



**PARLAMENTO
NACIONAL**
República Democrática de Timor-Leste

INFRASTRUCTURE, TRANSPORT AND COMMUNICATIONS COMMITTEE

REPORT No. 10/2016/CE-PN

Subject: Analysis of Proposed Budget Rectification / 1st Amendment to 2016 State Budget

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I. General Considerations:

1. This analysis takes into account the observations made in Committee E's analysis of the draft State Budget for the year 2016, the analysis of the Government Program submitted to the National Parliament and the results of public hearings that took place to discuss this amendment to the State Budget in force for 2016.
2. The Government presented to the National Parliament the Proposed Budget Rectification Law for the year 2016 (Law 1/2016 of 14 January), with proposed amendments to the Law and to Books 1, 2 and 3, annexed, this proposal has been received and the object was dispatched by the President of Parliament on 4 July to the permanent specialized committees C and E for the purpose of issuing an opinion and to report to the Committee of Public Finance.
3. The opinion of the Infrastructure, Transport and Communications Committee is issued pursuant to paragraph 1 of Article 164 of the Rules of Procedure of the Parliament, according to which the specialized standing committees send to the Public Finance Committee within 2 days, a reasoned opinion on the bill.

4. To this end, the Committees on Infrastructure, Transport and Communications and Public Finances held, on 5 and 6 July 2016 in Maubara, Liquiça, joint hearings with the Petroleum Fund Consultative Council, the Timor-Leste Central Bank, the Minister of Planning and Strategic Investment, Minister of Public Works, Transport and Communications and Minister of Finance, pursuant to paragraphs 3 and 4 of Article 164 of the Rules of Procedure of the National Parliament.
5. The draft amended budget maintains the budget structure in place, and the proposed amendment includes the first amendment to the General State Budget Law for 2016, as well as amendments to Books 1, 2 and 3 Annexes to the 2016 State Budget.
6. In the proposed amendment to the State Budget, there are significant changes in terms of Investment Programs in infrastructure, transport and communications, focusing changes on the revenue side to strengthen the funds available from the Petroleum Fund by increasing its contribution and, on the expenditure side, to increase the appropriations for the general category of "development capital", passing an appropriation of \$436.5 million to an amount of \$827.0 million - which represents an increase of \$390.5 million, almost double the initially expected value.
7. Similarly, in the allocation of "capital development", the amended appropriations respect will transfer funds to the Infrastructure Fund, which is reinforced its initial allocation for a new value of 784.5 million USD, fully funded through the State Budget;
8. According to this proposed state budget, the total amount of expenses will be \$1,952.938 million, with the fiscal deficit to be covered by the Petroleum Fund and for credit to the state loan program, totaling \$1,781.538 million, which correspondingly requires a withdrawal above the Sustainable Income of the Petroleum Fund in the amount of \$1129.7 million.

II. Public hearings:

1. The conducted hearings resulted in the analysis of the following conditions and supporting aspects of the proposed amendment to the State Budget for 2016:
2. **Petroleum Fund Consultative Council and Timor-Leste Central Bank** - The hearing of representatives of these entities took place simultaneously and the following concerns were raised:
 - ❖ In the process of contract and tender for the Port of Tibar, since they have little information and do not know their final contours, but what is known, this project has total investment of more than \$400 Million. Since this contract is a Public Private Partnership (PPP), has a long-term (30 years), we do not know what impact it will have on public accounts, in terms of income and expenditure. Unaware of the operating costs and projections estimated in terms of traffic and demand in the new port;
 - ❖ Question of low evolution of the domestic product, as well as the non-oil economy and tax revenues;
 - ❖ Reduction of oil production, and, at first, the Bayu-Undan field produced 100 thousand barrels/day and now it produces only 45 barrels/day (sic);

