

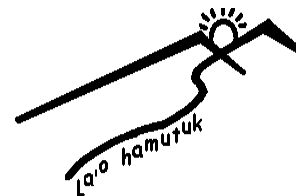
# La'o Hamutuk

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**Submission to**

**Committee D**

**Agriculture, Fisheries, Forests, Natural Resources and Environment  
National Parliament, Democratic Republic of Timor-Leste**

**From**

**La'o Hamutuk**

**Regarding the**

**Proposed General State Budget for 2011**

**3 December 2010**

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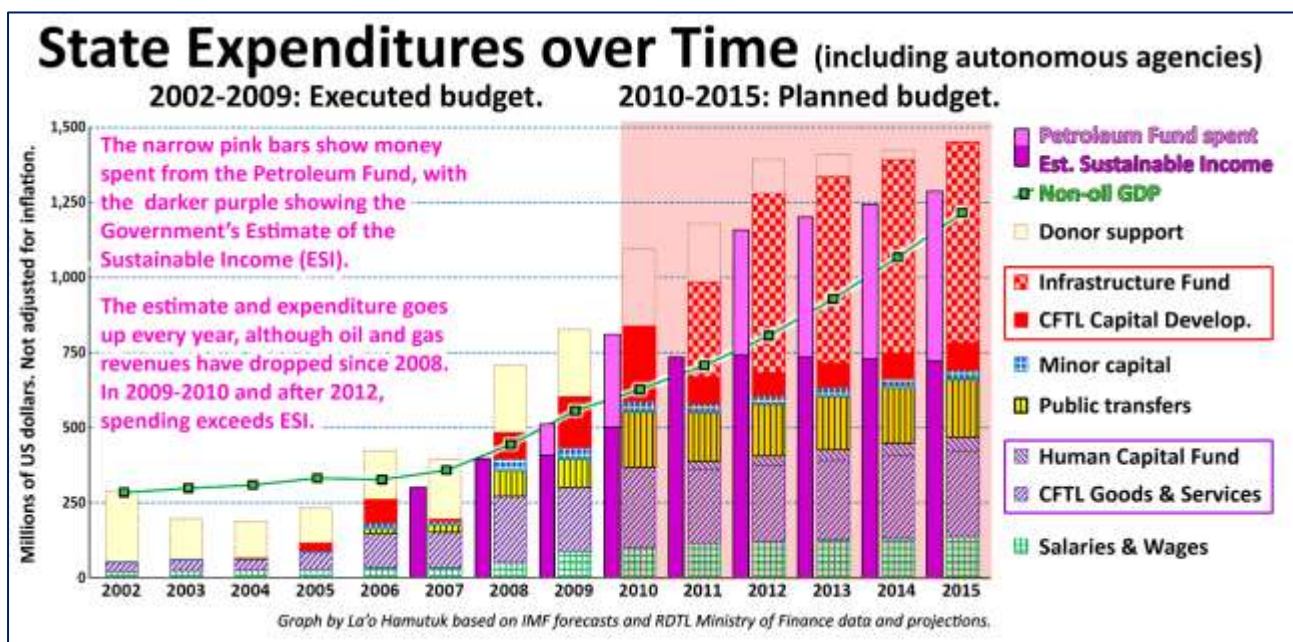
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La'o Hamutuk appreciates the invitation from Committee D to present at your hearing last Friday, and we wish you well in your work to analyze and comment on the complex State Budget for 2011, in spite of the difficulties in obtaining complete information. We apologize for not having had a written submission at that time, and hope that this submission will help clarify some of the concerns that we raised, as well as some of the questions and issues mentioned by members of Committee D during the hearing. If you have any questions or would like to discuss these issues further, we are more than willing to do so.

**Spending at this level is unwise and unsustainable.**

The proposed budget would expend \$985 million of Timor-Leste’s money next year, including \$734 million to be transferred from the Petroleum Fund during 2011 and \$141 million to be carried over from unspent 2010 budget funds, nearly all of which came from the Petroleum Fund. In other words, 89% of this budget is financed by extracting and exporting Timor-Leste’s non-renewable oil and gas wealth and converting it into dollars.

The 2011 budget represents a large increase in expenditures over the last several years, an increase which the Government wants to continue in the future. Between 2006 and 2012, the State Budget will have grown by a factor of five, from \$262 million to \$1,280 million, an average annual increase of 30%. But the benefits to Timor-Leste’s people have not increased five-fold.

