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Timor-Leste Institute for Development Monitoring & Analysis

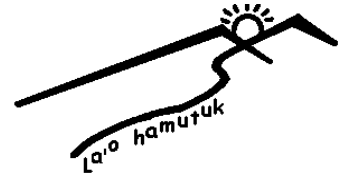
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**Submission to**  
**Timor-Leste National Parliament**  
**from**  
**La’o Hamutuk**  
**on the**  
**Proposed Revision to the Petroleum Fund Law**  
**and the**  
**Budget and Financial Management Law**  
**11 July 2018**

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National Parliament is about to consider a proposed law which would revise Petroleum Fund Law no. 9/2005 and Budget and Financial Management Law no. 13/2009 to address an urgent cash flow situation. Although La’o Hamutuk has not been asked for input, we are providing this submission in an effort to help Timor-Leste enact better legislation, and to preserve the strong, effective system already in place to manage the nation’s petroleum wealth and state budget for the interests of all of Timor-Leste’s people.

For many years, La’o Hamutuk has offered analysis, submissions, testimony and presentations to assist National Parliament to enact laws to manage state finances and budgets. We welcome this opportunity to engage with the new National Parliament, and look forward to continuing collaboration with Government and Parliament.

## **This proposed law goes too far too fast.**

The proposed law would revise two of the most fundamental pillars of Timor-Leste's fiscal management system. Although it is meant to address a temporary, imminent cash flow problem caused by the absence of a 2018 General State Budget and the lack of Parliamentary authorization for transfers from the Petroleum Fund, the hasty, non-consultative process by which it has been proposed and enacted will have far-reaching consequences. It would be better to solve the immediate problem for FY 2018, and to leave longer-lasting structural changes in Timor-Leste's legal framework for more thoughtful, consultative deliberation during the next few years.

It is clear that the duodecimal system defined in Article 31 of the Budget and Financial Management Law (BFM) did not anticipate a situation where a General State Budget Law has not been enacted more than halfway through the year. Although revisions to the BFM Law may be appropriate in the future, Parliament has a five-year mandate in which to do that.

At the moment, Parliament has many pressing matters to consider, including the State Budget Laws for 2018 and 2019, the Maritime Boundary Treaty, and other draft laws which have been pending for more than a year. We doubt that the distinguished Deputies, many of whom have just been elected for the first time, will be able to give appropriate attention and consideration to the revision of these two fundamental laws.

To address the current cash flow emergency, Parliament should authorize a specific transfer from the Petroleum Fund to enable the duodecimal system to continue until a 2018 General State Budget can be enacted into law. This pressing need should not be made more complicated than it needs to be, and there is no need to revise the Petroleum Fund Law.

Everyone in Timor-Leste is proud of our effective and transparent system for managing petroleum revenues and state finances, and this system should only be changed in a transparent, thoughtful way, with input from civil society, academia, the Petroleum Fund Consultative Council and others. Committee C should conduct a public hearing and issue a report after hearing various points of view.

This proposed law would transfer some of Parliament's legal authority to the Government. We hope that Parliament is cautious about surrendering its Constitutional powers so readily, especially when you have just received a mandate from the voters and the Government is still in the process of formation. Please do not let partisan or political maneuvers interfere with your duty to create and protect fundamental laws to safeguard the people's wealth.

## **The cash flow emergency can be addressed with existing law.**

The depletion of the State Treasury has been foreseen since before the President of the Republic dissolved National Parliament last January. Unfortunately, no action was taken to authorize transfers from the Petroleum Fund to finance state operations during the first several months of 2018 when there would be no state budget. Last October, when Parliament decided not to consider the proposed 2017 Budget Rectification, it was clear that there would not be a state budget for 2018 and that an extended period of duodecimal finance would follow. La'o Hamutuk's analysis, released last January, was that there was only enough money in the treasury to support state operations for four to six months.<sup>1</sup>

In May, the Ministry of Finance directed the Central Bank to transfer \$70 million from the Petroleum Fund to the Treasury. Although this was done, its legal basis is dubious. If Parliament

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<sup>1</sup> <http://www.laohamutuk.org/econ/OGE17/16OGE17.htm#2018>

had been in session, this could have been resolved by Parliament authorizing the transfer, but the election was imminent and no political party was ready to take responsibility for freezing state operations, so the money was transferred. However, now that a new Government and Parliament are in office, Timor-Leste should return to the rule of law.

We agree that Parliament should quickly authorize an extraordinary transfer from the Petroleum Fund to address the current cash flow problem until a 2018 budget can be adopted. However, a variant of article 3.1 of the proposed law is sufficient to authorize such a transfer, which can be done in compliance with articles 7 and 8 of the Petroleum Fund Law. The other articles in this proposed law should be deleted, and there is no pressing need to revise either the Petroleum Fund Law or the Budget and Financial Management Law.

