

# Proposed 2023 Budget Book

## PRODUCTIVE INVESTMENT AND INCLUSIVE GROWTH FOR FUTURE GENERATIONS

# REPORT

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## **Elements of the Budget Report by responsible entity**

<b>Elements</b>	<b>Entity</b>
Budget strategy	GMF
Projections of the main macroeconomic indicators with influence on the State Budget and its evolution	DGPO/DGE
Evolution of the financial situation of the Public Administrative Sector of the subsectors that compose it	DGT
Performance of the execution of the previous budget	DGT
Development and sustainability of the Petroleum Fund	DGGRE
Development and sustainability of public debt	GPRCGFP
Situation of treasury operations and treasury accounts	DGT
Tax revenue forecast and outgoing tax revenue	AA/AT
General guidelines for budgetary policy and programs	DGPO
Budget management streamlining measures	DGPO
Temporary and permanent budget policy measures	DGPO
Budgetary risk analysis	DGPO
Information on Contingent Liabilities of the Administrative Public Sector	DGPO
Annual and multi-year expenditures with public-private partnerships and respective overall debt situation	DGGRE
Information on Administrative Public Sector Arrears	DGPO/DGT
Comparison between the macroeconomic and budgetary forecasts used and the forecasts made by international reference organizations	DGPO
Comparison between the macroeconomic and budgetary forecasts used in the State Budget Law for the previous fiscal year and the observed real evolution	DGPO

## Executive Summary

### Budgetary Strategy

The theme of the proposed State Budget for 2023 is: **Productive Investment and Inclusive Growth for Future Generations**

Considering that Timor-Leste relies heavily on the Petroleum Fund to finance the State Budget and that the natural resources that contribute to the Petroleum Fund are finite, Timor-Leste's budget strategy seeks to diversify the economy away from dependence on natural resources, while creating jobs, reducing poverty, and promoting economic growth.

The government has adopted the following priorities:

- Mobilizing domestic revenues and introducing new tax initiatives.
- Using more and more alternative sources of financing, such as concessional and commercial loans and Treasury bills.
- Concentrating public spending on quality rather than quantity, abandoning traditional line-item budgeting and improving the annual and medium-term budgeting of programs, which will focus on impact rather than execution.

For the State Budget for 2023, the choice of expenditures was selected to align with a sustainable fiscal strategy, through the promotion of productive investment in the real economy as a driver of inclusive growth investing in social capital to ensure the present and future well-being of the Timorese people and prioritizing social inclusion and gender-sensitive policies to ensure that no one is left behind.

As foreseen in the Law of the Major Planning Options, the Government proposes in the General State Budget for 2023 expenditure of \$3,155,715,306.

**Table 1: Revenues and Expenditures of the State General Budget for 2023**

Sub-Sectors	Revenue	Expenditure
Central Administration	2,800,000,000	2,800,000,000
Social Security	235,715,306	235,715,306
RAEOA	121,206,835	120,000,000
Total	3,156,922,141	3,155,715,306

Source: DGPO, Ministry of Finance, September 2022

### Macroeconomic Overview

The year 2021 saw a recovery in economic growth to 2.9% after a negative growth in 2020. This was due to a private sector activity better than expected. The recovery of the economy is expected to continue with stable and continued growth forecasts in the medium term.

**Table 2: Indicators Macroeconomic Overview**

Summary	Actual		Forecast					
	2020	2021	2022	2023	2024	2025	2026	2027
% of real non-oil GDP	-8.3	2.9	3.3	3.5	3.6	3.5	3.4	3.6
Inflation CPI %	0.5	3.8	7.2	5.5	3.3	2.8	2.6	2.4

Source: GDP/Inflation 2020-2021= DG Statistics, National Accounts, GDP/Inflation Forecast 2022-2027= national Directorate of Economic Policy, Ministry of Finance, 2022.

Inflation is expected to reach 7.2% by the end of 2022. This is mainly due to rising world oil and food prices due to supply disruptions caused by the war in Ukraine. Despite this, the forecast has been slightly reduced from 7.8% after a recent calming of world prices. Inflation is expected to decline from 2023 onwards, in line with the latest IMF estimates.

### **Budgetary Measures**

The draft General State Budget for 2023 is formulated on the basis of the following Strategic Objectives of the VIII Government that aim to provide for all citizens as a whole:

1. Opportunity to have a healthy, safe and long life
2. Access to knowledge, technology and innovation
3. Access to sufficient resources to ensure a life of dignity

With these three objective and strategic goals in mind, the Government's inclusive development agenda aspires to promote holistic wellbeing for people and foster an environment for people to live in, contribute to, and participate in the economic development of the country.

Such an ambition requires the development of livable communities, which includes access to quality education, health, water and sanitation, social protection, basic infrastructure, and major investments in the productive sector to recover and diversify the economy.

The State Budget for 2023 supports the development of public infrastructure so that the Timorese economy will continue to grow in a sustainable and inclusive way, connecting the country through an ambitious network of roads and bridges, bringing electricity to all sucos and villages, and connecting Timor-Leste to the world economy through the expansion of ports and harbors, and the construction of an undersea cable with Australia for high-speed internet. This will be combined with support for the growth of emerging industries such as agriculture, agro-industry, manufacturing, and tourism.

About 36% of the State Budget for 2023 will be allocated to the social capital sector, which includes health, education, and social protection. This equals \$772 million and makes the social capital sector the largest recipient of budget funds in 2023, reflecting the importance placed on universal access to quality education (\$137 million) and health (\$92 million) and social protection (\$301 million), especially for vulnerable segments of society.

### **Revenue and Financing**

The total expenditure budgeted for 2023 is higher than the domestic revenue that will be collected in the same period. This results in a non-oil deficit (domestic revenues minus expenditures). This deficit is financed through several sources: Petroleum Fund withdrawals, borrowing, use of cash balances, and Direct Budget Support from the European Union and the Government of Australia.

Domestic revenues are expected to reach \$153.7 million this year. It is expected to rise to \$174.9 million in 2023 as a result of the introduction of new tax rates.

The Estimated Sustainable Income (ESI) of the Petroleum Fund is estimated to be of \$490.1 million in 2023. The government plans to take \$855.9 million in addition to the ESI for the 2023 State Budget. This figure represents a significant decrease from the excess withdrawals planned in the State General Budget for 2022, which totaled \$1,998.5 million.

## **Budget Sustainability**

Timor-Leste is highly dependent on the Petroleum Fund to finance the budget deficit, and therefore, this should be the main focus of any analysis of fiscal sustainability. The long term sustainability of the Petroleum Fund depends not only on the budget choices made this year, but also on the choices made for the following years.

The analysis shows that under the current spending trend, the Petroleum Fund will be exhausted in 2034. By then, the difference between domestic revenues and public spending may reach \$1.6 billion.

Gradual reductions in spending could extend the life of the Fund until at least 2044. If such cuts are combined with the introduction of VAT and property taxes, the fund could last at least until 2049. Further improvements in budgetary sustainability can also be assured if the investment projects in the Budget are successful and lead to economic growth.