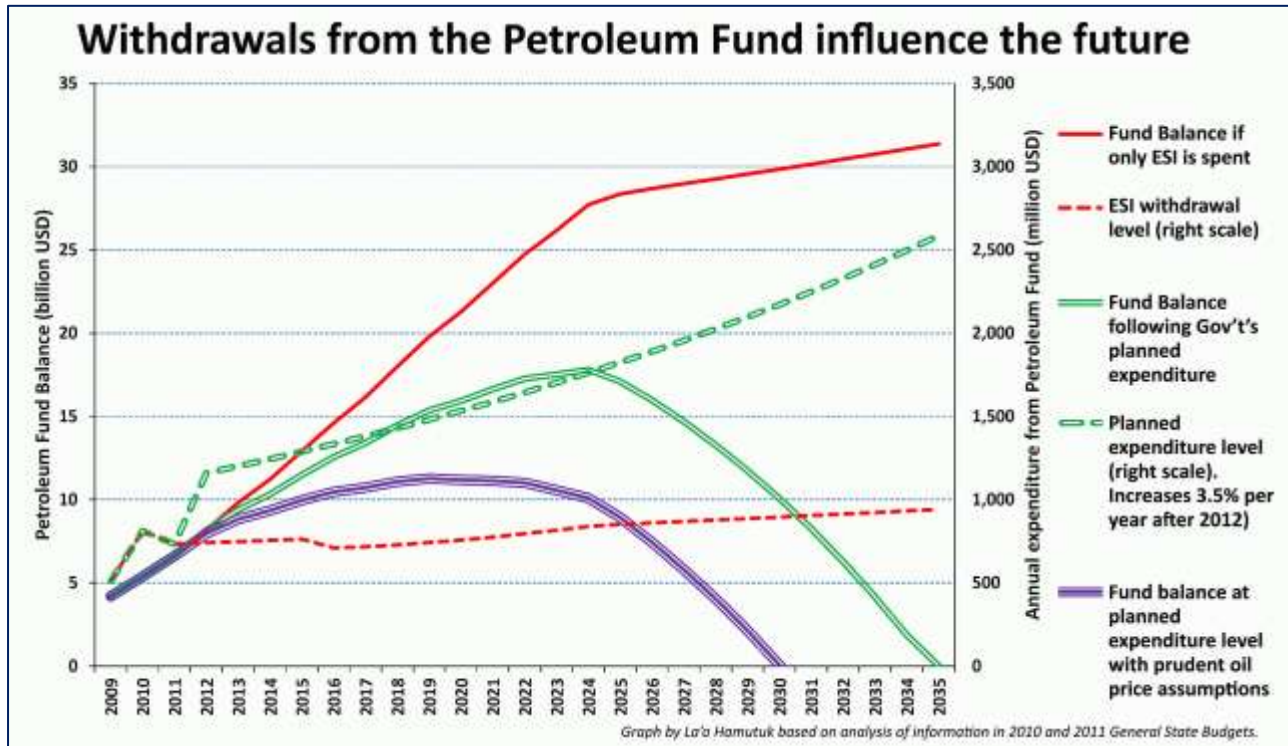


As the graph above shows, the 2011 budget is a major increase over 2010, and 2012 will be even higher. We believe that the budget does not adequately consider where this money is coming from. The budget documents demonstrate that the Government’s does not realize that if the state spends more money from the Petroleum Fund in the short term, less will be available for the future.

In tables 5.8 and 5.9 of the Revenue chapter of Budget Book 1, future balances in the Petroleum Fund and the Estimated Sustainable Income are projected assuming that the Government will only withdraw the ESI amount every year. The Government makes optimistic predictions about future world market oil prices, and assumes that the investments from the Petroleum Fund will earn 4%

more than inflation. In this case, the amount in the Petroleum Fund gradually increases, reaching \$14.6 billion by the end of 2015 and \$31.7 billion by 2035.

This is shown in the graph below, with the dashed single red line (right-hand axis) indicating the amount withdrawn from the Fund every year, and the solid single red line showing the balance in the Petroleum Fund.



