPs projects are currently ongoing: the Tiber Bay Port PPP which is in the Implementation and Operation Stage, the Medical Diagnostic PPP, in the procurement and negotiation stage, the Affordable Housing PPP, Cristo Rei PPP and President Nicolau Lobato International Airport, in Feasibility Stage.

Development Partners

The amount of ODA to Timor-Leste has consistently exceeded US\$150 million from 2016 onwards. Development partners are reporting a projected total of \$167.5 million in disbursements in 2022. Development Partners' support is forecasted to experience a \$12.4 million increase as compared to 2021 planned figures.

It is important to note that these figures do not include the European Union's Direct Budget support modalities, which potentially amount to \$9.0 million, nor does this figure include Australia's support to PNDS and the Bolsa de Mae Jersaun Foun programs, which amount to \$6.4 million. These significant contributions are not included as they are already accounted for and included directly in the state budget elsewhere.

Additionally, forecasted funding more than one year in advance is typically unreliable. This is due to several reasons, most notably due to the fact that many donors operate on single year budgets. The dramatic decline in funding shown in the future years above is based on data collected at the project level, thus it does not include donor's funding that has been secured yet not committed towards specific projects.

2 Macro-Fiscal Overview

2.1 Summary

Table 3: Economic Indicators, 2020-2023, %

Summary	Actual	Forecast		
	2020	2021	2022	2023
Real GDP (non-oil)	-8.6%	1.6%	2.1%	2.6%
Inflation CPI	0.5%	2.7%	2.0%	1.8%

Source: Ministry of Finance, October 2021.

- Real non-oil GDP growth was negative by 8.6% in 2020 due the combined effect of the Budget being delayed, political uncertainty, COVID-19 and the State of Emergency. 2021 is due to see GDP return to positive growth of 1.6% although this has been revised down due to Covid-19 confinement, the Easter floods and poor execution of the large state budget, particularly capital development which was at around 15%, by the end of Q3 2021.
- 2022 budget allocation is being reduced compared to OJE 2021 in order to put public finances on a sustainable footing in order to preserve the country's Petroleum Fund. Despite this, 2022 is due to see positive growth of 2.1% due to expected stronger execution, many planned PPP projects and reduced leakage through imports due to a smaller budget.
- Inflation is expected to increase and stable to 2.7% and 2.0% in 2022 and 2023 respectively due to an uptick in world oil prices as they recover from the Covid- induced suppressed demand.
- Between September 2020 and September 2021 the US dollar depreciated by -2.3% against a weighted basket of currencies of Timor-Leste's trading partners (the nominal effective exchange rate, NEER). There has been a small overall appreciation in the last few years which has reduced the price of imports, placing downward pressure on domestic inflation, benefiting Timorese consumers. However, this appreciation also made Timorese non-oil exports more expensive in international markets constraining the development of the country's exports. Therefore the recent depreciation in the nominal effective exchange rate could benefit exports.
- The exchange rate forecast suggests a small depreciation with Timor-Leste's trading partners in the medium term, 2021 to 2024, which should provide a boost to competitiveness.

2.1.1 Growth

Timor-Leste

Given the relatively low level of employment in the oil sector, total GDP is not the best measure of economic performance for Timor-Leste. Instead, it is more useful to monitor economic performance using non-oil GDP together with a wide variety of other indicators relating to the non-oil economy. This approach provides a more accurate indication of the real impact of changes in the economy on the people of Timor-Leste.

In 2020, non-oil real GDP in Timor-Leste declined to -8.7% to \$1,481m. National Accounts data exist up to 2020, after that DNPE forecast GDP into the future.

Timor-Leste experienced GDP growth, averaged 2% per year over 2010-2020. These growth rates have been driven by increases in government expenditure associated with the government’s economic strategy to ensure that Timor-Leste has the necessary infrastructure to allow the private sector to flourish in the long-run. The Government’s economic strategy uses loan financing and excess withdrawals ^[1] from the Petroleum Fund to finance high quality investment in infrastructure and human capital development. As outlined in Timor-Leste’s Strategic Development Plan, the Government’s high return investments will provide the necessary foundations for long-term sustainable private sector led development. Government investment has enabled a significant upgrade to road and electricity coverage throughout Timor-Leste, which has helped to improve both living standards and the business environment.

Non-oil GDP growth showed a negative growth in 2020. The contraction was a consequence of declines in government expenditure, private sector investment and lower exports and imports. Political uncertainty also led to lower development partner spending and reduced business activity. Export of goods and services fell by -51.1% driven by the COVID 19 restrictions on the international borders and the lockdown in the each of the trade partners. Forecasts for 2021 indicate a return to positive growth of 1.6%.

International

Table 4: Growth Indicators, 2018-2021, %

Country	Actual		Forecast	
	2019	2020	2021	2022
World	3.6%	-3.2%	6.0%	4.9%
Advanced Economies	2.2%	-4.6%	5.6%	4.4%
Emerging and Developing Economies	4.5%	-2.1%	6.3%	4.5%
Emerging and Developing Asia	6.3%	-0.9%	7.5%	6.4%
China	6.8%	2.3%	8.1%	5.7%

Source: IMF World Economic Outlook, July 2021.

Global growth outlook is projected to rebound by 6.0% in 2021. Advanced economies are forecast to grow by 5.6%, while growth for emerging markets and developing economies is forecast to rise to 6.3%. The increase in global growth was mostly driven by a great number of people got vaccinated and countries now entering in new normal situation to allow the economic activities to recover again following the negative growth due to covid experiences in most economies. The U.S. economy is projected to expand this year by 7.0%. However, China will grow higher at 8.1% in 2021.

In 2022, global growth is expected to increase to 4.9%, the advanced economy group is forecast to grow at 4.4%, while growth for the emerging market and developing economy group is forecast to grow at a similar rate of 4.5%. Nevertheless, the global is 2022 still subject to risk in the possibility to increase in the number of COVID-19 cases and increase in debt. On the other hand, a lot of effort have been done in accommodating the public health requirements around the world to prevent the spread of the virus. The high levels of growth, especially in Asia, still provides a solid foundation for Timorese exporters and economic development. The international environment provides favourable conditions for Timor-Leste to take advantage of in 2022 and beyond.

2.1.2 Prices and Inflation

Table 5: Global and Regional Inflation Rates, %

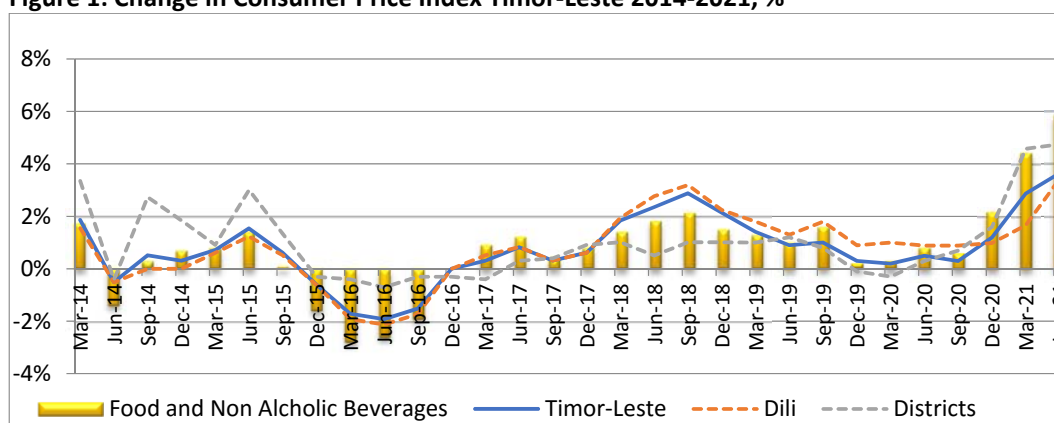
Country	Actual		Forecast	
	2019	2020	2021	2022
World	3.5%	3.2%	3.5%	3.2%
Advanced Economies	1.4%	0.7%	1.6%	1.7%
Emerging and Developing Economies	5.1%	5.1%	4.9%	4.4%
Emerging and Developing Asia	3.3%	3.1%	2.3%	2.7%
Timor-Leste*	0.9%	0.5%	2.7%	2.0%

Source: IMF World Economic Outlook, April 2021. *Ministry of Finance forecast.

Timor-Leste

With year on year inflation in August 2021 of 3.9%, Timor-Leste's level of inflation has seen a definite uptick. Due to the significant weight of food and non-alcoholic beverages in the CPI basket and the high proportion of food imported into Timor-Leste every year, international food prices remain one of the key drivers of the overall CPI rate, and the MoF continues to monitor price levels. The World Bank (WB) food price index has increased significantly between August 2020 and August 2021 increasing 34%. Domestic food prices have also been seeing a increase of 6.0% in the same time frame. It is expected that the current world food prices are projected to start stabilizing in 2022 into the short and medium term. Rice specifically is a staple part of the Timorese diet. The benchmark Thai decreased -20% in August 2021, this will have a positive effect on poorer households where basic foods make up the majority of their spending and this will leave them with more disposable income. Coffee prices (both Arabica and Robusta) increased 32% in August 2021 year on year. This will positively affect those families who rely on coffee production in Timor-Leste.

Figure 1: Change in Consumer Price Index Timor-Leste 2014-2021, %



Source: Ministry of Finance, October 2021.

International

Global inflation forecast at 3.5% by the IMF in 2021. The rebound in the commodity prices especially increase in oil prices have contributed to the increase in consumer price inflation in 2021. In advanced economies, inflation is projected to soften in the coming years. For the emerging market economies, inflation has fallen reflecting the impact of currency appreciation making imports cheaper. Lower inflation in Timor-Leste than in the rest of Emerging and

Developing Asia will help to improve competitiveness as Timor-Leste's exports are relatively cheaper.

Oil prices

Oil prices are important to Timor-Leste both for consumers, through consumer prices, and as an oil exporting country. The average international price of crude oil has witnessed dramatic declines since June 2014 from highs of \$112 per barrel to lows of \$34.7 per barrel in January 2016. This decline was driven by the increased global supply during a period of low global demand. The price of oil halved in the 1st quarter of 2020 year due to the fall in global demand during the height of the COVID-19 crisis, bottoming out at \$22.7 per barrel in March 2020, but prices have recovered since, increasing to \$79.0 per barrel in October 2021. The price of oil is now higher than it was before the start of the COVID-19 crisis in Dec 2019. This strengthening recovery has been driven by the tight demand-supply balance this year and the production cut by OPEC+, including Russia and other non-OPEC oil exporters. The oil price is projected to increase only moderately in the near future. In 2021, crude oil in September rose dramatically 79% to its price compared to the same time last year.

Agricultural Commodity Prices

A significant portion of the food consumed in Timor-Leste is imported and thus changes in international food prices can have a significant impact on both the rate of inflation and standard of living. According to the World Bank Commodities Price Index (2011=100), international food prices have continued to decline from a high of 105.8 in August 2012, though prices had been stable averaging at 73 and 70 in 2018 and 2019 respectively. International food prices have generally remained stable and the World Bank (WB) food price index increased 27% between September 2020 and September 2021, world rice price (Thai benchmark) decreased -21% and Coffee Arabica prices increased 35% during the same period. Although world food prices in general have increased, the price of rice has decreased which is good for consumers, whereas the price of coffee increasing is good for producers.

Figure 2: Commodity Price Indices 2011-2021



Source: Ministry of Finance, October 2021.

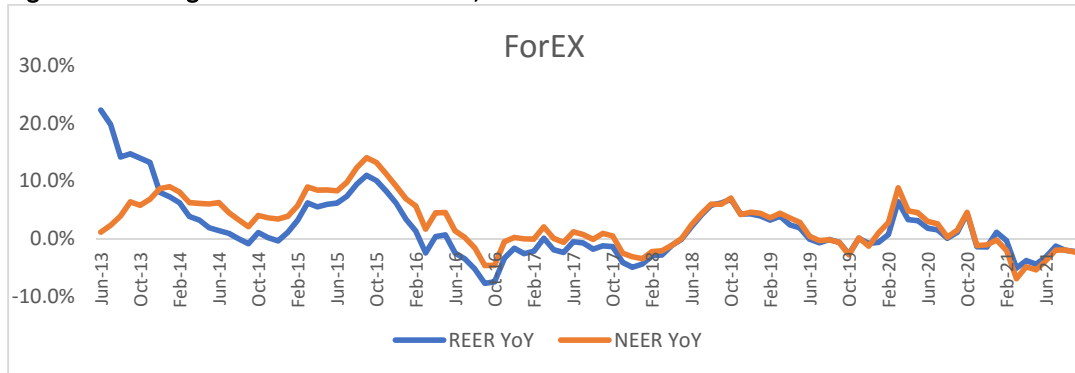
2.1.3 Exchange Rates and Competitiveness

Between September 2020 and September 2021 Timor-Leste’s NEER depreciated by -2.3% while the REER depreciated -2.2%. Over this period the NEER also experience -7.3% against a weighted Thai Baht and Vietnamese Dong Hong-Kong dollar basket and, the REER depreciated by -8.9% against the same basket. This slight real depreciation places some upwards pressure on rice prices and inflation (as Thailand and Vietnam export large quantities of rice to Timor-Leste).

An inflation-adjusted measure of the exchange rate, the real effective exchange rate (REER), is a better measure of competitiveness. If inflation in Timor-Leste is lower than in other countries, this can help mitigate exchange rate depreciation. The REER has depreciation by -2.2% between September 2020 and September 2021, driven by the exchange rate changes captured in the NEER and bottom inflation in Timor-Leste compared to its neighbours over the last year.

The inflation rate in Timor-Leste is expected to be lower than its neighbours in the near future, and so Timor-Leste can expect an improvement in competitiveness. This will help the Timorese export market be well-placed in the international market. While this is to be welcomed, the government is not complacent about the issue of competitiveness. A key priority is improving the business environment to encourage improved competitiveness, and the inflation target policy is a part of meeting the priority.

Figure 3: Exchange Rate Indices 2013-2021, %



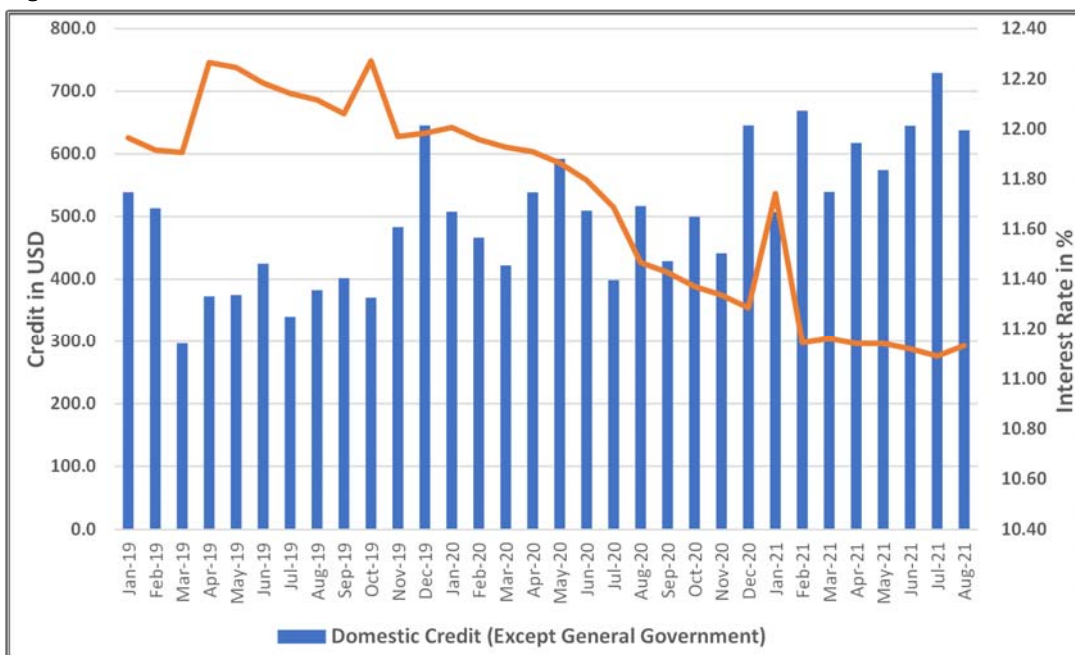
Source: Ministry of Finance, October 2021.

2.1.4 Financial Sector Trends

Commercial Interest Rates and Credit

The amount and cost of credit to the private sector is an important indicator for private sector development. Loans to the private sector were at an average interest rate of 11.13% in August 2021 it was increase by 0.4% compare to July 2021. And these have declined over the last 18 months which is good for businesses who can borrow money to expand their business at a cheaper cost of financing. Total domestic credit, excluding general government, was \$637.9 million in August 2021 and it was increase by 14.4% compare to July 2021 with an average of \$623, 9 million over the prior 6 months, this has also increased over the last 18 months. However, information from the Central Bank indicates that loans are increasingly being given to individuals rather than businesses.

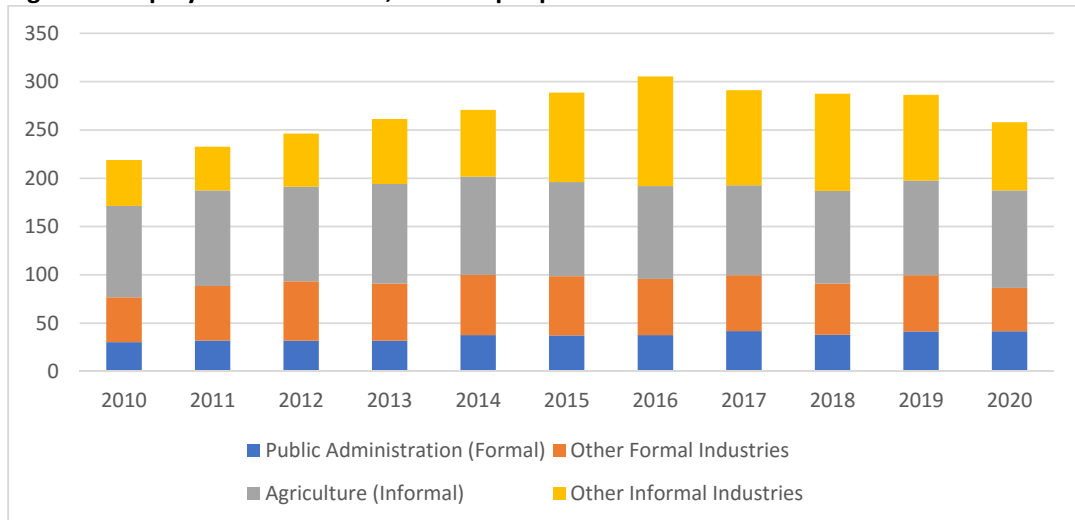
Figure 4: Commercial Interest Rates and Credit



Source: Central Bank of Timor-Leste, August 2021. Interest Rate (RHS, %), Credit (LHS, \$m).

2.1.5 Employment

Figure 5: Employment 2010-2020, 000's of people



Source: Ministry of Finance, August 2021.

Trends in employment over time

Employment is 20% higher in 2020 than it was in 2010, however today it is still 15% lower than its peak in 2016. The informal sector accounts for around two-thirds of employment in Timor-Leste. In 2020, it is estimated that formal employment fell around 13% whereas informal employment fell around 8%. Overtime, employment in public administration, other formal industries (e.g. construction, bank and insurance) and agriculture has stayed relatively flat. Other informal employment (mainly in services like small retail, taxi-drivers) has been the factor driving headline changes in employment figures.

Data

Estimations of employment in Timor-Leste use several sources reconciliated by National Accounts, for example, the Labor Force Activity Survey, Business Activity Survey, and MoF Financial report .

2.2 Economic Outlook

The Ministry of Finance is forecasting non-oil GDP growth to be 1.6% for 2021. Despite the large budget for 2021, this has been revised down from earlier forecasts due to the impact of discovery of Covid-19 community transmission and associated lockdown, recent floods and poor execution of government spending. An increasing inflationary environment due to the rebound in world oil prices may strain consumption to some extent, but the fall in the cost of rice and increase in the price of coffee should help poorer and rural households.

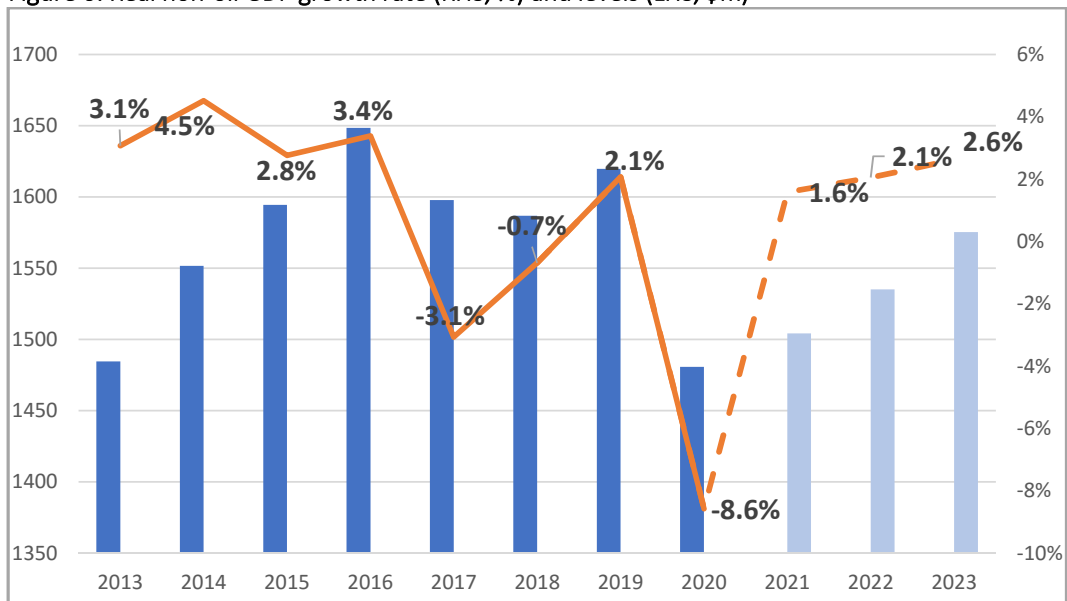
Public sector investment in 2020 was constrained by the duo-decimal system, political uncertainty and Covid-19. However, the new coalition should provide the political stability for the Budget to be approved for 2021 providing greater momentum for public infrastructure

projects, especially in education, health, and water and sanitation. Despite the large budget for 2021, expected growth has been revised down to 1.6% due to Covid-19 confinement, the recent floods and poor execution of the large state budget by Q3 2021, especially development capital which was only 15% at the end of September.

2022 budget allocation is being reduced compared to OJE 2021 in order to put public finances on a sustainable footing in order to preserve the country's Petroleum Fun. Despite this, 2022 is due to see positive growth of 2.1% due to expected stronger execution, many planned PPP projects and reduced leakage through imports due to a smaller budget.

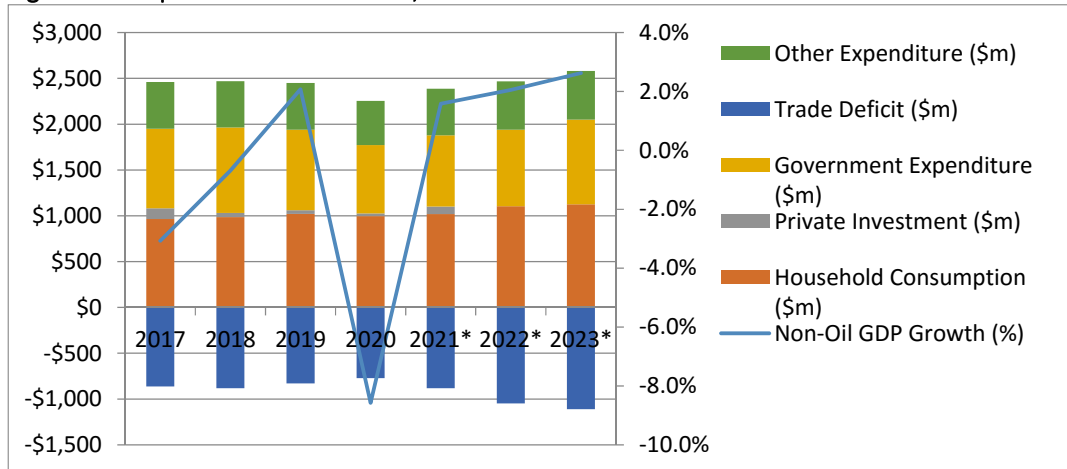
Over the medium term, Ministry of Finance expects return to positive sustainable growth based on political stability and private sector investment. In the short and medium term one will see continued construction on the Tibar Bay Port, and the expansion of existing and new commercial projects throughout the country. Such investments are consistent with the Government's economic strategy, alongside continued investments in human capital and education, to attract investors and consequently creating jobs domestically.

Figure 6: Real non-oil GDP growth rate (RHS, %) and levels (LHS, \$m)



Source: Timor-Leste National Accounts 2000-2020, 2021-2023 Economic Forecasts, Ministry of Finance, October 2021.

Figure 7: Components of non-oil GDP, 2017- 2023



Source: Timor-Leste National Accounts 2000-2020, 2021-2023 Economic Forecasts, Ministry of Finance, October 2021.

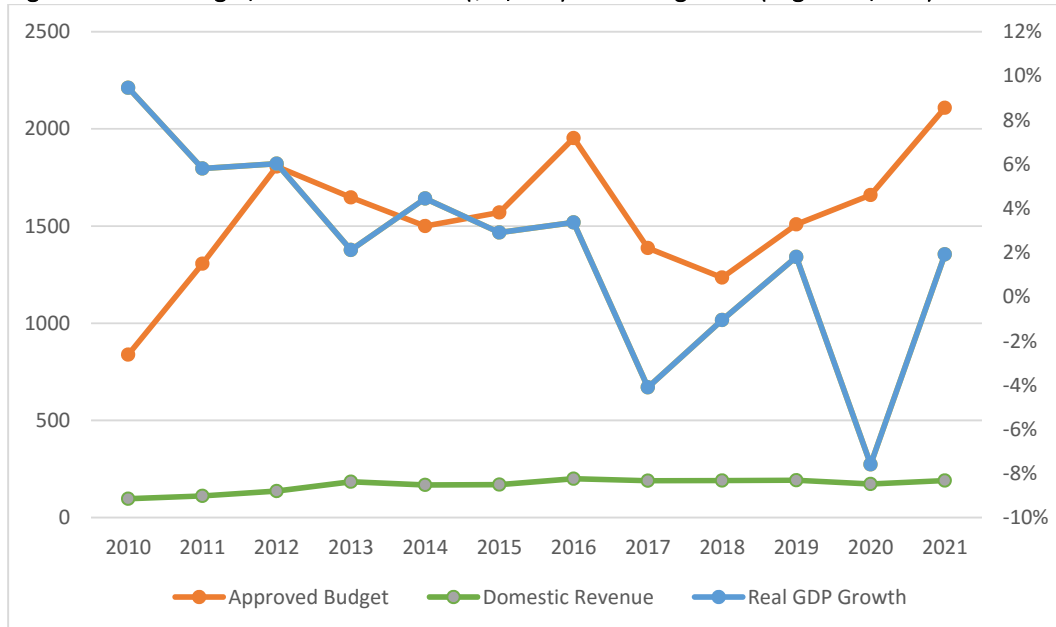
Risks and Uncertainty

Economic forecasts or projections aim to predict annual GDP growth rates and high level macroeconomic figures. Making forecasts about what macroeconomic variables may be in the future is important to help governments and businesses make decisions with regard to policies, planning and investment. However, it is important to understand that in order to make these predictions we have to make some assumptions about future conditions. Therefore all projections always include an element of uncertainty. The main uncertainties in the forecast come from imports and government budget execution. If government spending is particularly import-dependent, meaning that much of the new spending goes to goods and services from outside Timor-Leste, the GDP forecasts for future years may be reduced downwards as imports have a negative effect on final GDP.