## **Statement of Budgetary Risks and Contingent Liabilities**

This year's State Budget report contains the statement of budgetary risk for the country. Budgetary risks are budgetary outcomes that deviate from expectations or forecasts. They can arise from macroeconomic shocks or as a result of contingent liabilities. Contingent liabilities are expenditure commitments that arise when a specific event occurs. For example, a natural disaster may lead to public spending on social assistance programs.

Timor-Leste has some contingent liabilities, including those stipulated by law such as contracts, PPPs, public guarantee schemes and court decisions.

These contingent liabilities can result in the obligation to incur unforeseen expenses. There are also contingent liabilities, such as natural disasters, where there may not be a legal obligation to make an expenditure, but there may be a moral obligation to do so.

This year's State Budget allocated \$66 million for contingency funding. If budgetary risks result in an obligation to incur expenditure beyond this level, the Government can resort to withdrawals from the Petroleum Fund.

# 1. Budgetary and Public Finance Strategy

## A new budgetary and public finance management framework

1.1 The General State Budget Proposal for 2023 is the first one presented under the new rules approved by Law 2/2022, Framework for the General State Budget and Public Financial Management, published on February 10, 2022, , which replaced Law no. 13/2009, on Budget and Public Finance.

1.2 The new State Budget and Public Financial Management Framework Law (LEO) is the culmination of the Fiscal Reform and Public Finance Management started in 2015 with the objective of aligning Timorese legislation with international best international best practices.

1.3 The new law enshrines program budgeting as a means of preparing and organization of the State Budget, adding substantial planning elements to all phases of the planning elements to all phases of the budget process.

1.4. Budgetary classifications have been revised and expanded, notably through a new economic classification and the adoption of the functional classification based on the classification of the functions of government (COFOG) developed by the Organization for Economic Cooperation and Development and published by the United Nations Statistical Division as the standard classification of government activities, ensuring the comparability of government activities, ensuring the comparability of Timor-Leste's accounts with those of other countries.

1.5. The new law adopts a “two-step” budgeting process, with a approving the total expenditure ceiling for the Budget at the beginning of the budget process in May. the beginning of the budget process in May, and a General State Budget Law that approves the budget appropriations in October, allowing the National Parliament to contribute from the beginning to the definition of the budget ceiling and the main priorities of the of the Budget.

1.6. With the 2023 budget process, a new budget calendar is implemented which begins in May, and brings forward the date of presentation of the Law of the General State Budget Law from October 15 to October 1, in order to avoid the extension of the previous year's Budget Law, as has happened four times in the past last six years.

1.7 The new law significantly increases transparency, accountability and control of Public Finances, providing more information to the National Parliament for a more informed decision.

1.8. Some changes impact on the structure of the State Budget and budget tables, as well as in the documents that accompany the Budget Proposal, namely, the Budget Proposal, namely, the simplification of the Budget Law, being that much of the content that was previously in the Law, such as definitions, financial definitions, financial schemes and budget classifications, are now contained in the contained in the LEO, as well as subsequent regulations, and the budget tables are now clearly defined are now clearly defined and include three tables for General Government revenues and expenditures, including by functional classification, and three tables each for the revenues and expenditures of the Central Government, Social Security and including by programmatic structure, and organic and economic classification.

1.9 The new economic and functional classifications represent considerable progress considerable progress towards a more transparent and efficient budget. The classifications, regulated by Government Decree No. 19/2022, May 11, allow detailed organization of revenues and expenditures by type and function and follow international best international best practices.

1.10. The documents that accompany the Budget Proposal were reorganized into three parts: the Report, the Budgetary Developments and the Informative Elements. The Report presents the budgetary policy and analyzes the main variables that have an impact on the budget. The budgetary developments present the revenues and expenditures of each budget entity specified up to the maximum levels of disaggregation, according to the structure of the programs and by organic and economic classifications. Finally, the Informative Elements present all the relevant additional information necessary to understand the proposed Budget, as well as the financial situation of the Public Sector.

## **Budgetary Strategy**

1.11. The Budgetary Strategy defines the main objectives and priorities of the State Budget and underpins the budget policy options, respecting the principles of sound financial respect for the principles of sound financial management.

1.12. Considering that Timor-Leste depends heavily on the Petroleum Fund to finance the General State Budget and that the natural resources that contribute to the Petroleum Fund are finite, Timor-Leste's budget strategy seeks to diversify the economy away from reliance on natural resources, while creating jobs, reducing poverty and promoting economic growth.

1.13. Timor-Leste has made withdrawals from the Petroleum Fund beyond the Estimated Sustainable Income (ESI) since 2009, pursuing a policy of frontloading to finance infrastructure investments in an effort to boost economic growth.

1.14. However, oil revenues are declining and therefore, sound budgetary plans are critical to avoid a fiscal abyss in the short term, i.e. a dramatic drop in Government spending if alternative sources of funding do not fill the gap.

1.15. The Government has adopted the following priorities:

- Mobilization of domestic revenues and introduction of new fiscal initiatives.
- Use of increasingly alternative sources of financing, such as concessional and commercial loans and Treasury bills.
- Concentration of public spending on quality rather than quantity, abandoning traditional line item budgeting and improving the annual and medium term budgeting of programs, which now focus on impact rather than execution.

1.16. For the 2023 State Budget, the choice of expenditures has been selected to align with a sustainable fiscal strategy by promoting productive investment in the real economy as a driver of inclusive growth, investing in social capital to ensure the present and future well-being of the Timorese people, and prioritizing social inclusion and gender-sensitive policies to ensure that no one is left behind.

1.17. Thus, the theme of the proposed 2023 State Budget is: ***Productive Investment and Inclusive Growth for Future Generations***

1.18. The Budget proposal takes a decisive step towards achieving the budgetary budget objectives.

1.19. New measures on the revenue side are foreseen in the budget, including an increase in excise tax rates on sugar, sugary drinks, tobacco and luxury cars, as well as an increase in import tariffs.

1.20. We also anticipate that the drafts of a new Tax Law and new Tax Procedure Code will be presented to the National Parliament in the coming months, setting the stage for an overhaul of the tax regime.

1.21. In 2023, the Government plans to regulate and issue the first treasury bonds, directed to national entities and funds, which will provide a new source of revenue for the Government and reduce the cost of financing.

1.22. The planned opening of the Port of Tibar and the completion of some major road developments show the success of PPPs and concessional loans, allowing the Government to further rely on these tools for productive investment.

1.23. Finally, the Budget proposal moves away from traditional line item budgeting and a purely quantitative view to a focus on quality and performance by adopting program budgeting that values impact rather than execution, to better monitor the effects of the Budget on economic growth.

1.24. As the Covid-19 pandemic continues to dissipate compared to previous years, the Government is not going to be complacent in protecting the most vulnerable and promoting productive investment.

1.25. The Government will invest in the real economy in order to expand economic opportunities for Timorese throughout the country and reduce economic dependence on the Petroleum Fund or emigration.

1.26. The 2023 State Budget supports the development of public infrastructure so that the Timorese economy continues to grow in a sustainable and inclusive manner, connecting the country through an ambitious network of roads and bridges, bringing electricity to all sucos and villages, and connecting Timor-Leste to the world economy through the expansion of ports and harbors, and the construction of a submarine cable with Australia for high-speed internet. This will be combined with support for the growth of emerging industries such as agriculture, agro-industry, manufacturing, and tourism.

