



## Submission to Timor-Leste National Parliament

### from La'o Hamutuk

## on the Proposed Rectification of the 2016 State Budget

12 July 2016

In order to fund several large infrastructure projects, the Government of Timor-Leste has proposed to spend \$391 million more this year than the \$1.562 billion already allocated in the 2016 State Budget. The resulting \$1.953 billion budget will be the largest in the Nation's history. La'o Hamutuk is extremely concerned that this proposed revision will squander Timor-Leste's limited wealth, further undermining the sustainability of our Petroleum Fund by wasting more public money on projects with no clear benefit.

### Megaprojects need to be analysed and planned more seriously.

La'o Hamutuk has often written to your Excellencies about our concern that some of the large, expensive infrastructure projects being built by foreign companies at public expense – including Tasi Mane (Suai Supply Base, South Coast Highway and Betano Refinery), ZEESM, Dili Airport and Tibar port – will not provide sufficient benefits to current and future generations of Timorese people, which is the principal purpose of the Petroleum Fund as provided by Law.

We have urged that these projects be planned better, with cost-benefit-risk analyses to determine if the advantages outweigh the financial, social and environmental impacts. The lack of realistic planning has now become obvious to all – the Government is asking Parliament to double the amount

*Table from Ministry of Finance Rectified Budget Book 1. Colors added by La'o Hamutuk.*

| Color | On left (title)             | On right (number)          |
|-------|-----------------------------|----------------------------|
|       | Cut by more than 50%        | Cut by more than 20%       |
|       | Increased by more than 100% | Increased by more than 20% |

*Table 2.3.2.2.1 Infrastructure Fund Budget by Programme (in \$ million)*

| Program   | 2016 Original Budget | 2016 Rectification Budget |
|---|----------------------|---------------------------|
| <b>Total Infrastructure (including loans)</b>       | <b>393.0</b>         | <b>783.7</b>              |
| <b>Total Infrastructure (excluding loans)</b>       | <b>286.0</b>         | <b>676.7</b>              |
| Agriculture and Fisheries                           | 2.0                  | 2.5                       |
| Water and Sanitation                                | 12.5                 | 15.8                      |
| Urban and Rural Development                         | 12.2                 | 5.9                       |
| Public Buildings                                    | 3.6                  | 3.9                       |
| Financial Sector                                    | 19.1                 | 26.8                      |
| Youth and Sport                                     | 3.4                  | 5.3                       |
| Education   | 0.6                  | 0.9                       |
| Electricity   | 6.3                  | 41.0                      |
| Information Technology                              | 1.6                  | 1.8                       |
| Millennium Development Goals                        | 4.8                  | 8.7                       |
| Health  | 1.7                  | 1.6                       |
| Security and Defense                                | 2.8                  | 3.6                       |
| Social Solidarity                                   | 0.0                  | 0.0                       |
| Tasi Mane Project                                   | 56.6                 | 183.9                     |
| Roads   | 104.2                | 208.0                     |
| Maintenance and Rehabilitation                      | 16.0                 | 4.9                       |
| Bridges   | 6.5                  | 2.1                       |
| Airports  | 15.2                 | 24.5                      |
| Ports   | 10.6                 | 131.3                     |
| Transport   | 0.0                  | 0.0                       |
| Tourism Sector                                      | 0.2                  | 1.1                       |
| Preparation, Design and Supervision of New Projects | 6.0                  | 3.1                       |
| Loans Program                                       | 107.0                | 107.0                     |

Source: Major Projects Secretariat, Ministry of Finance, 2016

you approved for the Infrastructure Fund only six months ago. At that time, the Ministries of Finance and Public Works already knew that they would need \$131 million in 2016 to pay for the Tibar Port, but they failed to inform Parliament, causing you to enact an insufficient budget.<sup>1</sup>

Today, they are making the opposite error. The contract for the Suai Supply Base was rejected by the Tribunal Rekursu, and the company has pulled out of the project, so there is no way that a legitimate new tender can be held in time for construction to start this year.<sup>2</sup> Yet the Government wants Parliament to allocate \$127 more for Tasi Mane during 2016. Are they playing you for fools?