In addition, if there is a large change in execution rates this may have a noticeable impact on the economy, especially given that the state budget makes up a large portion of Timor's GDP. Execution rates differ each year for different reasons and also depend on the absorptive capacity of the Timor-Leste economy. Absorptive capacity means how much money line ministries are actually able to spend despite how much money they have. For example even if the budget was increased a large amount, line ministries may find it impossible to spend all of that money. As with all forecasting, the more time and accurate data one has, the less assumptions we have to make and the closer we move to the true value.

2.3 Government Expenditure, Domestic Revenues and GDP Growth

Figure 8: State budget, domestic revenue (\$m, LHS) and GDP growth (% growth, RHS) 2010-2021



Source: Ministry of Finance, August 2021.

Over the last 11 years there has been no clear relationship between real GDP growth, levels of domestic revenues and the state budget. To ensure government expenditure contributes to economic growth, allocation of state budget supporting sectors that have high potential contribution to economic growth is essential.

A cut in government spending may not necessarily have a proportionally negative effect on GDP growth rate as long as government spending focuses on sector promoting private sector investment such as basic infrastructure and investment in human capital in order to create job opportunities and reduce the poverty rate.

In addition, larger budgets have not necessarily lead to higher economic growth as line ministries may not be able to spend all the money and this leads to a lower execution rate. This is known as the government's absorptive capacity i.e. how much money it is actually able to spend.

Government revenue may affect the economy through changes in tax policy to influence investment decisions, consumption, savings and employment. Like government spending priorities, in order to contribute to economic growth, government tax reform should promote private sector investment decision, job creation and help diversify the economy. In Timor-Leste, government revenue has been low; and at this stage it needs improve tax collection to sustain the state budget.

Other key factors that influence GDP growth, separate to the total government expenditure ceiling:

- **Political stability;** Political stability encourages private sector, foreign direct investment and facilitates development projects. In Timor-Leste, recent political instability, delays to the budget being approved and subsequent duo-decimal regimes in 2017, 2018 and 2020 contributed to the negative growth in those years.

- **Private sector activity;** Private sector plays an important role in poverty reduction, promoting economic development and diversifying the economy away from oil dependency. To achieve this the government will need to provide better business environment especially in productive sectors such as agriculture, tourism and other transformative industries. Improving the business environment means improving laws and regulation to reduce bureaucracy and streamline business as well as improving the workforce's overall skills and health. High private sector investment can provide jobs and reduce the poverty rate.
- **Composition and allocation of budget;** Fiscal policy is crucial to boost economic growth. The *type* of government spending influences economic growth when the share of budget allocation is higher in productive sectors. Investment in crucial infrastructure such as roads, machinery, research and development may encourage private sector to invest. Social capital investment i.e. health and education spending may not have an instant impact on GDP but are crucial for the medium and long term growth and prospects of the country.
- **Development partner spending;** Development partner spending will contribute to economic growth. To support long term growth, aid tends to be more effective in supporting institutional strengthening, health and education. Aid is also effective in short term growth in sectors like infrastructure, agriculture and industry.
- **Household consumption;** When employment rate is higher, households tend to spend more as many people tend to have higher disposable income to spend on non-essential non-food items, this has a multiplier effect in the economy.

2.4 Revenues

Non-oil domestic revenues are expected to rise in 2022, compared to in comparison to the sharp decline in 2021. Forecasts for 2021 see a significant fall in domestic revenue collections. This is mainly due to the exclusion of EDTL and BEE TL line items from Fees and Charges collections. However the economic downturn associated with the continuation of the COVID-19 global pandemic has also put a downward pressure on tax revenues, particularly Excise, Sales and Withholding. The decline in Infrastructure Fund spending as part of the rectified 2021 budget will also impact Withholding tax collections due to its link to capital spending. However Autonomous Agencies are expected to end the year significantly higher than 2020 due to more agencies reporting collections than the previous year and a large collection from the Centre National Logistics (CLN).

While it is still unclear how long the impact of COVID-19 will affect both the global economic system as well as the internal Timorese economy, current forecasts predict that 2022 will see an 8.4% rise in domestic revenue collections as the economy bounces back from the COVID-19 induced recession. Future projections of non-oil domestic revenues are expected to grow positively year-on-year. Greater private sector activity, political stability and the continuation of government capital projects will also help to promote revenue growth. The positive trend is expected to continue until 2025, given current macro-economic growth expectations. However due to the structural change in revenue collections, domestic revenues are forecast to continue to remain below 'normal' levels (the amount collected in 2019) until 2026. It is important to

note that the current estimates do not include additional revenue from some of the potential reforms under discussion, such as the introduction of VAT, as these are still to receive Parliamentary approval.

Timor-Leste is highly dependent on oil revenue which represented nearly 80% of total revenue in 2019. However, petroleum revenues are expected to decline as production from existing field draws to a close. 2022 is the first year in recent years where domestic revenues are estimated make up the majority of total revenues. This makes Fiscal and Public Financial Management reforms a priority for the country going forward. Improving revenue collection capacity through the introduction of new fiscal instruments, as well as reviewing the existing ones, and revisiting tax policies and legislation that promotes investments could help lead to increased revenue collection, considerably improving both fiscal and non-fiscal revenues.

Table 6: Total Revenue, 2019 – 2025, \$millions

	2020 Actual	Proj 2021	Proj 2022	Proj 2023	Proj 2024	Proj 2025	Proj 2026
Total Revenues	508.5	367.3	196.5	263.3	167.2	175.7	184.6
Domestic Revenues (excluding RAEOA-ZEESM)	182.4	139.2	150.9	159.1	167.2	175.7	184.6
Petroleum Revenues (excl investment return)	326.2	228.1	45.6	104.2	-	-	-

Source: Ministry of Finance, October 2021.

2.4.1 Domestic Revenues

Domestic revenues are composed of tax revenues, fees and charges, interest on cash balances and revenues from autonomous agencies and special administrative regions. In the budget books 2022, these no longer include RAEOA-ZEESM. However they are shown in the table below for comparison.

Table 11 breaks down domestic revenues into these categories showing actual and forecasted amounts between 2020 and 2026.

Table 7: Domestic Revenue 2020 – 2026, \$millions

	2020 Actual	Proj 2021	Proj 2022	Proj 2023	Proj 2024	Proj 2025	Proj 2026
Total Domestic Revenue (excluding RAEOA-ZEEMS)	182.4	139.2	150.9	159.1	167.2	175.7	184.6
Taxes (excluding ZEEMS)	114.7	112.5	121.7	127.8	134.2	140.9	148.0
<i>ZEESM Taxes</i>	<i>3.2</i>	<i>2.6</i>	<i>2.8</i>	<i>2.9</i>	<i>3.1</i>	<i>3.2</i>	<i>3.4</i>
Fees and Charges	59.0	12.0	16.8	17.8	18.7	19.7	20.6
Interest	0.3	0.5	0.6	0.6	0.7	0.7	0.7
Autonomous Agencies and Special Administrative Regions	8.4	14.3	11.8	12.8	13.6	14.4	15.3
<i>ZEESM - Fees and Charges</i>	<i>0.7</i>	<i>0.7</i>	<i>0.2</i>	<i>0.2</i>	<i>0.2</i>	<i>0.2</i>	<i>0.2</i>

Source: Ministry of Finance, October 2021. Forecasts used in 2020 actual values for RAEOA-ZEESM Taxes and Fees and Charges.

2.4.2 Tax Revenues

Tax revenues consistently comprise the largest source of domestic revenues in Timor-Leste, totalling 63% of total domestic revenues in 2020. This is estimated to increase substantially in future years, given the significant fall in Fees and Charges collections from the removal of EDTL and BEE TL revenues from the Treasury account. Current forecasts put total tax revenues making up 81% of total domestic revenues in 2021 and 2022. These tax projections are summarized in Table 12 and are divided into Direct Taxes and Indirect Taxes. The table does not include RAEOA-ZEESM taxes as those have not been forecast at the line item level. Total RAEOA-ZEESM taxes can be found in Table 11.

Tax collections in 2021 are expected to see a slight fall compared to the previous, a difference of 2%. This is largely due to the continuing impact of the COVID-19 pandemic and periods of mandatory confinement/ sanitary fences enacted to prevent its spread across the country. Despite seeing its first case in March 2020, no community transmission was detected within Timor-Leste until nearly a year later in February 2021. This means the majority of population and business activity confinement activities took place in 2021 rather than 2020, meaning that 2021 is expected to see even lower collections than 2020. Overall tax revenues are forecast to fall 8% between pre-pandemic levels in 2019 and 2022, compared to 6% between 2019 and 2021.

Indirect taxes, those levied on goods and services, are expected to be effected the most in 2021 with an expected fall of -6%. Indirect taxes are often used as proxy for household consumption, therefore this decrease suggests a further slowing down of the Timorese economy in 2021. Excise tax, the largest single contributor to domestic revenues, is estimated to fall by 7% compared to collections in 2020. Sales tax is expected to fall by 11%. On the other hand, Service Taxes and Import Duties are forecast to see small increases. Direct taxes are also predicted to rise 3% overall, driven particularly by an increase in public sector Income Taxes. Corporate taxes are also forecast to increase due to high collections during Q2 2021.

At the end of Q3 2021, tax revenues equalled 74% of the forecast revenue for the year. The highest two taxes are Service and Corporate taxes which equal 87% and 81% of their total, implying that their total for the year may be higher than estimated, while the lowest is Withholding tax at 68% which may suggest the final collection for the year will be lower than its forecast. In 2019, the total cumulative tax revenue at the same point in the year was 74% of total tax collections for the year. In 2020, it was 73%.

Forecasts for 2022 see a significant rise in tax revenues, rising an estimated 8% compared to 2021 estimates, though they are still expected to not surpass their pre-COVID-19 levels. Comparing 2019 collections and 2022 forecasts, tax revenues are still 1% lower. Taxes are not expected to return to their pre-pandemic levels till 2023.

Direct taxes are expected to see a slightly smaller rise in 2021, due to their increase in 2020, with a forecast rise of 7.9%. Indirect taxes are usually the main drivers of growth and forecast to rise 8.5% in comparison to 2021 estimates. The largest rise is expected by Withholding tax, the tax with the second largest fall the most in 2021 (followed by Sales tax), due to an expected increase in capital expenditure execution. Sales and Service taxes are also expected to see double digit growth.

Future years are expected to see a rise in tax revenues, on average 5% a year, driven by a stable macroeconomic and political environment. The positive trend is expected to continue through to 2026. Reforms in the tax collection systems, with the shift to SIGTAS (Standard Integrated Government Tax Administration System) 3.0, should enhance the Tax Authority's capacity to enforce greater tax compliance and regulate tax avoidance. Please note, these forecasts do not include the introduction of VAT, given the uncertainty in the timeline. This, as well as other possible reforms will be discussed more in a later section. It is vital that other tax instruments are explored during this time period, to increase the tax base of the country and help ensure fiscal sustainability in the medium and long term.

Table 8: Total Tax Revenue, Actuals and Projections 2020 – 2026, \$millions

	2020 Actual	Proj 2021	Proj 2022	Proj 2023	Proj 2024	Proj 2025	Proj 2026
Total Tax (excluding ZEEMS)	114.7	112.5	121.7	127.8	134.2	140.9	148.0
Direct Taxes	46.4	48.0	51.8	54.3	57.1	59.9	62.9
Income Tax	16.9	19.0	19.6	20.6	21.7	22.7	23.9
<i>Individual Income (Public Sector)</i>	5.0	7.5	7.8	8.2	8.6	9.0	9.5
<i>Individual Income Other</i>	11.9	11.5	11.9	12.4	13.1	13.7	14.4
Corporate Tax	9.1	10.1	10.3	10.8	11.3	11.9	12.5
Withholding Tax	20.4	18.8	21.8	22.9	24.1	25.3	26.5
Indirect Taxes	68.3	64.5	70.0	73.5	77.2	81.0	85.1
Service Tax	4.0	4.3	4.9	5.2	5.4	5.7	6.0
Sales Tax	14.7	13.0	14.6	15.3	16.1	16.9	17.7
Excise Tax	36.3	33.6	36.3	38.1	40.0	42.0	44.1
Import Duties	13.4	13.5	14.2	14.9	15.6	16.4	17.2

Source: Ministry of Finance, October 2021.

2.4.3 Fees and Charges

Fees and charges include a wide selection of categories from non-tax sources that contribute to domestic revenue. These comprise administrative fees, utility payments and royalty payments to the Government from natural resources other than petroleum. Fees and charges historically make up around 30% of total non-oil domestic revenues. In 2021, they are forecast to make up 9% due to a decline in collections of nearly 80%.

The reason for the significant decline is that from the start of 2021, Electricidade de Timor-Leste E.P. (EDTL) and BEE Timor-Leste E.P. became Public Enterprises. This means that while they remain in the public sector, their revenues are no longer counted in in the Treasury account as they are not included as part of the General Government. Public Enterprises are the most autonomous of all public entities. Therefore the line items Water Fees, Electricity Fees & Charges and EDTL Receipts from New Installations are no longer included under domestic revenues. Until 2020, electricity payments were consistently the largest contributor to fees and charges revenues; often making up over 60% of collections. However most of the other large contributors to revenues also are expected to decline from last year, including Property Rentals, Vehicle Inspection and Registration Fees and Mining and Quarry Operations Royalties. Passport and ID collections and visa fees are also expected to remain low compared to pre-pandemic levels, which is not surprising given the continuation of the State of Emergency ensuring the validity of all visas, thus reducing the need for extensions, as well as the significant reduction of

international travel given the COVID-19 pandemic and associated closure of most commercial flights. Dividends from BCTL, usually one of the largest contributors, is also expected to decline 76% compared to its 2019 amount.

Forecasts for 2022 see a significant growth in collections, with a growth rate of 40% compared to 2021 projections. This is due to an expected recovery in many of the largest line items to close to their pre-pandemic levels. This positive trend is expected for outer years given the current forecasts of GDP growth in 2022 and beyond. In particular, mining is seen as a key sector for the economy in the future, especially given the declining returns from the Bayu-Undan field. Growing decentralization of collections has also seen the introduction of non-fiscal instruments in the municipalities through advertising and parking services. Further decentralization, improvements and reinforcement of collection mechanisms in line ministries and the introduction of new non-tax instruments are expected to boost collections. Contributions from transport, property rentals, dividends and social games fees and charges are forecast to return to a stable growth path. However recovery to levels seen before the introduction of EDTL and BEE Timor-Leste will take many years.

Table 9: Fees and Charges, Actuals and Projections 2020 – 2026, \$thousands

		2020 Actual	Proj 2021	Proj 2022	Proj 2023	Proj 2024	Proj 2025	Proj 2026
Collecting Ministry	Total Fees and Charges	58,953.6	12,013.1	16,835.0	17,805.3	18,714.9	19,650.1	20,632.0
Ministry of Finance	Other Non- Tax Revenues of Customs	848.5	409.9	430.4	452.0	474.6	498.3	523.2
Ministry of Finance	Customs Service Fees	1.3	1.4	1.2	1.3	1.4	1.4	1.5
Ministry of Finance	Customs Penalties	1.0	3.1	3.1	3.4	3.5	3.7	3.9
Ministry of Finance	Late Payment Interest Sales	0.9	0.9	0.9	1.0	1.0	1.1	1.1
Ministry of Finance	Other Customs Duties	-	-	-	-	-	-	-
Ministry of Tourism, Commerce and Industry	Commercial License Fees	5.8	7.1	7.4	7.7	8.1	8.5	9.0
Ministry of Transport and Communicatio n	Postage Fees	20.8	4.7	12.4	12.8	13.5	14.2	14.9
Ministry of Justice	Property Rentals	3,082.7	2,669.8	3,087.5	3,320.1	3,486.1	3,660.4	3,843.4
Ministry of Public Works	Water Fees	262.0	-	-	-	-	-	-
Ministry of Transport and Communicatio n	Vehicle Registration Fees	1,591.2	932.3	1,406.6	1,477.0	1,550.8	1,628.4	1,709.8

		2020 Actual	Proj 2021	Proj 2022	Proj 2023	Proj 2024	Proj 2025	Proj 2026
Ministry of Transport and Communication	Vehicle Inspection fees	968.8	446.1	751.0	788.6	828.0	869.4	912.9
Ministry of Transport and Communication	Driver Licence Fees	543.1	192.0	327.8	344.2	361.4	379.5	398.5
Ministry of Transport and Communication	Franchising Public Transport Fees	344.5	237.0	335.6	352.4	370.0	388.5	407.9
Ministry of Transport and Communication	Transport Penalties/Trajectory	121.1	57.4	97.3	102.2	107.3	112.7	118.3
Ministry of Transport and Communication	Other Transport Fees	134.9	9.8	24.5	25.7	27.0	28.4	29.8
Ministry of Justice	Passport & ID	743.9	328.5	951.1	1,105.9	1,161.2	1,219.2	1,280.2
Ministry of Interior	Visa Fees	1,179.0	645.8	917.2	953.9	1,001.6	1,051.6	1,104.2
Courts	Tribunals - Fines & Penalties	511.0	304.0	318.7	331.5	348.1	365.5	383.7
Ministry of Public works	Electricity Fees & Charges	35,476.4	-	-	-	-	-	-
Ministry of Transport and Communication	TL Internet Domain Revenue	174.2	108.7	144.5	151.7	159.3	167.3	175.6
Secretary State Vocational Training and Employment	Fines & Forfeits	265.5	142.8	171.4	180.0	189.0	198.5	208.4
Ministry Petroleum Resource and Minerals	Mining & Quarry Ops. Royalty	2,726.0	1,916.4	2,475.7	2,599.4	2,729.4	2,865.9	3,009.2
Ministry of Finance	Bid Document Receipts - Ministries	17.6	93.5	70.1	80.6	84.7	88.9	93.3
Ministry of Finance	Auctions	28.9	509.2	532.8	600.0	650.0	682.5	716.6

		2020 Actual	Proj 2021	Proj 2022	Proj 2023	Proj 2024	Proj 2025	Proj 2026
Ministry of Tourism, Commerce and Industry	Social Games Receipts	735.3	768.5	1,014.4	1,115.8	1,171.6	1,230.2	1,291.7
Ministry of Tourism, Commerce and Industry	Rent of Government Property	48.6	20.9	38.7	44.6	46.8	49.1	51.6
Ministry of Agriculture and Fisheries	Forestry Products	107.7	85.4	93.5	97.2	102.1	107.2	112.5
Ministry of State Administration	Sanitation Services Fee	12.3	4.3	6.5	6.8	7.1	7.5	7.9
Ministry of Health	Registration of Health Professionals	35.5	29.9	36.9	38.4	40.3	42.3	44.4
Ministry of Education	Polytechnic Institute of Betano	51.2	46.8	50.3	52.3	54.9	57.7	60.6
National Commission for Elections	Hall Rental Fee	2.9	2.4	2.5	2.6	2.6	2.8	2.9
Presidency of the Council Ministers	Printing Fee - PCM	60.1	66.7	103.5	113.9	119.6	125.6	131.8
Ministry of Health	Pharmaceutical Fee	45.2	35.9	41.3	43.0	45.1	47.4	49.8
Ministry of Finance	BCTL Dividends	6,549.8	1,541.1	2,941.6	2,941.6	3,088.7	3,243.1	3,405.3
Ministry of Finance	Returned TPOs from Prior Years	1,663.0	-	-	-	-	-	-
Ministry of Finance	Other Non-Tax Revenue	118.6	195.0	167.8	174.6	183.3	192.5	202.1
Ministry of State Administration	Dili Municipality - Advertising Revenue	179.2	119.7	168.1	176.5	185.4	194.6	204.4
Ministry of State Administration	Ainaro Municipality - Advertising Revenue	0.9	1.8	1.8	1.9	2.0	2.1	2.2
Ministry of State Administration	Dili Municipality - Parking Fee	41.8	16.0	38.7	40.6	42.6	44.7	47.0
Ministry of Health	Administrative Sanctions and Fines	-	53.4	55.5	57.7	60.0	62.4	64.9
Ministry of Public Works	EDTL Receipts -	218.8	-	-	-	-	-	-

		2020 Actual	Proj 2021	Proj 2022	Proj 2023	Proj 2024	Proj 2025	Proj 2026
	New Installation							

Source: Ministry of Finance, October 2021.

2.4.4 Interest

Interest reflects interest payments received from cash held in Government funds.

Actual 2020 saw a decline in collections in comparison to the original forecasts, as interest rates around the world declined. Collections are expected to remain relatively stable over the next 5 years, ranging between \$0.56m in 2022 and \$0.71m in 2026. The slight rise is due to an expected rise in global interest rates over the next 5 years.

Table 10: Interest Receipts, Actuals and Projections 2020 – 2026, \$thousands

	Actual 2020	Proj 2021	Proj 2022	Proj 2023	Proj 2024	Proj 2025	Proj 2026
Interest Receipts (all funds)	335.36	468.30	595.19	618.99	649.94	682.44	716.56

Source: Directorate General of Treasury, Ministry of Finance, October 2021.

2.4.5 Autonomous Agencies

The number of autonomous agencies has been increasing steadily in recent years, reflecting government's desire to grant greater financial independence to institutions to improve their efficiency. Total collections constitute around 4% of total non-oil domestic revenues. In 2021, they are forecast to make up 10% of total collections. In 2022, it is forecast as 8%.

Autonomous Agency collections are expected to rise significantly in 2021, with collected forecast to be over 70% higher than in the previous year. This is largely due to a significant \$4.8 million collection by the National Logistic Centre (CLN) in September for the sale of rice. In 2021, they reported no collections for that line item. Given information provided by the autonomous agencies, there are also expected to be significant rises for Licensing Fee collections by the National Communications Authority (ANC) and revenues from the National Industrial Learning Service (SENAI) which are estimated to more than double their previous year totals, with receipts from Autonomous Service and Medicines and Health Equipment (SAMÉS) increasing even more.

Some line items are expected to decrease from last year's total, specifically National University Fees at National University of Timor-Leste (UNTL). While revenues had been increasing over time, due to more students attending university, they are expected to see a decline in 2021 due to the COVID lockdown, sanitary fence around Dili and requirement for online classes. Students were not able to come into Dili/ UNTL to complete their 'Monografia', the final essay of their degree, so the university was unable to collect the fees from them. Equipment Management Institute (IGE) is also estimated to have a significant fall based on the current collections reported for this year suggesting a substantial and persistent decline.

Collections are due to remain higher than pre-pandemic levels in 2022, but fall compared to 2021. This is due to a decline in the Sale of Rice line item, given the uncertainty of current political

decisions. Revenues from ANC are also expected to decline, given their rapid forecast increase in 2021. However collections from Port Authority of Timor-Leste (APORTIL) and UNTL are forecast to rise. Future years expect to see a growth in revenues even further as the economy recovers from lockdown and the global effects of COVID-19.

Table 11: Autonomous Agencies, Actuals and Projections 2020-2026, \$thousands

	2020 Actual	Proj 2021	Proj 2022	Proj 2023	Proj 2024	Proj 2025	Proj 2026
Total Autonomous Agencies	8,379.2	14,252.4	11,770.6	12,826.9	13,644.7	14,401.6	15,260.9
CLN - Sale of Local Product	105.9	1.1	37.4	41.2	45.3	49.8	54.8
Nacional Laboratory	84.7	254.5	209.0	217.4	228.2	239.7	251.6
ANC - Licensing Fee	1,234.7	4,028.2	3,625.4	3,824.8	3,920.4	4,018.4	4,118.9
APORTIL - Port Charges & Fees	3,224.3	3,195.0	3,375.4	3,672.1	3,965.7	4,209.0	4,482.5
ANATL - Aviation Service Fees	0.0	-	-	-	-	-	-
IGE - Receipts	265.3	78.4	127.3	173.9	182.6	191.8	201.4
SAMES - Receipts	8.2	55.7	75.0	82.5	90.8	99.9	109.8
UNTL - National University Fees	1,806.1	1,021.8	1,579.6	1,860.6	2,000.1	2,100.1	2,240.9
HNGV - Hospital & Medical fees	330.6	257.7	308.3	295.8	305.6	315.9	326.7
Bamboo Center Tibar - Revenue	272.9	60.5	66.6	73.2	80.5	88.6	97.4
AMRT - Fees	3.9	3.3	4.0	4.1	4.3	4.5	4.8
IADE Service Fees	11.0	10.8	7.9	8.2	8.6	9.0	9.5
AIFAESA Fees	83.8	75.5	64.3	66.9	69.6	72.4	75.3
SENAI Centre - Revenue	3.0	9.5	14.7	15.3	16.1	16.9	17.7
SERVE IP - Revenue	272.2	199.4	250.0	262.5	275.6	289.4	303.9
CLN - Sale of Rice	0.0	4,844.2	2,025.7	2,228.2	2,451.1	2,696.2	2,965.8

Source: Ministry of Finance, October 2021.

2.4.6 Future Reforms

Domestic revenue mobilization should be a key priority for Timor-Leste in the coming years, to ensure the sustainability of public finances and the maintenance of the Petroleum Fund for future generations.

A number of new reforms are in the pipeline to improve the efficiency of the current system. One important area is the modernization of the tax system through upgrades to the SIGTAS V1 (System Integrated Government Tax Administration System). This will allow tax officials to be able to manage tax issues in a more efficient manner through the ability to track uncollectible taxes and decide if they wish to continue collecting tax arrears. The new system also includes a Business Intelligence feature which allows tax officials to more easily spot issues related to tax avoidances and take a preventive action, as well as automatically selecting tax audits to improve efficiency in resource allocation. It can be linked to Fiscal Devices in all businesses which generate income, to connect to daily transactions of businesses and thus mitigate tax evasion whenever possible. The lead unit for this new system, the Tax Authority in Ministry of Finance are also ensuring that users of new system, including taxpayers themselves, are trained through

video animations. Their aim is to ensure that taxpayers are aware of their obligation as the citizens, thereby convincing them to contribute.

Another key reform is the introduction of the National Single Window (NSW) which was launched in February 2021 with the aim of promoting trade in Timor-Leste and boosting possible revenue collections in a transparent way. The NSW is a single electronic gateway where traders can submit all documents relating to trade and can access all relevant information regarding trade in one central customs portal. It will work to connect the Customs Authority with all other government agencies relating to trade in Timor-Leste, including the Tax Authority, Immigration, Quarantine, Ministry of Health, Ministry of Transport and Telecommunications, MTCI, Trade Invest and the Port Authority.