1.27. Diversifying the economy and the tax base and ensuring productive investment and inclusive growth is the best strategy to ensure that medium and long term national objectives are achieved.

## Macroeconomic Overview

**Table 3: Economic Indicators, 2020-2027, %**

Summary	Actual		Forecast					
	2020	2021	2022	2023	2024	2025	2026	2027
% of real GDP (non-oil)	-8.3	2.9	3.3	3.5	3.6	3.5	3.4	3.6
Inflation CPI %	0.5	3.8	7.2	5.5	3.3	2.8	2.6	2.4

Source: GDP 2020= DG Statistics, National Accounts, GDP Forecast 2021-2027= National Directorate of Economic Policy, Ministry of Finance, September 2022.

1.28. Timor-Leste experienced an average GDP growth of 3.1% per year from 2001-2021. These growth rates were more pronounced in the early 2010s, driven by the government's economic strategy of frontloading so that Timor-Leste has the necessary infrastructure for long-term, private sector growth.

**Table 4: National Accounts 2016-2021 \$m**

	2016	2017	2018	2019	2020	2021
<b>Private Consumption</b>	970.1	1,000.3	1,017.0	1054.8	1022.3	995.0
<b>Public Consumption</b>	926.6	872.8	870.3	897.9	941.6	974.9
<b>Total Consumption</b>	1,896.7	1,873.0	1,887.3	1,952.6	1,963.9	1969.8
<b>Private investment</b>	126,1	142,8	68,8	67,3	56,2	50,9
<b>Public investment</b>	527,2	401,5	467,6	375,9	198,5	170,6
<b>Total investment</b>	653.3	544.3	536.4	443.2	254.6	221.5
<b>Other (*)</b>	26.3	42.8	46.2	54.1	51.6	25.4
<b>Total National Expenditure</b>	2.576,3	2460,2	2.469,9	2.449,9	2.270,2	2.216,7
<b>Exports</b>	52.6	32.1	37.4	31.0	15.1	38.2
<b>Imports</b>	980.6	894.3	920.3	860.8	799.5	726.7
<b>Real non-oil GDP</b>	1.648,4	1.598,0	1.587,0	1.620,0	1.485,8	1.528,2
<b>% GDP growth</b>	<b>3,4</b>	<b>-3,1</b>	<b>-0,7</b>	<b>2,1</b>	<b>-8,3</b>	<b>2,9</b>

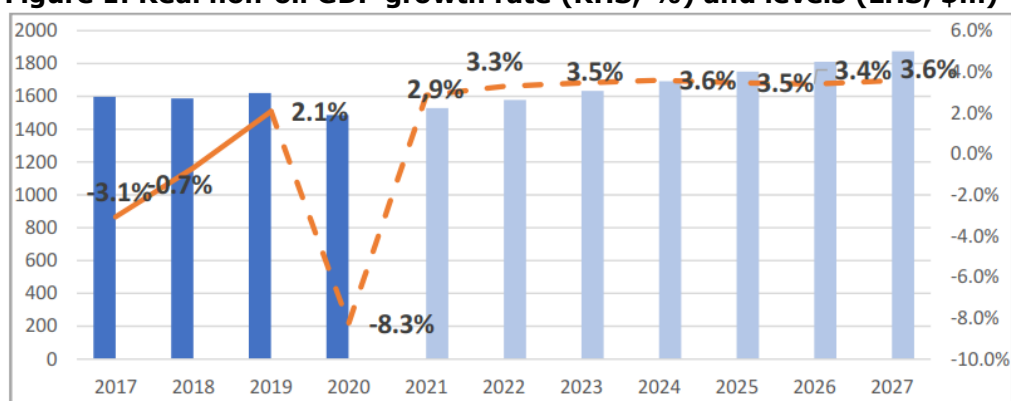
Source: National Accounts, Direção Geral de Estatística, September 2022

1.29. Government investment has allowed for a significant improvement in the coverage of road and electricity and electricity coverage in Timor-Leste, which has helped to improve living standards and the standards of living and the business environment. However, negative economic growth in 2017, 2018 and 2020 threatened the progress made.

1.30. Public investment in 2020 was constrained by the application of the duodecimal system, political uncertainty, and the Covid-19 pandemic. In 2021, despite the confinement caused by the Covid-19 pandemic, the impact of cyclone Seroja, and the low execution of Capital Development expenditures, non-oil real GDP in Timor-Leste was real non-oil GDP in Timor-Leste increased by 2.9% to \$1,528.2 million, which exceeded forecasts.

1.31. The economy of Timor-Leste should return to positive and stable growth rates in the medium term.

**Figure 1: Real non-oil GDP growth rate (RHS, %) and levels (LHS, \$m)**



Source: National Accounts of Timor-Leste 2000-2021, Direção Geral de Estatística; Economic Forecasts 2022-2027, National Directorate of Economic Policy, Ministry of Finance, September 2022.

1.32. The budget allocation for 2022 is particularly large due to the increase of the budget ceiling after the Amending Budget presented in May 2022 (\$ 3.4 billion). However, this will not have a significant effect on GDP, which is expected to grow by 3.3%, as \$1 billion is earmarked for the Fund of the Combatants Fund (FCLN), which will be invested in the financial markets to generate future generation of future income.

1.33. Growth forecasts have been adjusted slightly to reflect more positive investment indicators. One of the main drivers of growth for 2022 is the strong execution in the Port of Tibar, which is a significant PPP project for the economy (for information on why there are changes in the historical National Accounts figures and how GDP forecasts are made see the Methodological Annex).

1.34. In 2023, GDP is expected to grow by 3.5 percent due to a return to pre-COVID levels of pre-COVID private investment levels and political stability. It is expected that economic growth 2024-2027 to be stable and continuous.

1.35. The overall growth outlook is expected to decline from 3.2% in 2022 to 2.9 percent in 2023. In advanced and emerging economies and developing economies, GDP is projected to grow on average 2.5 percent and 1.4 percent in 2022 and 2023, respectively. The war in Ukraine and the pandemic are the main factors that have contributed to the significant slowdown in growth in 2022 and to the increase in inflation. China is expected to grow 3.3 percent in 2022 compared to 2021, when it grew by 8.1%.

**Table 5: Growth Indicators, 2020-2023, %**

Region/Country	Actual		Forecast	
	2020	2021	2022	2023
World	-3.1	6.1	3.2	2.9
Advanced economies	-4.5	5.2	2.5	1.4
Emerging & developing economies	-2.0	6.8	3.6	3.9
Emerging and developing Asia	-0.8	7.3	4.6	5.0
China	2.2	8.1	3.3	4.6

Source: IMF World Economic Outlook, July 2022.

1.36. Consumer prices are expected to rise, with the IMF forecasting an expected overall inflation growth of 8.3 percent in 2022 and 5.7 percent in 2023.

1.37. The increase in inflation reflects the impact of higher demand and lower supply due to the war in Ukraine and the sanctions on Russia.

1.38. The rise in oil prices has contributed to the increase in inflation in advanced economies, but is projected to slow in the coming years.