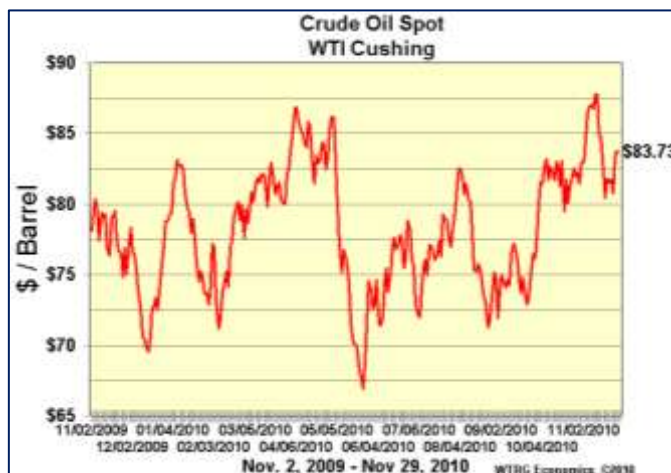
However, table 4.2 in the Expenditure chapter of Budget Book 1 explains that the Government plans to withdraw \$418-\$526 million more than ESI from the Fund every year starting in 2012 on (dashed double green line), settling down to a 3.5% annual increase in withdrawals after the 2012 election. In this case, the balance in the Fund (solid double green line) is \$12.6 billion at the end of 2015 and begins to decline in 2025. The Fund will be used up by 2035 if no new oil or gas projects come on-line to replace Bayu-Undan and Kitan.

### The budget makes imprudent assumptions about oil prices.

In the proposed 2011 budget, the Government assumes that future world market oil prices will be about 50% higher than they assumed in the 2010 budget, an assumption that La'o Hamutuk believes violates the Petroleum Fund Law's requirement that "all assumptions made shall be prudent."<sup>1</sup> The higher price assumptions are used in the two scenarios discussed above. If one recalculates the data based on the oil prices assumed in the 2010 budget, with the level of expenditures in the 2011 budget, the balance in the Petroleum Fund (triple purple line in the graph) is only \$10.5 billion at the end of 2015, and the fund will be entirely exhausted by 2030. The Government which takes office in 2017 will have \$13.9 billion in the Fund, as compared with \$17.1 billion if spending had been within sustainable levels.

<sup>1</sup> Schedule 1 to Law no. 9/2005, paragraph V: "All assumptions made shall be prudent, reflect international best practice and be based upon internationally recognized standards." The Law's Preamble and Article 11.4 also state that "The Petroleum Fund shall be managed prudently..."

As the graph at right shows, global oil prices fluctuate every day. Nobody can predict accurately what they will be in six months, let alone a decade. Nobody in the world predicted the \$145 peak and \$30 trough that occurred during 2008. This is why the Petroleum Fund Law requires conservative assumptions – it is safer to guess too low and have extra money in the Fund than to guess too high and deprive our children of benefits from Timor-Leste's non-renewable resources.



The oil prices assumed in the 2011 Budget increase every year after 2011, reaching \$114 per barrel in 2025, leading to an Estimated Sustainable Income of \$734 million. La'o Hamutuk believes it would be better to continue to use the price assumptions in the 2010 budget, which increase to \$70/barrel in 2025, and would produce a 2011 ESI of \$527 million according to the Government's other assumptions.

### **The Ministry of Agriculture doesn't reflect farmers' challenges.**

The Ministry of Agriculture and Fisheries (MAP) receives an allocation of \$12,909,000 for 2011. If this were divided among all Timorese farm families, about 87%<sup>2</sup> of this country's population (about 927,926<sup>3</sup> people), each person would receive \$1.16 each month. This is a very small budget, if we think that this sector is the future of Timor-Leste.

We believe that the Ministry's Action Plan for 2011 doesn't reflect MAP's own objectives to increase farmers' income. MAP's plan doesn't reflect the realities confronting grassroots farmers. These include:

- Difficult to sell their products.
- Difficult to increase the price of their products.
- Difficult to adapt themselves to climate change.

We are also concerned because although MAP's Action Plan intends to improve Timorese people's lives, it doesn't have a clear action to promote our own resources. MAP has no concrete plan to develop local seeds, develop organic fertilizer and local pesticides, to use the extensive experience we find at the grassroots. Construction of agricultural infrastructure often doesn't involve local communities or farmer-landowners.