Lastly is the planned introduction of a new VAT Law. Studies have shown that the introduction of VAT has boosted revenues by 1-1.5 percentage points of GDP in Gambia, 2.5 percentage points of GDP in Mauritania and 2 percentage points of GDP in Rwanda¹. However the paper also highlights the importance of political commitment to any potential tax reforms, including support from key stakeholders. Joint reforms of tax policy and revenue administration also saw more significant impacts, as well as links to be general fiscal reform.

The law for Timor-Leste was originally drafted in 2017, but it was delayed in parliament given the political uncertainty. In December 2020, the Ministry of Finance through the Tax Authority started to revisit the draft VAT law and have plans to seek the opinion, comments and feedback from any third party (an international law firm) on the draft law prior to submission and presentation to Council of Minister and National Parliament by late 2021/early 2022 (under current plans).

2.4.7 Public Enterprises

The Ministry of Finance is committed to promote transparency and accountability of public finance management to all Government Entities including State-Owned Enterprises (SOE). Budget Book 1 2022 provides information on all SOE, including Public Enterprises (PE). Below are the Ministry of Finance estimate on 2021 unused revenue, 2022 revenue projection, 2022 budget proposal and forecast deficit to inform the public about Government subsidies to all SOE through their supervision Ministry in the form of public transfers.

¹ Akitoby, B., Honda, J., Miyamoto, H., Primus, K. and Sy, M., 2019. *Case Studies in Tax Revenue Mobilization in Low-Income Countries. IMF Working Papers, 19(104)*.

Table 12: Government Subsidy to Public Enterprises

	Budget allocation 2021 through supervision ministry transfer to state own enterprise	Forecast balance after 31 December 2021	Revenues		Budget Proposal 2022	Differnece	Allocated 2022 budget
			Unused to finance 2021 activities	2022 Projection			
EDTL.EP	\$157,986,402	\$9,766,361	\$32,000,000	\$40,000,000	\$121,990,831	\$ (40,224,470)	\$40,224,470
BE'E.EP	\$36,013,598	\$16,200,000	\$170,000	\$250,000	\$17,000,000	\$ (380,000)	\$380,000
TIMOR GAP.EP	\$65,739,702	\$4,926,360	\$ -	\$408.826	\$90,400,000	\$(85.065.613)	\$34,700,000
RTTL.EP	\$2,876,981	\$52,641	\$ -	\$392,766	\$2,193,528	\$ (1,748,120)	\$1,748,120
ANATLE P	\$1,550,000	\$40,020	\$ -	\$3,313,170	\$3,715,852	\$ (362,661)	\$362,661
Total	\$264,166,683	\$30,985,383	\$32,170,000	\$44.363.962	\$235,300,211.00	\$(127.780.866)	\$77,415,252

Source: Ministry of Finance, 2021

These figures are based on estimates. The final amounts will only be available at the end of the financial year once confirmed by Treasury

The table above shows that the estimates closing balance of all the PEs by the end of 2021 will be \$30.98 million, based on their previous years assigned budget and current levels of execution. EDTL and BE'E TL were fully subsidized in 2021 due to their status as new Public Enterprises. Therefore the total expenditure they received was not dependent on their forecast revenues. This additional funding (equal to their estimated revenues for 2021) is shown in the unused revenues column which is estimated as \$32.17 million. Forecast revenues across all PE's for 2022 is \$44.7 million. This means the accumulated total estimated balance across all PE's is forecast to be \$107.8 million. On the other hand, proposed expenditure in 2022 for all PE's was \$235.30 million, total estimated financial deficit \$127.4 million (difference between revenues and proposed expenditure). However, considering the limited government financing to cover all government spending in 2022, the allocated government financing to PEs for 2022 was only \$77.4 million.

2.4.8 Petroleum Fund Revenue

The Petroleum Fund remains the principal source of financing for the state budget each year. The total withdrawn from the Fund can be broken down into the Estimated Sustainable Income (ESI) and any excess withdrawal that is justified by the Government to be in the long-term interests of Timor-Leste. This section presents the ESI calculation for 2022 along with the underlying assumptions. It also describes the changes to the Fund's investment strategy in 2021 and concludes with projections for the Fund over the budget period.

2.4.8.1 Calculating Petroleum Wealth and the ESI for 2022

The fiscal guideline specified in the Petroleum Fund Law is the ESI. The ESI represents the maximum amount that can be withdrawn from the Petroleum Fund in a fiscal year so as to leave a sufficient Fund balance for an amount of equal real value to be appropriated in all later years. The ESI is set to be 3 percent of the Petroleum Wealth, which comprises the balance of the Fund and the Net Present Value of future petroleum revenue.

Total Petroleum Wealth is estimated to be \$18,469.3 million on 1 January 2022. This is \$206.8 million higher than the figure previously calculated in the 2021 Budget. This is caused by an upward revision to the opening balance of the Fund due to a higher than estimated actual outcome in 2020, increased expected petroleum revenues and investment returns in 2021 and a slight increase of the expected petroleum revenues in 2022 and 2023 compared to previous estimates. The details are described in the next section. Table 13 shows the estimated Petroleum Wealth and the ESI from 2020 and onwards, assuming that withdrawals from the Fund are equal to the projected withdrawals in this budget book.

The ESI for 2022 is \$554.1 million. The ESI estimates for the following financial years decline as a result of the projections for continued excess withdrawals and lower expected future investment incomes.

Table 13: Petroleum Wealth and the Estimated Sustainable Income (ESI), \$millions

	2020*	2021*	2022	2023	2024	2025	2026
Estimated Sustainable Income (PWx3%)	544.4	547.9	554.1	536.3	475.0	414.7	369.4
Total Petroleum Wealth (PW)	18,145.0	18,262.5	18,469.3	17,875.5	15,832.3	13,823.1	12,313.7
Opening PF Balance	17,691.8	18,065.7	18,323.8* *	17,772.5	15,832.3	13,823.1	12,313.7
Net Present Value of Future Revenues	453.2	196.8	145.5	103.0	0.0	0.0	0.0

Source: Ministry of Finance, October 2021.

*ESI and opening PF balance for 2020 and 2021 figure as estimated in Budget 2020 and 2021. Actuals were higher and was incorporated in the ESI 2022 calculation.

**Fund's reported balance as at 1 January 2022 adjusted for potential revaluation in the loan to Timor Gap E.P in 31 December 2020.

The key assumptions behind the calculations are set out in Table 14 and discussed below.

Table 14: Key Assumptions behind the ESI Calculation in 2022

Asset recognition	Forecast petroleum revenues are included only for projects with approved development plans. Bayu-Undan (BU) is the only operating field.
Petroleum Reserves and Production Forecasts	The project operator provides production estimates. The Operator provided 3 scenarios in July 2021 for Low, Base, and High forecasts. The average of the Low-Base case production is used for ESI 2022.

Oil price forecast	<p>Brent crude oil has been shown to be the best indicator of the price of BU liquid products, namely condensate and LPG.</p> <p>ESI for Budget 2022 is prepared using the average of the Energy Information Agency's (EIA) Low case and Reference case for Brent in its Annual Energy Outlook (AEO) for 2021, released in February 2021.</p>
Prices for specific petroleum products	<p>BU produces condensate, Liquefied Petroleum Gas (LPG) and Liquefied Natural Gas (LNG). Forecast assumptions for prices of condensate and LPG are derived from historical differentials observed with Brent. The historical relationship has been relatively stable, with condensate averaging about 95 percent and the LPG averaging about 71 percent of the benchmark.</p>
Production costs	<p>This is the central estimate of future capital and operating costs as provided by the project operator Santos. The estimate includes proposed drilling and higher decommissioning cost provisions.</p>
Discount rate	<p>Under Schedule 1 of the Petroleum Fund Law, the interest rate used to discount future petroleum revenue is the expected rate of return on the portfolio of financial assets held in the Fund. The Fund's investment strategy, which includes the Liquidity and Growth portfolios and the Investment in Petroleum Operations, is described in section 2.4.8.2. The expected long-term nominal return on the portfolio was revised down to 2.5 percent.</p>

Source: Ministry of Finance, October 2021.

Changes in the ESI 2022

The current estimate of the 2022 ESI is \$27.5 million higher than the estimate in the Budget Book 2021 of \$526.6 million. The difference is mainly because of the higher actual outcome in 2020 than estimated, a higher expected return on investment in 2021 and higher estimated petroleum revenues in 2021 and 2022-23.

One significant change is adjusting the Fund's actual end balance in 2020 for a potential devaluation of the Petroleum Fund's loan to Timor Gap E.P. The Fund's external auditor advised that the loan needs to be reported at fair value rather than its amortised cost, which was \$701.350 million as at December 2020. The loan was structured on the basis that Timor Gap E.P. will make the repayments from the cash flows it receives from participating in the Greater Sunrise project. However, Timor Gap E.P. wrote down the value of its interest in Greater Sunrise from \$673.3 million to zero as at 31 December 2020.² According to the notes in the consolidated financial statements, the impairment loss was triggered by: uncertainty about the fiscal and regulatory regime of the Greater Sunrise Special Regime; uncertainty about the Joint Venture partners agreed development concept; revisions to mid and long-term oil/gas price forecasts; and expected effects on margins from the macro-environment, COVID-19 pandemic and energy market demand and supply fundamentals. The fair value of the Fund's loan is being assessed by an independent expert and the valuation will be incorporated in the Fund's final 2020 financial statements. Consequently, publication of the Petroleum Fund's annual report has been

² Timor GAP E.P.'s Audited Financial Statements for FY ended 31 December 2020 provided to the *Gabinete de Política e Gestão do Fundo Petrolífero (GPGFP)* on 29 September 2021.

postponed. The value of the loan is uncertain and is assumed to be zero for the 2022 ESI estimate.

The *first driver* of the increase in the 2022 ESI is a higher end balance in 2020 compared to what was estimated in the 2021 Budget. The end balance in 2020 was higher than estimated for the 2021 Budget. The Fund's balance at the start of 2021 becomes \$18,289.3 million when adjusted for the loan.³ This still exceeds the \$18,065.7 million estimated in the 2021 Budget, which included the carrying value of the loan. This is because inflows and returns in 2020 were higher than expected and outflows were lower than expected. As of 31 December 2020, \$326.2 million of petroleum revenues were paid to the Fund, which was higher than the estimated \$306.1 million in the 2021 Budget. The return on the Fund's investments in 2020 is estimated as \$1,157.6 million after adjusting for the loan, exceeding the previous estimate of \$1,031.6m because of a very strong last quarter for equities. As noted above, the fair value of loan is being assessed, and will require recalculating the Fund's return for 2020. Lastly, the total withdrawal of \$886.3m was lower than the approved withdrawals of \$969m.

The *second driver* is the upward revision to investment income and petroleum revenue in 2021. The expected return for 2021 has risen to 6.68% from 3.8% last year. The higher return reflects the strong investment returns from financial market investment up until August 2021 of 5.81%.⁴ This results in an estimate for investment income of \$1,184.0 million compared to the previous estimate of \$661.6 million. The petroleum revenues projected for 2021 are revised up from \$68.1 million to \$228.1 million. The projected withdrawal is equal to the approved amount of \$1,377.6 million. These changes result in a higher estimated PF closing balance at the end of 2021.

The *third driver* is a combination of the new data on production, cost and oil price forecasts relative to Budget 2021. This results in slightly higher projected revenues for 2022 and 2023; hence the expected net present value of the future revenue increases. The oil prices and production projections are explained below.

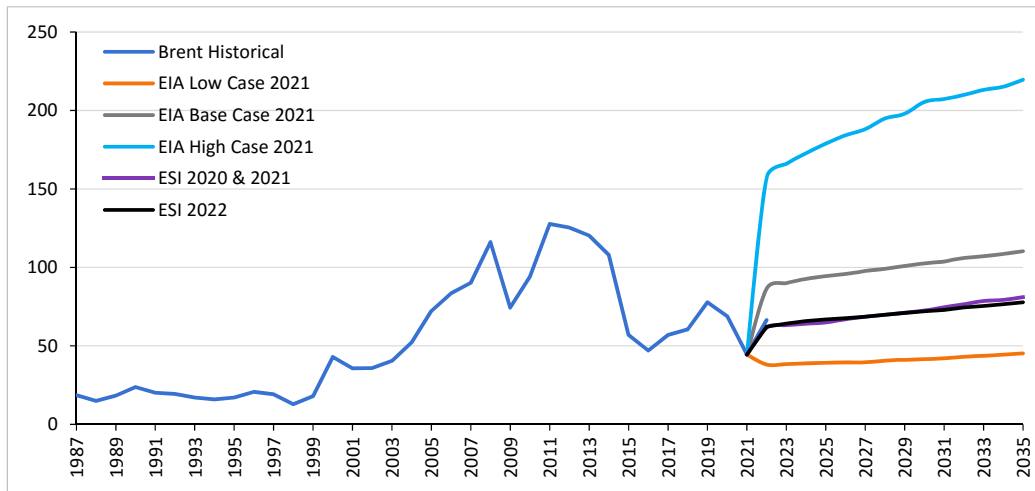
The oil price forecasts used in the ESI represent the average of the Low and Base cases of the Brent oil prices forecast by the US Government's Energy Information Administration's (EIA) Annual Energy Outlook, which was released in February 2021. The estimated price for 2021 in the 2022 ESI is \$57.6 per barrel. This accounts for the average actual price until August 2021, \$67 per barrel, and the average of the EIA's Low/Base forecast for 2021, \$39 per barrel. The projected price used for 2022 in the ESI is \$44.1. There is some upside to the ESI estimates as the EIA's base case is now that monthly Brent spot prices will average \$71/b during the fourth quarter and decline to an average of \$66/b in 2022.⁵

³ According to the BCTL's Petroleum Fund performance and activity report for Q4 2020, the value of the loans was \$701.35m as at 31 December 2020. The Fund's balance was \$18,990.6 million.

⁴ The return calculation excludes the interest accrued by Timor Gap E.P.'s loans. Please refer to PF's summary of financial information and performance as of August 2021 published at BCTL's website (documento_1632190453_3967.pdf (bancocentral.tl)).

⁵ EIA's Short-Term Energy Outlook, released on September 8, 2021. The Short-Term Energy Outlook is not used in the ESI as it only forecasts the Base case and has a limited projection period. www.eai.gov.

Figure 9: Oil Price Forecast in the 2022 ESI (from Budget 2021 to Budget 2022)

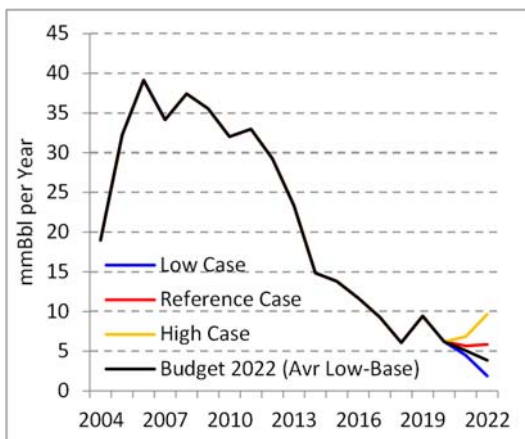


Source: Ministry of Finance, October 2021

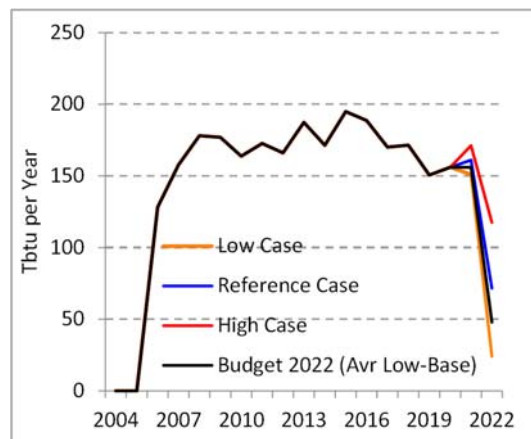
In terms of expected production, as noted in previous Budgets, the Bayu-Undan field is a mature field and its productivity has gradually declined since its peak in 2012. The production from its existing wells has decreased with increasing water and declining pressure. The decline is shown in Figure 10A and 10B. However, the current forecast for years 2021–22 projects 92% higher liquids production and 35% higher gas production relative to last year’s forecast used in ESI 2021. The recently approved Bayu-Undan Phase 3C (BUP3C) project in early 2021 has helped to boost production relative to projections a few years ago. It involves drilling 3 production wells and is expected to add over 20 million barrels of gross reserves and extend the life of the field. The first well drilling was successfully executed in May 2021 and production commenced in September 2021. The Operator reported that the first well production exceeded expectations.⁶

Figure 10: Bayu-Undan Production Forecast in the 2022 ESI

A. BU Liquids Forecasts for B2022



B. BU Gas Forecasts for B2022



Source: Ministry of Finance, October 2021.

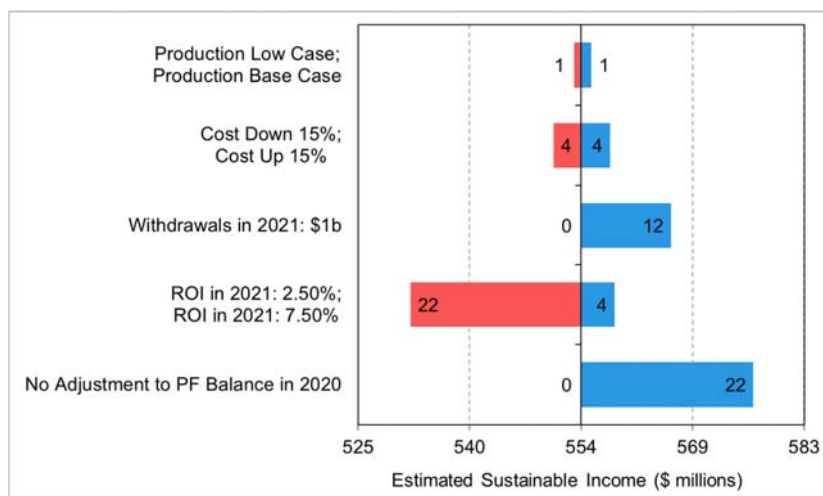
⁶ <https://www.santos.com/news/bayu-undan-phase-3c-infill-production-exceeds-expectations/>

The combination of these factors results in 1) a higher estimate of the opening balance of the Fund at 1 January 2022 of \$18,323.1m versus the \$17,417.8m previously estimated; and 2) a slightly higher net present value of future revenues of \$145.8m versus the previous estimate of \$134.9m). As a result, Petroleum Wealth is higher, which in turn increases the ESI.

ESI Sensitivity Analysis

The Government’s objective is to prepare an ESI that is prudent overall, as required by the Petroleum Fund Law. While the calculations are based on the best information available, each input is subject to significant uncertainty. Figure 11 shows how the 2022 ESI of \$554.1 million would change if the assumptions for key variables were changed individually. Each sensitivity calculation is briefly described below.

Figure 11: Sensitivity Analysis –Estimated Sustainable Income, \$million



Source: Ministry of Finance, October 2021.

1. As noted above, the ESI is now using the average Low-Base production forecast. If the Low case (P90) forecast is used, the ESI would decrease by \$1 million, while if the Base case (P50) was used the ESI would increase by \$1 million.
2. As noted above, the forecast of future Brent prices, which is used to forecast prices for Timor petroleum prices, is based on the average of the AEO Low and Reference (Base) Cases. If the price changes by 15% up or down, the ESI would change by \$4 million higher or lower.
3. If the withdrawal in 2021 is \$1,000 million instead of the approved \$1,377.6 million, the ESI would increase by \$12 million.
4. As discussed above, the ESI 2022 is calculated on the assumption that the loans to Timor Gap are now worth ‘nil’ at the end of 2020. An independent valuation will be undertaken and the fair value reported in the published financial statements. The ESI 2022 would increase by \$22 million if the loan’s fair value equals its current carrying value.
5. If the long-term expected investment return of 2.5% is used in 2021, instead of the assumed 6.68% that accounts for the year-to-date return, the ESI would decrease by \$22 million. A higher return of 7.5% this year would increase the ESI by \$4 million.

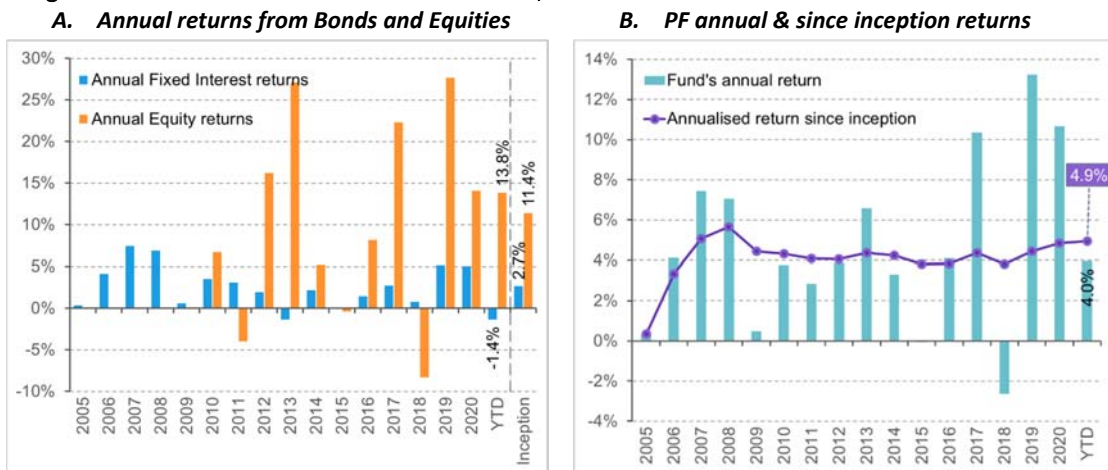
2.4.8.2 Change to the Petroleum Fund Investment Policy in 2021

The Petroleum Fund’s design followed the concept of permanent income. When the government’s withdrawals are limited to the expected real return on the Fund’s investments, the real value of the Fund can be maintained in perpetuity. The result is an even withdrawal profile that balances the need for immediate expenditure and national development with maintaining savings for future generations.

The PF Law sets 3% of Petroleum Wealth as Timor-Leste’s sustainable level of withdrawals. However, the Law in 2005 largely constrained the Fund to low-risk investments in order to allow time for the Fund’s institutions to develop expertise and also to build public confidence. The changes in the PF Law that were introduced in 2011 correctly recognised that to earn a 3% real return, the equity allocation of the Fund needed to increase significantly. The Law was amended to allow up to 50% of the Fund to be invested in equities. The Minister of Finance adopted the advice of the Investment Advisory Board in 2012 to set the equity allocation at 40%. The increase in equities was implemented incrementally and completed in the middle of 2014. Importantly, at that time, the fiscal framework meant that the Petroleum Fund was seen as a very long-term investor and therefore able to withstand the short-term volatility that necessarily comes from investing in equities.

Equities have performed in line with expectations since they were introduced. Figure 12A shows that the equity portfolio has boosted the Fund’s performance by returning 11.4% per annum since the first investment in stocks in 2010. This compares to the bond portfolio’s average annual return of 1.7% over the corresponding period.⁷ The Fund’s return since inception to June 2021 is 4.9% per annum or 2.8% in real terms after accounting for US inflation, which is close to the implied 3% real return target. As expected, the volatility in the Fund’s performance has increased with the higher weight in equities and the Fund incurred annual losses in 2015 and 2018. The fixed income portfolio, which includes cash, bonds issued by the US Government and bonds issued by other developed countries, has helped to offset the volatility in equity returns. When equity markets have fallen, government bonds have generally increased in value.

Figure 12: Petroleum Fund Investment Returns, %



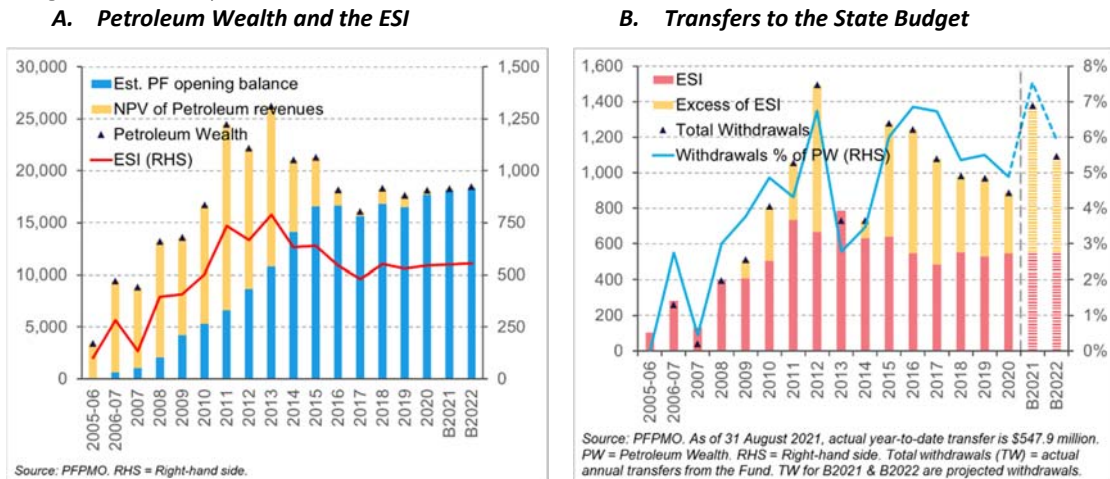
⁷ The performance of the Fund in 2020 will be discussed in more detail in the Petroleum Fund Annual Report for 2020.

Source: Ministry of Finance, June 2021.

As explained in the Explanatory Notes presented to the National Parliament on 2 June 2021, the Government decided to segment the Petroleum Fund to account for the change in circumstances faced by the Fund. The fiscal framework is interrelated with the Fund’s investment strategy and the Fund’s sustainability faces three substantial challenges.

The first challenge is that withdrawals have not followed the fiscal framework. Under the permanent income framework, sustainable withdrawals are offset by the long-run real investment return, thereby protecting the Fund’s purchasing power. However, as Figure 11B shows, withdrawals have exceeded the ESI since 2009, averaging about 5% of Petroleum Wealth rather than the 3% in the PF Law. The budgeted withdrawals for 2021 and 2022 are also shown. Governments have justified excess withdrawals on the basis of prioritizing economic development but there has been no commitment to ending the front-loading policy. Since the inception of the Fund in September 2005 until August 2021, a total of \$13,018.7 million has been transferred to finance the State Budget. This is about \$4,814.4 million above the ESI for that period.

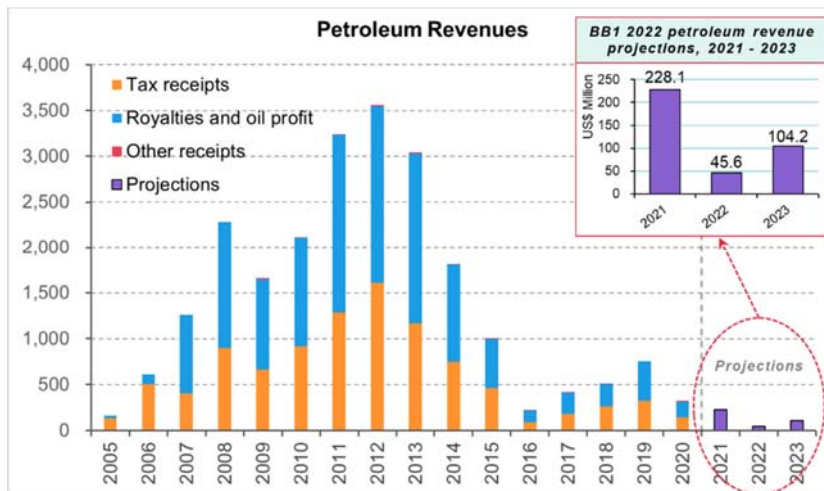
Figure 13: History of the ESI, Petroleum Wealth and Withdrawal



Source: Ministry of Finance, October 2021.