- ❖ Evolution of the value of the Petroleum Fund, which is now worth about \$16.58 billion, possible to maintain when the use is limited to 3%, which can sustain up to 30 years; the situation will be different if the capital starts to be used;
 - ❖ The need for the Government to clarify clearly on the feasibility study on the return of operating Tibar Port, supply base and Dili drainage to justify the investments;
 - ❖ Need to increase domestic revenue by at least 15% of the value;
 - ❖ Need for wealth creation policies which enable revenues but do not make the country more dependent on the Petroleum Fund;
 - ❖ To reaffirm the spirit of the Petroleum Fund as a fund for future generations, so the government has to reduce spending and reduce debt;
 - ❖ The need to ensure budgetary discipline in the implementation of Government policies;
 - ❖ The need for investments through the execution of the resources of the Petroleum Fund to be carried out in accordance with the objectives set out in the law, including ensuring that such investments also generate economic returns.
 - ❖ The Central Bank has not clarified the information provided by the Government on the recent appreciation of the Petroleum Fund investments in the equity component, with a disparity between information from the Government and from the Central Bank on this matter.
3. **Government – Minister of Planning and Strategic Investment** - The Minister of Planning and Strategic Investment, representing the Government, accompanied by the Minister of Finance and the Minister of Public Works, Transport and Communications, members of the Administrative Council of the Infrastructure Fund, expressed the following positions:
- ✓ The Government continues to fulfill the Program approved by the VI Constitutional Government to ensure the management of Public Administration in the Territory;
 - ✓ The importance of executing the Infrastructure Fund Budget to improve the development and living conditions in the country and promote the good management of public resources by the Administration;
 - ✓ The decisive and strategic importance for the country, which need to recover and improve its infrastructure; for which you have to allocate the necessary resources from the Budget;
 - ✓ The need to solve and overcome a number of existing debts which are a major problem for the State, for the economy and for companies;
 - ✓ The perception that begins to exist, to the Government and Parliament, of the need to improve but also that it is improving the condition of roads;
 - ✓ The importance of improving the drainage system in the city of Dili, very important for the impacts that always cause there are floods;
 - ✓ The need to ensure the completion of the Port of Tibar with the allocation of about 130 million, a contract for the design, financing, construction and operation of the new Port of Tibar, with an investment of 400 million, to ensure a deposit guarantee of benefits and payments from the State, to be realized in coming years;

- ✓ The need to solve the problem that arose with the contract with Hyundai company in the prior approval process, since the country is in a situation of having to pay a contractual fine after every three months of the contract;
- ✓ The need to ensure the payment for labor in works related to the distribution of water (about \$11 million), debt of EDTL, to pay two packages of work performed, with amounts of \$16 million and \$12.9 million;
- ✓ The need to ensure payment for 94 projects which were implemented but not yet paid (about \$19.2 million);
- ✓ Foreseeing increasing the allocation for the burden of the Suai Supply Base, where there is the need to increase to 56 million;
- ✓ The estimated projection of infrastructure costs for 2017, is \$237 million;
- ✓ The need to reduce the costs of goods with the improvement of service in Dili port;
- ✓ The need to build a new road with four lanes, to ensure the connection of Rai-kotu to Tibar;
- ✓ Compliance with the programs defined for the Sustainable Development Goals;
- ✓ Finally, the intention to ensure, through this 2016 Rectification Budget, that in the year 2017, the government will not accept debts or late situations and that the new government will not receive debt in the next legislative term (from 2017).

4. Analysis:

1. The draft budget amendment maintains the budget structure in place, and the proposed amendment includes the first amendment to the 2016 State Budget Law, as well as amendments to Books 1, 2 and 3 Annexes to the 2016 state budget.
2. With regard to the Ministry of Public Works, Transport and Communications, there are no changes to the appropriations called the Consolidated Fund (TLCF), even though it is the middle of the 2016 financial year and there is information on the estimated predictability of its execution.
3. As regards the chapter of revenues, the increase results entirely from the contribution of the Petroleum Fund, by increasing the total amount of withdrawals from that source.
4. Expected non-oil revenues remain unchanged and continue to be very low in relation to the total amount of revenue.
5. Once the increase in value of the revenue comes entirely from the Petroleum Fund, this means that the state budget dependency rate increases in relation to its funding by direct and indirect oil revenues, thus increasing the estimated dependence on oil, with regard to budget funding, and coverage ratio of 11, 77% and now represents only 9.28% of the state budget relative to 2016.
6. It maintains the structural situation of the state budget as regards the absence of criteria, since the organization of the budget does not properly segregate the various state sectors, including the government sector and the public business sector.