We recommend that MAP also includes in its action plan:

- How to increase farmers' capacity to process their production, access markets, and financially manage their revenues.
- A concrete plan on how to improve farmers' and MAP's capacity to adapt to climate change.

<sup>2</sup> Speech by the Minister of Agriculture at the launching of *Relatoriu Mudansa Klimatika SoL*, MAP, Comoro, 27 October 2010.

<sup>3</sup> Based on preliminary results from the 2010 Census of population.

- A concrete plan to promote organic agriculture, especially to develop local seeds, fertilizers and pesticides.
- Beginning to develop legislation and policies to promote local products, and to limit importation of foreign agricultural products.
- Involving farmers and land-based communities in all Governmental processes of planning, implementation and monitoring of projects, to encourage such projects to give long-term benefits to the community.

### **The “Tasi Mane” project is a troublesome foot in the door.**

This budget allocates \$36 million from the Infrastructure Fund for the “Tasi Mane” south coast petroleum infrastructure corridor, but that is only the initial payment, primarily for designs and studies. Like other multi-year projects in the Infrastructure Fund, no information has been provided about the total costs of these projects, including construction, operation and maintenance, which could be in the many hundreds of millions of dollars.

Furthermore, nothing is said about how many jobs these projects will provide for Timorese workers, how much land they will take away from uses such as agriculture and fishing, how many people will have to be displaced, or how much revenue they will generate for the state. We understand that detailed designs will be required to give precise projections of these figures, but preliminary estimates are essential to deciding whether they should be undertaken at all. If Parliament does not receive such information in a credible and accessible form, we urge you not to give the Government a “blank check” for a project which may turn out to be useless or have negligible benefits.

Projects like those envisioned for “Tasi Mane” are often undertaken by private investors and industries because they can be profitable in many situations. Government support is appropriate to encourage private investors and to ensure that they don’t encounter regulatory difficulties, and some public money may be needed to attract private companies to a marginal project. However, if these projects were expected to make money, investors would be implementing them already.

We are also concerned about the amount of Timor-Leste’s money being spent on research and studies related to a possible onshore LNG plant for the Greater Sunrise gas and oil field. The 2010 rectified budget included \$3.1 million “for studies in Beaçu by marine specialists”, and last month the Council of Ministers awarded a contract to Toke-EGS for this work.<sup>4</sup> The proposed 2011 budget allocates \$23.6 million for “oil and gas infrastructure” to be spent from the Infrastructure Fund during 2011, including \$5.8 million for “Detail site survey, design, and supervision of southern cost development of Beaçu” and another \$3.5 million for “pipeline route analysis.”

If these are approved, Timor-Leste will spend at least \$12.4 million for a project that may never happen. Although the Timorese public and the Government want the Sunrise gas to be piped to an onshore LNG plant in Beaçu, the Sunrise project’s operator (Woodside Petroleum, working under contracts signed in 2003, the Timor Sea and CMATS Treaties, and the International Unitization Agreement, all legally binding commitments of the Timor-Leste government) is uncooperative. Woodside remains committed to a mid-sea floating LNG plant, which it believes is the most profitable option. It seems unlikely that Woodside will believe Timor-Leste’s studies more than its

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<sup>4</sup> According to *Suara Timor Lorosa’e*, 2 December 2010, the Secretary of State for Natural Resources said that this contract is for \$6.6 million. Perhaps it includes both the 2010 appropriation and funds not yet approved for 2011.



own research, or that additional information from Timor-Leste will change Woodside's view that a Timor-Leste onshore LNG project would earn the companies \$2 billion less than a floating project. If Woodside is not persuaded, the project will remain stalled, and Timor-Leste's \$12.4 million or more will have provided work for foreign consultants and contractors, but no benefits for our people.

The Government often discusses the need to move Timor-Leste's economy, including state revenues, away from our overwhelming dependence on oil and gas. The "Tasi Mane" project, however, is still in the oil and gas sector, and will become useless when our finite petroleum reserves have been used up in 15-40 years. It would be much better for Timor-Leste's future economic growth for major infrastructure projects, especially those paid for with the people's money, to directly benefit our population, rather than to provide services for international oil companies who will be here for only a few decades.

If the main objective of the "Tasi Mane" project is to provide jobs for Timorese workers (even if it loses money), shouldn't those jobs contribute directly to the lives of Timorese citizens by improving health care, education, rural roads and water systems, electricity, housing, or other services that people across this country desperately need?

