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**PRESIDENCY OF THE REPUBLIC
CIVIL HOUSE**

N. Ref. : GCCC/44/XXIII-I/2019

V. Ref. : 201/GPPN/XI/2018

Subject: Return of National Parliament Decree No. 4/V- General State Budget for 2019

Exmo. Mr President of the National Parliament,
Arão Noé de Jesus da Costa Amaral.
National Parliament Building.
Dili

Excellency,

It is incumbent on the President of the Republic, Dr. Francisco Guterres Lú Olo, to transmit to Your Excellency the Message to the National Parliament from the President of the Republic, dated January 23, 2019, on which he bases the exercise of his competence of enactment or veto in relation to Decree No. 4/V - General State Budget for 2019, in accordance with articles 85(a) and 88(1), both of the Constitution of the Republic.

Consequently, also attached, attached, for the due effects, the original of said Decree of the National Parliament.

I am grateful in advance and without further question at this time, Please accept, Excellency, the assurance of my highest consideration.

The Chief of Staff,

/s/

(Dr. Francisco Maria de Vasconcelos)

Dili, Presidential Palace Nicolau Lobato, January 23, 2019

[seal]
President of the Republic

**MESSAGE TO THE NATIONAL PARLIAMENT FROM THE PRESIDENT OF
THE DEMOCRATIC REPUBLIC OF TIMOR-LESTE,
DR. FRANCISCO GUTERRES LÚ OLO**

(Decree of the National Parliament no. 4/V - General State Budget for 2019)

Mr President of the National Parliament,
Arão Noé de Jesus da Costa Amaral, Excellency,

Ladies and gentlemen, Your Excellencies,

Having received, on 24 December 2018, for the purposes of promulgation, pursuant to Article 85(a) of the Constitution of the Republic, Decree of the National Parliament No. 4/V - General State Budget for 2019, through Your Excellency's Office, Mr. President of the National Parliament, with the reference 201/GPPN/XI/2018, with registration of entry in the Presidency of the Republic of the same day, I hereby formally communicate to the National Parliament, through Your Excellency, Mr. President of the National Parliament, the meaning of the timely exercise of promulgation or veto of the President of the Republic with respect to said Decree of the National Parliament, as provided for in Article 85(a) and 88(1), both of the Constitution of the Republic.

Terms in which, as President of the Republic, I formally pronounce my veto of Decree of National Parliament No. 4/V - General State Budget (GSB) for 2019.

The basis of my veto appears in this Message in which I specify the meaning of my sovereign decision, in compliance with the provisions of article 88.1 of our Constitution.

I exercised my right to veto National Parliament Decree No. 4/V - General State Budget for 2019 in order to contribute to its new parliamentary appreciation for a fair, balanced and sustainable, as well as more efficient, use of financial resources available to the State and People of Timor-Leste to meet their essential needs and national growth and development. I am worried and I am sure that the entire Timorese Nation is worried about the way we have been spending the financial resources from petroleum, without having ensured the sustainability of our social and economic development, while generating real benefits for the present and future generations, who should be the recipients of the use of these financial reserves generated with the use of natural resources, belonging to the entire People and State of Timor-Leste.

We all know that the overall value of GSB 2019 is the largest ever Timor-Leste General State Budget. This budget corresponds to \$2,132 million. There is an increase of 66.9% and 53.7% in relation to GSB 2018 and 2017, respectively.

However, given that GSB 2019's total revenues are only \$1,243 million, the non-oil fiscal deficit amounts to \$1,933.4 million.

The financing of this deficit is made through transfers from the Petroleum Fund, which, in GSB 2019, rise to \$1,846.4 million. Of this transfer, only \$529 million is within the limit of Estimated Sustainable Income (ESI), and \$1,317.4 million is above the ESI, a percentage corresponding to 249% above this Income. GSB 2019 forecasts non-oil domestic revenues to be only \$198.6 million.

The internal financing capacity of GSB 2019 is only 9.3%, while in the previous year it was 15.8%.

One can simply conclude that the amount of \$1,317.4 million, of authorized transfer over and above ESI for GSB 2019 financing is the largest ever. This amount represents a serious worsening of the trend of authorizing transfers above the Petroleum Fund's ESI, for annual financing of the GSB, upon approval by the National Parliament, on proposal of the Government.