1.39. In emerging and developing economies, inflation increased reflecting the impact of currency depreciation and higher commodity prices, which increase the prices of imported goods, but the projection is for moderation by 2023.

**Table 6: Global and regional inflation rates (%)**

Country	Actual		Forecast	
	2020	2021	2022	2023
<b>World</b>	3.2	4.7	8.3	5.7
<b>Advanced economies</b>	0.7	3.1	6.6	3.3
<b>Emerging and developing economies</b>	5.2	5.9	9.5	7.3
<b>Timor-Leste*</b>	0.5	3.8	7.2	5.5

Source: IMF World Economic Outlook July 2022. \*Ministry of Finance forecast, September 2022.

1.40. Oil prices are important to Timor-Leste both for consumers and as an exporting consumers as well as an oil exporting country. Global demand fell sharply the beginning of the pandemic to \$21/barrel in April 2020, but then started to increase sharply and reached \$116.8/barrel in June 2022 due to the war in Ukraine. Prices are expected to slow down in the near future, and we are already seeing a decrease in prices.

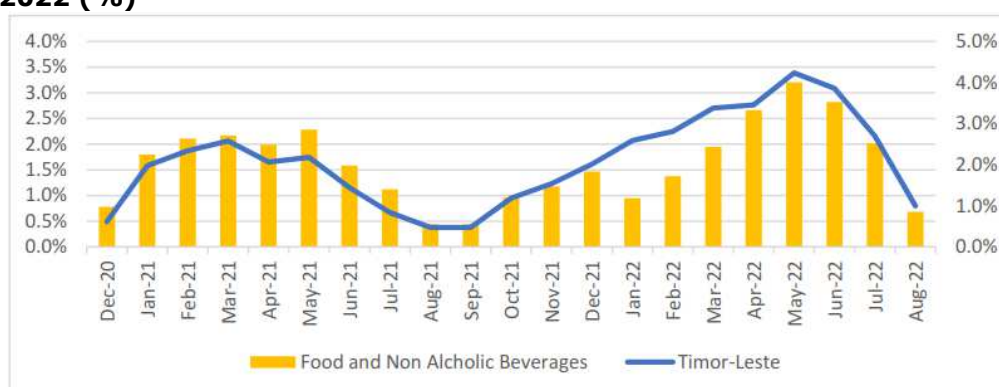
1.41. Due to the significant weight of food and non-alcoholic beverages in the basket the Consumer Price Index (CPI) basket and the high proportion of food imported by imported by Timor-Leste each year, international food prices remain a major driver of remain one of the main drivers of the overall CPI rate, so that changes in international food prices international food prices can have a significant impact on both the inflation rate and the on both the inflation rate and the standard of living.

1.42. During 2022, the increase in commodity prices is related to supply disruption, the war in Ukraine and sanctions on Russia, however, the World Bank expects the food price index to moderate until December 2022. This will have a positive effect on the poorest households, for whom staple foods make up the bulk of spending.

1.43. The level of inflation in Timor-Leste has experienced a sharp increase over the past year. In August 2022 the year-on-year inflation in Timor-Leste was 7.9%; this means that a basket of goods and services that cost \$100.00 in August 2021 cost \$107.9 in August 2022.

1.44. Annual food and non-alcoholic beverage inflation in August 2022 was 8.3%, higher than the 3.9% increase seen in August last year. This is mainly due to the sharp increase in world oil prices as a result of the war in Ukraine, driving up import and food prices, as explained above.

**Figure 2: Recent Changes in the Timor-Leste Consumer Price Index Dec 2020-Aug 2022 (%)**



Source: Direção Geral de Estatística, Ministry of Finance, September 2022.

1.45. The DNPE forecasts the inflation rate using the latest IMF World Economic Outlook annual forecasts for global inflation and major indices and commodities, such as food and oil, as well as the monthly updated CPI data from DGE.

1.46. The effective exchange rate is the exchange rate of a country's currency, measured as the weighted sum of the exchange rates with its trading partners. The real effective exchange rate (REER) is adjusted for the effects of inflation and is a better measure of competitiveness.

1.47. Between August 2021 and August 2022, the REER appreciated by 5.7 percent. During this period, the REER appreciated 3.7% against a basket weighted in Thai Baht and Vietnamese Dong. This real appreciation puts downward pressure on rice prices and inflation in Timor-Leste (as Thailand and Vietnam export large quantities of rice to Timor-Leste).

1.48. The amount and cost of credit to the private sector is an important indicator for private sector development.

1.49. The average interest rate on loans to private enterprises has fallen since January 2020, by an average of 11.1 percent over the past 12 months. Total domestic credit excluding the Public Administrative Sector was \$337.7 million in July 2022 and private loans increased by 12.4% in July 2022 compared to July 2021, this indicates that the private sector is showing signs of recovery.

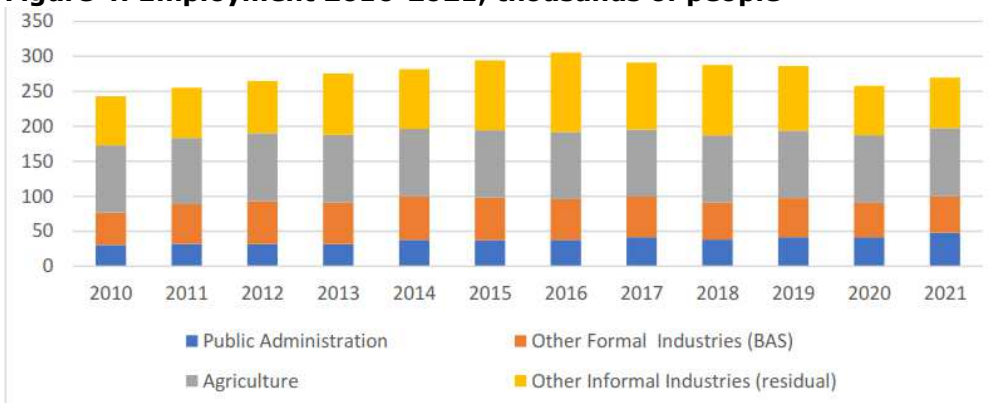
**Figure 3: Commercial Interest Rates and Credit**



Source: Central Bank of Timor-Leste, 2022. Interest Rate (RHS, %), Credit (LHS, \$m), August 2022.

1.50. Total employment (formal and informal) is about 9% higher in 2021 than it was in 2010, but is still 11% lower today than its peak in 2016, with the informal sector accounting for about two-thirds of employment in Timor-Leste. Over this period, informal employment in agriculture has been relatively stable. At 2021, formal employment is estimated to have increased by about 10% over 2020 - this is an all-time high.

**Figure 4: Employment 2010-2021, thousands of people**



Source: Directorate General of Statistics, Ministry of Finance, September 2022.

1.51. Employment estimates in Timor-Leste use various sources reconciled by the National Accounts, for example, the Labor Force Activity Survey, Survey of Business Activity and the MF financial report. Note that this is an internal estimate made by the National Accounts and does not replace the Annual Employment Survey.