### **The PETRONATIL National Oil Company is dangerous and problematic.**

Although it is not clear in the budget law, the proposed 2011 Stage Budget includes a \$2 million transfer from the SERN budget to establish PETRONATIL, Timor-Leste's state-owned oil company.<sup>5</sup> The decree-law for this new entity is currently being considered by the Council of Ministers.<sup>6</sup>

We believe that PETRONATIL should be created by Act of Parliament, not by decree-law, and that its budget should be approved by and overseen by Parliament. Unfortunately, the draft decree-law envisions otherwise, and would exempt this agency from Parliamentary oversight and transparency, while giving it powers to take out loans; invest in overseas projects; spend petroleum revenues (bypassing Petroleum Fund and Parliamentary budget processes), ignore civil service, procurement and salary rules; and open opportunities for corruption and abuse of power.

Since this may be Parliament's only opportunity to participate in the decision to establish PETRONATIL, we urge you to use "the power of the purse" to encourage the Government to create a more transparent, accountable, democratic, responsible and less risky state-owned oil company which will serve the interests of Timor-Leste's people.

### **The Institute for Petroleum and Geology should be a normal Government department.**

We cannot tell if the budget appropriates initial capital for the Institute of Petroleum and Geology (IPG), a new autonomous agency (*Instituto Publico*) which the Government hopes to create soon by decree-law. Perhaps its funding (as well as the subsidy for the National Petroleum Authority) is concealed in the \$4.3 million of SERN public transfers (\$2 million of which is allocated to

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<sup>5</sup> This expenditure is not mentioned in Budget Books 1-5 or the Budget Law, but it is in the Explanatory Memorandum as a main item in the Public Transfers category.

<sup>6</sup> For information on PETRONATIL, including the draft decree-law, see <http://www.laohamutuk.org/Oil/PetRegime/NOC/10Petronatil.htm>. We are appending our submission to SERN (also at <http://www.laohamutuk.org/Oil/PetRegime/NOC/LHSubPetronatil24Nov2010En.pdf>) so that Committee D can have a better understanding of the dangers and lack of planning behind this initiative.

PETRONATIL) or the \$1.2 million SERN will spend on “professional services.” We hope that Committee D is able to get more clarity about the Government’s funding for the ANP and IPG.

La'o Hamutuk feels that the draft IPG decree-law is unnecessary and risky.<sup>7</sup> We support the establishment of an effective state organ to collect and manage information about Timor-Leste’s geology, including our mineral and petroleum resources, but we believe that it should be done through normal government structures, and subject to standard processes for hiring, salaries, procurement and contracting. It should not be empowered to take out loans or enter partnerships or investments with private companies.

### **The Infrastructure Fund undercuts Parliamentary authority.**

When Parliament approved the Budget and Financial Management Law (Law No. 13/2009) last year, you probably didn’t expect that more than a third of the state budget would be moved into “Special Funds” created under article 32 of that law. As that article explains, such funds carry over from year to year, and the Minister of Finance (with approval from the Council of Ministers) can change what they are allocated for, provided that Parliament is informed. In short, Parliament’s power to enact and oversee much of the state budget will be surrendered to the Council of Ministers.<sup>8</sup>

The Infrastructure Fund is intended to facilitate the implementation of the National Strategic Development Plan (PEDN), which may eventually be submitted to Parliament for approval. The Government has not yet released a draft of the PEDN, and the Prime Minister discussed only its objectives during his subdistrict socializations, with no information about implementation, cost or timing. Therefore, we believe it is too early for Parliament to approve hundreds of millions of dollars to execute the PEDN. After the Plan has been amended and approved by Parliament, the Government can ask for the Infrastructure Fund to be created, and a budgetary allocation can be made for it in a 2011 mid-year Budget Rectification or in the 2012 General State Budget. These are major decisions with long-term impacts on Timor-Leste’s people, and should not be done in haste.

The largest part of Infrastructure Fund spending for 2011 is \$166 million for the troublesome Heavy Oil power plants and national electric grid, which have been through numerous design changes, contract revisions, and supplier reassignments since the project started in 2008. Timor-Leste spent nearly \$100 million for this project in 2008-2010, and the total cost will be more than \$600 million. The original promise to provide 24/7 electricity to all district capitals by the end of 2009 is long forgotten; it is clear that the current promise to complete the entire project by the end of 2011 will not be met. We encourage Parliament to think carefully before allocating unlimited funding to this challenging project, and to insist that the Government provide more complete information about past and current activities, and about future plans, management and total project cost.