7. The true essence of the budget proposal has to do with the need for increased spending on infrastructure investments, the level of capital expenditures (development capital), stressing the following main changes (in descending order of their value) :
 - a) Investment contract on public-private partnership arrangements for the new **Port of Tíbar** (+\$127.6 million);
 - b) **Tasi Mane Program**, with the start of new contracted projects and works, including the contract for the Suai Supply Base and the new highway from Suai - Beacu (first phase), amounting to \$119.1 million;
 - c) **Roads Program** for the payment of costs of activities already undertaken and new contracts (+\$111.8 million), including, in particular, the increase in spending on roads to finance the resulting payment of expenses so-called " Emergency Works of 2013", for the designated packages A and B (+\$20.12 million), as well as 38 other current contracts included in the roads program;
 - d) **94 projects and various works with situations to be regularized and paid** (+\$19.288 million), which is a new activity, not foreseen in the initial budget);
 - e) **Electricity Projects** to finance the payment of debts of work carried out on packages A and B (+\$29.735 million);
 - f) Development of **Dili drainage** (+\$8.3 million).
 - g) Achieving the **Millennium Development Goals**, with an increase of funds to resolve existing charges (+\$5.9 million).
8. The presentation of this draft amending budget reflects, to a large extent, delays in contracting and development of some of the major projects and public works (in particular, the contract for the Supply Base and the South coast highway), for reasons arising from problems in finalizing the contracts and obtaining prior review from the Court of Appeals / Audit Chamber, whose execution was scheduled to start in the last quarter of 2015.
9. However, it is not clear or fully guaranteed that these contracts will be executed before the end of the year, given that the Government assumes that the relevant planned budgets are designed to ensure advance payments provided for in the contracts.
10. Similarly, it is not yet known the contract or the outcome of the "financial close" process on the Tibar Port PPP.
11. With regard also to the contract of the Tibar Port, it must take into account the need for the contract to be subject to prior review.
12. The total expected increase in these expenses is more than \$421 million, partially offset by the reduction in appropriations for some activities of the Infrastructure Fund, among which we highlight the following:
 - a) infrastructure **maintenance and rehabilitation** of program (-\$11.1 million);
 - b) **Bridges Program** (-\$3.9 million);
 - c) Preparation of **drawings and supervision** of new projects and construction (-\$2.8 million).

13. We must verify the reductions in appropriations for maintenance and rehabilitation activities, bridges and the development of new studies, design and supervision of public works - which contradicts the recommendations from the discussion and approval of the 2016 budget by the Committee and the final report and opinion of the National Parliament and from international partners, which have reinforced the idea that it is necessary to increase investment in the operation & maintenance, rehabilitation, as well as the need to improve the quality of planning processes, preparation of studies and projects and supervision of public works;
14. With regard to planning and design, there is no complete information about the new studies and projects related to public works and equipment, recognizing that reduced funding for these activities now becomes even more reduced. We expect, at least as regards the supervision of public works, that there would be an increased obligation for the supervision of such activities, to promote their quality as well as the economy and efficiency of public spending.
15. The amounts provided for in the 2016 budget, well below the 5% or 10% which would be expected, now become even lower - when the increase in investment amounts was expected to lead to exactly the opposite. While recognizing that part of the spending increase has to do with needs and contractual requirements (e.g. Port of Tíbar PPP contract) or even with work already performed (e.g. payment of 2013 works and emergency activities), we would expect that in other cases there would be an increased obligation related to its management, implementation and oversight. That is not the case.
16. In the case of an amending budget, it does not seem appropriate, nevertheless, to make structural changes. However, this should be a matter to address in future budget years and, in particular, the state budget should consider in the future, the breakdown of public investment programs, to include annual and multi-year forecasts, as well as the identification of evolutionary stages in the life cycle of projects and works.
17. With regard to the charges for the "2013 Emergency Program", the Government had chosen in the 2016 budget to provide an apparently small amount (less than \$10 million), which already at that time seemed inadequate to solve the existing problems and the state's responsibilities, opting to include in this Amending Budget a solution to the problem, but without clarifying whether this measure will resolve, for the state's part, all existing situations or if other situations claimed by private companies are still under consideration.
18. Finally, regarding the proposed diploma on the "**First Amendment to Law No. 1/2016 of 14 January, approving the General State Budget for 2016,**" the government intends to approve:
 - a) Amending the Annexes of Law no. 1/2016 of 14 January, on the Petroleum Fund (Annex I) and the Infrastructure Fund (Annexes II and III), and Articles 4 and 7 of the 2016 Budget Law;
 - b) The authorization of a new limit for obtaining funding transfers from the Petroleum Fund up to a total amount of \$1,674.5 million in 2016;
 - c) The authorization to make escrow deposits, in accordance with the regulations;

- d) For contracts with suspended effectiveness, the authorization to suspend the respective performance guarantees until their effectiveness conditions are fulfilled;
- e) The rules of budgetary execution of Autonomous Funds and Services are defined in law on budget execution.