The second challenge is the declining future petroleum revenues. High petroleum revenue allowed the Petroleum Fund to grow in previous years by filling the gap between withdrawals and actual investment returns. Petroleum receipts have totalled US\$ 23,130.7 million from inception until August 2021. However, the reserves in Bayu-Undan have declined and future petroleum revenue will be relatively low, even if production is extended. With low petroleum revenue over the coming years, withdrawals will be financed by selling the Petroleum Fund’s investments. This will continue at least until inflows are received from the Greater Sunrise or other significant prospective fields.

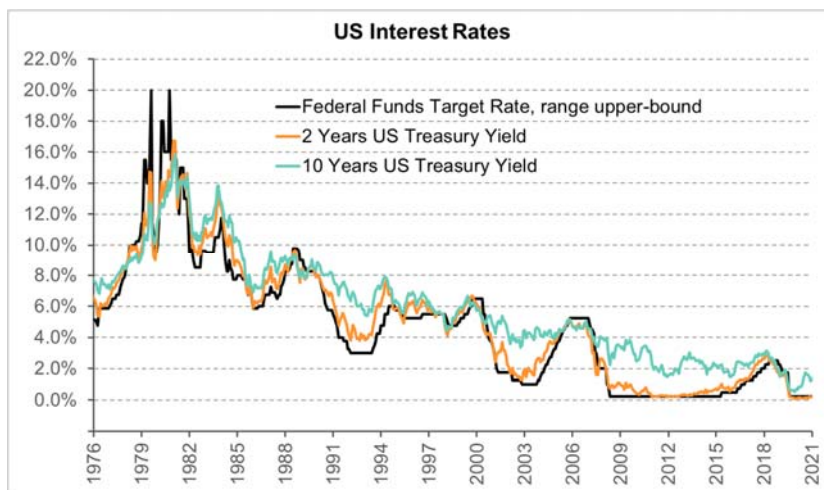
Figure 14: Future petroleum revenues are low



Source: Ministry of Finance, October 2021.

The third challenge is that the expected investment return is now considerably lower than when the 40% equity allocation was originally devised to meet a 3% real return target. As noted, historical performance has been close to the 3% real return target, even though the 40% equity allocation was not reached until the middle of 2014. The annual nominal investment return since inception of the Fund is 5.0%. As of August 2021, the investment return has added US\$ 9,397.0 million to the Fund. Future returns from the Fund’s investments are expected to be much lower because of very low interest rates and elevated equity valuations. As a result, the Petroleum Fund is unlikely to earn a 3% real return over the next 10 years based on its current asset allocation. It is projected that the return for our portfolio with 35% invested in equities will equal about 2.5% per annum over the next 10 years. This means that the true level of sustainable withdrawals is lower than 3%.

Figure 15: Interest rates are very low, meaning future returns are expected to be low

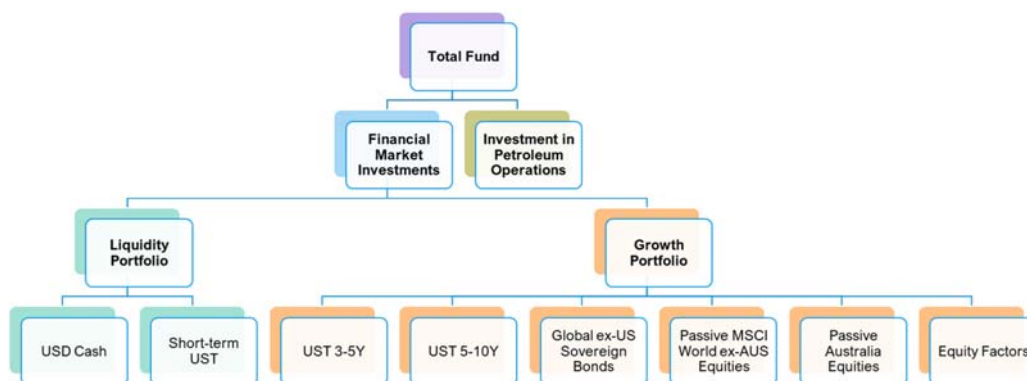


Source: Bloomberg data as of Aug 31, 2021.

The balance of the Fund is projected to decline as a result of these changes. If expenditure and withdrawals continue to grow and there are no significant new petroleum revenues, the Fund

will be exhausted in about 10 years, as was shown in the 2021 Budget Book. The Investment Advisory Board advised the Minister of Finance that it is important to manage risk during the expected decumulation phase. The IAB advised segmenting the Fund into 1) a liquidity portfolio and 2) a growth portfolio. This structure is now incorporated in Annex 1 of the Operational Management Agreement, as illustrated in Figure 16.

Figure 16: Overview of the Global Mandate



Source: Annex 1 of Operational Management Agreement between the Ministry of Finance and Banco Central de Timor-Leste, effective 1 July 2021.

Only the Fund’s investment in financial markets – fixed interest and equities - are subject to rebalancing so the investment in petroleum operations is treated separately.⁸ Parliament amended the Petroleum Activities Law in 2019 to allow the 5% allocation in “other eligible investments” in Article 15.4 of the Petroleum Fund Law to be applied to investments in petroleum operations in national territory or abroad. The Petroleum Fund then implemented the government’s decision to enter into loans totalling \$650 million with Timor Gap E.P. and its subsidiaries in April 2019. The loans are expected to be held until maturity and unlikely to be able to be traded. As noted earlier, the loans to Timor Gap E.P. are currently being independently valued.

The Fund’s financial market investments are invested in offshore, financial assets - namely, fixed interest securities, listed equities and other eligible investments - that meet the criteria and exposure limits in Article 15.1 to 15.3 of the Petroleum Fund Law. Under segmentation, the holdings in Financial Market Investments are divided into:

- 1) a **Liquidity Portfolio** of very low risk assets that will be used to finance the withdrawals projected for the next three years. The low-risk portfolio will be invested in USD Cash and short-term US Government Treasury bonds; and
- 2) a **Growth Portfolio** that maintains the 35%/65% allocation to equities and fixed interest. The aim of the growth portfolio is to benefit from equity’s higher expected return, which comes with higher risk and volatility.

Segmentation reduces the equity risk in the Petroleum Fund, which is required because of the expected shorter horizon for the Fund’s investments. Segmenting the Fund provides a number of other benefits in addition to reducing investment risk:

⁸ The change in rebalancing policy will be discussed in detail in the PF annual report for FY 2020.

- Each portfolio has clear investment objectives. The liquidity portfolio will finance withdrawals for the next three years, while the growth portfolio can seek a higher return. This helps in setting the investment strategy and communicating performance to stakeholders.
- It provides confidence to policymakers and other stakeholders that the next three years of withdrawals are covered by relatively safe assets. It follows that there can be less concern about fluctuations in the market value of the growth portfolio.
- It reconnects the Fund’s investment strategy with the government’s fiscal policy. This connection was broken when the 3% ESI guideline was abandoned for “front-loading” and investment return expectations lowered. Holding the next three years of withdrawals in safe, lower-return assets encourages planning and efficient execution of public sector budgets, as required by the Preamble of the Petroleum Fund Law.

Parliament was notified of the proposed change to the investment policy on 2 June 2021, in accordance with Article 14.5 of the Petroleum Fund Law. The changes were consistent with the asset allocation guidelines set in Article 15 of the Petroleum Fund Law and the requirement in Article 14 to establish an investment policy that seeks to maximise the risk-adjusted financial returns after taking into account Timor-Leste’s ability to bear risk and other considerations. The Fund was segmented into the liquidity and growth portfolio in July 2021. The liquidity portfolio held \$3,027.6 million and the remainder of the Fund continued to be invested according to the current asset allocation.

2.4.8.3 Updated projections for the Petroleum Fund

The Petroleum Fund’s balance is a function of petroleum receipts, investment income and government withdrawals. Table 15 shows an update of Petroleum Fund revenues. As noted, petroleum receipts for 2021 is revised up to \$228.1 million from \$68.1 million in the Budget 2021, although remains significantly lower than receipts in previous years. Petroleum revenue are forecast to continue to decline in 2022 before rising to \$104.2 million in 2023 as a result of the VAT on decommissioning. The projections do not include Greater Sunrise as the development is not yet approved.

Table 15: Petroleum Fund Revenues 2020-2026, \$millions

	2020	2021	2022 Proj	2023 Proj	2024 Proj	2025 Proj	2026 Proj
Total Petroleum Fund Revenue	1,483.7	1,412.1	491.2	519.1	366.1	322.7	288.6
Petroleum Fund Investment Return	1157.6	1,184.0	445.6	414.9	366.1	322.7	288.6
Total Petroleum Revenue	326.2	228.1	45.6	104.2	0.0	0.0	0.0
FTP/Royalties	136.1	27.5	7.7	0.5	0.0	0.0	0.0
Profit oil	28.4	95.0	13.2	0.0	0.0	0.0	0.0
Income Tax	32.2	36.6	3.7	0.0	0.0	0.0	0.0
Additional Profit Tax	96.1	48.7	6.4	0.0	0.0	0.0	0.0
Value Added Tax	3.5	2.8	4.6	103.8	0.0	0.0	0.0
Other Tax Payments	29.8	17.6	10.1	0.0	0.0	0.0	0.0

Source: Ministry of Finance, October 2021.

The expected investment return for 2021 is assumed to be 6.68% after accounting for the year-to-date performance. The investment returns for the rest of the year, 2022 and beyond is set equal to the long-term nominal return assumption of 2.5% p.a. The long-term return

assumptions have been revised down to reflect the low interest rate environment and high equity valuations.

Table 16: Estimated Petroleum Fund Savings, \$millions

	2020 Prov	2021	2022	2023	2024	2025	2026
Opening PF Balance	17,691.8	18,289.3	18,323.8	17,772.5	15,832.3	13,823.1	12,313.7
Petroleum Revenue (excl. PF Interest)	326.2	228.1	45.6	104.2	0.0	0.0	0.0
Petroleum Fund Interest, Net*	1,157.6	1,184.0	445.6	414.9	366.1	322.7	288.6
Total Withdrawals	886.3	1,377.6	1,042.5	2,459.3	2,375.3	1,832.1	1,537.4
Closing PF Balance	18,289.3**	18,323.8	17,772.5	15,832.3	13,823.1	12,313.7	11,064.9

Source: Ministry of Finance, October 2021.

* Net of management fees and market revaluation.

** Fund's reported balance adjusted for potential revaluation in the loan to Timor Gap E.P in 31 December 2020.

As of August, \$547.873 million has been withdrawn from the Fund although the approved amount of \$1,377.6 million is expected to be withdrawn by the end of the year. Table 19 shows that the Fund is forecast to equal \$18,323.8 million by the end of 2021, with withdrawals roughly equal to petroleum receipts and investment returns. Withdrawals are projected to exceed petroleum revenue and investment income in future years and the Fund's balance is projected to fall to \$11,064.9 million by the end of 2026. These are central forecasts and considerable variation needs to be expected given that investment returns are volatile and future withdrawals uncertain. As the Fiscal Sustainability section explained, the Fund is expected to continue to decline in value beyond the projection period, unless there is a significant change in fiscal policy or until significant new petroleum revenues come online.

2.5 Fiscal Sustainability Analysis

The economy of Timor-Leste is currently highly dependent on the Petroleum Fund for financing the fiscal deficit. In recent years, government policy has been one of front-loading expenditure, running high government budgets in the short run to finance capital spending for key infrastructure, with the aim to encourage development of the private sector, increase diversification and grow the overall economy. A stronger non-government Timorese economy would require less funding from the Petroleum Fund in the future as the fiscal deficit would be smaller due to higher non-oil domestic revenues and a lower need for government spending to boost the economy in normal times.

The Ministry of Finance conducts a fiscal sustainability analysis for the budget ceiling chosen each budget cycle. Through the use of modelling, the impact of the selected budget ceiling on the long term sustainability of Timor-Leste can be estimated, specifically the overall balance of the Petroleum Fund. The model used mainly focuses on the impact of capital spending on longer-term GDP and domestic revenues and their impact on the Petroleum Fund reserves.

Due to uncertainty of future variables in the model, e.g. the budget of future years, the model uses a number of assumptions. Firstly, it makes assumptions about the growth rates of the ceilings for all appropriation categories, based on historical data, while the growth of Capital and Development is estimated to follow the requested amounts set out by the Infrastructure Fund in the years 2022-2026 and a long term growth rate based on past data after that. Short term

GDP and inflation figures are based on forecasts by the National Directorate of Economic Policy in the Ministry of Finance. The long run growth rate of GDP, inflation and domestic revenue growth and the long term return on the Petroleum Fund are constructed using set base line levels. Changes to any of these assumptions would have significant changes on the forecasted end date of the Petroleum Fund. For example, if the rate of expenditure growth were to increase more than that assumed in the model, then the Petroleum Fund would finish quicker than forecasted. The ESI (Estimated Sustainable Amount) from the Petroleum Fund is set at 3% of the Petroleum Fund value and counted as part of Total Revenue. This means that as the amount of the Petroleum Fund falls, so does the amount of the ESI.

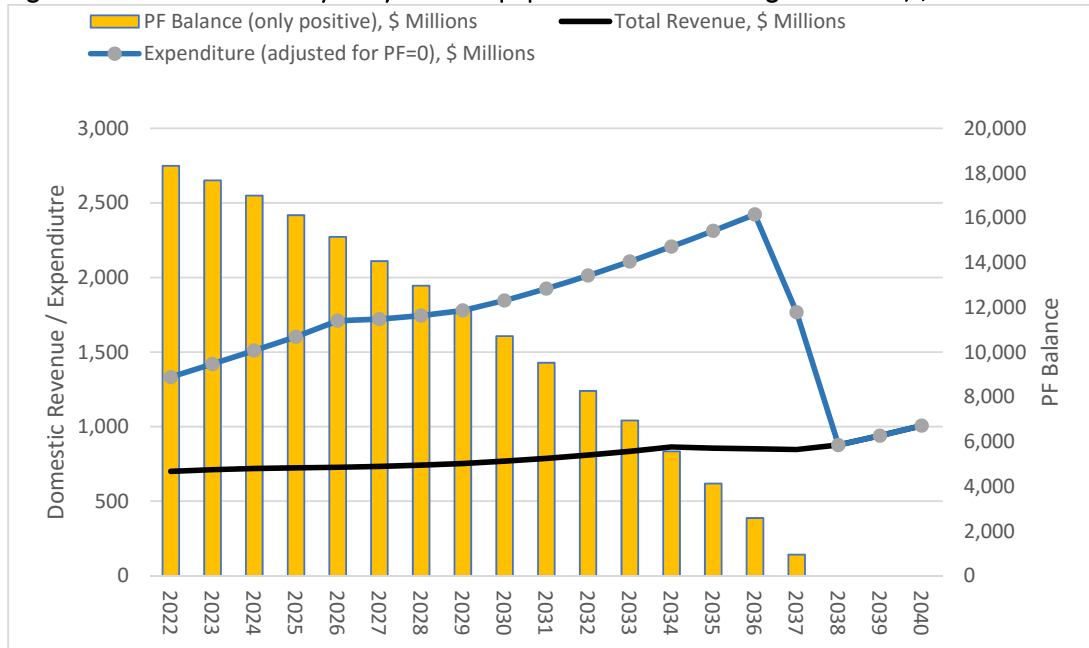
It is important to state that the model does not factor in any effect to GDP when the Petroleum Fund balance hits zero, or close to it. This seems unlikely as the associated fall in expenditure would likely cause an economic downturn, with a fall in consumer and private sector spending and a decline in GDP. This downturn would also have an effect on domestic revenues, further decreasing possible expenditure.

The sustainability of the petroleum fund is not only dependant on the choice of expenditure, but also all subsequent years. Here 2 different expenditure paths are presented to show the potential impact on the lifetime of the fund. Please note, the forecasts are also effected by a number of other assumptions. Since the publication of the sustainability estimates in the Pre-Budget Statement, the assumed expected return on Petroleum Fund investments has been downgraded from 3.9% to 2.5%. This has caused a more rapid decline in the PF balance across all scenarios.

Option 1: Population and Inflation growth rates

To ensure that the budget remains constant per capita in real terms, it would be necessary for the budget to grow at both the same rate as the population and as the expected rate of inflation. The long-run population growth rate and expected level of inflation is 3.9% per year. Using this assumption as also the long run budget growth rate, the model estimates that the Petroleum Fund would run out in 2039. This is 18 years away.

Figure 17: Fiscal sustainability analysis under population and inflation growth rates, \$Millions



Source: Ministry of Finance, October 2021.

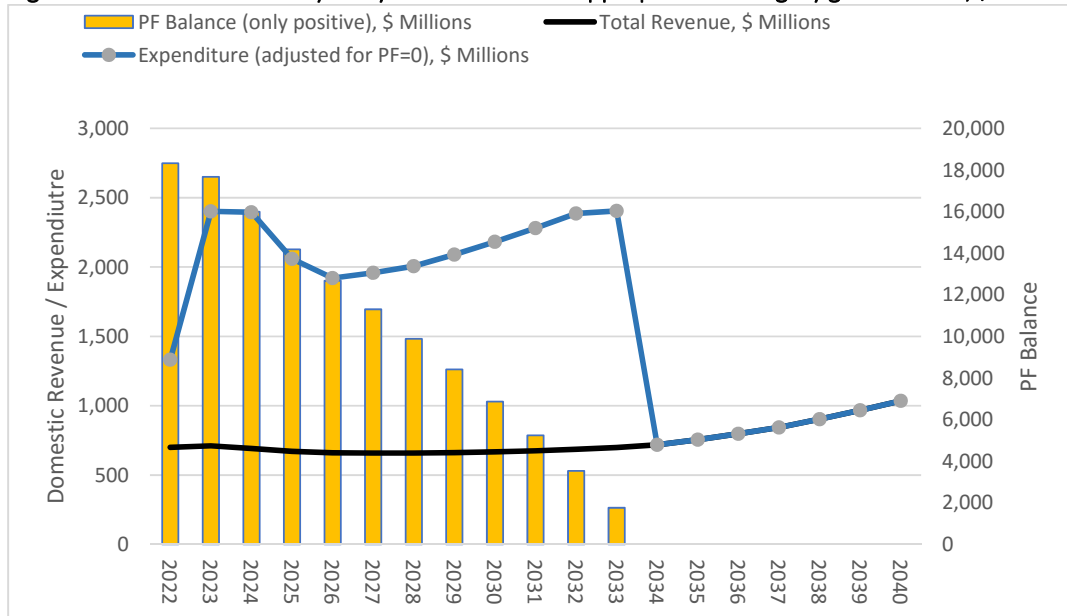
The model estimates this would mean a 70% fall in expenditure in two years (2037-2039), the final two years that the Fund can be used to support government spending. This relates to a fall from \$2.4 billion to \$0.9 billion (when expenditure must equal domestic revenue). As the Fund begins to get close to zero, expenditure would have to fall rapidly in order to match domestic revenues as that would be the only source of income (excluding external debt). ESI would no longer exist as neither would the Petroleum Fund. If revenues do not rise as quickly as the model forecasts, the fall in expenditure would have to be even greater. Therefore it is vital that mobilisation of domestic revenues is a key focus of the government over the coming years.

Option 2: Historic appropriation category growth rates

The average growth rate of approved budget spending (not adjusted for execution) across all appropriation categories (including loans but excluding contingency expenditure) between 2012 and 2021 was 28.1% per year. This masks significant variation between categories with Minor Capital seeing the largest annual growth (95.3%) and Capital and Development the smallest (5.0%).

Assuming spending follows these historic growth rates (with some small adjustments for categories with excessively high changes), the model estimates that the Petroleum Fund would run out in 2034, 13 years away.

Figure 18: Fiscal sustainability analysis under historic appropriation category growth rates, \$Millions



Source: Ministry of Finance, October 2021.

The model estimates this would mean a 70% fall in expenditure in just one year (2034), falling from \$2.4 billion to \$719 million (when expenditure must equal domestic revenue).

Both options estimate that the Petroleum Fund will run out within the next twenty years. However the increased timeframe of option 1 would give the private sector more time to grow, thus allowing domestic revenues to rise to a higher level. This means that when the Petroleum fund did run out, the required fall in expenditure would be much lower; making the process much less difficult and the adjustment time shorter. The government should be sure to make strong efforts to focus on the quantity and quality of public spending to ensure the Petroleum Fund is used effectively and efficiently. The mobilisation of domestic revenues in order to reduce the country's dependence on the Petroleum Fund to finance government spending should be a key priority.

2.6 Contingent Liabilities

Timor-Leste, like any other nation has a number of contingent liabilities, ie potential government spending that is triggered by a specific event. It is important for governments to understand their contingent liabilities as they are a type of fiscal risk. Fiscal risks are factors that may cause fiscal outcomes to be different from expectations or forecasts. In the case of Timor-Leste this can lead to excess withdrawals, depleting the petroleum fund or last minute virements which divert resources away from planned activities.

Timor-Leste's contingent liabilities are varied: for example, natural disasters such as the recent floods can lead to government interventions to rebuild infrastructure or droughts can trigger government intervention to support farmers for example. Some are more specific and can be quantified (for example the Central Bank's SME Government Guarantee Scheme).

Some contingent liabilities are more difficult to quantify and will take some time and further consultation to better understand. Examples include, unpaid taxes, government participation in private companies and the social security fund. It is the government' responsibility to identify, manage and mitigate risks to reduce to possibility of unexpected pay outs. The government will aim to provide comprehensive disclosure in the coming years.

3 Social Economic Indicators

It is important to not only use GDP when evaluating the state of an economy. Broader social indicators are also key to develop a full understanding of the position of a country and the impact of government’s policy choices on people’s everyday lives.

All data sourced from the World Bank, unless otherwise indicated.

1. Human Development Index

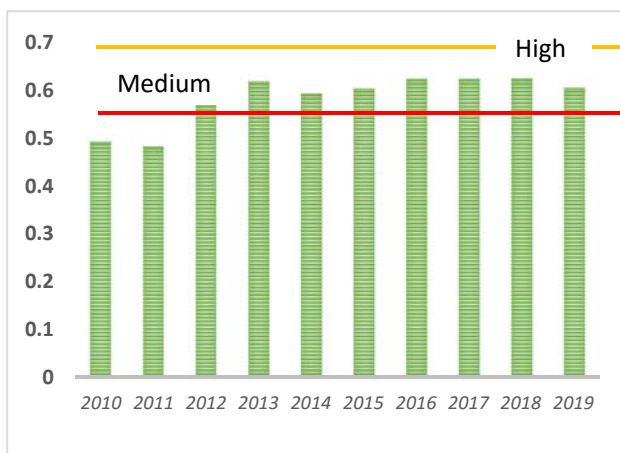
The Human Development Index (HDI) is a summary measure of average achievement in three key dimensions of human development: a long and healthy life, being knowledgeable and have a decent standard of living. The health dimension is assessed using indicators such as life expectancy at birth while the education dimension is impacted by mean of years of schooling for adults aged over 25 years and expected years of schooling for children of school entering age. The standard of living dimension is measured by gross national income (GNI) per capita. The HDI uses a logarithm of income, to reflect the diminishing importance of income with increasing GNI.

HDI is broken down into four ranges including score very high human development (0.8-1.0), high human development (0.7-0.79), medium human development (0.55- 0.70), and low human development (below 0.55).

In 2019 Timor-Leste was ranked as Medium Human Development stage with score of 0.61 and ranking 141 out of 189 countries. The rank was lower than Fiji but is above Solomon Island as shown in Graph 2. Over time Timor-Leste’s HDI score has improved a lot since 2010 and 2011 when it was a low human development country but the improvements have plateaued in recent years.

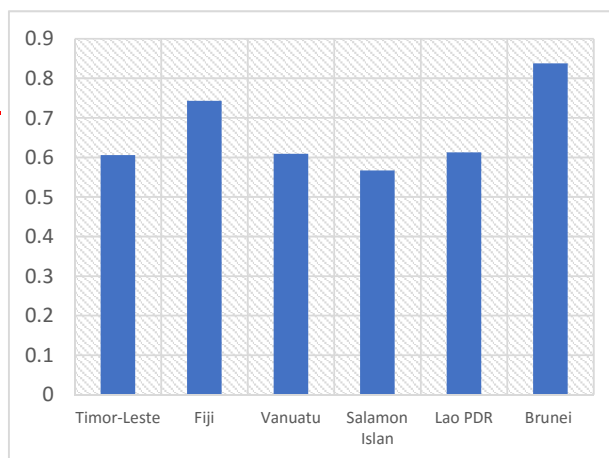
Timor-Leste’s mean years of schooling score was lower than Fiji, Vanuatu, Solomon Island, Lao PDR and Brunei Darussalam in last five years. On the other hand, Timor-Leste has seen progress on the life expectancy score which is now above Myanmar, Lao PDR and Fiji compare to 2018.

Figure 20: Timor-Leste HDI score, 2010 - 2019



Source: UNDP, Human Development Report 2020.

Figure 19: Comparison of Timor-Leste HDI with other countries in Asia Pacific, 2019

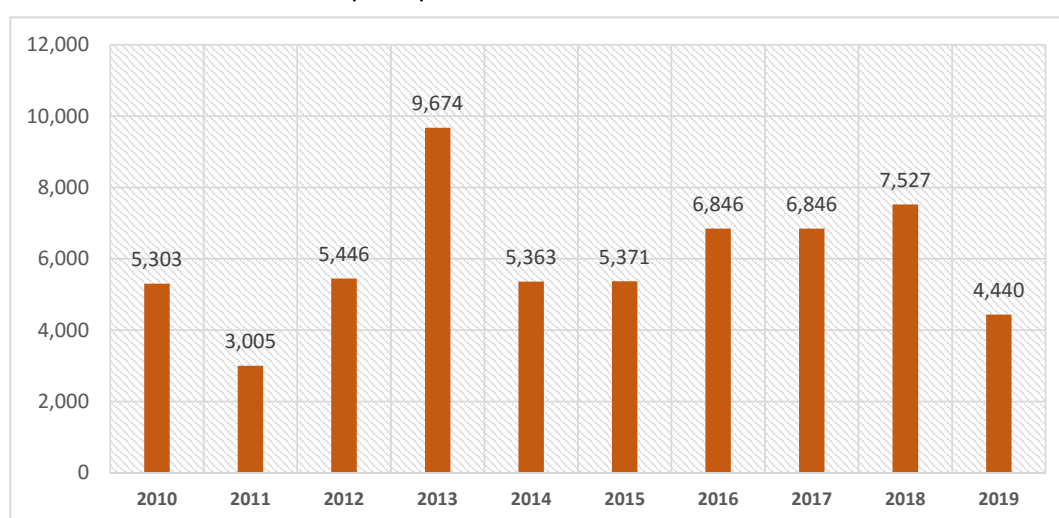


2. Inequality

The Gini index is used to measure how much the distribution of income within an economy deviates from a perfectly equal distribution. The Gini index is ranged from 100 to 0. A Gini Index score of 0 represents perfect equality i.e. all citizens have equal income and 100 implies perfect inequality i.e. 1 citizen has all the wealth. In 2014, the GINI index for Timor-Leste was 28.7 % (World Bank 2014). GINI index of Timor-Leste fell gradually from 35.9 % in 2001 to 28.7 % in 2014 indicating the society has become more equal.