## **2. Fiscal Policy**

### **Government Priorities and Measures for 2023**

2.1. The State Budget for 2023 continues to place people at the center of policy center of policy formulation and prioritizes the welfare of citizens to ensure a fair and equitable ensure a fair and equitable distribution of national resources, to improve service delivery and service delivery and assist economic recovery and resilience, to promote sustainable and sustainable and inclusive economic growth over the medium-term, and to ensure that Timor-Leste can become a Timor-Leste can become an upper-middle income country by 2030.

2.2 The draft General State Budget for 2023 is formulated based on the Strategic Objectives of the VIII Government with a view to providing all citizens with 1) The opportunity to lead a healthy, safe and long life; 2) Access to technology and innovation; and 3) Access to sufficient resources to guarantee a dignified life.

2.3 With these three strategic objectives in mind, the Government's agenda for inclusive development aspires to promote holistic wellbeing for the population and population and promote an environment for citizens to live in, contribute to, and participate in the economic development of the country.

2.4 Such an ambition requires the development of livable communities, which includes access to quality education, health, water and sanitation, social basic infrastructure, and major investments in the productive sector to recuperate and diversify the economy.

2.5. The general characteristics of budget policies and programs for 2023 specifically aim to invest in social capital to ensure the present and future well-being and future well-being of the Timorese people, as well as promoting productive investment in the economy as an engine of inclusive growth.

2.6 All this is done while respecting the fundamental principle of social inclusion and gender-sensitive policies to leave no one behind. A gender sensitive budgetary approach will also be realized by developing plans that recognize differences in outcomes for all citizens, thus requiring potentially tailored approaches in key areas such as gender-based violence, social gender-based violence, social protection, health, education, leadership, and programs for women's economic empowerment.

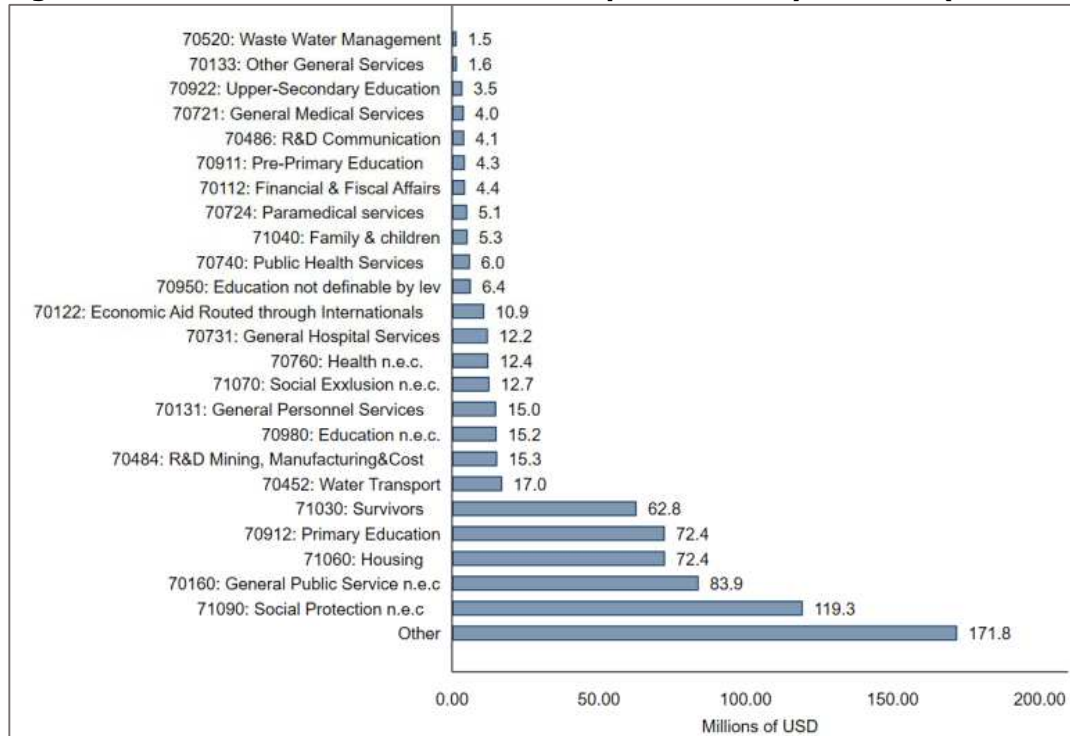
### **Investing in social capital to ensure the present and future well-being of the Timorese people**

2.7 Although the Covid-19 pandemic will have subsided by 2022, some of its social and economic impacts are considered long-lasting and persistent.

2.8 Between 2020 and 2022 the Government provided various financial incentives to households and businesses, absorbing most of the decline in economic growth induced by Covid-19.

2.9 For the 2023 budget year, the Government will continue to support the most vulnerable and provide incentives for productive investment as the economy returns to growth, so that the recovery does not accentuate the inequalities triggered by the crisis.

**Figure 5: OGE distributions in the social capital sector by function (excl. FCLN)**



Source: *Planning and Budgeting System of Timor-Leste (Dalan Ba Futuru)*, September 2022.

2.10. Excluding the \$1 billion for the National Liberation Fighters' Fund (FCLN), about 26% of the 2023 State General Budget will be allocated to the social capital sector, which includes health, education, and social protection, as shown in the chart above. This equals \$739 million and makes the social capital sector the second largest recipient of budget resources in 2023, reflecting the importance given to universal access to quality education (\$140 million) and health (\$92 million) and social protection (\$301 million), especially for more vulnerable segments of society.

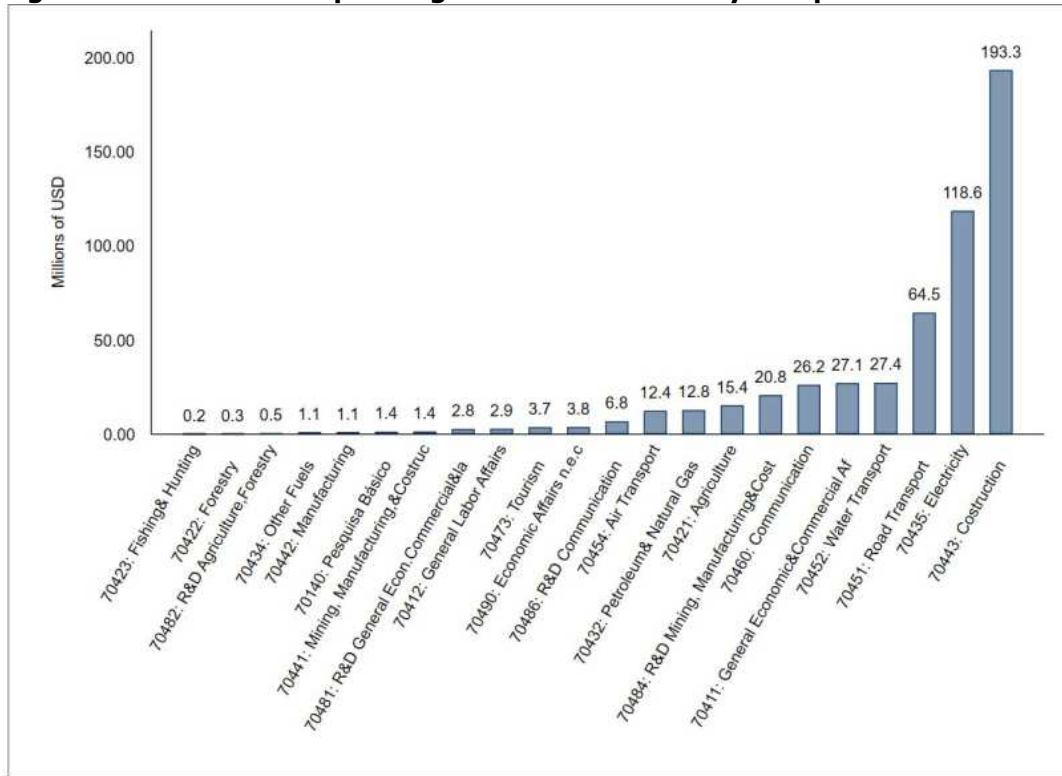
### Promoting productive investment in the real economy as an engine of inclusive growth