5. Conclusions.

In light of this analysis, the Committee on Infrastructure, Transport and Communications presents the following conclusions:

- A) The proposed amendment to the 2016 State Budget is based on the prediction of a budget increase for expenditure, entirely for Infrastructure Fund programs;
- B) The overall increase in spending on new and already provided activities, is more than \$420 million, being offset by a reduction of costs of close to \$30 million in some existing programs - so that the expenditure provided in the programs the Infrastructure Fund has a negative balance of \$390.5 million; mostly with the increased cost of activities;
- C) The necessary budgetary financing is entirely realized through withdrawals from the Petroleum Fund;
- D) The data for the first six months of budget execution are not relevant to justify the changes to revenue and expenditure provided for in the proposed budget amendments;
- E) Despite the increase in public investment in recent years, we do not foresee a significant increase in terms of revenues from the non-oil economy;
- F) The increase in budget funding amount realized through the Petroleum Fund money deepens the country's fiscal dependence from 88.23% to 90.72% of budget revenues;
- G) The increased investment made through the Infrastructure Fund does not match an increase in responsibility for the management and control of expenditure, since the majority of the new funds are made through the fulfillment of overdue contractual payments, as in the case of payments of state charges in the "2013 Emergency Program", for carrying out contractual advances (contractual conditions of the contracts of the new southern highway and the contract for the Supply Base) and the provision of guarantees (the PPP Port of Tíbar with the escrow clause);
- H) In view of its autonomy and independence, the allocation of funds to the Infrastructure Fund does not permit, after authorization and transfer, that these funds return to the state budget or are redistributed if there is no execution in the current year, and it is possible that in some cases, when necessary, such execution will take place in following years;
- I) The Government assumes, with full legitimacy, the will not to carry over past obligations and debts for future resolution, assuming in this their responsibility;
- J) The prediction of the "escrow" clause in the contract for Tíbar Port - representing the largest share of this amending budget - results, according to information provided to the National Parliament, from circumstances applicable to Timor-Leste with regard to the provision of contractual guarantees concerning various government bonds, it seems justified as a result of the absence of a rating classification or history of the public debt of the Democratic Republic of Timor-Leste, as regards the fulfillment of contractual

- obligations of this nature - particularly as, in the case of Timor-Leste, when it is the first PPP contract;
- K) The prediction of the inclusion of this clause in the contract of Tíbar Port, since it was not provided for in the initial state budget for 2016, may raise the question with respect to whether the same was provided for in the initial program and specifications, as well as in the concession contract basis;
 - L) The proposal does not explain, clearly, the situation of the evaluation process and settlement of contingent liabilities and charges the designated "2013 Emergency Program", not knowing whether the payments made allow completion of the process or even if there are other pending situations which the evaluation has not yet occurred;
 - M) Are not clarified the circumstances in which debts and obligations to the state for electricity projects originated, worth nearly \$30 million, whose responsibility it is proposed that the Budget take on;
 - N) In the justifications for the proposed budget amendment, the circumstances which led to delays in the completion of contracts for the Supply Base and the south coast highway are not clear, which are believed to result from procedural difficulties in interacting with the Court of Appeals / Chamber of Accounts, in obtaining the respective prior approval;
 - O) The high appropriations for these large integrated projects in the Tasi Mane Program appear to be justified for early payments to be made under such contracts, since it does not seem possible to carry out such high volumes of investment in works of this nature in the remaining part of 2016;
 - P) The reduced expenses in some Infrastructure Fund appropriations was carried out in sensitive areas and activities, including through the reduction of funds for the operation & maintenance, to develop new projects and supervision of public works;
 - Q) Despite the significant increases in capital expenditure, with increased investment in infrastructure, there is no increase in revenues in the non-oil economy, or increase in the operational costs relative to their execution - this situation statistically improves the rational between fixed costs and management of projects;
 - R) The increase in 2016 budget appropriations seems to represent the effort and will, by the Government, to solve a number of situations of the past, whose resolution seems necessary, since they deal with situations which will not recur in the future;
19. As for the diploma proposal for the "**First Amendment to Law No. 1/2016 of 14 January, approving the State Budget for 2016,**" it is considered to be appropriate legal measures in the proposal, taking into account the specific circumstances of each situation.
20. The situation referred to above, does not invalidate the clarification of escrow contract compliance in the face of the budgetary framework law.
21. It is assumed that the Government has the power to suspend contractual performance guarantees until the situation where there is the full effectiveness of the contract, and this effect seems to refer to the production of contractual effects, since the financial efficiency it is dependent on obtaining approval of contracts subject to them under the law. Still, it seems prudent to anticipate authorizing the Government to do so as and when necessary.