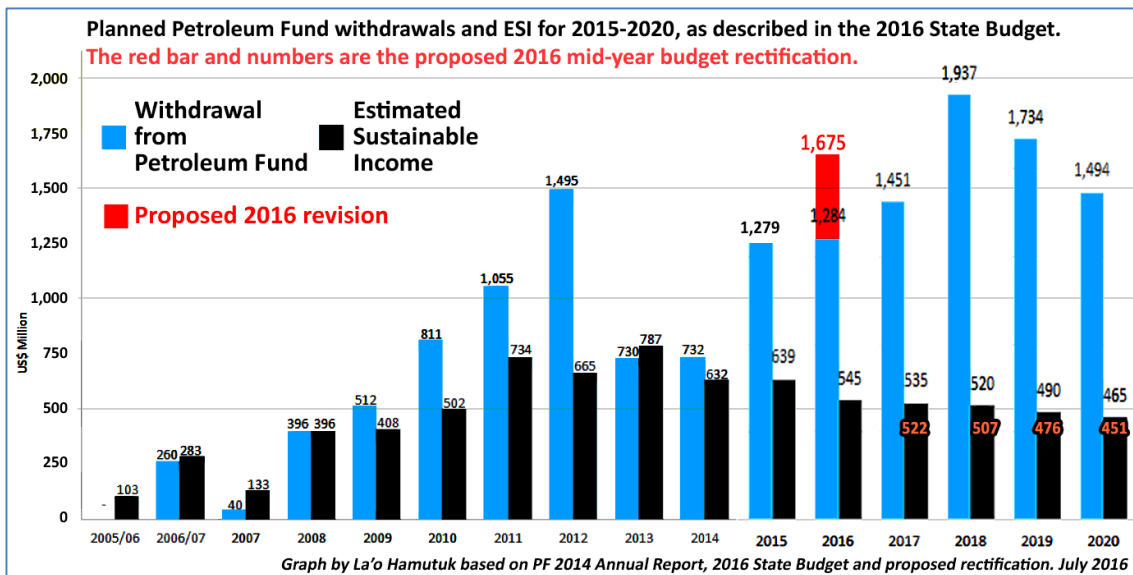
### Timor-Leste no longer even pretends to spend sustainably.

The proposed budget increase will be entirely funded by withdrawals from the Petroleum Fund. It asks to spend 9.2% of Timor-Leste's entire petroleum wealth this year, more than three times the Estimated Sustainable Income.

Last month, the IMF published its latest Article IV Report on Timor-Leste, pointing out that:

*"While prudent saving of its oil wealth in the Petroleum Fund has provided Timor-Leste with a financial cushion to help offset revenue losses related to the recent fall in global oil prices, fiscal trends under existing capital expenditure plans are unsustainable as the Petroleum Fund will be depleted in the long term at the current rate of withdrawals."*<sup>3</sup>

This report was published with consent from the RDTL Ministry of Finance. The IMF and World Bank economists did not imagine that capital expenditure plans would become even more unsustainable a month or two after they wrote the report.



La'o Hamutuk had previously projected that Timor-Leste's Petroleum Fund could be entirely spent within ten years. However, if the hasty over-spending proposed in this rectification is a precedent, the Fund could be used up even sooner.

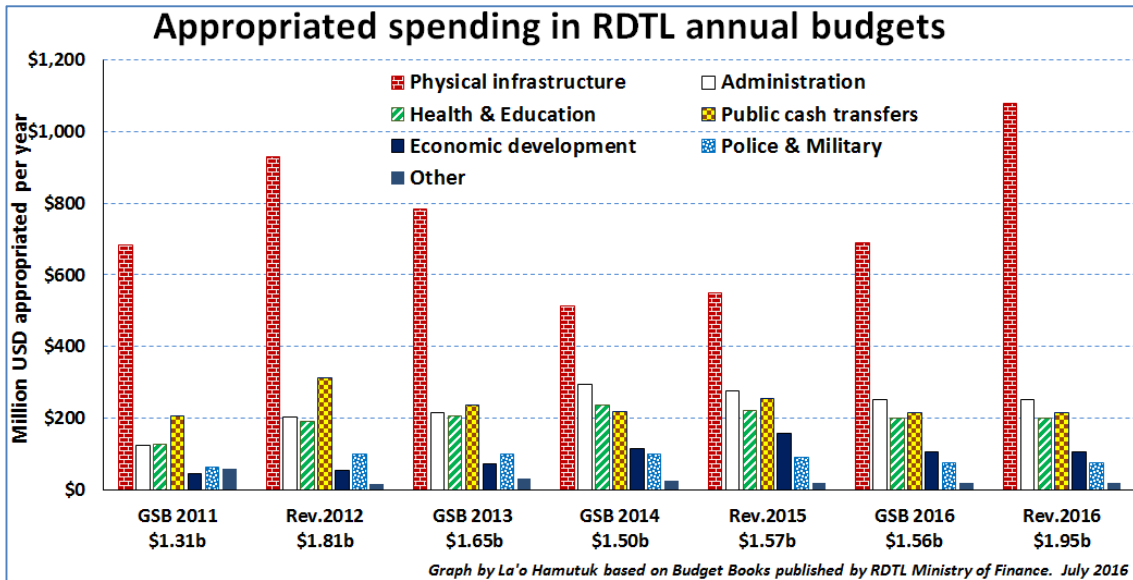
While budget allocations for physical infrastructure have steadily increased, investment in human resources, basic services and the non-oil economy are still inadequate, and spending on health care, education and agriculture has decreased in the last two years. This budget revision will further

<sup>1</sup> <http://www.laohamutuk.org/econ/PPP/Tibar/TibarIndexEnTe.htm>

<sup>2</sup> <http://laohamutuk.blogspot.com/2016/06/suai-supply-base-contract-cancelled-its.html>

<sup>3</sup> <http://www.imf.org/external/pubs/cat/longres.aspx?sk=44006.0>

increase spending on dubious physical infrastructure mega-projects. The following graph shows how physical infrastructure will get much more money than everything else put together.