2.11. The Government will invest in the real economy to create economic opportunities for Timorese throughout the country and reduce economic dependency on imports and emigration.

2.12. The Government believes that the political independence of our country is guaranteed by its economic independence.

2.13. Therefore, for fiscal year 2023, the Government will continue to support the development of basic infrastructure so that the economy continues to grow in a sustainable and inclusive manner, connecting the country through an ambitious program of roads and bridges, bringing electricity supply to all villages (suco), fostering Timor-Leste's insertion in the world economy through an adequate network of ports, and supporting Timorese businesses in economic sectors where we have a competitive advantage such as agriculture, agribusiness, manufacturing, mining, oil and gas, and tourism.

**Figure 6: Government spending on the real economy and productive infrastructure**



Source: Timor-Leste Planning and Budgeting System (*Dalan Ba Futuru*), September 2022.

2.14. As shown in the graph above, the Government has allocated \$125 million<sup>1</sup> to develop an extensive network of quality, well-maintained roads, connecting communities, promoting rural development, industry and tourism, and providing access to markets.

2.15. The Government will also invest \$17 million in the construction, rehabilitation maintenance and conservation of bridges and rural roads, \$ 15 million in the construction of the National Pante Macassar Road and \$7.8 million in the rehabilitation of 30 km of municipal road in Laga-Baguaia among other initiatives.

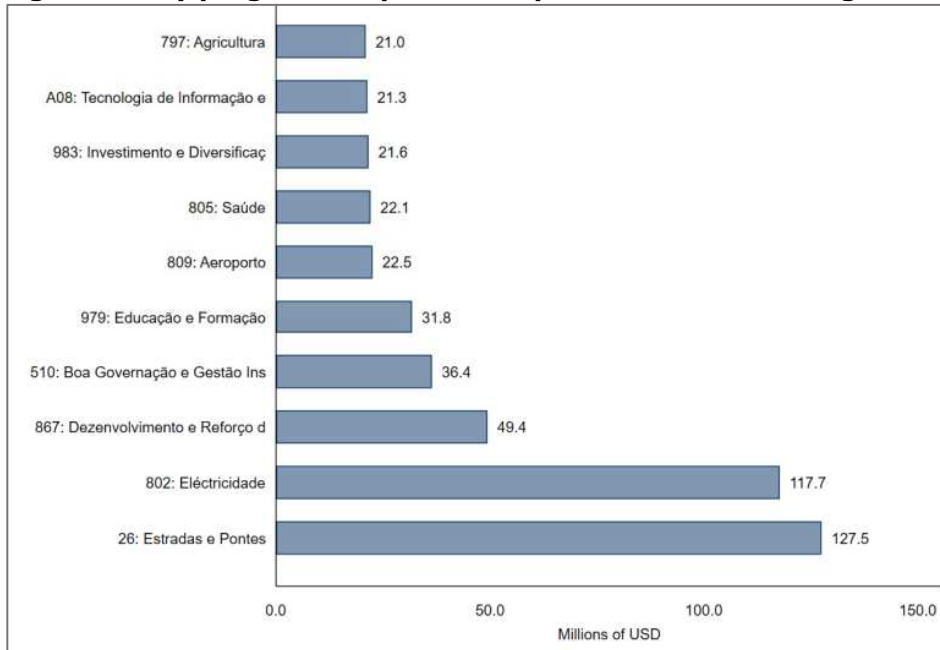
2.16. Making electricity available at a fair price to all households and businesses in the country is another pillar of the Government’s strategy to promote productive and inclusive and inclusive growth. Access to electricity is a basic right and the basis for our economic future.

2.17. By 2023, the Government will invest \$119 million to ensure that by 2030 all Timorese households have access to electricity, either through the expansion of the national electricity distribution system or by promoting small-scale, local renewable energy systems.

2.18. A significant part of this total will be spent on the construction of new facilities, focusing on renewable energy sources, and \$100 million will contribute to the direct supply of electricity to direct supply of affordable electricity nationwide through the EDTL.

<sup>1</sup> Some road investments are included in the construction category.

**Figure 7: Key programs to promote equitable and inclusive growth in 2023**



Source: *Timor-Leste Planning and Budgeting System (Dalan Ba Futuru)*, September 2022.

2.19. In addition, the Government also aims to promote equitable and inclusive growth geographically.

2.20. The General State Budget for 2023 has increased the resources allocated to municipalities and the RAEOA. The Oe-Cusse Ambeno region will be an example for the nation of a successful social market economy, where citizens can have access to health care quality health care, education and basic services, and opportunities for sustainable economic development opportunities in an urban and rural environment.

2.21. The region will implement a \$50 million program aimed at strengthen its economy. The program will finance multi-year socio-economic projects (\$12 million), public works programs (\$7 million), the construction of an administrative complex in Pante Macassar (\$5 million) and the construction and rehabilitation of rural roads (\$5 million) among other activities.

2.22. Measures will also be taken to promote the diversification of the economy and support the private sector in areas where Timor-Leste has comparative advantages to integrate into the world economy.

2.23. Thus, a \$21 million program in the agricultural sector will support a sustainable increase in production and productivity to improve economic returns and competitiveness and gain efficiency. A thriving agricultural sector is necessary to reduce poverty, provide food security, and promote economic growth economic growth in rural areas and in our nation.

2.24. With this goal in mind, in 2023 the Government will expand the irrigation systems in Laivai (\$3.6 million) and Galata (\$2.6 million), support the extension of agricultural areas and their mechanization (\$2.6 million), and develop integrated agricultural zones in irrigated areas (\$2.1 million).

2.25. Finally, recognize the potential and important role that the agricultural sector will play in the economic rise of the country does not mean limiting oneself only to this economic activity. The Government believes that Timor-Leste has enormous potential to diversify and expand its economy into modern, technology-based sectors.

2.26. However, in order to build the nation and provide employment and income to the people, Timor-Leste needs to attract investors in key industry sectors, partner with industry, partner with international companies in building infrastructure, and support local infrastructure, and support local businesses to start up and grow. Thus, by 2023 the Government is investing \$25 million to accelerate economic diversification, investing in the telecommunications sector (\$14.5 million), promoting local products (\$6.4 million), creating a one-stop-shop for business registration (\$2 million), and establishing industrial parks (\$1.3 million).