The proposed General State Budget Law for 2011 may be the only opportunity for Parliament to exercise its competence with regard to the Infrastructure and Human Capital Development Funds, as once they have been created, all authority will go to the Ministers. In fact, the Infrastructure Fund could be seen as an attempt to constrain whoever wins the 2012 election, by beginning projects which will be difficult to modify even if the voters change the Government.

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<sup>7</sup> Our submission regarding the draft IPG Decree-Law is attached and also available at <http://www.laohamutuk.org/Oil/PetRegime/NOC/LHSubIPG25Nov2010En.pdf>

<sup>8</sup> This is reinforced by article 9.4 of the proposed General State Budget Law for 2011.

We urge you not to approve the Infrastructure Fund until you have received the following:

- Estimates of the total cost of each project to be implemented, including design, construction, operation and maintenance, broken down by year. Article 3.3 of the Budget and Financial Management Law requires that such information be provided for 2011 and 2012. Although the budget documents provide it only for 2011, Parliament should require information for as long as each project will require state funds.
- Timetables for design, construction and completion of every multi-year project.
- Detailed information on the progress of the national electric generating stations and power grid, including all contractual and design changes undertaken since the Prime Minister's letter to Parliament in November 2009, as well as a revised schedule and cost projections.
- A legally-binding commitment that the projects promised to Parliament in the budget documents will be built unless Parliament approves a reallocation of funding.<sup>9</sup>
- A promulgated Parliamentary Law approving the National Strategic Development Plan.
- A promulgated Decree-Law establishing the National Development Agency (ADN).
- A promulgated law describing the procurement process which will be used for the very lucrative, complex Infrastructure Fund projects, including detailed Terms of Reference, open and transparent tenders, and publicly announced contract awards.

The Infrastructure Fund creates a new state agency in an effort to repair a deficiency in governmental function: the inability to execute infrastructure projects. This Fund reverses the trend to distribute project management authority from line Ministries to local authorities (through PR and PDD), centralizing it in the yet-to-be-created ADN and EPIA. Structural changes cannot fix fundamental deficiencies. If state leaders are committed and capable (including understanding what kind of help they need) to solve this problem, they will do so regardless of the structure – and if they aren't, no change in structure will make a significant difference.

### **The Human Capital Development Fund prioritizes the state over our citizens.**

We believe that an educated population is the key to developing Timor-Leste's economy, as well as to improving the functioning of state institutions and the lives of our people. But short-term quick-fixes, such as trainings and scholarships for state employees, will not accomplish this goal. We find it unconscionable that the proposed 2011 budget allocates twice as much money (\$12.952 million) for scholarships to send a few students abroad as it does for the National University of Timor-Leste (\$6.355 million).

The great majority of scholarships are for public servants, and we hope that their expensive education will improve the functioning of state institutions in the short-term, reducing reliance on foreign advisors and national consultants. But in the medium- and long-term, Timor-Leste's own educational system, from primary school through university, must give our people the understanding, knowledge and skills to work for state institutions, the private sector, foreign

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<sup>9</sup> In mid-2009, the Government transferred \$70 million from the National Electricity Project (which had been the explanation for exceeding the ESI in 2009) to *Pakote Referendum* without informing Parliament or seeking approval.



investors or their own businesses. This was the key to the development of Singapore and other small countries, and is the only way to develop Timor-Leste.

In addition to providing better education for much larger numbers of Timorese people, prioritizing local institutions can help Government function better. In the Committee D hearing last, week, the President suggested that UNTL students and professors could do research to help Committee D understand the agricultural situation in rural areas. This is one illustration of how a strong National University, with skilled faculty and well-educated students, can help this country develop.

Timor-Leste can afford to spend oil money on expensive, elite overseas education for only a little while. Who will replace today's civil servants when they retire? Who will provide the workers for the many industries and agencies envisioned in the National Strategic Development Plan, or to start and run the businesses which can substitute for imports and add value to our agricultural products? Where will the next generation of leaders come from, once those who received education in Indonesia or in exile during the Indonesian occupation of Timor-Leste can no longer work?