## **Petroleum Fund transfers should obey duodecimal principles.**

The proposed law would allow withdrawals up to the ESI for 2018, which has not been estimated for nearly two years and was never certified by an independent auditor as required by Petroleum Fund Law Article 8(c). It asks National Parliament to authorize a transfer without saying how much money is to be authorized.

In order for this transfer to be enabled in an efficient and straightforward way, La'ó Hamutuk suggests that the number included in the 2017 State Budget as the ESI for 2018 – \$475.1 million – be specified in this law. If the Ministry of Finance has the capacity to produce a new estimate for 2018 ESI and get it certified by an external auditor before Parliament debates this proposed law, that number could replace the \$475.1 million figure, but the discussion below is based on the earlier number. Parliament should not authorize a withdrawal from the Petroleum Fund in general terms – the specific amount should be written into this law.

**Table 2.6.3.2.2: Petroleum Wealth and the Estimated Sustainable Income (ESI)**

	2015*	2016*	2017 Budget	2018	2019	2020	2021
Estimated Sustainable Income (PWx3%)	638.5	544.8	481.6	475.1	447.9	419.6	393.3
Total Petroleum Wealth (PW)	21,283.3	18,159.6	16,054.6	15,836.4	14,928.6	13,988.0	13,110.1
Opening PF Balance			15,606.6	15,634.1	14,799.8	13,887.2	13,021.5
Net Present Value of Future Revenues			448.0	202.3	128.8	100.8	88.6

Note: \* ESI for 2015 & 2016 figures as estimated for in Budget 2015 and Budget 2016

*Table from Book 1, enacted General State Budget for 2017, page 55.*

Furthermore, the withdrawals should be authorized on a monthly basis, according to the guiding duodecimal principle. In other words, if the total ESI for 2018 is \$475.1 million, one-twelfth of that amount – \$39.6 million – should be authorized to be withdrawn each month, calculated as follows, in millions of U.S. dollars:

<b>2018 ESI in 2017 State Budget</b>		<b>\$475.1</b>
<b>Monthly allocation</b>	<b>x 1/12</b>	<b>\$39.6</b>
Seven months through July	x 7	\$277.1
Already transferred in May		-\$70.0
<b>Remaining for July transfer</b>		<b>\$207.1</b>

The proposed law has retroactive effect from 1 January 2018. Therefore, by the end of July, withdrawals totaling \$277.1 million (seven-twelfths of ESI) would have been authorized. Since \$70 million was already withdrawn in May, a transfer of \$207.1 million could be made in July, to be followed by \$39.6 million in each succeeding month until the 2018 Budget comes into effect.

This would avoid the immediate cash flow crisis and could finance state operations until the end of 2018, although we hope that Government and National Parliament will enact a 2018 Budget Law before then:

Month ending	Treasury balance	Domestic revenues & loans	Transfer from Petroleum Fund	Executed expenditure
<b>31-Dec-17</b>	<b>287.8</b>			
31-Jan-18	236.5	13.2	-	56.1
28-Feb-18	181.8	14.9	-	66.3
31-Mar-18	126.3	27.4	-	86.1
30-Apr-18	69.4	16.8	-	73.7
31-May-18	86.4	19.2	70.0	66.9
30-Jun-18	<b>36.0</b>	19.1	-	69.5
31-Jul-18	<b>191.5</b>	<i>18.4</i>	<b>207.1</b>	<i>70.0</i>
31-Aug-18	<b>179.4</b>	<i>18.4</i>	<b>39.6</b>	<i>70.0</i>
30-Sep-18	<b>167.3</b>	<i>18.4</i>	<b>39.6</b>	<i>70.0</i>
31-Oct-18	<b>155.2</b>	<i>18.4</i>	<b>39.6</b>	<i>70.0</i>
30-Nov-18	<b>143.2</b>	<i>18.4</i>	<b>39.6</b>	<i>70.0</i>
31-Dec-18	<b>131.1</b>	<i>18.4</i>	<b>39.6</b>	<i>70.0</i>

In this table, numbers in black with gray background are actual data from the Transparency Portal and monthly Pro-Forma Balance Sheets from the Central Bank. The *green italicized numbers*, for revenues and expenditures, are based on the monthly average of executed income and expenditure during the second quarter of 2018. **Blue bold numbers** are La'o Hamutuk's proposed transfers from the Petroleum Fund, as described above. The **brown underlined bold numbers** for the end-of-month treasury balance are calculated by adding monthly income and transfers, and subtracting expenditures, from the balance at the end of the previous month.

If the Ministry of Finance re-estimates the ESI for 2018 based on more recent data, it will probably be higher than the \$475.1 million estimated in October 2016. However, if the Government wants to spend money much faster than it did during the last quarter, it should move expeditiously to enact a General State Budget for 2018, with not only a new ESI estimate but with new budget lines for the costs of all state activities during this year, as well as whether it needs to withdraw a larger amount from the Petroleum Fund than the ESI.