However, the Petroleum Fund is already greatly stressed, and its \$16.591 billion balance at the end of May 2016 was \$541 million lower than it was 12 months earlier. The information provided in the Budget Books about future petroleum revenues includes several errors and distortions. We would like to call Parliament's attention to some important facts:

- Oil revenues continue to fall due to the shutdown of the Kitan field, declining Bayu-Undan production and continued low global oil prices. The year-old "prudent" price projection that the Ministry still uses was that Brent Crude prices in 2016 would average \$64.70/barrel. So far this year, the actual Brent average has been \$39.97, and the June 2016 U.S. Energy Information Administration projection is that Brent prices will average \$43.03 during all of 2016. (A prudent price projection would be about \$8 lower than the EIA "reference" price).
- However, as Bayu-Undan is more than 90% depleted, future oil prices will not make a large difference in Timor-Leste's finances even if they go back up. During the first five months of 2016, the JPDA produced 5% fewer barrels each month than it did during 2015, and 33% fewer than in 2012. It will continue to decline as the field is nearly exhausted.
- ConocoPhillips and other companies will keep about \$125 million of what they would have paid Timor-Leste this year to recover overzealous assessments of back taxes in 2012.
- Petroleum revenues deposited into the Petroleum Fund during the first quarter of 2016 totalled \$125.3 million, and if they continue at this level Timor-Leste's total oil and gas receipts this year will be \$501 million. Yet the Budget continues to expect \$719 million in revenues.
- The return on investing Timor-Leste's Petroleum Fund during 2015 was less than zero, yet the Budget Books continue to use an optimistic, speculative prediction that they will earn 5.7% return every year. Global markets continue to be volatile.
- About \$641 million of the Fund is invested in securities denominated in British Pounds, and the fall of the pound after the Brexit vote last month cost Timor-Leste \$63 million due to currency exchange rates.

- The projected ESI figures in the Minister of Finance’s 23 June letter to the Prime Minister<sup>4</sup> are misleading, as they wrongly assume that all withdrawals from the Petroleum Fund after 2016 will be limited to ESI, which is not what the Government plans to do.

## Conclusion

Therefore, in light of this information, La’o Hamutuk urges Parliament not to approve this budget rectification. The Government has promised to engage in a review of the five-year-old Strategic Development Plan, and this review should be undertaken before approving hasty, thoughtless spending of nearly four hundred million more dollars -- an amount equal to about \$6 for every Timorese family every day, which more than 40% of our citizens have for their daily lives. The \$400 million increase is more than Timor-Leste will spend this year on health, education, police, military, agriculture and social solidarity all added together.

Budget Book 1 justifies the mid-year spending increase because “given that next year is an election year, it is expected that there will be a moderate budget that would be unable to accommodate these expenditures.” This flies in the face of Timor-Leste’s experience – the 2012 State Budget was the largest in the nation’s history ... until now.

There is no need to rush to enact this budget without public hearings or adequate analysis, consultation and debate. The Government will still be here when you come back from recess, the Infrastructure Fund will not be empty, and the appropriations and transfers authorized by the original 2016 budget will not have been used up.

Under the Constitution, each Member of Parliament is responsible to represent all Timorese citizens on fundamental issues, including the State Budget. Your role is not to rubber-stamp the Government’s proposals without analysing them and considering whether or not they are in the public interest.

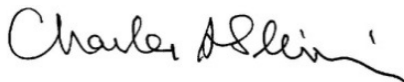
We understand that your time is limited, and appreciate your attention. We sincerely hope that this information will help policymakers make wise decisions which benefit all of Timor-Leste’s people and maximize the sustainability of our Petroleum Fund, and would be glad to provide further information or testimony if you wish.

Thank you very much for your attention.

Sincerely,



Juvinal Dias



Charles Scheiner



Adilson da Costa Junior



Marta da Silva



Celestino Gusmão



Niall Almond

Researchers on Economy and Natural Resources

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<sup>4</sup> Rectification Budget Book 1, Attachment 4.2 (page 63 of English version and 65 of Portuguese version).