### **Key state institutions must continue to grow.**

Although no information is provided about staffing levels for 2011, Budget Book 1 says that new recruitment will be frozen for all ministries and agencies except PNTL, F-FDTL and the Civil Service Commission. We believe that this is a mistake.

Current levels of service in key sectors such as education, health and agriculture are inadequate, and additional teachers, nurses, doctors and extension workers are needed to adequately meet the needs of our growing population. These ministries should be scaling up the quality and quantity of their staff. It seems absurd to allocate half the budget to foreign companies to provide infrastructure which benefits hardly any Timorese citizens, while not providing salaries for more Timorese workers to address people's daily lives.

EDTL provides another example. Repairs to the Comoro generating station and construction of the national grid and Hera power plant will hopefully provide electricity to more citizens and sucos around the country. But if EDTL cannot expand its staff to install meters, sell pulsa, maintain and repair equipment and manage this much larger system, how can it operate?

### **Recommendations**

We agree with the IMF that in Timor-Leste's Government, "Planning and budgeting are largely unconnected, and a medium-term perspective is just starting. Strategic planning is largely absent."<sup>10</sup> While it is impossible for Parliament to remedy these shortcomings completely, the following recommendations summarize what we have explained in our submission above.

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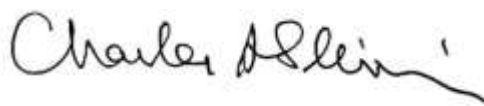
<sup>10</sup> IMF, *Timor-Leste: Report on the Observance of Standards and Codes (ROSC): Fiscal Transparency Module*, 9 November 2010, <http://www.imf.org/external/pubs/ft/scr/2010/cr10340.pdf>. This report, although slightly too optimistic and already a little out of date, contains much important information about the strengths and weaknesses of Timor-Leste's budget process, summarized as "The main issues with the openness of the budget process regard: the weak linkage between planning and budgeting, no fully-developed functional or program classification, macro-fiscal forecasting capacity is limited and planned resource provision by donors is not collected for the medium term, capital and recurrent budget are largely developed separately, expenditure review, especially of capital projects, needs to be substantially strengthened, the medium-term planning and budgeting process are embryonic, both for capital and recurrent expenditure, and strategic planning needs to be further developed. FreeBalance does not record accounts payable and there is no monitoring of arrears, its interconnectivity needs to be improved, and the procurement module activated." (Paragraph 94)

1. Keep spending within sustainable levels, based on prudent projections of future oil prices. The proposed massive budget increases for 2011 and 2012 should be limited, and withdrawals from the Petroleum Fund in future years should not exceed the Estimated Sustainable Income.
2. Emphasize that expenditures are connected with revenues, and that the current surge in petroleum-related income is only temporary.
3. Provide additional funding to the Ministry of Agriculture and Fisheries and encourage it to implement policies which address the needs of local farmers.
4. Insist on clear cost information and revenue and employment projections for the full project cycle of the Tasi Mane projects, so that Parliament can decide if they are a reasonable investment of state resources.
5. Evaluate whether spending large amounts of public funds to prepare for a possible Beaçu LNG plant is worthwhile, since the company with decision-making power refuses to consider that option.
6. Prioritize development of a strong non-oil economy, primarily based on agriculture, to replace transient oil revenues and industry.
7. Reject funding for the PETRONATIL national oil company until it has been established by Parliamentary law with adequate safeguards, accountability and transparency.
8. Reject funding for the Institute of Petroleum Geology as an autonomous institute, but provide for it within the structure of SERN.
9. Refuse to establish the Infrastructure Fund until complete and detailed annual cost, employment and schedule information is provided for each project, and until Parliament has approved the National Strategic Development Plan, with necessary organs and laws.
10. Insist that the budget give priority to education of Timor-Leste citizens in Timor-Leste, rather than sending a few public servants for expensive schooling overseas.
11. Allow hiring of additional personnel for key Ministries like health, education and agriculture, as well as to manage and maintain newly expanded infrastructure.

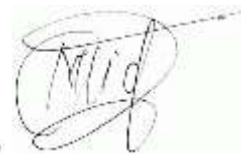
Thank you very much for your attention and consideration, and we are happy to discuss these or other relevant concerns with anyone who is interested.



Juvinal Dias



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