Government has always informed Parliament of the amount to be withdrawn from the Petroleum Fund before Parliament discusses, revises and approves the annual Budget Law. The Budget Law includes specific numbers for the amounts to be withdrawn within and beyond ESI. Although Article 8 of the Petroleum Fund law requires only that Government inform Parliament of ESI (with supporting documentation) prior to a transfer being executed, every Government in Timor-Leste's history has provided this information to Parliament as part of its request to authorize transferring from the Petroleum Fund, and that precedent should be followed in this case.

Parliament should not write the government a blank check, with the amount to be filled in later. This would be a serious infringement on Parliamentary authority, the Petroleum Fund system, and the exclusive responsibility of Parliament to oversee the State Budget system, as defined in Constitution Articles 95.2(q) and 145.

## **Revising the Budget and Financial Management Law should be done more carefully.**

Article 31 of the current BFM law includes two paragraphs and two sub-paragraphs. It was intended for when the state budget is a month or two late, and did not anticipate the current situation. Therefore, it only covers appropriations, and does not authorize revenues, Petroleum Fund transfers, or borrowing.

The proposed revision would add six paragraphs and four sub-paragraphs to this article, covering revenues, taking on new loans, and authorizing the Government to “adopt implementation rules”, which could further infringe on Parliamentary authority. It is an excessive transfer of power from Parliament to the Executive, going far beyond what is needed to address the current situation.

Although it may be necessary to amend the BFM law to cover revenues and (following explicit Parliamentary authorization) transfers from the Petroleum Fund, we believe that the omission of borrowing is appropriate and should remain. Taking out loans imposes a debt on future governments and generations, and should not be a decision made by the executive alone. Timor-Leste borrows for long-term projects that take many years to carry out, and disbursements are made gradually as the project is implemented. There is no urgency, or indeed justification, for allowing the contracting of new loans in the absence of an enacted State Budget Law.

This proposed law is dangerous because it makes it easier for the Government to ignore the sovereign powers of the President and Parliament. If, at some future time, the President vetoes the State Budget Law and Parliament fails to negotiate a satisfactory compromise or override the veto. Rather than distorting public finance mechanisms to protect against differing opinions, political leaders from all parties should be looking for ways to cooperate to better serve the public interest.

Revising the Budget and Financial Management Law and the Petroleum Fund Law requires more thorough consideration than is possible right now, and we should reflect on how they were developed:

- In 2004-2005, the First Constitutional Government conducted nearly a year of public consultation across the country on the Petroleum Fund Law, which Parliament approved unanimously, showing the consensus of the leaders of this new nation to manage its petroleum wealth transparently, responsibly, and sustainably.
- In 2010-2011, the Fourth Constitutional Government revised the Petroleum Fund Law after more than 20 months of extensive discussion and consultation, and the principal change (diversifying investments into equities) was phased in over three years after the law was promulgated.

It would be disrespectful to Timor-Leste's democracy to rush through a revision of this law as the first legislative act of the Fifth National Parliament and Eighth Constitutional Government, with no Minister of Finance, no public hearings, and no visible analysis of the potential consequences of this change. It would establish a poor precedent for the next five years of Constitutional democracy.

## **It is time to stop playing politics and move ahead to serve the citizens of this country.**

As proposed, this law may be vetoed by the President, or at least referred to the Court of Appeal for advice on its constitutionality. If this happens, it will not come into force soon enough to

address the imminent, temporary cash flow emergency. There will be a lot of blaming and finger-pointing, and the citizenry will suffer.

It would be better to enact a simpler, less controversial and less far-reaching law, authorizing specific withdrawals from the Petroleum Fund for 2018 alone.

More permanent changes to the BFM Law may be made in the future, following careful deliberation. We do not believe that the Petroleum Fund Law requires substantive revision, but a technical amendment could be required for conformity with BFM Law revisions. This can wait.

Government and National Parliament have urgent work to do in developing the General State Budgets for 2018 and 2019. It would be better to spend time and energy on that work than to look for ways to circumvent fiscal responsibility and undermine Parliamentary power.

We also feel compelled to remind your Excellencies that the temporary "urgency" caused by the lack of legal authorization to transfer money from the Petroleum Fund will become permanent after the Petroleum Fund has been entirely depleted, which could occur within ten years. If the non-oil economy has not diversified and strengthened, and if inefficient and misguided state expenditures continue, no revision to financial management legislation will rescue a future government from bankruptcy.

La'o Hamutuk hopes that our recommendations will help your Excellencies overcome the temporary cash flow shortage resulting from Governmental and Parliamentary paralysis during the past ten months. We are happy to provide further information or testimony if needed, and look forward to continuing to participate in these important processes.

Thank you very much for your attention.

Ami be saran lia,



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