## **The Major Planning Options for 2023**

2.27. Following the promulgation of the LEO, which provides for the development of a budgeting model that represents a paradigm shift in the way public policies are planned and budgeted, containing information on their purposes and impact on public accounts, the economy and society, the 2023 budget process was developed through a “two-step” process, specifically the Major Planning Options Law and the State Budget Law.

2.28. The Major Planning Options (Grandes Opções de Plano) (GOP) is the document that fills the gap between planning and budget, and identifies the measures that will be carried out that year and will have budgetary implications.

2.29. The measures of the GOP are obtained from the Strategic Development Plan, the medium-term plans and the annual plans of the services and entities of the Public Administrative Sector, from national and international commitments assumed, as well as from any other political and strategic documents of the Government.

2.30. The GOP constitute the justification for the budgeting of activities that will integrate the General State Budget, presenting concrete and abstract measures that contribute to the achievement of objectives and targets set in the Annual Plan.

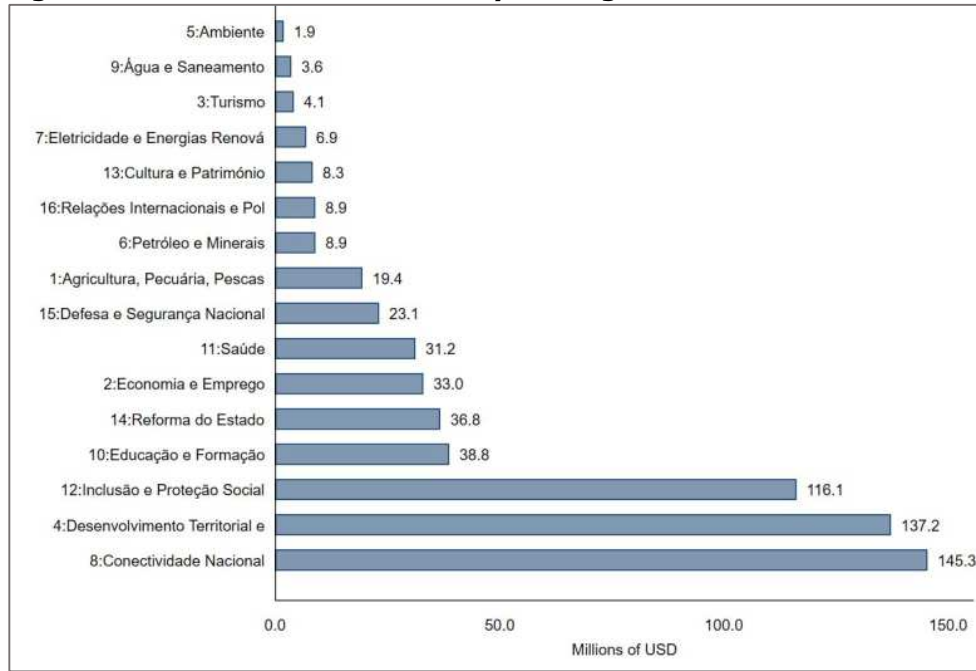
2.31. While the GOP are not a Medium Term Plan, they provide key concrete measures focusing on large multi-year investments in the productive sector to recover and diversify the economy, as well as key measures in strategic areas such as education, health, social security protection, water and sanitation, etc., which will have budgetary implications.

2.32. The GOP will be reviewed and updated annually for each measure in key strategic areas and submitted to the National Parliament on May 10 of each year for discussion and approval.

2.33. For FY 2023, \$600 million (as shown in the chart below) has been distributed to fund 275 key GOP measures organized into sixteen (16) strategic areas that align with sub-sectors of the Strategic Development Plan: Agriculture, Livestock, Fisheries and Forestry; Economy and Employment; Tourism; Rural Development and Housing; Environment; Petroleum and Minerals; Electricity and Renewable Energy; National Connectivity; Water and Sanitation; Education and Training; Health; Social Inclusion and Protection; Culture and Heritage; State Reforms; Defense and National Security; International Relations and Foreign Policy.

2.34. The measures of the GOP will be implemented in 30 national programs and will contribute to the 28 national outcomes as presented in the Law of the Great Options of the Plan (Law no. 8/2022). The graph below shows the distribution of the State General Budget for 2023 across the 16 strategic areas of the GOP.

**Figure 8: Distribution of the OGE by strategic areas of the GOP**



Source: Timor-Leste's Planning and Budgeting System (*Dalan Ba Futuru*), September 2022.

2.35. In the above chart, the National Connectivity strategic area (\$145 million) is the one that receives the largest amount of the total State Budget aligned with the information presented by programmatic structure and functional classification. The Government's objective of prioritizing equitable and inclusive growth, including from the geographical point of view, is reflected in the fact that the strategic areas of the GOP. Territorial Development and Housing (\$136 million) and Social Protection and Inclusion (\$108 million) are, respectively, the second and third largest recipients of funding from the General State Budget. The following highlights the main information on concrete actions in each of the strategic areas of the GOP that will be implemented in 2023:

### **Agriculture, Livestock, Fisheries and Forestry**

2.36. Agriculture, livestock, fisheries and forestry are strategic areas for the settlement of rural populations and for the development of the country's economy.

2.37. For 2023, the Government intends to consolidate measures and increase the budget allocation to strengthen investment in this sector.

2.38. The main interventions in this area include the improvement of agricultural productivity and accelerating the transition from subsistence agriculture subsistence farming to a modern, market-oriented agricultural model that ensure food security, diversification and strengthening of domestic consumption.

2.39. In addition, the Government is also investing in the livestock sector because of its great potential to contribute to improving the nutrition of the Timorese people through access to and consumption of fresh meat and dairy products.

2.40. To improve this sector, in 2023 the Government intends to invest in affordable and quality feed and ensure the vaccination and deworming of animals.

2.41. Similarly, the Government plans to improve investment in the fisheries sector and expand the sector to combat food insecurity and malnutrition and contribute to economic growth, improved livelihoods and job creation.

2.42. Finally, for this sector, the Government continues to invest in the protection of the fauna and biodiversity of the country, promoting investment in the forestry sector making the demarcation and measurement of potential areas for the development of commercial plantations of sandalwood and encouraging the development of nurseries.

## **Economy and Employment**

2.43. The creation of new businesses and industries and investment in the private sector is the engine of growth, innovation and job creation for the Timorese people and will enable the transition to a non-oil economy.

2.44. The Government is committed to diversifying the economy and creating the fiscal and bureaucratic and fiscal conditions that allow a greater predisposition for national and international investors to invest in the country.

2.45. In this sense, for 2023, the Government proposes interventions in five key areas, trade, industry, private sector, employment and cooperatives, to improve the business and investment environment, create conditions for entrepreneurship stimulate active participation in the economy, and increase the export of goods, which contributed to an increase in state revenue through the collection of taxes.

## **Tourism**

2.46. Tourism is an important engine for the development of the national economy its impact on the creation of employment and income, as well as contributing to the safeguarding the natural and cultural heritage of Timor-Leste.