On the other hand, the trend of GNI per capita in the last five years was volatile. In 2019 it went down to \$ 4,440 per capita. The highest GNI per capita since 2010 to 2019 was in 2013 as shown in table 2.

Figure 21: Trend of Timor-Leste GNI per capita 2010 to 2019



Source: UNDP, Human Development Report 2020.

3. Malnutrition

According to Timor-Leste's Demographic Health Survey 2016, 46% of children under age 5 are stunted; 23% of children under age 5 are severely stunted, 24% percent of children are wasted and about 10% of children are severely wasted. 40% of children are underweight and 6% are overweight.

The prevalence of stunting has declined from 58% to 46% since the 2009/10 DHS. The prevalence of underweight children have also declined, from 45% to 40%. However, the prevalence of wasted children has increased from 19% to 24%. Additionally, the prevalence of stunting among children under 5 years is 45.6%, with males experiencing a higher rate of stunting of 48%, compared to the rate of females of 43%.

4. Human Capital Index (HCI)

HCI, from The World Bank, measures the amount of human capital that a child born today can expect to attain by age 18. It conveys the productivity of the next generation of workers compared to a benchmark of complete education and full health. Worldwide a child born in

2020 can expect, on average, to be 56 percent as productive as she/he could be when she/he grows up. All data represent the status of countries pre-COVID-19.

For Timor-Leste, a child born today will be 45 percent as productive when she grows up as she could be if she enjoyed complete education and full health. This is lower than the average for East Asia & Pacific region (give number) and Lower middle income countries (give number). However there has been progress overtime as between 2010 and 2020, the HCI value for Timor-Leste increased from 0.41 to 0.45.

5. Drinking Water

In 2017, 78% of the population has at least access to basic source of drinking water. This is lower than both the average for the East Asia and Pacific region (92%) and the average for its (lower middle) income group (81%).

6. Labour force

In 2016, 64% of Timor-Leste's working-age population was employed. This is lower than the average for its region (65%) but higher than the average for its income group (54%). The labour force participation rate for female was 62%. This is higher than both the average for its region (57%) and the average for its income group (50%).

7. Adult Survival Rate

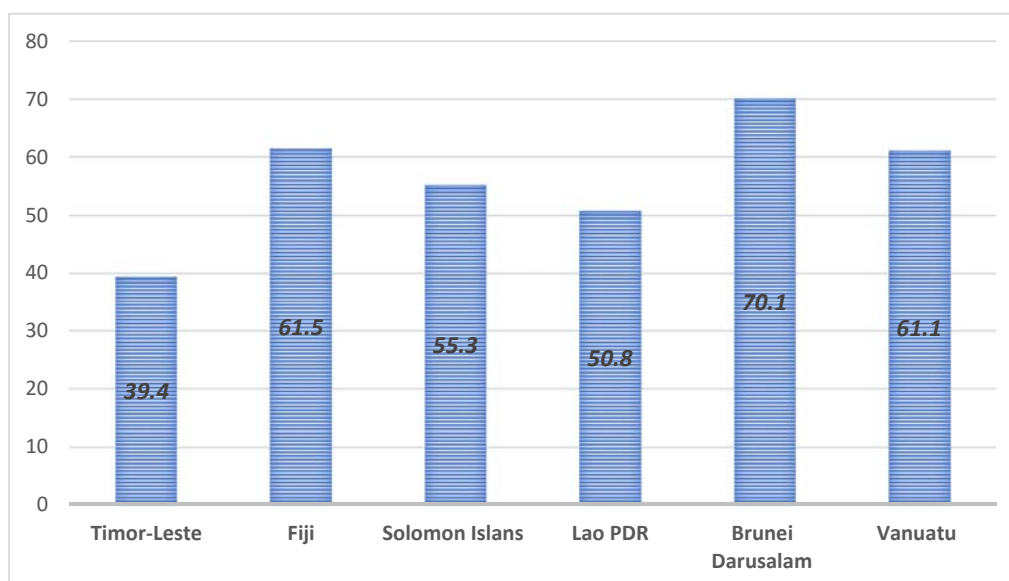
Across Timor-Leste, 86 percent of 15-years old will survive until age 60. This statistic is a proxy for the range of health risks that a child born today would experience as an adult under current conditions.

8. Ease of Doing Business

The Ease of Doing Business report is produced by The World Bank to measure the index of business regulatory performance of a country. The range of doing business scale from 1 to 100, where 0 represents the worst regulatory performance and 100 is the best regulatory performance.

For global comparison, in 2020, Timor-Leste's score was 39.4 or rank 181 out of 190 countries in the world. This score was lower compared to similar countries such as Fiji, Solomon Island, Lao PDR, Brunei Darussalam and Vanuatu.

Figure 22: Comparison in Ease of Doing Business scores of countries in Asia and Pacific



Source: World Bank, Ease Doing Business Report 2020

The calculation of ease of doing business score obtained from individual indicators for each economy including: starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts, and resolving insolvency.

Timor-Leste's best indicator was Starting a Business (68 out of 190 countries) while its worst indicator was enforcing contracts which it ranked bottom out of all 190 countries.

Table 17: Comparison of Ease of Doing Business scores between Timor-Leste and Pacific Countries

Indicator	Timor-Leste		Solomon Island		Vanuatu		Kiribati		Micronesia	
	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score
Starting a Business	68	89.4	110	85.6	137	81.5	149	78.4	174	69.6
Registering Property	187	0	155	47.4	84	65.6	150	49.1	0	187
Getting Credit	173	20	104	50	37	75	173	20	104	50
Enforcing Contracts	190	6.1	157	43.5	138	49.3	121	53.4	184	29.4

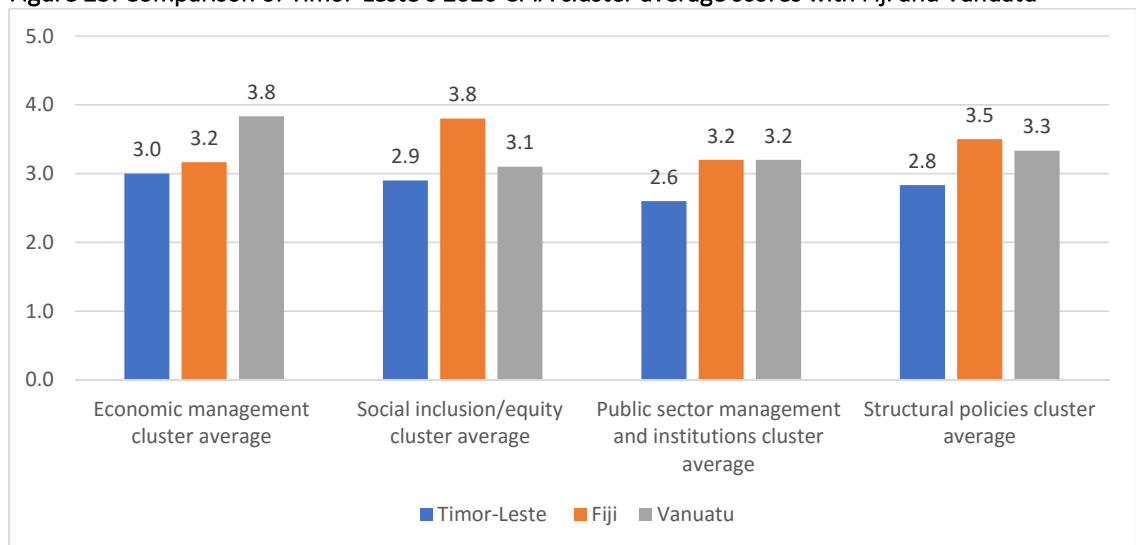
Source: The World Bank, Ease Doing Business Report 2020

9. Country Policy and Institutional Assessment

The Country Policy and Institutional Assessment (CPIA) by the World Banks is a framework to measure and compare countries ability to effectively utilise aid. It consists of 16 criteria, each marked out of a possible 6 points, over 4 categories; economic management, structural policy, social inclusion/equality measures and public sector management and institutions.

In 2020, Timor-Leste's highest categories were economic management and social inclusion/equality measures with an average score over the related indicators of 3.0. Public sector management and institutions had the lowest average with 2.5 and structural policy averaged at 2.8. The highest individual score was for Trade at 4 out of 6. The lowest scores was 2 out of 6 which was assigned to business regulatory environment, environmental sustainability, property rights and rule-based governance and quality of public administration. In fact Timor-Leste has seen very little change in their scores since they were first collected in 2006. In 2006, the average score across all indicators was 2.7 out of 6. In 2020, it has only risen to 2.8.

Figure 23: Comparison of Timor-Leste's 2020 CPIA cluster average scores with Fiji and Vanuatu



Source: The World Bank, Country Policy and Institutional Assessment 2020.

Timor-Leste has the lowest scores across all categories, when comparing with Fiji and Vanuatu. Timor-Leste has a particularly low rating when comparing the business regulatory environment, financial sector, public sector management and transparency, accountability, and corruption in the public sector. However scores on the trade rating and transparency accountability and corruption in public sector were more closely aligned.

4 Government Priorities

4.1 Government Priorities

In June 2021 the Council of Ministers approved the ceiling for the draft 2022 General State Budget (GSB), set at \$1.57bn, and its disaggregation to Line Ministries, SFAs, Municipal Authorities and other relevant institutions. Both the ceiling and its disaggregation are preliminary and may undergo amendments through the Budget Review Committee assessment, the Parliamentary debate and the Presidential evaluation. In September, the Budget Review Committee proposed an increase in the budget ceiling to \$1.675m to accommodate additional requests by the line ministers, this was subsequently approved by the Council of Ministers.

The approved draft Budget aims to finance the VIII Constitutional Government's Program for the 2022 fiscal year. Six areas are defined as priorities for the 2022 Budget and of the remainder of the Government's mandate, 2021-2023:

Table 18: Priorities of the VIII Government, 2022

No.	Priorities 2022	Allocation OJE 2022 (\$)	% OJE 2022
1.	Development of Human Capital (Education, Training and Health)	226,513,224	13.5%
2.	Housing and Social Inclusion	387,295,315	23.1%
3.	Productive Sectors (Agriculture, Tourism), Environment and Connectivity	345,931,170	20.7%
4.	Private Sector Development	78,563,312	4.7%
5.	Rural Development	72,156,425	4.3%
6.	Good Governance	116,276,834	6.9%
	Others	448,263,720	26.8%
	Grand total	1,675,000,000	100.0%

Source: Ministry of Finance, August 2021.

The proposed Budget allocations aim to reflect, therefore, such priorities. The aggregate allocation to each Pillar and their respective new measures are described below. Please note all sectoral allocations described below are preliminary and do not include final budgets for new measures.

Development of Human Capital (Education, Training and Health)

- Create education and training opportunities which are of quality, inclusive and which respond to the needs of the economy.
- Continue to prepare the health sector in terms of quality and service delivery especially in response to the COVID-19 pandemic and continue vaccination roll out.
- Continue professional development of professionals within the health and education sectors.

Housing and Social Inclusion

- Improve access to clean water.
- Continue to focus on basic sanitation.
- Continue to develop access to electricity in sukos.
- Investing in housing programs, both new and on-going.

Productive Sectors (Agriculture, Tourism), Environment and Connectivity

- Diversify the economy and increase the growth rate in an inclusive and sustainable manner.
- Increase agricultural productivity and food security by improving and creating new infrastructure, distribution channels and storage of agricultural products.
- Develop training to support hospitality industry.
- Promote sustainable behaviour and emphasise the principle of reduce, reuse and recycle.

Private Sector Development

- Focus on recovery of the economy following the economic downturn due to the impacts of COVID-19 and confinement in 2020 and 2021.
- Facilitate investment in the private sector, prioritising small and medium size enterprises.
- Create employment options to increase national productivity and opportunity for all.

Rural Development

- Continue decentralization agenda as a tool for promoting local development, promote national identity and territorial cohesion.
- Establishing strong institutions and capacity at all levels of government to ensure the delivery of quality public services to improve efficiency, accountability and transparency.
- Reduce inequalities between regions and make sure vulnerable or minority groups' voices are heard and no one is left behind.

Good Governance

- Introduce medium term plan for all public entities.

- Develop key indicators for national government
- Continue Public Financial Management reform to prioritise Fiscal Reform and Fiscal Sustainability.

4.2 Economic Recovery Package (ERP)

At the beginning of the COVID-19 pandemic, the VIII Constitutional Government defined a set of measures aimed at mitigating the negative impact of this new reality on families and companies. However, the prolongation of the pandemic situation that led to the worsening of the social consequences and the economic crisis that spread worldwide, required the Government to apply more robust medium/long-term economic intervention measures, in order to overcome it as quickly as possible. For this purpose, the Commission for the Elaboration of the Economic Recovery Plan (PRE) was created, with the mission of supporting the recovery of the economy of Timor-Leste, through the creation of a clear, objective and realistic intervention plan.

On 29th July 2020, the Council of Ministers approved short term measures to be taken in 2020 to mitigate the impact of the economic crisis due to COVID-19. On the 12th August 2020, the Council of Ministers approved a \$104.6m Economic Recovery Package of 71 measures with the objective of aiding the recuperation of the economy post COVID-19 between 2021 and 2023.

The plan has 3 clear objectives:

- 1) Increasing employment: ensuring all jobs are both productive and dignified
- 2) Realisation and consolidation of public social investment programmes (Education, Health, Housing or Social Protection)
- 3) Review productive sectors and promote areas that contribute to economic growth

Nearly 90% of the 71 measures in 2021 were included in the ongoing activities integrated in the Dalan Ba Futuru Timor-Leste (DBFTL) system. The cost of these activities were included in the allocations given to LM/SFA/Ms. Some LM/SFAs received some additional funding for new economic recovery measures provided that they supported essential services/contribute to essential activities. The Ministry of Finance through DGGMRE (Directorate-General for Resource Management and External Mobilization) also mapped the existing/new donor support received which will be detailed in Budget Book 5 2021.

In 2021, the ERP's biggest measures were related to management of COVID-19 crisis (\$110m) including management of quarantine facilities, conducting contract tracing and training to front line staff. In addition to this other measures included distribution of the Cesta Basica (Basic Basket) (\$7m), household subsidy (\$7.3m) as well as policy for creating jobs for young people (\$1.9m). The total amount allocated in 2021 for the ERP was \$316m (originally \$310m due to virements).

For OJE 2022, ERP measures total \$194m. The top 5 biggest measures related to the ERP are:

- Establishing electricity to all territory of \$90m
- The Suko development programme (PNDS) \$22.4m

- Providing a comprehensive package of basic services to multiple primary care units: \$20m
- Supply of drinking water and drainage \$17m
- Hospitalization of patients, including specialized medical services \$10.4m

4.3 Gender Sensitive Budgeting

Advancing gender equality and social inclusion continues to remain at the heart of the VIII Constitutional Government. Since 2017, the Government has reinforced Gender-Responsive Budgeting (GRB) to be adopted as a strategy to achieve gender equality and social inclusion agenda, following the approval of the *Timor-Leste Roadmap to Budgetary Governance Reform by the Council of Ministers* on 7 March 2017.

GRB is a process that supports budgetary decision-making and priority setting to ensure that fiscal policies and resource allocation create equitable outcomes for women, men, boys, girls and marginalized groups. It uses fiscal policy and public financial management practices at different stages of the budget cycle to promote gender equality and the empowerment of women and girls which ultimately leads to improved outcomes for inclusive growth.

At the preparation stage of General State Budget, each Government entity is required to conduct a gender analysis as part of GRB when developing their programs, subprograms and activities. Gender analysis is an essential element of socio-economic analysis as it provides the necessary data and information to integrate a gender and inclusion perspective into plans, policies, programs and projects.

It identifies the differences between and among women, men, boys, girls, elderly, people with disabilities, and marginalized groups in terms of their relative position in society and the distribution of resources, opportunities, constraints, and power in a given context. In this way, conducting a gender analysis allows for the development of Government programs and fiscal interventions that address existing inequalities and meet the different needs and concerns of women, men, boys, girls and anyone that might otherwise have been marginalized or excluded.

For the fiscal year of 2022, the Government has institutionalized and mainstreamed the gender equality and social inclusion agenda in the overall Program-based Budgeting structure. Below are some of the major achievements that resulted from the preparation of the proposed State Budget for 2022:

- a) A National Program called **“Gender Equality and Social Inclusion”** now exists in the Program-based Budgeting structure, which covers relevant issues related to women, children, youth, elderly, people with disabilities, war survivors, and veterans as well as addressing critical equality issues within the public service and infrastructure sector. This program also demonstrates Government’s commitment and investment in implementing various gender policies, such as the National Action Plan against Gender-Based Violence, the Maubisse Declaration, and National Action Plan on UNSCR 1325 — addressing gender-based violence, women’s economic empowerment and women, peace and security, respectively.
- b) A standardized gender activity entitled **“Abordagem Integrada de Género”** now exists in the Good Governance subprogram. This activity will be implemented by Government

entities that are not directly responsible for the implementation of the aforementioned national gender policies. This approach aims to improve public officials' knowledge and understanding on gender and inclusion issues as well as how to address it through GRB, and to prevent and address sexual harassment in order to create a new culture of respectful behavior in workplaces.

- c) Gender mainstreaming strategy is adopted when developing programs and subprograms as a strategy to achieve positive impact for the promotion of gender equality, empowerment of women and girls and social inclusion.
- d) Improvement in gender-sensitive indicators and sex-disaggregated data where practical to measure the impact of budgets on gender equality, inclusion and the empowerment of women and girls.

To track the proportion of General State Budget earmarked for the promotion of gender equality and the commitments made to eliminate existing inequalities, the Government has established a Gender Marker in the planning and financial system. It is a monitoring and accountability tool and applied at the subprogram level in the planning stage after conducting a thorough gender analysis and is reflected in approved budgets and actual expenditures. The aforementioned Gender Marker contains three markers, namely:

1. **Principal (P):** The principal expected result of the subprogram is to reduce gender inequalities. The subprogram would not have been undertaken without this gender equality and social inclusion objective.
2. **Significant (S):** Gender equality and social inclusion aspect is an important and deliberate expected result, but not the principal reason for undertaking the subprogram. The subprogram, in addition to other expected results, is designed to have a positive impact on inclusivity and advancing gender equality and/or the empowerment of women and girls (gender mainstreaming).
3. **Not Targeted (NT):** The subprogram does not intend to reduce gender inequalities nor addressing the needs and concerns of vulnerable and marginalized groups.

For the fiscal year of 2022, the Government has invested a **US \$203,784,892** towards a National program promoting gender equality and social inclusion (programme 980). In addition, from the overall allocation of the General State Budget, an investment of **US \$157,452,653** has been allocated to directly contribute to advancing gender equality, the empowerment of women and girls and social inclusion, through various subprograms considered as Principal when applying the Gender Marker.

The Government is further investing and committing to a comprehensive range of subprograms (Significant by Gender Marker) through the adoption of Gender Mainstreaming strategy with a total amount of **US \$235,774,721**. This investment will support achieving gender equality and social inclusion in all dimensions of life, empower all women, girls and marginalized groups to end all forms of discrimination, open up entrepreneurial and leadership opportunities and creating pathways for the full and effective participation of women, youth and marginalized groups as well as equal opportunities to leadership at all levels of decision-making in political, economic and public life.

5 Programme Budgeting

5.1 What is Programme Budgeting (PB)?

- Contrary to conventional budgeting, PB describes and gives the detailed costs of every activity or program that is to be carried out with a given budget (1 program will have 1 objective but may have a number of activities in order to achieve that goal). For example, expected results in a proposed program are described fully, along with its necessary resource, raw materials, equipment, and staff costs. The sum of all activities or program constitute the Program Budget. Thus, when looking at a Program Budget, one can easily find out what precisely will be carried out, at what cost and with the expected results.
- One of the key justifications for moving to program or output based budgeting is that traditional budgets are too focused on details and inputs. Budget documentation is often voluminous with many pages of tables detailing inputs for each of the budget entities. Performance based budget systems, on the other hand are designed to shift the focus from 'inputs' to 'outputs' or 'programs' - the services to be delivered by Ministries, the targeted results for these services, and the reporting on these results. In this framework, accountability for the use of government resources (taxpayer's funds) is separated so that:
 - the government becomes accountable for allocating appropriate levels of funding to the ministries to meet the results; and
 - the line Ministries become accountable for the achievement of these results, and the effective management of the inputs entrusted to them by the government through the budget.

5.2 History of PB in Timor-Leste

- 2015: The first phase of PB started in TL
- 2015-2019: TL remained still using organic and economic classifications
- 2020: VIII Government presented first GSB in programmatic format
- 2021: Implemented first OJE in programmatic form

5.3 Objective to improve Programme Budgeting Structure for GSB 2022

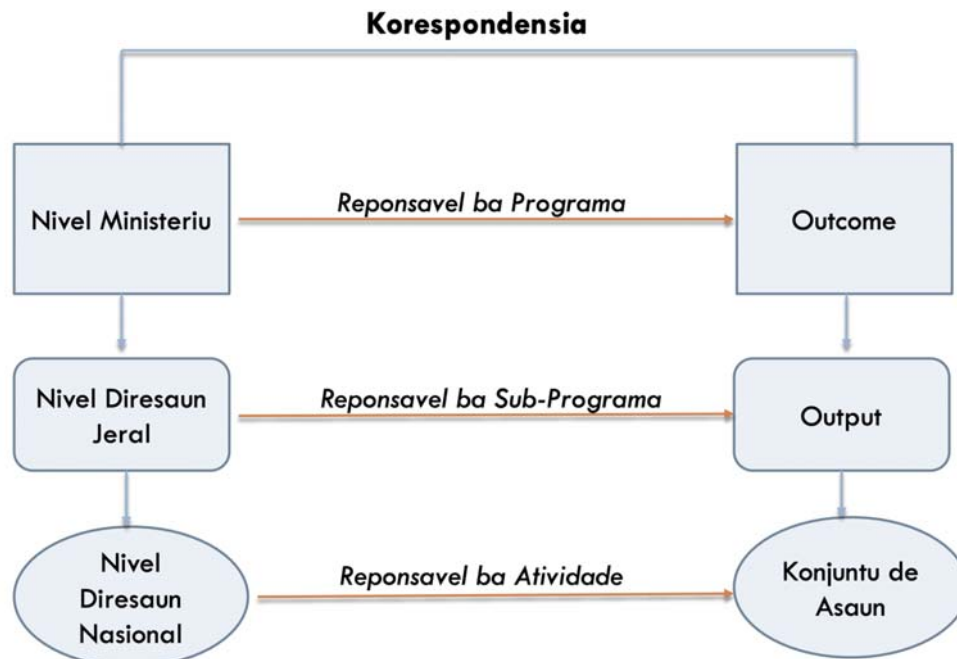
For GSB 2022 the entirety of government activity went through a rationalisation process to reduce the number of programmes from 145 to 45. The purpose of this being to:

- promote strategic investment;
- ensure public services efficient and fair;
- connect the Financial Management Information System (FMIS) system to Dalan Ba Futuru (government system to assist planning, monitoring, tracking and evaluation of public programmes);
- and record objectives,
- impacts and results of public spending;
- ensure monitoring of meeting goals and targets;

- focus based on results rather than execution rates;
- ensure alignment to government priorities;
- move from item budgeting to programme budgeting;
- shift focus onto results rather than execution;
- focus on few programmes to improve on quality and control.

The process for mapping programme structure onto organic structure and reducing the existing 145 to 43 programmes involved connecting the activity to a PED (Strategic Development Plan) subsector, analysing how the PED subsector is connected to LMs or institutions and remapping existing subprogrammes and activities. Municipality programmes and subprogrammes will automatically realign to the relevant ministry based on decree law no. 3/2016 and in line with the decentralisation process. Cross cutting programme include the Good Governance programme which are supported by more than 1 line ministry.

Figure 24: Mapping of Responsibility for Programmes, Sub-Programmes and Activities



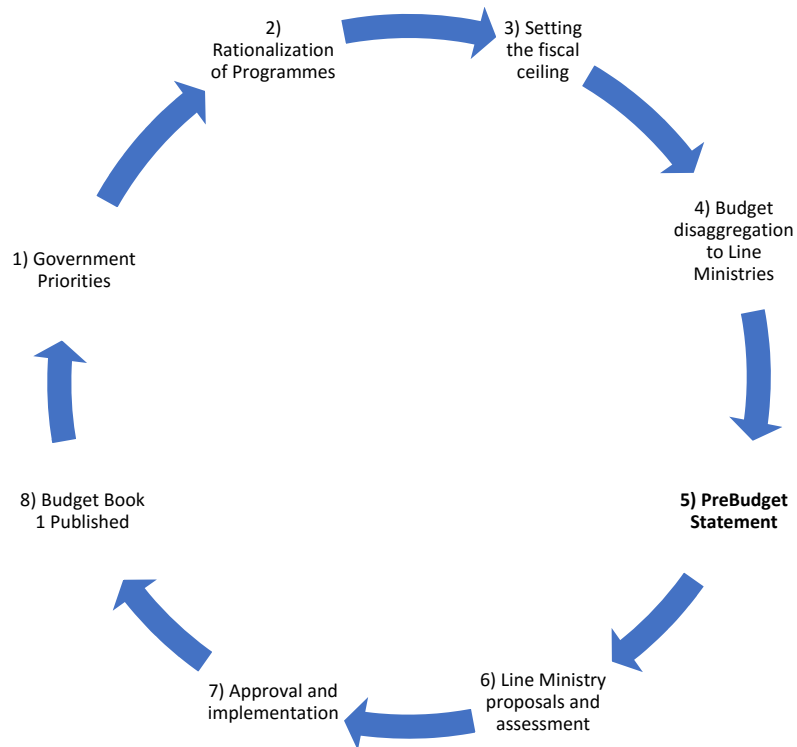
Source: Ministry of Finance & UPMA, June 2021.

Table 19: Mapping Programmatic Structure to Organic Structure

ORGANIKA MAXIMU NO ESTRUTURA PROGRAMATIKA	ESTRUTURA ORGANIKA
Ministériu Finanzas	
Programa 1	Ministériu
Sub-Programa 1	Diresaun Jerál 1
Atividade 1	Diresaun Nasionál 1
Atividade 2	Diresaun Nasionál 2
Sub-Programa 2	Diresaun Jerál 2
Atividade 1	Diresaun Nasionál 1
Atividade 2	Diresaun Nasionál 2

Source: Ministry of Finance & UPMA, June 2021.