There is no doubt that GSB 2019 represents a significant increase in the budget deficit and, consequently, the transfer value of the Petroleum Fund, which is 249% above ESI!

The amount of the transfer authorized by National Parliament Decree No. 4/V - GSB 2019 is not sustainable and contributes significantly to an excessive use that tends to the exhaustion of the Petroleum Fund, which is currently the only *mandatory financial reserve* from natural resources, oil and gas, available to the Timorese Nation. This reserve is mandatory, as well as its constitution for preservation and profitability, by determination of article 139.2 of the Constitution of the Republic.

As such, it is our obligation to ensure the maintenance and profitability of the Petroleum Fund. Its use must be sustainable in order to make progress in achieving its main purpose, which is the financing of the State Budget.

As a reserve resulting from natural resources, it must be used in a fair and egalitarian manner, according to the national interest, according to paragraph 1 of the aforementioned article.

But the structure of GSB 2019 reveals a contrary policy, which does not benefit the citizens. It shows in terms of percentage value the distribution of funds by the following budget lines: *Public Transfers*, representing 32%, are the largest and are intended to purchase the aforementioned assets in the Greater Sunrise Consortium; *Goods and Services* represent 22%; *Development Capital* represents 19%; *Salaries and Wages* represent 10%; and *Capital Minor* represents 1% of the Budget!

It should also be noted that out of GSB 2019 total (\$2,132,001,000), only about 10% is allocated to vocational education and training, health, agriculture and tourism. But of this allocation for education, therefore, 6% of these 10% are allocations to ministries and secretariats of state of the sector, UNTL, training institutes and Human Capital Development Fund. For the health sector, 3% of the budget is allocated, which includes the ministry, Guido Valadares National Hospital and SAMES. Agriculture has an allocation of only 0.69% and tourism only 0.54%!

These allocations are largely to ensure salaries, wages, and remuneration. They are not allocations that allow the accomplishment and development of the activities of the referred sectors to satisfactory levels that allow the satisfaction of the needs in services of the citizens. They do not even allow the execution of policies of effective support to the growth and development of agriculture and tourism in our country. The consequence will be that public servants will not have the financial means to provide services to citizens and economic and social activities.

In amounts, only the allocation in public transfers to the Ministry of Petroleum and Minerals of \$678.747 million, representing 32% or 1/3 of GSB 2019 for payment, through TimorGap, E.P., for the purchase of the rights and interests (Assets) in the oil exploration of the Greater Sunrise Fields. These holdings currently belong to companies wholly owned by ConocoPhillips and Shell. These companies operate in the Joint Petroleum Development Area (JPDA), in accordance with Production Sharing Agreements (PSAs) under the Timor Sea Treaty (2002), with the Designated Authority.

But since the payment for the assets to be acquired from Shell is not contractually foreseen until the end of the third quarter of 2020, why should you enter the value of the purchase already in 2019? The Decree of the National Parliament approving GSB 2019 does not give us any explanation for this

registration. Unless otherwise understood, the financial rationale for drawing up the State Budgets recommends the entry of appropriations corresponding to amounts owed and due in the reference year of the Budget, rather than their enrollment. Note that the Government Resolution to approve said transaction with Shell is not yet included in the *Jornal da República*.

However, we must be aware that in order to verify the purchase of these assets, we will not only have to pay the price in favor of the sellers, but also to make further investments by the State of Timor-Leste or its responsibility. Such investments will be to satisfy the activities of Greater Sunrise, as the State, through TimorGap E.P., and its subsidiaries, have entered into commitments in relation to petroleum operations, including commercial ones. Government Resolution No. 20/2018, dated 24 October, already indicates the companies owned by TimorGap, E.P., who receive the assets acquired in the meantime and begin to act as partners in the consortium's oil and commercial activities, in which Woodside is the Operator, in the JPDA, currently under the Timor Sea Treaty, concluded on March 6 2002.

This structure of GSB 2019 unequivocally reveals that it does not contribute to the improvement of essential services, necessary for the citizen, nor to support agriculture and tourism, essential sectors of our economy for the generation of occupation and employment, especially for young people, in the short and medium term. This conclusion stems clearly from the imbalance of allocations made by sector. This imbalance and alteration of budgetary priorities does not correspond to the Government's own Program, which was accepted by the National Parliament, which is a self-binding guide to current government activity, in particular what the electorate expects. For example, the GSB for 2019 does not reflect the intentions stated in the Preamble of the Program with regard to economic diversification and job creation, as well as the prioritization of investments in social capital and economic development.

