



Dili, 20 December 2011

His Excellency Dr. José Ramos-Horta
President of the Democratic Republic of Timor-Leste
Dili, Timor-Leste

Subject: Please consider the General State Budget for 2012 carefully before promulgating

Mr. President, with our respect,

Last month, our National Parliament approved Proposed Law No. 54/II, the \$1.674 billion General State Budget for 2012. This election year budget is 28% larger than the 2011 State Budget. According to IMF data, only Zimbabwe's state budget grew faster than Timor-Leste's during the past four years.

We believe that the proposed budget contains a number of unwise or questionable provisions and urge you to study it deeply before you decide to promulgate it. It may violate the requirement of Article 145.2 of the RDTL Constitution that the budget be based on efficiency and efficacy (*com base na eficiência e na eficácia*). However, even if the budget is legal and Constitutional, it is still bad policy.

In October, La'o Hamutuk wrote the annexed submission to Parliament Committee C. Many Parliamentarians, including Committee C's official report, agreed with much of our analysis. We were gratified that the Parliament followed our recommendation to reject \$200 million for the Timor-Leste Investment Company, which would have wasted money and invited corruption, although we were saddened that they then appropriated \$111 million of the savings to various small projects. Unfortunately, the revised Budget approved by Parliament still includes provisions which inflict the "resource curse" on Timor-Leste, leading to worsening poverty and economic development if current policies are not changed.

Therefore, we ask Your Excellency to deliberate carefully before promulgating or vetoing the Budget under Constitution Article 88. We hope you will consider the following factors, which are discussed more fully in our submission and on our website¹, as you evaluate whether this proposed budget will benefit Timor-Leste's people today and tomorrow:

The Resource Curse is truly here.

- The "Dutch disease" of inflation, currently at an annual rate of 14.4%, exacerbates poverty in Timor-Leste. It is largely caused by public spending in excess of what the local economy can absorb.
- We continue to neglect non-oil development. Timor-Leste's total oil and gas reserves, including Sunrise and with optimistic price and discovery assumptions, could provide enough income to spend \$1.88 per citizen per day over the next four

¹ <http://www.laohamutuk.org/econ/OGE12/100JE2012En.htm> or <http://www.laohamutuk.org/econ/OGE12/100JE2012Te.htm>

decades. The proposed 2012 budget will spend \$3.76/person/day, of which \$3.36 is from oil and gas revenues. Petroleum can sustain only half the current spending level over the long term, and we will be unable to import basic necessities, provide education and health, or fund public infrastructure after the oil money runs out.

- Our people are our most important resource, yet less than 10% of the 2012 State Budget will go for education and health combined. This is about one-third of the level for countries on track to meet the Millennium Development Goals, and undercuts development of our post-petroleum, non-oil economy.

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

- Timor-Leste is a world leader in budget escalation, with our state budget growing much faster than our non-oil GDP, 28% this year. It is nearly four times larger than the Government projected two years ago for the 2012 state budget.
- Don't spend twice the Sustainable Income from the Petroleum Fund. Although our oil revenues are falling as reserves are depleted, the proposed 2012 budget will spend 6.7% of our petroleum wealth, far more than the 3% rule in the Petroleum Fund Law.
- Special Funds continue to erode Parliamentary authority. The Infrastructure Fund in particular has little accountability, and enables shifting of money from one project or year to another. The President may want to request more information than was given to Parliament about how these funds will be used.
- Although the Budget includes large borrowing and public expenditures for multi-year projects, little information is given about the total costs of these projects. The national electricity project will cost nearly triple the 2009 budgeted amount, while the South Coast Highway is projected to cost more than six times the amount given in the 2012 budget. No information has been provided to Parliament or the public about the projected cost to implement the National Strategic Development Plan.
- As in the last two years, the 2012 budget continues to allocate its largest portion, close to \$400 million, for electricity. This is more than education, health care, police, military, water, agriculture and local infrastructure added together. Although expectations have been lowered and deadlines extended, we still doubt that electricity deserves more public money than virtually everything else. In addition, estimated operation and maintenance costs for the national electricity system exceeding \$200 million/year are left out the proposed budget.
- Agriculture deserves more attention. It is the livelihood of more than 80% of our population, yet receives about 1% of the state budget.

Some new developments give more reason for concern.

- It is too soon for Timor-Leste to borrow, and more information must be provided. Although the budget contains no information about sources, terms or conditions of the authorized \$160 million in loans (\$43.1 million to be spent in 2012), we have learned that they will come from the World Bank, Asian Development Bank, Japan International Cooperation Agency and Chinese Export-Import Bank. Before you approve loans which will have to be repaid after oil revenues have ended, we

encourage you to obtain full information about interest rates, terms, consequences of default, complete project-cycle financing and other factors which will enable you to evaluate if they are in the long-term interests of Timor-Leste's people.

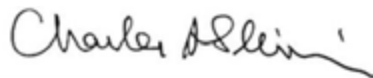
- The Tasi Mane project could be a multi-billion-dollar white elephant, receiving \$163 million in the 2012 budget and billions more in the future. However, basing post-petroleum development in Timor-Leste on the construction of petroleum infrastructure makes little sense and diverts attention and resources from more productive, job-providing, sustainable, safer and environmentally benign development alternatives. The economic returns from this petroleum mega-project are unclear, while the advantages of investing in sectors like agriculture, small industry, ecotourism and import substitution have not been adequately analyzed.
- The South Coast Highway, budgeted at \$45 million for 2012, is likely to cost well over a billion dollars. Even if traffic increases ten times over today, every single car driving the length of the highway will receive a \$156 subsidy.

In closing, we appreciate your consideration of our ideas, and we are confident that Your Excellency will make a wise decision, bearing in mind the 21 recommendations we made to Parliament in the attached submission.

Sincerely,



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La'ó Hamutuk Economics Team