Figure 25: Current Budget Cycle



Source: Ministry of Finance, August 2021.

Table 20: Rationalised List of Programmes for Budget 2022

45 Programmes for OJE 2022
023: Public Financial Management
024: Culture and Heritage
025: Administrative Decentralization and Local Authority
026: Roads and Bridges
028: Rural and Urban Development
029: State Reforms
030: Secure Permanent Land and Sea Borders with Indonesia
031: Fostering the International Relations and Cooperation of the Parliament
148: Contingency
152: Establish the Maritime Borders Office as a Center of Excellence on Maritime Borders and maritime jurisdiction in Timor-Leste - Blue Economy
157: Human Rights and Good Governance
159: Guarantee the exercise of the constitutional functions of the parliament
160: Promoting a culture of openness and transparency in parliament
161: National Identity
162: State Rule of law
163: Diplomatic International Relations
165: Sustainable Development
171: Bringing the Services of the Population Courts
252: Telecommunications
304: Professional Qualification
313: Technical Training
314: Scholarship
315: Other Types of Training
366: National Security
388: National Defence
392: Access to Justice
400: Timor-Leste Foreign Policy
401: Management of Petroleum And Mineral Resources
439: Ensuring Freedom of Expression and Access to Information
502: Transports
510: Good Governance and Institutional Management
797: Agriculture
798: Water and Sanitation
802: Electricity
805: Health
809: Airport
867: Development and Strengthening of Areas with Special Administrative and Economic Treatment
874: Ports
977: Maintenance, Rehabilitation and Response to the Structures Damaged by Calamity
979: Education and Training

980: Gender Equality and Social Inclusion
981: Protection and Conservation of Environment
982: Tourism
983: Investment and Economic Diversification
984: Territorial Ordering

Source: Ministry of Finance & UPMA, October 2021.

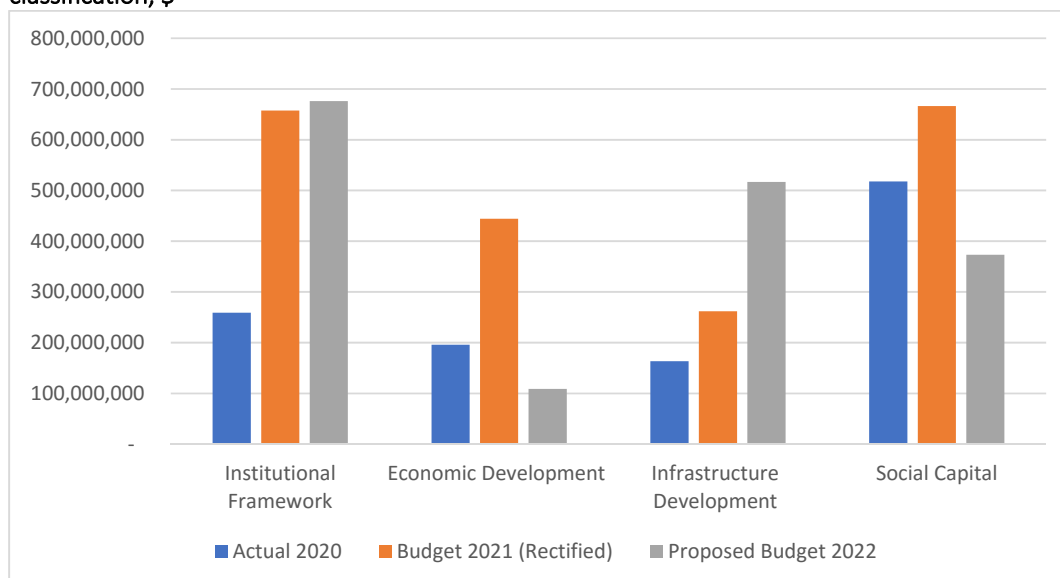
6 Budget Proposal

6.1 Comparative Analysis of the 2022 Proposed General State Budget

Due to the implementation of programme budgeting and the reduction in the total number of programmes between the 2021 budget and 2022, this comparative analysis has been done using institutional level data only to allow a fair comparison between the three budget years. Future years will conduct the same analysis at the programme level instead. The figures below include loans disbursements and transfers to RAEOA-ZEEMS.

Timor-Leste's Strategic Development Plan is organized around four pillars: Institutional Framework, Social Capital, Economic Development and Infrastructure Development. The proposed 2022 Budget allocates the largest share to the Institutional Framework, followed by Infrastructure Development, Social Capital and Economic Development.

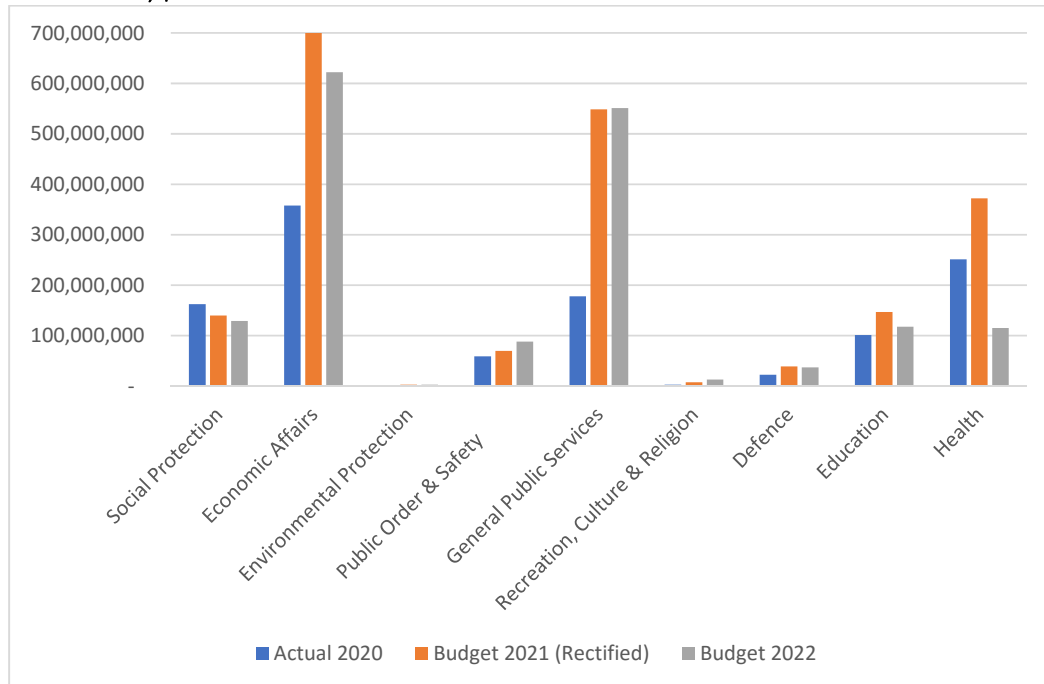
Figure 26: Comparison of 2020 Expenditure, 2021 rectified GSB & proposed 2022 GSB by SDP classification, \$



Source: Ministry of Finance, October 2021.

When comparing on the international sectorial and more detailed classification COFOG (Classification of the Functions of Government), the 2022 budget sees the largest proportion going to Economic Affairs, followed by General Public Services. This mirrors the previous year's budget. The smallest share is for Environmental Protection and Recreation, Culture and Religion which is the same as in 2020 actual spending and the final rectified budget of 2021.

Figure 27: Comparison of 2020 Expenditure, 2021 rectified GSB & proposed 2022 GSB by COFOG classification, \$



Source: Ministry of Finance, October 2021.

6.2 New Measures for OJE 2022

For OJE 2022 new measures introduced include:

- Food subsidy (on corn, rice, beans, soy and pulses) for public servants - \$25m
- Emergency response fund against natural disasters - \$15m
- Investment fund for establishing the new Municipality of Ataúro - \$13m
- Bolsa da Mae Jersaun Foun (new phase of supporting nutrition in pregnant women and young babies) - \$13m (This is the TL government expenditure on the project which also will receive \$6.4m in Direct Budget Support from the Australian government)
- Presidential Elections 2022 - \$12m
- Development of SME's - \$5m
- Acquisition of vehicles and equipment for Firefighters in order to response to disasters - \$3.9m
- Population Census - \$3.1m
- Establishing Unique ID system - \$3m
- Salary for 1,200 new FDTL recruits - \$1.2m

6.3 Total Expenditure by Programme

The program budgeting policy initiated in 2015 by the Office of Prime Minister with the objectives to give attention to government strategic priorities on public administration. In March 2017, budgetary governance roadmap was approved through Government Resolution; and between 2018 and 2019, line ministries were requested to report their annual action plan per trimester using program budgeting structures. Next year in 2022 will be the first year to implement program budgeting. Therefore, 45 programs has been identified for 2022 budget. The program with the highest budget in 2022 is Good Governance and Institutional Management with total budget of more than \$295 million; followed by Gender Equality and Social Inclusion at \$203.78 million. Roads and Bridges is the program sits in the third place with total budget allocation of over \$202 million. Other programs with high budget including Health, Education and Training and Electricity with total budget allocation of \$106.78 million, \$105.87 million and \$101.73 million respectively.

Table 21: Programmes for OJE 2022 in order of allocation, \$

Programme	Allocation (\$)	Allocation (% of OJE 2022)
510: Good Governance and Institutional Management	295,787,095	17.66%
980: Gender Equality and Social Inclusion	203,784,892	12.17%
026: Roads and Bridges	202,191,290	12.07%
805: Health	106,781,969	6.38%
979: Education and Training	105,871,255	6.32%
802: Electricity	101,730,383	6.07%
983: Investment and Economic Diversification	78,163,312	4.67%
366: National Security	56,737,208	3.39%
867: Development and Strengthening of Areas with Special Administrative and Economic Treatment	55,324,900	3.30%
023: Public Financial Management	45,997,258	2.75%
401: Management of Petroleum And Mineral Resources	44,396,436	2.65%
797: Agriculture	44,313,264	2.65%
809: Airport	40,141,002	2.40%
028: Rural and Urban Development	37,329,261	2.23%
388: National Defence	36,558,037	2.18%
798: Water and Sanitation	29,697,017	1.77%
148: Contingency	29,500,000	1.76%
025: Administrative Decentralization and Local Authority	24,201,199	1.44%
252: Telecommunications	20,125,664	1.20%
400: Timor-Leste Foreign Policy	19,712,155	1.18%
977: Maintenance, Rehabilitation and Response to the Structures Damaged by Calamity	17,529,207	1.05%
392: Access to Justice	13,796,246	0.82%
171: Bringing the Services of the Population Courts	9,214,825	0.55%
159: Guarantee the exercise of the constitutional functions of the parliament	7,853,290	0.47%

Programme	Allocation (\$)	Allocation (% of OJE 2022)
439: Ensuring Freedom of Expression and Access to Information	7,544,999	0.45%
314: Scholarship	6,533,064	0.39%
502: Transports	5,501,492	0.33%
024: Culture and Heritage	4,701,537	0.28%
982: Tourism	4,575,954	0.27%
313: Technical Training	3,567,543	0.21%
874: Ports	3,013,283	0.18%
984: Territorial Ordering	2,943,465	0.18%
165: Sustainable Development	1,423,913	0.09%
981: Protection and Conservation of Environment	1,304,696	0.08%
031: Fostering the International Relations and Cooperation of the Parliament	1,235,259	0.07%
163: Diplomatic International Relations	1,100,552	0.07%
304: Professional Qualification	1,027,800	0.06%
029: State Reforms	901,560	0.05%
315: Other Types of Training	871,593	0.05%
161: National Identity	648,242	0.04%
030: Secure Permanent Land and Sea Borders with Indonesia	445,204	0.03%
160: Promoting a culture of openness and transparency in parliament	331,575	0.02%
162: State Rule of law	254,080	0.02%
157: Human Rights and Good Governance	193,024	0.01%
152: Establish the Maritime Borders Office as a Centre of Excellence on Maritime Borders and maritime jurisdiction in Timor-Leste - Blue Economy	144,000	0.01%
Grand Total	1,675,000,000	100.00%

Source: Ministry of Finance, October 2021

6.4 Expenditure by Fund

Government expenditure in Timor-Leste is spread across a number of different funds. The proposed breakdown for expenditure in 2022 is set out in the table below.

Table 22: Expenditure by Fund, \$millions

Government Expenditure	2022
Total	1,675.00
Consolidated Fund of Timor-Leste	1,150.48
Infrastructure Fund (including loans)	332.45
Human Capital Development Fund	12.00
COVID-19 Fund	37.63
Social Security Fund	58.00
RAEOA	84.44

Source: Ministry of Finance, October 2021.

6.4.1 Consolidated Fund of Timor-Leste

The CFTL is the Government's central account and includes all expenditures for line ministries and autonomous agencies. Within it, expenditure is spread across 45 programs.

It does not include the HCDF, IF, COVID, SSF and RAEOA which will be presented in the following sections.

Table 23: Breakdown of CFTL expenditure, \$

Total Proposed 2022 Budget	1,150,484,879
023: Public Financial Management	42,967,258
024: Culture and Heritage	3,748,637
025: Administrative Decentralization and Local Authority	24,201,199
026: Roads and Bridges	37,695,847
028: Rural and Urban Development	24,949,245
029: State Reforms	526,120
030: Secure Permanent Land and Sea Borders with Indonesia	445,204
031: Fostering the International Relations and Cooperation of the Parliament	1,235,259
148: Contingency	29,500,000
152: Establish the Maritime Borders Office as a Centre of Excellence on Maritime Borders and maritime jurisdiction in Timor-Leste - Blue Economy	144,000
157: Human Rights and Good Governance	193,024
159: Guarantee the exercise of the constitutional functions of the parliament	7,853,290
160: Promoting a culture of openness and transparency in parliament	331,575
161: National Identity	648,242
162: State Rule of law	254,080
163: Diplomatic International Relations	1,100,552
165: Sustainable Development	1,423,913
171: Bringing the Services of the Population Courts	4,807,008
252: Telecommunications	3,310,197
366: National Security	50,586,776
388: National Defence	32,480,520
392: Access to Justice	12,590,457
400: Timor-Leste Foreign Policy	19,712,155
401: Management of Petroleum And Mineral Resources	42,246,436
439: Ensuring Freedom of Expression and Access to Information	7,094,999
502: Transports	5,101,492
510: Good Governance and Institutional Management	260,959,035
797: Agriculture	38,097,059
798: Water and Sanitation	20,543,949
802: Electricity	89,571,533
805: Health	66,379,452
874: Ports	55,582
979: Education and Training	96,648,463
980: Gender Equality and Social Inclusion	140,466,520
981: Protection and Conservation of Environment	1,199,023
982: Tourism	3,469,035
983: Investment and Economic Diversification	75,154,278
984: Territorial Ordering	2,793,465

Source: Ministry of Finance, October 2021.

6.4.2 Human Capital Development Fund (HCDF)

The Human Capital Development Fund (HCDF) created in 2011, has its main objective to develop the human resources of the strategic priority areas in line with the National Strategic Development Plan. The programs financed through the HCDF are classified into four main groups, which are: Vocational Training, Technical Training, Scholarships and Other Types of Training.

The vocational training program is primarily focused on training young people in a foreign language to seek opportunities for service abroad and training in the industry. The technical training program covers training activities for public administration as part of the professional development program to raise the capacity of civil servants in all government departments. The scholarship program aims to increase the knowledge and skills necessary for the country's economic and social development. It covers grants and scholarships for the children of veterans, civil servants, teachers at private universities and young people without means. The other types of training program covers programs related to research, studies, inspection, professional internship to promote the newly graduated beneficiaries of HCDF scholarships and others.

The total 2022 budget of HCDF is \$12 million. This amount will finance 4 main programs listing in the table below with scholarship program become the program with the highest budget allocated total of \$6.53 million followed by technical training program with the budget allocated of \$3.567 million, professional qualification of \$1.027 million and other types of training amount of \$871,593.

Table 24: Breakdown of HCDF expenditure, \$

Total Proposed 2022 Budget	12,000,000
304: Professional Qualification	1,027,800
313: Technical Training	3,567,543
314: Scholarship	6,533,064
315: Other Types of Training	871,593

Source: Ministry of Finance, October 2021

6.4.3 Infrastructure Fund

According to the Strategic Development Plan, a central pillar for the long-term development of Timor-Leste is the building and maintenance of core, productive infrastructure in order to support sustainable economic growth, social inclusion, and promote the national connectivity. The Infrastructure Fund was established in 2011, with the role of financing the strategic infrastructure projects on the multi-year basis. Since 2016, the Infrastructure Fund has been operated as an autonomous agency.

The VIII Constitutional Government set the infrastructure development priorities in the area of basic infrastructure for both social and economic sectors. That includes programs for roads, bridges, water and sanitation, and the provision of sustainable energy. Many projects have already been completed in previous years. Other important infrastructure will be required to support modernization and growth of the Timor-Leste's economy, including digital

infrastructure, transport and logistics infrastructure for trade, as well as supporting of industrial development.

In 2022 budget, IF will have a total budget of \$ 332 million for 26 programs (including loans) The road and bridge program is the largest and represents 49% of the total IF budget. Airport is the program with the second highest budget allocated of 12% of IF budget. The remaining budget is allocated to 24 other program of IF.

Table 25: Infrastructure Fund budget by program 2022 -2026, \$

	2022	2023	2024	2025	2026
Grand Total	332,453,139.00	1,277,358.40	689,977.75	587,178.00	216,141.72
023: Public Financial Management	3,030,000.00	16,920.93	18,797.82	13,187.12	6,220.70
024: Culture and Heritage	950,000.00	1,164.93	240.55	-	-
026: Roads and Bridges	164,495,443.00	396,916.54	301,952.26	111,161.19	69,013.29
028: Rural and Urban Development	11,989,298.00	11,339.10	13,494.30	12,500.00	-
171: Bringing the Services of the Population Courts	4,407,817.00	30,507.39	11,718.72	-	-
252: Telecommunications	16,815,467.00	18,600.00	13,725.00	5,050.00	-
366: National Security	6,099,832.00	19,771.50	25,017.36	4,201.50	-
388: National Defence	4,077,517.00	45,997.27	60,805.48	31,989.87	12,265.47
392: Access to Justice	50,000.00	130.00	20.00	-	-
401: Management of Petroleum And Mineral Resources	2,150,000.00	328,281.27	257,804.43	181,346.27	81,121.20
439: Ensuring Freedom of Expression and Access to Information	450,000.00	350.00	21.22	-	-
502: Transports	400,000.00	8,490.00	14,350.00	5,460.00	1,000.00
510: Good Governance and Institutional Management	11,053,764.00	57,241.99	57,347.50	18,513.14	7,314.16
797: Agriculture	5,774,544.00	67,091.00	86,245.45	29,017.73	8,478.79
798: Water and Sanitation	9,150,068.00	35,696.26	41,103.41	33,955.45	3,205.45
802: Electricity	11,419,593.00	7,497.55	5,950.00	16,000.00	-
805: Health	2,777,319.00	31,235.88	30,011.40	8,631.21	3,400.00
809: Airport	40,141,002.00	42,625.02	42,261.01	34,501.89	-
874: Ports	2,957,701.00	31,097.28	49,708.94	33,700.00	11,000.00

	2022	2023	2024	2025	2026
977: Maintenance, Rehabilitation and Response to Structures Damaged by Calamity	17,529,207.00	42,602.53	12,606.00	2,828.71	-
979: Education and Training	7,749,407.00	49,839.62	54,983.43	32,261.53	9,186.67
980: Gender Equality and Social Inclusion	5,126,310.00	20,711.59	14,953.98	4,624.40	1,636.00
981: Protection and Conservation of Environment	100,000.00	1,200.00	2,300.00	400.00	-
982: Tourism	1,032,500.00	713.00	-	-	-
983: Investment and Economic Diversification	2,576,350.00	8,487.75	14,438.00	7,848.00	2,300.00
984: Territorial Ordering	150,000.00	2,850.00	-	-	-

Source: Major Projects Secretariat, Ministry of Planning and Strategic Investment, October 2021.

6.4.4 COVID-19 Fund

For OJE 2022, the COVID-19 Fund is allocated \$37.6 million, its sole programme is Health. Key measures this year include provision of quarantine facilities \$13.1m, treatment of COVID-19 cases \$9.8m, contact tracing \$5.1m and vaccination for prevention of COVID-19 \$1.8m.

Table 26: Programmes for COVID-19 Fund Budget, \$

Total Proposed 2022 Budget	37,625,198
980: Health	37,625,198

Source: Ministry of Finance, October 2021.

6.4.5 Social Security Fund

Social protection comprises two components; non-contributory social security (citizenship) and contributory social security (social security). Non-contributory social security is fully financed by transfers from the State's central administration budget and aims to ensure social minimums for all in order to guarantee a decent life and fight poverty. Contributory social security associates rights to receive cash social benefit) with duties (to contribute to the system), is self-financed (by the social contributions of workers and employers) and aims to protect workers and their families from social risks throughout of life, ensuring superior protection. The social security system in Timor-Leste has been built since 2008, in phases, by floors/pillars, taking into account the reality and technical, human and financial capacity.

Pillar 0 is the first level of protection, corresponding to the non-contributory social security scheme, which provides social pensions to all elderly people, in order to guarantee them a decent life and access to essential services and care, regardless of resources and the situation

regarding the labour market. In Timor-Leste, this level of protection was created in 2008, with the support subsidy for the elderly and disabled (SAII) (Decree-Law no 19/2008, of 19 June).

Pillar 1 corresponds to the contributory (and mandatory) social security scheme, which provides greater protection to those who work and contribute to the scheme, in order to ensure the maintenance of the standard of living after retirement or during working life, in situations of loss of income from work (e.g. in maternity hospitals). In Timor-Leste, the construction of this level of protection began in 2012, with the creation of the first social security pension scheme: the transitional social security scheme for civil servants (Law no 6/2012, of 29 February). However, under this scheme from beginning thought of as transitory- no contribution rate was created, so pensions were only calculated according to the time worked and financed by the State's Central Administration Budget.

In 2016, the new general regime was finally approved (Law 12/2016, of 14 November), which integrates the previous transitional regime for civil servants, is effectively contributory, associates the right to benefits with the duty to contribute, extends protection to workers in all sectors of activity, and also includes protection in parenting and in cases of work accidents (the latter still to be regulated), as provided for in the Labour Law. The new general social security regime is characterized by being a public, contributory, mandatory and single regime, based on the principles of intra and intergenerational solidarity, self-financed and shared-managed. It is, therefore, a "defined benefit" regime, where the risk is assumed collectively and the beneficiaries know, from the outset, how the values of the benefits they will receive are calculated (through a publicly known calculation formula and approved by legal diploma), being the contributions and social benefits proportional to the remuneration declared to the social security.

For OJE 2022 the SSF contains 2 subprograms:

- i) Contribution of the State to the Social Security Contribution Scheme
- ii) Provision for the Social Security Budget under the programme Gender Equality and Social Inclusion at a total of \$58m.

Table 27: Programmes for Social Security Budget, \$

Total Proposed 2022 Budget	58,000,000
980: Gender Equality and Social Inclusion	58,000,000

Source: Ministry of Finance, October 2021

6.4.6 RAEOA-ZEESM

The Special Administrative Region Authority of Oé-Cusse Ambeno (RAEOA- ZEESM) is allocated \$84.4 million. This comes entirely from utilizing their cash balances which have been built up over the years.

Table 28: Programmes under RAEOA-ZEESM, \$

Total Proposed 2022 Budget	84,436,784
024: Culture and Heritage	2,900
028: Rural and Urban Development	390,718
029: State Reforms	375,440
366: National Security	50,600

Total Proposed 2022 Budget	84,436,784
392: Access to Justice	1,155,789
510: Good Governance and Institutional Management	23,774,296
797: Agriculture	441,661
798: Water and Sanitation	3,000
805: Health	739,257
867: Development and Strengthening of Areas with Special Administrative and Economic Treatment	55,324,900
979: Education and Training	1,473,385
980: Gender Equality and Social Inclusion	192,062
981: Protection and Conservation of Environment	5,673
982: Tourism	74,419
983: Investment and Economic Diversification	432,684

Source: Ministry of Finance, October 2021.

6.5 Ministry Allocations

To allow a cross-year comparison, data on the actual Line Ministry expenditure in 2020, as well as the final 2021 and proposed budget for 2022 is set out in the table below.

As seen by the figures, when focusing on line ministry spending only, the highest allocation is given to Institutional Framework, followed by Social Capital, Infrastructure Development and Economic Development. This is the same ordering as the previous year but a change from 2020, where Social Capital was the highest percentage of actual spending, followed by Institutional Framework, Infrastructure Development and Economic Development.

Table 29: SDP Sector and Line Ministry actual expenditure and budget allocations, 2020 -2022, \$

SDP Sector	Ministry	2020 Actual Expenditure	2021 Rectified Budget	2022 Proposed Budget
Economic Development	Ministry of Agriculture and Fisheries	7,046,584	29,479,242	21,400,322
	Ministry of Mineral Resource and Oil	27,485,988	79,583,158	42,257,061
	Ministry of State, Coordinator of Economic Affairs	705,976	1,993,485	1,653,170
	Ministry of Tourism, Commerce and Industry	4,233,652	11,230,248	13,584,356
	Secretariat of State for Vocational Training Policy and Employment	3,739,372	5,927,796	4,815,221
	Secretariat of State for Cooperative Sector	2,300,860	7,137,481	4,605,547
Infrastructure Development	Ministry of Planning	13,029,517	14,833,713	6,480,851
	Ministry of Public Works	143,788,853	234,511,942	160,431,417
	Ministry of Transport and Communications	6,524,745	11,806,256	8,876,153

SDP Sector	Ministry	2020 Actual Expenditure	2021 Rectified Budget	2022 Proposed Budget
Institutional Framework	Appropriations for all of Government	57,135,832	207,932,624	260,841,120
	Minister of State for the Presidency of the Council of Ministers	3,959,663	5,022,647	4,717,347
	Ministry of Defence including FDTL	20,908,780	37,903,143	36,461,964
	FDTL			25,527,233
	Ministry of Finance	13,259,405	31,831,990	29,869,289
	Ministry of Foreign Affairs and Cooperation	20,003,558	26,365,811	23,533,166
	Ministry of Interior including PNTL	46,227,447	56,424,451	56,760,948
	PNTL			34,082,481
	Ministry of Justice	11,666,825	14,842,589	12,506,594
Ministry of Parliament Affairs and Social Communications including SECS	4,534,424	8,013,016	9,066,076	
Social Capital	Ministry of State Administration	14,737,606	54,010,999	33,723,731
	Prime-Minister	6,329,814	11,676,232	4,915,494
	Ministry of Education, Youth and Sports Including SEJD	73,980,512	106,341,251	81,708,623
	Ministry of Health	39,978,292	56,767,506	52,113,565
	Ministry of Higher Education, Science and Culture Including SEAC	5,017,234	6,133,915	5,186,739
	Ministry of National Liberation Combatants Affairs	97,571,833	100,117,580	99,684,114
	Ministry of Social Solidarity and Inclusion	53,440,106	19,942,903	22,727,705
	Secretariat of State for Equality and Inclusion	933,199	2,390,650	2,027,440

Source: Ministry of Finance, October 2021.