In addition, these allocations do not even correspond to the Strategic Development Plan (SDP).

This imbalance of distribution of funds in GSB 2019 is so marked and in disfavor of the social services of direct benefit to the citizens, which I consider to be insensitive to the policies of social orientation that would follow from the parameters of programmatic nature, contained in the Constitution of the Republic. Articles 57 (health), 58 (housing), 59 (education and health), and 61.3 (environment and safeguarding the sustainable development of the economy) imply that State budgets are more sensitive to the satisfaction of the rights to education and health and, more generally, economic and social rights.

The State Budget contributes to the non-sustainability of the *mandatory financial reserve*, as a constitutional rule binding, in the first place, on the sovereign bodies responsible for drafting and approving the State Budget. It aggravates the lack of consideration regarding the respect of Estimated Sustainable Income (ESI), through the approval of a budget transfer limit that is much higher than this.

On the other hand, the recent conversion into law of the Petroleum Activities Law creates the possibility of greater pressure on the Petroleum Fund, through the admission that it may invest directly in Petroleum Operations, like other investments, provided they are through commercial transactions and having as subjects public capital companies, directly or indirectly owned by TimorGap, E.P.

From the perspective of its sustainability, the fundamental one for the Petroleum Fund and its applications strictly follow the rule of eligible investment of articles 14 and 15 of the Petroleum Fund Law (Law no. 9/2005, of August 3, with the first amendment by Law no. 12/2011, of 28 September). Only with the application of assets with high liquidity or timely returns will it be possible for the

Petroleum Fund to guarantee levels of income and capital accumulation that enable it to fulfill its mission or essential purpose, which is the financing of State Budgets, through authorized transfers annually, according to approval by the corresponding Law.

I emphasize in this respect that the rules of the Petroleum Fund Law are pre-eminent in the event of a conflict between them and the Budget and Financial Management Law, as well as, for most reasons, the Laws of approval of the State Budgets. It follows from this rule the understanding that seems to me normal and more in accordance with our normative system, that this pre-eminence of the Petroleum Fund Law applies in respect of other laws in matters affecting the core of rules on sustainability and eligible *investment*, which are protective of the Petroleum Fund's *mandatory reserve* nature, elected by virtue of the constitutional rule requiring its constitution and consequent preservation, as well as development, in which the sustainability of its use is critical .

The direct investment by the Petroleum Fund into financial assets is a means of raising the accumulated capital necessary to finance the State Budgets. Investments in activities of various sectors, including that of the oil industry and an investment-end is intended for its construction and development. As such, it is adjusted that the investment in these activities as in another of the same nature are carried out through the General State Budget. It is important to make investments in the scope of the State Budget which have quality, generate growth and gain returns, depending on the activities financed.

It is essential that we ensure the unity of the General State Budget, which should include all expenses and income, sufficiently discriminated, as we are guided by Article 145.2 of the Constitution of the Republic and the Budget and Financial Management Law.

I consider it inadmissible to use dual channels for the same type of investment, one through the State Budget and another directly through the Petroleum Fund, since both have different purposes and complement each other as part of the same financial and budgetary system. These are complementary, but it is the Petroleum Fund that is responsible for financing the State Budget.

But, the financial reserve and the same, results from revenues from the same natural resources, oil and gas. Withdrawal by one or the other route without being sustainable is to contribute in the same way to the exhaustion of the Petroleum Fund, as a *mandatory financial reserve*, by constitutional requirement and condition of the development of our society. If we do not have a sustainable use and prudent management of these resources, which are the same, they may seem like a lot, but will be quickly depleted. Let us be aware that these resources are in fact scarce for what we need for the development of our Nation.

If we go forward recklessly and carry out withdrawals from the Petroleum Fund at the current rate, Timor-Leste may be walking with great probability to financial bankruptcy, known in English as a financial cliff. Should such a situation occur, there will be profound negative consequences for the economy and the functioning of our society, which could jeopardize the very sovereignty of the State.