6. Recommendations.

Correspondingly, proposals are presented to Government to make the following **Recommendations:**

1. The Government must continue efforts to provide greater transparency and rigor in public accounts, in particular by promoting control actions and audit of the diversions, delays and late settlement charges and debts of their commitments;
2. Improvements to implement should include, first, adequate budgetary planning of state investments and commitments for the achievement of public expenditure, taking into account the extra costs and diseconomies stemming from by delays and lack of assumed contractual commitments with the concern to ensure greater economy and efficiency of the realization of public expenditure, but also to avoid budgetary changes that do strictly result from execution of its own state budget;
3. The Government should review the mechanisms for presenting and reporting to the National Parliament on the budget execution in the field of public programs of investment in infrastructure, should promote a new information reporting system, to be presented with a certain periodicity, without which mechanisms for tracking, monitoring and oversight by Parliament cannot be effective;
4. Periodic reports should be developed, identifying the periods to which they relate, which allow monitoring by the National Parliament with the information of all the projects included in public investment programs with the budget forecast;
5. The documentation report should include information to distinguish the state in which each activity is located, in particular on the situation in activities related to its classification as: (i) Study, (ii) Design, (iii) Contracting (procurement), (iv) Implementation, (v) Reception, (vi) Warranty, (vii) Operation & Maintenance, as well as an annex of information concerning the future financial burden, in relation to capital investment and operating costs, for the next 5 years;
6. The Government should promote an assessment of control over the existence of debts which originated with electricity projects, which result in unforeseen charges of close to \$30 million without explanation of the context, and a complete listing of all projects and works referred to such State debts and charges should be sent to the National Parliament;
7. According to the proposed amendment to Law No. 1/2016 of 14 January, the Government should promote the regulation of escrow clauses in public procurement contracts and ensure their compatibility with the budgetary framework law and with the legal framework of public-private partnerships;
8. In view of the increased costs of several projects, mainly roads and bridges, the main risks that originate these additional costs must be identified, and measures and actions proposed and developed to ensure that such risks are identified, known and dealt with in the future, so that these situations are not repeated with new charges and additional costs;
9. Ensure that, in contracts that require advances and payment anticipations, they are justified in light of the circumstances and the necessary guarantees to contractual compliance on the part of private partners are obtained;

10. The need to improve quality, efficiency and sustainability of projects and public works, requires greater care in the elaboration of the respective projects (designed and written documents), as well as enhanced monitoring of their implementation, so it should strengthen the means and resources needed for these activities - as opposed to expecting that they will reduce and shrink;
11. To develop, in a sustainable manner, mechanisms, instruments and policies to improve the investment conditions in operating & maintenance activities, rehabilitation and conservation of assets and equipment constructed and installed to service the country through permanent policies that maintain the its value and serviceability over time, to avoid the penalties of degradation and the exponential increase in costs for rehabilitation and future repairs, in addition to the decline in their quality and safety, as a result of this lack of maintenance and upkeep.
12. The Government and the Central Bank should take a clear position on the issue of valuing and income from the Petroleum Fund investment portfolio, notably from investments in equities, in order to provide consistent information on the state of its management and evolution.

7. Final Opinion.

The Infrastructure, Transport and Communications Committee is thus of the opinion that the amendment to the Budget Law and the books 1, 2 and 3-A its annexes, generically comply with the principles of budgetary management, in particular the balanced budget, and that it meets the constitutional, legal and regulatory requirements and is able to ascend to the plenary for discussion and voting in procedural terms in effect, so it is proposed to send to the Public Finance Committee for consideration.

8. Discussion and approval.

This opinion was discussed and approved unanimously at a meeting of the Committee E, held on July 8, 2016 and was approved with seven votes in favor.

Committee Vice-President,
(Manuel de Castro Pereira)

The Secretary of the Committee,
(Albina Marcal Freitas)