6.6 Municipality Allocations

There is also data presented on expenditure at the municipality level, including the new Municipality of Ataúro which is due to be created in 2022 in a separation from the Municipal Authority of Dili. The Municipal Authority of Dili is still expected to receive the highest allocation, with 15% of the total municipality budget. This is a reduction from 18% and 16% in 2020 and 2021 respectively. The Municipality of Ataúro has been assigned 5%. This is the smallest allocation for 2022. The Municipal Administration of Liquiçá and the Municipal Administration of Aileu had the smallest amounts in 2020 actual spending and 2021 final approved spending respectively.

Table 30: Municipality actual expenditure and budget allocations, 2020 -2022, \$

Municipality	2020 Actual Expenditure	2021 Rectified Budget	2022 Proposed Budget
Municipal Authority of Baucau	2,957,988	5,309,123	4,538,264
Municipal Authority of Bobonaro	2,477,479	5,002,575	4,426,163
Municipal Authority of Dili	5,203,552	8,667,122	7,684,680

Municipality	2020 Actual Expenditure	2021 Recified Budget	2022 Proposed Budget
Municipal Authority of Ermera	2,248,300	4,605,438	4,287,418
Municipal Administration of Aileu	1,641,520	3,015,344	2,811,963
Municipal Administration of Ainaro	1,866,285	3,407,826	3,051,446
Municipal Administration of Covalima	2,062,047	4,414,282	3,766,640
Municipal Administration of Lautém	2,320,098	4,157,022	3,821,889
Municipal Administration of Liquiçá	1,613,606	3,329,831	2,988,710
Municipal Administration of Manufahi	2,068,132	3,766,851	3,453,388
Municipal Administration of Manatuto	2,093,441	4,338,238	3,628,011
Municipal Administration of Viqueque	2,146,193	4,337,502	3,697,785
Municipal of Ataúro			2,508,100

Source: Ministry of Finance, October 2021.

7 Financing and External Resources

7.1 Definition of Financing

The total budgeted expenditure for 2022 is higher than the domestic revenue that will be collected over the same period. This results in a non-oil deficit (domestic revenue minus expenditure). This deficit is financed through a number of sources; withdrawals from the Petroleum Fund (PF), loans, the use of the cash balances (from many sources) and Budget Direct Support from the European Union and Government of Australia. Withdrawals from the PF can be either within a sustainable amount, using the revenue of the fund, or excess withdrawals above this sustainable level (see next section). The table below shows the amount drawn from each of the financing items.

Table 31: Source of Financing, 2020-2026, \$millions

	2020 Actual	2021 Rectified Budget	2022 Proposed Budget	2023	2024	2025	2026
Total Financing	429.2	1,291.8	970.0	1,975.6	1,937.0	1,498.3	1,223.7
Excess Withdrawals from PF	342.0	829.7	488.4	1,923.1	1,900.4	1,417.5	1,168.0
Use of Cash Balance	47.1	382.3	415.1	0.0	0.0	0.0	0.0
<i>Treasury Cash Balance</i>	<i>23.4</i>	<i>238.8</i>	<i>330.7</i>	<i>0.0</i>	<i>0.0</i>	<i>0.0</i>	<i>0.0</i>
<i>RAEOA ZEESM Cash Balance</i>	<i>23.8</i>	<i>97.0</i>	<i>84.4</i>	<i>0.0</i>	<i>0.0</i>	<i>0.0</i>	<i>0.0</i>
<i>Use of INSS cash return</i>	<i>0.0</i>	<i>35.0</i>	<i>0.0</i>	<i>0.0</i>	<i>0.0</i>	<i>0.0</i>	<i>0.0</i>
<i>Use of Idosos cash subsidy return</i>	<i>0.0</i>	<i>7.5</i>	<i>0.0</i>	<i>0.0</i>	<i>0.0</i>	<i>0.0</i>	<i>0.0</i>
<i>Use of BCTL credit moratorium return</i>	<i>0.0</i>	<i>4.0</i>	<i>0.0</i>	<i>0.0</i>	<i>0.0</i>	<i>0.0</i>	<i>0.0</i>
Borrowing /Loans (disbursements)	30.1	70.7	50.8	45.9	33.8	77.0	55.6
Direct Budget Support	10.1	9.1	15.6	6.6	2.8	3.8	0.0
<i>EU</i>	<i>10.1</i>	<i>9.1</i>	<i>9.0</i>	<i>5.0</i>	<i>2.8</i>	<i>3.8</i>	<i>0.0</i>
<i>Australia</i>	<i>0.0</i>	<i>0.0</i>	<i>6.6</i>	<i>1.6</i>	<i>0.0</i>	<i>0.0</i>	<i>0.0</i>

Source: Ministry of Finance, October 2021.

7.2 ESI and Excess Withdrawals

There are important economic reasons for distinguishing between revenue and financing items. Domestic revenue results from taxes borne by companies and individuals in Timor-Leste from production and income made. The ESI is the sustainable level of use of petroleum revenue, to ensure the continued use of the petroleum fund for ever. Spending only up to total revenue (domestic reviews and ESI) is a position that maintains fiscal sustainability. It is a benchmark level of spending for understanding the long run trend of government finances. The ESI can therefore be considered revenue. The government has changed the definition of revenue to include the ESI to make clearer what is fiscally sustainable.

The ESI is equal to 3% of the net petroleum wealth equals \$554.1 million in 2021. This is a slight increase from the ESI in 2020 (\$547.9 million) due to the increase in the Petroleum Fund balance. Further details on the ESI and petroleum wealth can be found in Section 2.5 of this Budget Book.

The Government plans to withdraw \$488.4 million in excess of the ESI in 2021. This is a near halving of the forecast excess withdrawals in 2021 which totalled \$829.7 million. It is an increase on the actual withdrawals in 2020 which were \$342.0 million. Excess withdrawals are in line with the Government's frontloading policy. These excess withdrawals are being used to finance core infrastructure and human capital, which is necessary for long-term growth.

7.3 Use of Cash Balances

The total cash balance to be used to finance 2021 State Budget is \$415.5 million. \$330.7 million is to come funds held in the Treasury Account. The specific breakdown is set out in the table below. The other \$84.4 million is to come from the cash balances held by RAEOA/ZEESM. This will be used to finance their expenditure for the year, with no additional transfers required from Central Government.

Table 32: Use of Cash Balances, \$millions

Total	415.15
Treasury Cash Balance	330.71
<i>FCTL</i>	<i>274.82</i>
<i>COVID-19</i>	<i>40.22</i>
<i>IF</i>	<i>15.29</i>
<i>FDCH</i>	<i>0.38</i>
<i>National Institute of Social Security</i>	-
RAEOA ZEESM Cash Balance	84.44

Source: Ministry of Finance, October 2021.

7.4 Loans

The Government currently still depends on foreign loan to meet its borrowing needs for concessional loans. As established in the Strategic Development Plan 2011-2030 and regulated by public debt regime law No.13/2011, the primary objective of taking concessional loans should be related to the construction of strategic infrastructure for the development of the country.

7.4.1 Terms of Loans

At present, external loans are mainly provided by international multilateral banks such as Asian Development Bank and World Bank including one bilateral loan from JICA. By creditor category, ADB is currently the major lender to TL and its loans accounts for nearly 53% of the total loan amount followed by WB and JICA. Below are the terms of the loans:

Table 33: Terms of Loans

Lender	Currency	Approved loan \$m	Grace Period (year)	Initial Amortization (year)	Year Complete	Interest rate FY 2020
ADB	USD, SDR	271.65	5.3	20	2044	1.89%
WB	USD, SDR	174.20	8	20	2060	2.72%
JICA	JPY	68.72	10	20	2042	0.71%
Total		514.58				

Source: Ministry of Finance, June 2021.

These are loans that have a considerable degree of concessionality and compare favourably to the opportunity cost of withdrawing funds from the petroleum fund. A key advantage is that the financial cost of concessional borrowing (2.03%) is currently lower than the return on the Petroleum Fund (4.84%) ensuring that the future debt repayments remain well within the country's capacity to pay.

Table 34: Cost of borrowing vs PF return

Description	2012	2013	2014	2015	2016	2017	2018	2019	2020
Cost of borrowing (effective rate)				1.02%	1.42%	1.68%	2.06%	2.34%	2.03%
PF historical return	4.1%	4.4%	4.2%	3.8%	3.8%	4.4%	3.8%	4.5%	4.84%

Source: Ministry of Finance, June 2021.

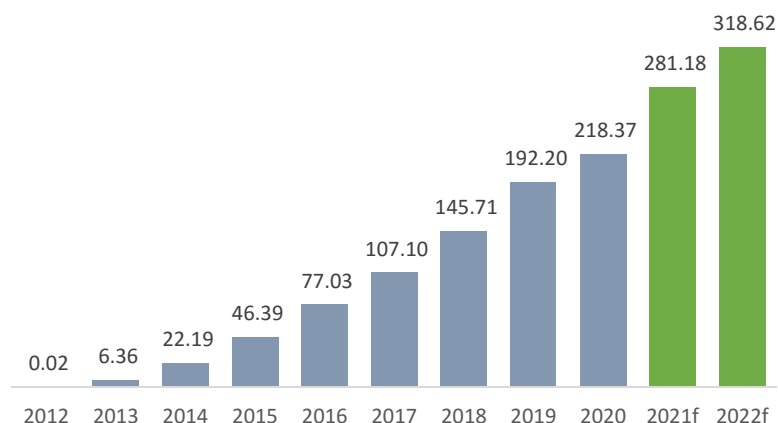
7.4.2 Portfolio Management

The management of public debt plays a critical role in determining the sustainability of fiscal policy. Due to poor macro-fiscal outlook, TL's debt carrying capacity is now rated lower than previous year by the IMF article IV mission held in 2021 from medium to weak leading to lower debt burden thresholds. Similarly, risk of external debt distress was also increased from low to moderate.

Changes in External Debt Stock

As end of the fiscal year, the stock of external debt increased to USD 218.37m in 2020 from \$192.20 at the end of 2019. The 14% increase is attributable to the total new disbursement of \$30.10m from multilateral and bilateral institutions including ADB, WB and JICA for ongoing and new projects. Interest and other fee related payments declined slightly from \$3.93 in 2019 to \$3.90m as at end of 2020. This amount is relatively small compared to the amount currently the Government owes to these lenders.

Figure 28: Stock of External Debt, \$millions



Source: Ministry of Finance, June 2021.

Considering the impact of Covid-19 outbreak, particularly delaying a number of key capital projects, a fall in disbursements is expected in 2021. Compared with the previous year, disbursement in 2021 is expected to fall by 27%. However a recovery is expected in 2022, with loan disbursements forecast to reach \$50.81 million, making the total debt stock estimated to be \$318.62 million by the end of 2022.

Debt Indicators

TL's debt ratios increased over the years, marginally. Despite this, total public debt remained sustainable over the year reflecting the Government's prudent management of the debt.

Table 35: External Debt Indicators for the period 2017-2022, % of GDP and Revenue

	2017	2018	2019	2020	2021f	2022f
Total External Debt to GDP	6.7%	9.2%	11.9%	14.9%	18.9%	21.4%
Total Debt Service to Revenue	0.3%	0.4%	1.0%	1.1%	2.3%	2.9%
In millions of US dollars, unless otherwise indicated						
Memorandum items:						
Total external debt	107.10	145.71	192.20	218.37	281.18	318.62
Debt Service	1.81	3.12	7.18	7.84	15.61	19.29
GDP	1590.50	1578.10	1620.00	1463.10	1491.21	1490
Revenue	671.15	741.17	716.78	726.47	680.17	673.78

Note: figures for year 2021-22 are estimates

Source: Ministry of Finance, June 2021.

External Debt to GDP - The size of external debt to GDP during the period was relatively small when compared to the debt burden threshold and benchmarks as established under the debt

sustainability frameworks for low income countries⁹. While the ratio constantly increased marginally from 6.7% percent in 2017 to 18.9 percent in 2021, the values are far below 30%. This marginal increase was due to an increase in disbursement and external downward growth trend in GDP. While there was a slight recover during 2018-2019, the percentage increase in external debt was still higher than GDP growth, hence, higher external debt to GDP ratio.

Debt Service to Revenue – The debt service to revenue ratio is expected to increase more than two times from 1.1% in 2020 to 2.3% in 2021. This was primarily due to an increase in debt service payments and a decrease in revenue. Repayment of principal started in September 2017 for ADB loan 2857. Despite the increase, this percentage of debt service to revenue is still well-under the threshold 14 percent.

Debt Service Forecast – Annual debt service is calculated on each loan to cover the repayment of principal, interest and other miscellaneous charges on a debt for a particular period.

Table 36: Debt Service Forecasts, \$millions

Lender	Debt Service	2019 Actual	2020 Actual	2021 Proj.	2022 Proj.	2023 Proj.	2024 Proj.	2025 Proj.
ADB	Principal	2.43	3.11	7.06	8.84	11.11	12.18	13.38
	Interest	2.66	2.39	5.34	3.38	4.22	4.53	4.64
	Charges	0.12	0.11	0.33	0.10	0.08	0.08	0.00
WB	Principal	0.83	0.83	0.83	2.19	2.79	2.79	2.79
	Interest	0.66	0.85	1.09	1.19	1.19	1.14	1.09
	Charges	0.36	0.38	0.62	0.95	1.10	1.12	1.14
JICA	Principal	0.00	0.00	0.00	2.34	2.34	2.34	2.34
	Interest	0.09	0.15	0.29	0.29	0.28	0.27	0.25
	Charges	0.03	0.02	0.05	0.01	0.00	0.00	0.00

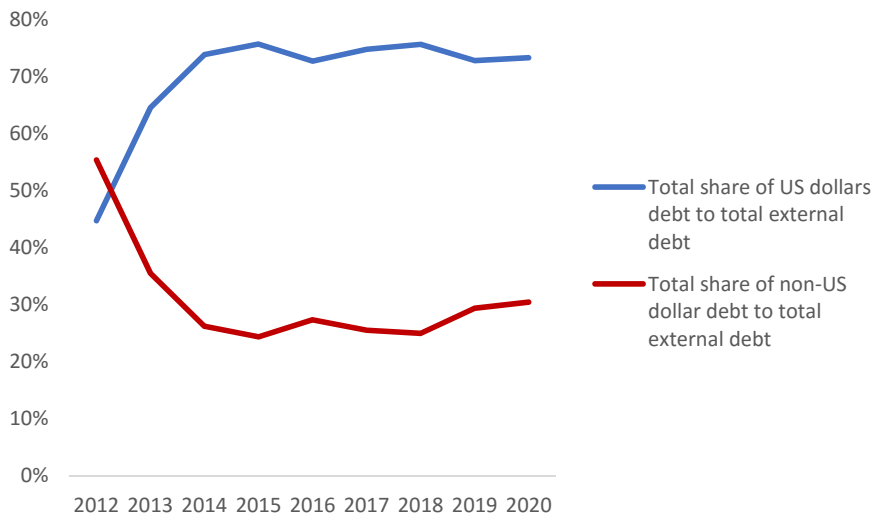
Source: Ministry of Finance, June 2021.

Risk Indicators

Foreign Exchange Risk – Complying with the loan policy note, the US dollar has remained the dominant currency in the Government’s external debt portfolio. Given the country’s highly dollarized economy, the large share of US dollar currency debt in the portfolio 73 percent in 2020 cushioned the Government from extreme exchange rate movements. The policy to retain a larger share of US dollars debt continues at least in the short to medium term.

⁹ Further reference on this subject: “Guidance Note the Bank-Fund Debt Sustainability Framework for Low Income Countries”, February 2018.

Figure 29: US dollars debt vs non-US dollars debts

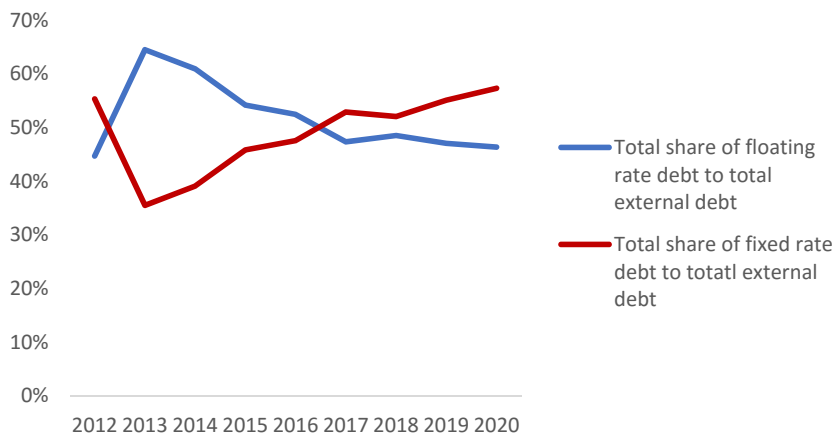


Source: Ministry of Finance, June 2021.

Interest rate risk – From 2013, the total share of fixed rate debt started to increase until it comprised the majority share of the debt portfolio, in 2017 and 2018 consecutively. The change occurred as a result of the ability of the Government in managing interest rate risk independently by converting the priority for disbursement from variable rate to fixed rate taken into account market interest rate fluctuation.

The cost of borrowing is expected to continue to rise as TL is now classified as a blend country¹⁰ and is slowly being phased out from concessional financing by its external creditors. To limit the exposure to interest rate shocks, there needs to expand the use of more concessional financing from bilateral loan providers.

Figure 30: Fixed vs Floating



Source: Ministry of Finance, June 2021.

¹⁰ Being a blend country, TL has a limited access to concessional lending with a fixed interest rate.

7.4.3 Current Project Status

There are currently 15 ongoing road projects funded by concessional loans of which 9 projects had already been completed. These include roads connecting Tibar-Liquica/Tibar-Gleno, Manatuto-Laclubar junction, Laclubar junction Natarbora, Manatuto-Baucau Solerema-Ainaro corridor and Hera-Manatuto. Other projects that most likely to be concluded by 2020/2021 are roads from Tasitolu-Tibar, Baucau-Lautem, and Maubara-Karimbala+Atabae- Motaain , bringing the total numbers of projects completion to 80% by end the year.

Total capital contribution made by this investment is \$429.85 m which is by a ratio of total investment, concessional loans accounted for approximately 63%. Of this, \$185.61 m has been disbursed leaving a balance of \$80.79m to be spent for next 1-2 years in accordance with project construction periods. On the other hand, state contribution to the overall budget of civil works contract was \$163.45m with an estimated remaining \$35.08m for further disbursement.

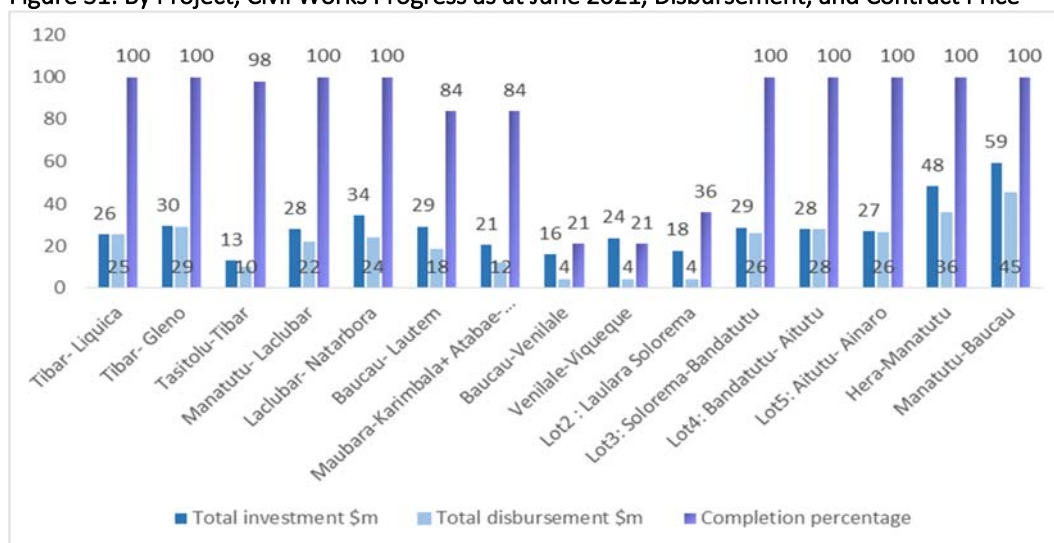
New projects include Gleno-Letefoho-Hatubilico road section, Water Supply and Sanitation for Baucau municipality and Basic Education Strengthening and Transformation (BEST). The key challenges in project implementation were mainly relating to the release of social safeguard documents by relevant line ministries including delay in environmental licensing and resettlements and payment delays. As for the latter, it explained the trends illustrated in the graph below, in which projects progress was relatively high, in comparison to disbursements.

Table 37: Total investment in Civil Works, \$millions

Source of Fund	Total Investment in Civil Works (USD\$ million)	Disbursement as at 30 June 2021 (USD\$ million)	Contract Balance (USD\$ million)
Loan Fund	266.40	185.61	80.79
State Contribution	163.45	128.36	35.08
Total	429.85	313.98	115.89

Source: Ministry of Finance, June 2021.

Figure 31: By Project, Civil Works Progress as at June 2021, Disbursement, and Contract Price



Source: Ministry of Finance, June 2021.

There is about \$40m loan saving from ADB ongoing loan-funded projects. The cost reduction increases year by year as a result of the number of participating bidders also increases in public procurement; hence, bringing down the co prices . This includes surplus in civil works, consulting services and unallocated loan contingencies. By projects, Baucau-Lautem/Maub-Karim/Atab-Motain contributed over \$20.04m in saving while other projects such as Manatuto-Natabora, Baucau-Viqueque, Manatuto- Baucau, and Tacitolu-Tibar accounted for the remaining balance.

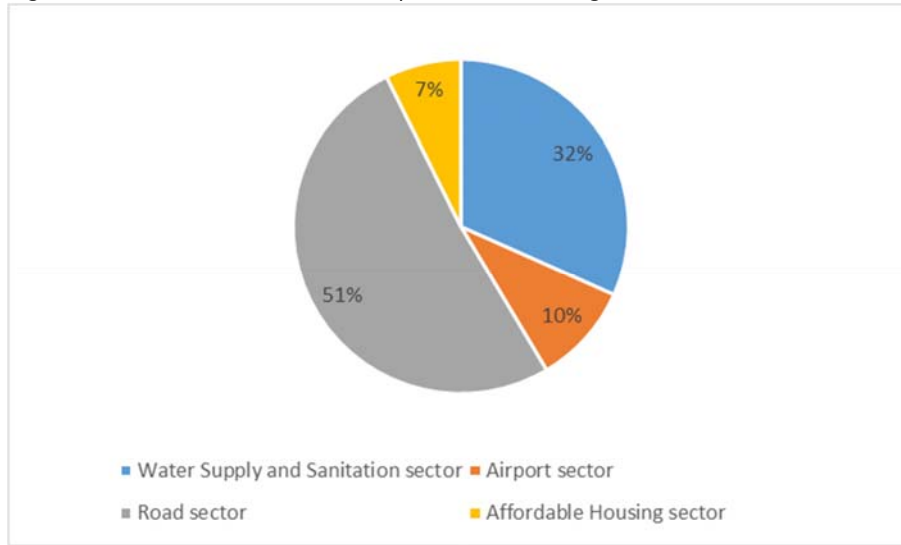
As a borrower, the Government can decide whether to fully utilise the saving or simply cancel the amount by complying with public debt law No.13/2011 and other relevant laws. For this purpose, the Government has already requested ADB to maximise the use of some of this saving to fund for the construction of three (3) bridges: Seical Bridge, Borouai causeway and Malailada causeway with a total estimated cost at \$14m a long Baucau-Lautem road section and mitigate the pressure on the state budget. Some amount have also been allocated to pay for detailed design for Lospalos –Viqueque road section project.

7.4.4 Future Loans

Infrastructure development would remain to play a key role in the country's economic development success in the medium term. New strategic sectors such as water, education, telecommunication, and air transports should receive concessional financing. This would help unleash the growth potential of other key economic activities; hence, inclusive economic growth and poverty reduction.

In this respect, annual loan ceiling is required for parliamentary approval, in the context of the State Budget Law, prior to implementing all these programs. The amount is set according to project cost estimates and debt sustainably analysis. On the DSA, based on the MOF internal analysis, the country's external debt stock to GDP remained relatively low in 2018 which is 9.2%. IMF staff completed the country's 2019 article IV consultation by stressing the need for making effective use of concessional borrowing for continued investment in infrastructure. In light of all the above, the Government is therefore, proposing a ceiling of \$410m for new concessional foreign loans to be negotiated in 2022.

Figure 32: Sectoral Allocation of Proposed Loan Ceiling for 2022



Source: Ministry of Finance, June 2021.

7.5 Public Private Partnerships

7.5.1 Overview of Public Private Partnerships in Timor-Leste

In general terms, the Public Private Partnership (PPP) refers to arrangements in which the private sector builds infrastructure assets and provides services that traditionally have been provided by the State. The underlying rationale for PPPs in Timor-Leste stems from the fact that, this arrangement may potentially allow the Government to benefit from the private sector's expertise, experience and financing, which then results in higher quality and efficiency, as well as lower risk borne by the Government. The government will also benefited from shifting the risks onto the private partner – for example, the risk of delays or cost run-ups in construction. Another advantage is the fact that the bundling together of the various stages of providing an infrastructure service creates the right incentives for the contractor to perform to a high standard. Should the same contractor is responsible for building, operating and maintaining a piece of infrastructure for a number of years, it will have an inherent incentive to build it in a way that optimizes the operation. Another advantage of proceeding with PPP arrangement is the fact that PPP contracts are typically output-based and extracting value-for-money through risk transfer to the private sector over the life of the project, rather than input-based as is generally the case with traditional procurement. This means that the Government is certain of paying for actually-functioning services that meet actual socio-economic needs.

Timor-Leste began exploring PPPs as a modality for project implementation over the last 8 years and started out by establishing a PPP Policy, PPP legislation and a dedicated PPP Unit under the Directorate General for External Resource Mobilization and Management, Ministry of Finance. The PPP policy establishes key principles of PPP, while the legislations (Decree-Laws no. 42/2012 as amended by Decree-Law no. 02/2014 and Decree-Law no. 08/2014) confirms the policy as formal process, sets a framework for enabling the public and private sectors to be parties in a PPP arrangement; define the powers of relevant agencies and regulates the procedures associated with the PPP Projects Cycle. All of these seek to ensure that only high-quality projects, which have high social and economic returns and which are aligned with the government's

strategic priorities, are considered for implementation through a PPP modality. For instance, the legislations on PPPs include a requirement that all PPP projects undergo both a pre-feasibility study and a full-fledged feasibility prior to proceeding to the procurement phase.

Decree Law no. 8/2014 stipulates the formation of PPPU or currently, National Directorate of PPP, a Directorate under the General Directorate of Management and Mobilization of External Resources under the Ministry of Finance to take on the task of facilitating, managing and implementing the PPP Project Cycle in coordination with line ministries and under oversight of the Council for Administration of Infrastructure Fund (CAFI). Another important role of the DNPPP is to promote and create environment for attracting foreign direct investment (FDI) through PPP modality, while at the same time looking for ways of encouraging local private sector involvement in PPP projects by pursuing policies and regulations that will allow for development of small to medium scale PPPs. One Sector that have high potential for this is the Tourism Sector.