It is the duty of all, and especially the organs of sovereignty with political, legislative and administrative decision-making powers, to prevent a disastrous situation such as this from happening in our country, and it is fundamental to respect the core of the rules of ordinary law concretized in the fundamental constitutional rule of the compulsory financial reserve and how it is to be used.

We must be attentive to what the Government itself gives us as data on the possible evolution of revenues from the use of Timor-Leste's oil resources. The fact is that these figures from the

Government are an inspiration in the opposite direction to decisions that favor unsustainable expenditures and even investments, which could lead to the shortage, bankruptcy or financial disaster.

It is even a paradox or contradiction, in relation to these policy tendencies and investment decisions, that the Government's own forecast is that the final balance of the Petroleum Fund will be only \$12 billion in 2023, which may even be lower than expected. In that year 2023, the oil wealth of Timor-Leste was estimated by the Government as being \$13 billion, with ESI at \$397 million (compared to 2019 and \$529 million). The current net value of future Petroleum Fund revenues is estimated to be only \$93 million for that year (2023).

Attention should also be drawn to the government prediction that Bayu-Undan is expected from 2023 to stop providing revenue (through royalties and taxes) to the existing Petroleum Fund.

The prediction of this situation does not indicate that there will be another oil exploitation in that year (2023) capable of generating new and additional revenues for the Petroleum Fund, in time to offset the loss of revenue from Bayu-Undan (in 2023). Although it is indicated that there are onshore drilling explorations for petroleum resources during 2019 by companies holding Petroleum Authorization for this purpose, there does not appear to be any data that allow reliable conclusions as to the results of this drilling.

So what are the economic and fiscal policies and strategies, reflected in the State Budgets, that are adequate to prevent a situation of extreme lack or drying up of financial resources, if the tendency that has prevailed of unsustainable use of financial resources from the oil sources we have?

Is it to continue the practice of the Government to propose State Budgets such as GSB 2019, which require financing far above ESI, rather than, in a qualitatively different sense, to adopt prudent management and financial austerity measures, and to carry out reproductive and profitable investments through the General State Budgets? And, at the same time, seek to significantly expand the tax base? And still to adopt policies and allocate resources for the productive sectors of employment generation, state revenues and income for families?

In conclusion, I do not believe that it is in the national interest of Timor-Leste that the State take full risk of intervention or participation in economic and commercial activity when such risks can or should be shared or even assumed by private-sector actors and the State can ensure profitable results and dividends by acting as a grantor and regulator, as well as possibly as a commercial operator in a similar manner to other commercial operators.

Therefore, in compliance with the provisions of the final part of article 88.1, of the Constitution of the Republic, I request a new assessment by the National Parliament of Decree No. 4/V - General State Budget for 2019, which I have vetoed.

This statement is made with due respect to the organs of sovereignty, Government and National Parliament, which are responsible for the preparation and approval of the General State Budget, as provided in Article 145.1 of the Constitution of the Republic.

I acknowledge the importance of the examination by the Council of State, and I especially welcome the Members who participated in the meeting with this body of political consultation for the President of the Republic for the valuable opinions they have expressed.

I welcome everyone who participated in the analyzes and formulated opinions on the General State Budget for 2019 (GSB 2019), thus contributing to a better scrutiny and decision-making on this fundamental instrument of economic policy and management of our nation's life.

I acknowledge in particular the contributions, expressed in many ways, with patriotism and commitment, which were expressed by religious congregations, jurists, members of the Consultative Council of the Petroleum Fund, representatives of the business community and civil society and academics, and the Central Bank of Timor -Leste (BCTL), during the consultations that I held on GSB 2019, in the current month of January.

All these contributions were valuable, but they are opinions and ideas, and the President of the Republic has the exclusive power to decide on the promulgation or veto, which, in this case, was exercised in the direction of the veto of the General State Budget for 2019.

Please accept, Sir, the assurance of my highest consideration, Your Excellencies, the Representatives of the People of Timor-Leste in the National Parliament. The legislative and oversight mission entrusted to you by the Constitution and the Laws of the Republic and of great significance and scope for our Nation!

Presidential Palace President Nicolau Lobato, Dili, 23 January 2019.

The President of the Republic,

/s/

Dr. Francisco Guterres Lú Olo