7.5.2 Existing PPP Projects

Currently, one PPP project is in **Implementation and Operation Stage** (Tibar Bay Port PPP), one in **Procurement and Negotiation Stage** (Medical Diagnostics) while others in **Feasibility Stage** (Affordable Housing, Cristo Rei and Presidente Nicolau Lobato International Airport/PNLIA). Note that the PNLIA project is currently in the procurement stage for the phase one runway extension.

Tibar Bay Port Project

The PPP modality chosen for Tibar Bay Port was a 30-year concession, including the design, partial financing, construction, operation and maintenance of the port infrastructure. The project was awarded to a consortium comprised by Bolloré Africa Logistics and SDV Timor Leste through an international competitive bidding which formed the Timor Port SA (TPSA/Concessionaire) to implement it.

The concession agreement was signed on 3rd June 2016 between the GoTL and TPSA and the concession was awarded for 30 (thirty) years including a construction period which started on 30 August 2018 and expected to be completed by May 2022. The construction progress until end of July 2021 was 62.26%.

The Environmental License was awarded on 15 March 2018 and currently extended until 15 March 2022. So far there is no record of major environmental impacts resulting from the construction of Tibar Port.

The capital expenditure of the Phase-I is around \$280m. The Concessionaire will fund the majority of the amount by means of equity and debt and the GoTL has allocated an amount of USD 129, 45 million as Viability Gap Funding (VGF) to the Concessionaire. Until end of July 2021, the total amount disbursed from VGF was USD 64.725 million. Undisbursed amount is still in the Escrow Account.

The Escrow Account is earning interests. As of 31st July, 2021, interest earned amounted to **\$8.632m**, deposited in the Escrow Interest Account. The Escrow Agreement stipulated that the interest earned can only be transferred to the Government account after the closing of the Escrow Account and/or termination of the Escrow Agreement.

Medical Diagnostics

Medical diagnostics PPP is currently in preparation of tender documents and other necessary structures (e.g. accessible data room) which are the early steps in the procurement and negotiation Stage. The Feasibility Study and Transaction Structuring Report (TSR) have been approved by CAFI on 11 July 2019 with clearance issued by the Ministry of Health in June 2019.

The TSR recommended that the project upgrade imaging and laboratory diagnostic services in the National Hospital, all referral hospitals and 8 Community Health Centers (CHCs) to achieve a demand coverage of 98.2% of the total population. Concession period is recommended at 11 years to consist of 1 year of upgrading and construction of National Hospital, all referral hospitals and CHCs and 10 years operation period. The estimated of Government contribution will be about \$12 million during initial year of operation stage and will go up to 17.9 million per year for operation and maintenance of health diagnostic services.

It is estimated that the contribution of private sector will be around \$11 million for the upgrading or construction of facilities, operate and maintain Laboratory and Imaging centers and provide quality diagnostic services to patients in Timor-Leste. In addition, private sector also will employ and train diagnostic services staff, comply with local regulation and international best practices in health care service delivery. Potential bid parameter and bid evaluation criteria have also been recommended. However, the project is progressing at a slow pace since the beginning of 2020 due to various reasons, particularly with the coronavirus disease (COVID-19) outbreak. Given that Financial Advisory Service Agreement (FASA) has expired on June 2020, both Government of Timor-Leste and International Finance Corporation (IFC) conducted negotiation and agreed to sign the extension of FASA up to June 2022.

Affordable Housing

The pre-feasibility study for Affordable Housing PPP project has been completed, submitted and approved by CAFI to proceed with feasibility study. In December 2020, the Financial Advisory Service Agreement (FASA) document was signed between GoTL and IFC (*International Finance Cooperation*). By March 2021, a kick off meeting was conducted with IFC and its consultants. The Prime Minister dispatch for the creation of Working Group for land and property acquisition was signed in April 2021 with Ministry of Planning and Territory as chair of the Working Group. Moreover, due to the April flooding and severe impacts observed on the site, it was decided that additional hydrological study will be needed for the project with IFC securing additional grant from the Global Infrastructure Facility. Technical, legal, financial, environmental and social due diligence data collection is currently on-going with Inception Report expected in third quarter of 2021.

Development of Presidente International Nicolau Lobato Airport Pursuant to the decision of the Council of Ministers to develop the International Airport of Presidente Nicolau Lobato ("Airport") through PPP Hybrid modality - a PPP modality that refers to a combined financing arrangement whereby some components of the airport infrastructures are taken on by public investment through loan, grants and state financing, while some other components are taken on through private sector investment. The private sector may participate through finance, construct, and/or operate and maintain the assets. Implementation of the modality for the Airport development will start with public investment through the Engineering, Procurement and Construction (EPC) contracts to be funded with external debt from the Asian Development Bank (ADB) and JICA grant financing. Engagement with the private sector will

come at a later phase with the possibility of private partner for later phase construction, operation and maintenance of the entire airport.

The Feasibility study for several Airport components such as extension of the runway to 2.1 Km, aprons, partial parallel taxiway and control tower has been completed and the loan negotiation (in the amount of \$165 million inclusive government counterpart) for these components have also been concluded in May 2021. Meanwhile, preparatory studies for Terminal development and its sub-components are anticipated to commence in Q1 2022 and financed through the Japan International Cooperation Agency (JICA) grant for \$44 million while other support infrastructures are still subject to discussion with Department of Foreign Affairs and Trade (DFAT) and other donors. Preparatory works for tendering of the Project Management Consultancy (PMC), Design-Build (DB) contractor and Consultant Supervision Company (CSC) are also on progress.

Moreover, for the purpose of undertaking the technical and management for the execution of the Airport project as well as the day-to-day aspects of the project will be under the Integrated Project Management Unit (IPMU). One important element of preparatory works is the land and property acquisition to make way for runway widening and extension. Affected communities from the development will need to be compensated for their land, structures and productive vegetation before they vacate the land. Data survey and its verification have been concluded and approved by the Inter-Ministerial Commission in June 2021. First draft of the Land Acquisition and Compensation Support Plan (LACSP) was published on ADB's website in March 2021. The LACSP will be further updated based on the results of the Resettlement Cost Study (RCS) to be conducted by an independent consultant team recruited by ADB before a final compensation support plan is presented to Inter-ministerial Commission for appreciation and approval by the Council of Ministers.

On the PPP process, the implementation of phase 1 milestone II of the FASA with IFC is progressing well, and due diligence reports have been critically reviewed by the Project Evaluation Team (PET) for submission to National Development Agency (ADN) for review and issuance of recommendation prior to proceeding to payment and works for next milestone.

Cristo Rei PPP

The Cristo Rei PPP has finalized its pre-feasibility study through Grant financing from the USAID's Tourism for All (USAID's TFA) program. After approval of CAFI was secured for the Pre-FS in November 2020, the project is now in the next phase, which is the Feasibility Study preparation phase. The Feasibility Study continues to be coordinated between USAID's TFA, the Directorate General of Tourism under the Ministry of Tourism, Commerce and Industry (MTCI) and the DNPPP - DGMMER. Results of this study has been submitted to the Government in July 2021 and will be undergoing review by members of PET for the project. The scope of the PPP project will involve operation and maintenance of current Cristo Rei site with some repair and upgrade of existing facilities such as expansion of restaurant, pavilion and green space to take advantage of larger space created from moving the parking area to Areia Branca. Impacts from the Covid-19 pandemic has also been analysed in the feasibility study with conservative assumption taken, where it was assumed that the number of visitors will only reach pre-Covid level in 2025. A recommendation has been put forward for the PPP model, which is the Design, Finance, Build, Operate and Transfer (DFBOT) modality. Once the Feasibility Study/Business Plan has been fully reviewed and recommendations from PET has been fully addressed by USAID's TFA consultant, the next step is to bring the project for CAFI approval to proceed to the procurement phase.

Dili Port Redevelopment PPP

Dili Port is located in the prime area of Dili. It is a landmark as well as historical site built from the Portuguese time. With Tibar Bay Port to be in operation soon, the international cargo terminal operation will all relocated to Tibar. Dili Port will remain as passenger port providing point of disembarks and embarkation to ferry as well as cruise ships calling on Dili. The transfer of international cargo and terminal operation create opportunities to redevelop the port into an iconic site that will enhance the appeal of Dili as tourism destination.

APORTIL - Ministry of Transport and Communication (MTC), DGGMRE-DNPPP and MTCI in collaboration with USAID's TFA have developed the Redevelopment Options Study for Dili Port with the aim of redeveloping the Port into a mixed use urban waterfront development incorporating the passenger operation with marina, hotels, apartment and commercial areas. The development will take into account the historic and prime urban characteristics of the development aiming to ensure a seamless incorporation of the plan into the historic surrounding areas. Dili Port Redevelopment PPP will be brought in front of Council of Ministers for determination of Government's preferred options for redevelopment. It will then be brought to CAFI for incorporation into the PPP project cycle and PET establishment.

7.5.3 New Initiatives

Tourism PPP

The impacts of the Covid-19 pandemic has significantly disrupted global economy but it is especially severe to the Tourism sector due to the travel restriction and other limitation imposed to curb the spread of the disease. The World Travel and Tourism Council (WTTC)¹¹ estimated that by the end of 2020, Tourism sector only account to 5.5% of the total global GDP, a significant reduction from the 2019 level which was estimated at 10.4%. The WTTC also estimated that whereas in 2019, tourism and travel account 334 million jobs, the number is seeing 18.5% reduction in 2020. During the pandemic, spending in the sector is also changing. Total spending is showing a reduction between 2019 and 2020, from USD 4,295 Billion (in 2019) to USD 2,360 Billion (in 2020). Between these two years, data from WTTC is also showing a changing trend, whereas in 2019, international tourism account to 28.3% of total tourism and travel spending, in 2020, its share is reduced to only 18% globally. This changing trend is showing the importance of robust domestic tourism to help cushion the effect of international tourism decline in force majeure events such as pandemia.

The socio-economic implications of this situation will definitely be far reaching, however, tourism sector is in a unique position where it will become the beneficiary of eventual stabilization as well as a key driver of economic recovery. It is also believed that lower long term interest rates induced by the pandemic will likely be prevalent for the foreseeable future providing favorable terms for bankable development projects. For Timor-Leste, where Tourism has been identified as one of the co-pillar of long term economic strategy (National Tourism Policy), it is therefore important to invest in this sector for the purpose of reviving lost jobs while

¹¹ World Travel and Tourism Council, Global Economic Impact Record

creating new ones and realizing the potential for multiplier effects through stimulating investment and supporting supply chain linkages.

DNPPP-DGGMRE will continue to collaborate with MTCI and development partners to pursue new PPP initiatives in the sector, prioritizing feasible projects and employing tools such as a separate regime for feasible small and medium sized PPPs and where found necessary, pursue bundling up of projects to increase economy of scale – all within the context of creation of network and synergy with neighbouring region including Indonesia, Darwin and others. The creation of a separate regime for small and medium sized PPPs will also allow for more streamlined process for projects that are smaller in size.

Other New PPP Initiative

Potential PPP projects in will continued to be explored in other potential sectors. Criteria for these projects include:

1. Alignment with VIII Government Program and Priority
2. Potential to realize better value for money
3. Preparation of business case for the projects
4. Projects meeting preliminary requirements to technical, legal, economic, commercial, social and environmental aspects

While continued emphasis is being put to new initiatives in Tourism sector, potential PPP projects in other sector will also be developed. Continuous collaboration with International Finance Corporation (IFC), USAID's TFA, ADB and the World Bank will be pursued for projects including those in the technical and vocational education and training, transport, agriculture and other sectors. These preliminary list of PPP projects will be discussed and coordinated with relevant line ministries before being presented to CAFI for approval in accordance with the PPP project cycle.

7.6 Direct Budget Support

Timor-Leste has been receiving Direct Budget Support (DBS) from the European Union since 2014. The latest agreement was signed in 2016 under the 11th European Development Fund.

EU DBS is considered as a financing for 2021 State Budget because it uses Government system (the money is in a Treasury sub-account) and on-budget, where the money is used directly by the beneficiary ministries for the public financial management program (Ministry of Finance), Malnutrition (Ministry of Health) and decentralization (Ministry of State Administration).

In this context, the funds are directly given to the country's government without prior earmarking. However, a variable tranche depends on specific Key Performance Indicators (KPIs) agreed upon by the Ministry of Finance and the EU. While the funds are not separate or additional to the Ministry's core business, they must support clearly stated priorities and the Ministry's own planning framework.

Total amount of DBS from the EU for 2022 State Budget is currently forecast \$8.96 million. Of this, \$2,240,000 allocated to Ministry of Health, \$2,800,000 for Ministry of State Administration and \$3,920,000 to the Ministry of Finance.

In 2021, the Government of Australia committed to \$8.2 million in Direct Budget Support to be allocated over the next two years. The funding is linked to the National Village Development Program (PNDS) and the expansion of the Bolsa Da Mae social assistance programme to include pregnant women and early childhood (Bolsa Da Mae Jersaun Foun) as approved in the Council of Ministers in February 2021.

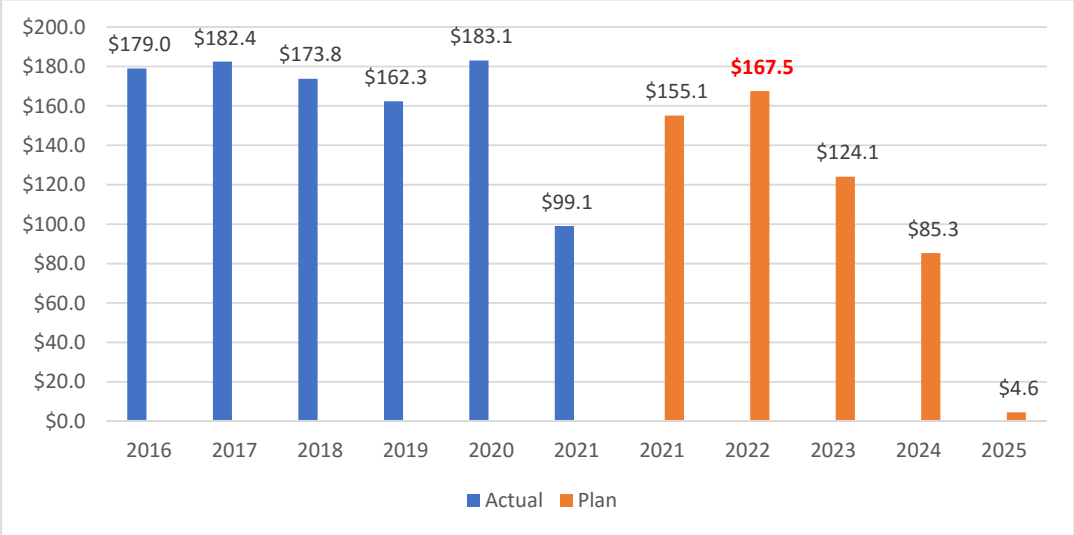
The PNDS investment will focus on funding new community investment programmes, particularly those focused on improved sanitation, draining and irrational channels and local road rehabilitation. The Bolsa Da Mae Jersaun Foun investment will concentrate on directly funding cash transfers as well as supporting the operational costs of the programme delivery. The indicative allocations imply that PNDS will receive \$3.3m in 2022 while Bolsa Da Mae Jersaun Foun will be given \$3.3m in 2022 and \$1.6m in 2023.

Total amount of DBS for 2022 State Budget is currently forecast at \$15.6 million.

7.7 Development Partners

The amount of ODA to Timor-Leste exceeded US\$150 million from 2016 on. Development partners are reporting a projected total of \$167.5 million in disbursements in 2022. Development Partners’ support is forecasted to experience a \$12.4 million increase as compared to 2021 planned figures.

Figure 33: Development Partner Non-lending Assistance 2016-2025, \$millions



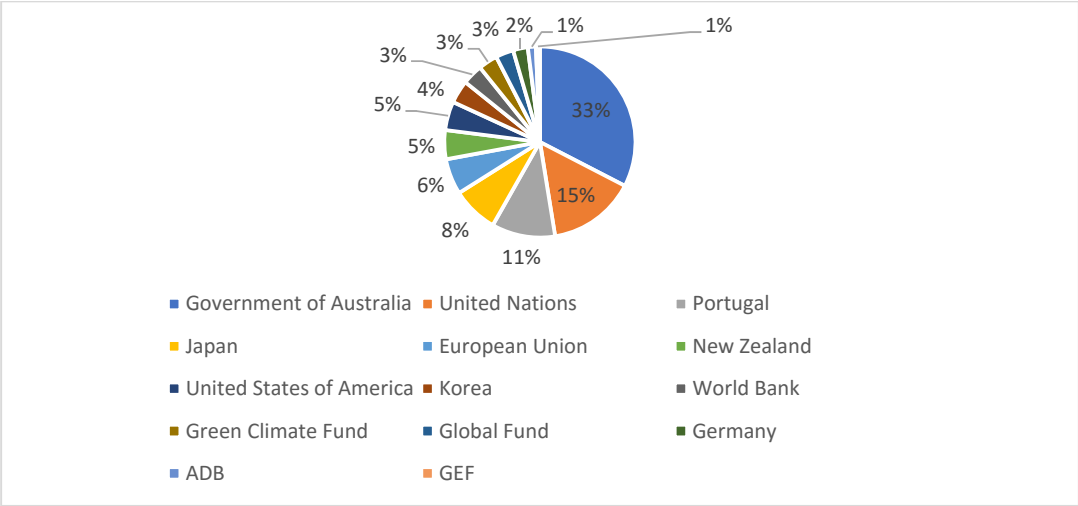
Source: Aid Transparency Portal, 28 September 2021.

It is important to note that these figures do not include the European Union’s Direct Budget support modalities, which potentially amount to \$9.0 million, nor does this figure include Australia’s support to PNDS and the Bolsa de Mae Jersaun Foun programs, which amount to \$6.4 million. These significant contributions are not included in this budget book as they are already accounted for and included directly in the state budget elsewhere.

Additionally, forecasted funding more than one year in advance is typically unreliable. This is due to several reasons, most notably due to the fact that many donors operate on single year budgets. The dramatic decline in funding shown in the future years above is based on data collected at the project level, thus it does not include donor’s funding that has been secured yet not committed towards specific projects. For example, the Millennium Challenge Corporation’s upcoming Compact is not included in these figures even though they are likely to contribute significantly towards the donor funding landscape.

In 2022 the five donor groups that are scheduled to disburse the highest amounts of funding are as follows: Government of Australia (\$54.6 million; 32.6% of total), the United Nations (\$24.8 million; 14.9% of total), Portugal including funding from Camoes (\$18.0 million; 10.8% of total), Japan (\$13.1 million; 7.8% of total) and the European Union (\$10.1 million; 6.0% of total). Please refer to Part 5 for a detailed summary of donor and executing agency disbursements. It is also important to note that these calculations do not include Direct Budget Support from our development partners, namely the Government of Australia, though PNDS and Bolsa de Mae, amounting to \$6.4 million and the European Union’s Direct Budget Support programs totaling \$9.0 million.

Figure 34: 2022 Planned Non-lending Disbursements by Donor Group, %



Source: Ministry of Finance, October 2021.

The table below provides a snapshot of the scheduled top funded donor projects and programs in 2022. Australia is responsible for five of the ten projects with the highest levels of scheduled funding. The combined total of the top ten projects represents 35.4% of all expected disbursements in 2022.

Table 38: 2022 Top 10 donor projects with highest scheduled non-lending disbursements

Project Title	Development Partner	SDP Sub-pillars	2022 Total, \$millions
5530-Escola Portuguesa Ruy Cinatti – Centro de Ensino e Língua Portuguesa	Portugal	Education and Training	8.4
Australia - Timor-Leste Partnership for Human Development - Health Sector	Australia	Health	8.3
Australian NGO Cooperation Program (ANCP)	Australia	<ul style="list-style-type: none"> • Agriculture • Health • Social Inclusion • Justice • Water and Sanitation • Public Sector Management and Good Governance • Education and Training 	7.6
Ai ba Futuru - Partnership for Sustainable Agroforestry Project (PSAF)	GIZ with Germany and EU funds	Agriculture	7.1
Safeguarding rural communities and their physical assets from climate induced disasters in Timor-Leste.	UNDP with Green Climate Funds	Rural Development	5.5
10383 - Escolas de Referência de Timor-Leste - Centros de Formação	Portugal	Education and Training	5.2
Partnership to Strengthen Village Development and Municipal Administration (PARTISIPA, formerly PNDS-SP)	Australia	Rural Development	5.2
Governance for Development	Australia	Public Sector Management and Good Governance	4.9
Timor Leste Police Development Program (TLPDP)	Australia	Security	3.6
Timor-Leste: Sustainable Agriculture Productivity Improvement Project (SAPIP) - P155541 - TFOA2869 & TFOA0236	World Bank	Agriculture	3.6

Source: Ministry of Finance, October 2021.

The General Directorate for Resource Management and Mobilization is pleased to contribute to the increase in direct budget support and budget support that has been occurring in recent years. In 2022, the Government of Australia will become the second donor whose funds will be placed directly onto the Government of Timor-Leste's budget. We hope to continue to contribute to and see an increase in this trend in the next coming years.

8 Public Financial Management

8.1 What is Public Financial Management (PFM)?

PFM refers to the set of laws, rules, systems and processes used by sovereign nations (and sub-national governments) to mobilise revenue, allocate public funds, undertake public spending, account for funds and audit results. In simple terms, it's how governments manage public resources. This includes all phases of budgeting, processes and procedures related to expenditure management, resource mobilization, and debt management. It is the framework for governments to consider the medium- to long-term implications of today's policy decisions and assess potential risks. Strong PFM is essential because it boosts the public's confidence and trust in government. Poor PFM allows waste, encourages corruption, reduces the ability to collect taxes, and has an adverse impact on services, the rest of the economy and investor perceptions of the country.

8.2 Timor-Leste's PFM priorities Roadmap 2021-2023

The reform of public financial management has been a stated goal for successive national governments in Timor-Leste.

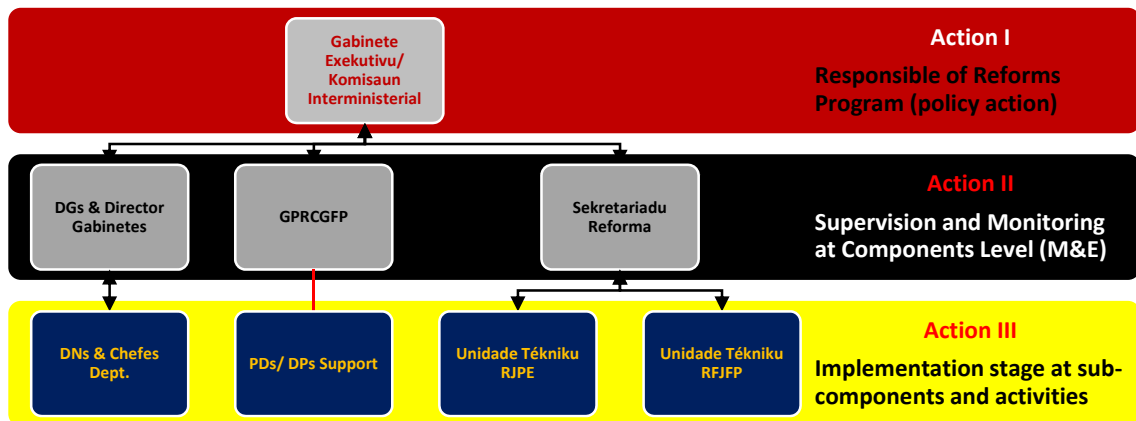
The reform of public finance management will be carried out through financial diversification in the areas of income and expenses, improving procurement and strengthening financial decentralization and budgeting based on the program.

Timor's PFM Road Map priorities main goals are:

- i) To enhance resource mobilization, improve planning and budgeting, improve budget execution, and strengthen accountability for quality, effective and efficient service delivery;
- ii) To improve and strengthen efficiency and effective management of non-financial state assets in accordance with international standards.

Timor-Leste has committed to improving how it manages public resources and continues on a journey to progress them. We have already seen TL's journey for introducing programmes budgeting, in addition, TL has completed two public expenditure reviews with the World Bank to examine inefficiencies in the budgeting process and how to improve efficiency and service delivery. A commitment has also been made to move towards Medium Term Expenditure Frameworks, budgeting for multiple years, so far pilot workshops have been undertaken to assist line ministries in costing programmes in the medium term with the aim to be applied in all institutions by 2023. Timor's ambitious goals also include: improving the fiscal framework; developing fiscal rules; improving management of PPPs and reform of domestic revenue.

Figure 35: Flowchart of Responsibility of PFM Reforms



Source: Ministry of Finance, August 2021.

8.3 Law on the Framework for the General State Budget and Public Financial Management

The Council of Ministers met in December 2020 and January 2021 and approved a draft of the new Framework Law on General State Budget (GSB) and Public Financial Management to present to Parliament. The proposed new law would replace and aims to improve on Law No 13/2009 which describes the processes for developing, enacting, executing and auditing the General State Budget. The proposed law should be enacted in time for the execution of OJE 2022.

Key features of new GSB and PFM law:

The current proposal has two objectives: to streamline public management and, at the same time, to increase transparency, responsibility, accountability and control of the services and entities of the Public Administrative Sector. The proposal now presented chooses to make substantial changes in some essential aspects of the fiscal framework and public financial management, while in other aspects where no need for change was identified, it will accept the existing law.

Key features of the proposal include:

- Enshrining program budgeting as a means of preparing and organising the General State Budget, adding substantial elements of planning to all phases of the budgetary process
- Adopting a “two-step” budget process, with a “Grand Planning Options” law approving the budget ceiling at the start of the budget process in May and the General State Budget law approving the budget allocations in October. This will allow the Parliament to have an early input on the budget ceiling and the main priorities of the budget, while giving the Government a general blueprint to prepare the more detailed General Budget Law. In addition, by locking the budget ceiling at the start of the budget process, it guarantees that the definition of the ceiling will be based on an assessment of the

existing financial resources and fiscal sustainability considerations, and not solely on the needs and demands of LMs and institutions based on their needs.

- Establishing a new budget calendar, starting in May, and advancing the date of presentation of the General Budget Law from October 15 to October 1st, to avoid extending the previous year Budget Law, as it has happened four times in last six years.
- Setting new budget balance requirements and controls, namely on recurrent expenditures.
- Establishing new rules on execution of revenue and expenditure when a General Budget Law has not been approved by the Parliament, avoiding the existence of a fiscal cliff.

Table 39: Proposed Budget Calendar and Key Milestones according new GSB and PFM Law

Date	New Calendar
10/05	Government presents draft Grand Planning Options law
30/05	Parliament approves Grand Planning Options law
30/06	Jornada Orçamental
15/07	Government approves detailed budget ceilings
20/07	MoF issues circular on General Budget Law preparation
15/09	Government approves draft General Budget Law
01/10	Government present draft General Budget Law to the Parliament
15/11	Parliament approves General Budget Law

Source: Ministry of Finance, August 2021.



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