2.47. With unparalleled natural beauty, a rich history and a unique cultural heritage, Timor-Leste has all the conditions to develop an original tourism sector tourism sector, which involves above all its people, religion and culture.

2.48. In this sense, for 2023, the Government has identified key measures that include the promotion of ecotourism, the combination of lodging with coffee or rice plantations rice and suco-level tourism sites, and building the capacity of communities to develop and manage the sites, and increasing the number of tourists by increasing the number of cruise ships docking in the national ports, as well as support to private companies that develop activities in the tourism sector.

## **Land Development and Housing**

2.49. The Government intends to promote the quality of life for all Timorese, especially those living in remote and hard-to-reach areas, through various initiatives ranging from the municipal level to the village level, to create local jobs and raise the standard of living and well-being of the population.

2.50. In this regard, for 2023, some of the major priorities include the continued implementation of the Integrated Municipal Development Planning (PDIM) program for new projects, the National Sucos Development Program (PNDS) and the Roads for Development (R4D) program, as well as promoting and developing community economic activities through the Manpower Administrative Post Program (PMOPA) and community economic activities through the Hafoun Village Movement Program (PMOHA).

2.51. In 2023, the Government also intends to extend the scope of intervention of the existing social housing program “Uma ba Ema Kbiit Laek “ (abbreviated as UKL) integrated into the PNDS that started in 2021, to create an additional measure, called “Uma ba Ema Kbiit Laek Plus “ (abbreviated as UKL+), which comprises the provision of two new forms of support to vulnerable households as the improvement of the current UKL project, and the conservation or repair of houses in poor condition and supply of building materials for the replacement of the house roofing material.

## **Environment**

2.52. Air pollution has grown substantially, especially in Dili, as a result of emissions from cars and motorcycles, in addition to fumes released from residences and forest fires.

2.53. The Program of the VIII Constitutional Government places special emphasis on the need to promote and implement an environmental policy, ensure the protection and conservation of nature and biodiversity, control pollution, combat climate change and strengthen environmental licensing and education services, as well as the supervision of activities harmful to flora and fauna and ensure national development in an environmentally sustainable manner.

2.54. In this context, some of the main measures planned to be implemented in 2023 include improving the system of environmental licensing services, including the collection of environmental fees, preparing and approving environmental taxes to increase revenue collection, and promoting the identification of plants to be included in the carbon market, as well as promoting resilience to climate change through adaptation, mitigation and control actions for ozone-damaging chemicals.

### **Oil and Minerals**

2.55. The petroleum sector has been the main source of revenue for the State Budget to provide public services to the population and to build and maintain our Nation's infrastructure.

2.56. The Government remains committed to increasing petroleum and mineral revenues and achieving the sustainability of the Petroleum Fund, to ensure its preservation for future generations.

2.57. The Government has identified key interventions that will be taken in 2023 to maximize investment in the petroleum and mineral sectors, including increasing study and research activities through the continued promotion of onshore and offshore exploration blocks to maximize investment in the petroleum and mineral sectors and develop feasibility and sustainability studies on the use of natural gas for power generation, seeking to use less costly energies that address environmental issues.

### **Electricity and Renewable Energy**

2.58. Access to regular and reliable electricity supply is a fundamental right and the basis for economic growth in Timor-Leste.

2.59. For 2023, the Government intends to continue to invest in upgrading and improving the transmission and distribution of electricity and rural electrification, while investing in the expansion of renewable energy.

2.60. Investing in renewable energy sources can contribute to a less polluted environment and mitigate the impacts of climate change in accordance with the commitments made in international conventions.

### **National Connectivity**

2.61. The Government is committed to improving national connectivity through the construction, rehabilitation and maintenance of climate and weather resilient core and productive infrastructure to connect and create conditions for the movement of people and goods, economic growth, job creation and private sector development.

2.62. For the year 2023, the Government remains committed to investing in three priority areas in this sector namely: a) infrastructure (ports, airports, roads and bridges); b) logistics (land, maritime and air transport system); and telecommunications (maritime and land optical fiber).

### **Water and Sanitation**

2.63. Access to clean, potable water and modern sanitation services are fundamental to protecting the health of all Timorese.

2.64. Improving the quality of water, sanitation and drainage in Timor-Leste will help build the resilience necessary for the country to meet future health challenges and grow the economy.

2.65. For 2023, some of the major interventions include starting the project to upgrade the water treatment, sanitation and drainage system in Dili in collaboration with the Millennium Challenge Corporation (MCC), increasing the coverage area of the drinking water supply service, and completing the rehabilitation of damaged clean and drinking water facilities.

### **Education and Training**

2.66. The provision of quality education and training are essential for shaping personality, creating conditions for employability and competitiveness of people of working age, and ensuring the economic development of the country, and are a key tool for moving out of poverty.

2.67. To ensure that all children and young people have access to the learning and skills essential for success in society, the Government remains committed to investing significantly in the rehabilitation of basic educational infrastructure, strengthening the quality of the national formal education curriculum and improving opportunities for the ongoing training and professional development of existing teachers and school leaders.

2.68. For 2023, some of the new initiatives in this sector include reforming the school feeding program, ensuring internet access in all schools and universities, providing merit scholarships to the best students in primary and secondary education, continuing the implementation of the home-schooling program, and implementing a recruitment program targeting the best students in national universities.

2.69. The Government also plans to start a pilot project for the implementation of day-care centers in the Municipality of Dili, for children from 0 to 3 years old, whose parents work and need this support.

2.70. Additionally, the Government also plans to undertake a study for the improvement of education through the development of a center of excellence that will provide initial training for future secondary school teachers and school leaders, and provide continuing and professional training for current teachers and school leaders, in collaboration with MCC.

## **Health**

2.71. Equitable access to essential, quality health services that are well-equipped equipped and staffed by competent health professionals is a fundamental health professionals, is a fundamental objective.

2.72. Thus, for 2023, the Government's intervention is oriented towards the rehabilitation basic health infrastructure at national and municipal level, expansion of health services, introduction of health services, introduction of public-private partnerships in Health Diagnostic Health Services, and improving the quality of health service delivery through health system innovation, promoting constant improvement in the development and deployment of development and deployment of human resources, strengthening efforts to combat malnutrition, and improving the national response to outbreaks and emergencies and emergencies of dengue, cholera and other diseases.

## **Social Inclusion and Protection**

2.73. The Government is continually committed to assisting the poorest and most vulnerable citizens of vulnerable citizens of the Timorese society.

2.74. The Budget proposal for 2023 will make a specific commitment to consolidation of a policy of social cohesion and guarantee of dignity and human rights for all rights to all Timorese, both by improving the sustainability of the Social Security Social Security System or by strengthening social assistance to the most disadvantaged.

2.75. In this context, the Government has identified key interventions to ensure that women and children, young people, as well as the elderly and other vulnerable citizens, have access to the satisfaction of their fundamental needs and well-being, as well as access to opportunities to move out of their fragile state.

2.76. Some of the key interventions include a number of reforms of the Bolsa da Mãe program, and the creation of protection in case of illness (temporary incapacity), family protection (temporary disability), family protection (family allowance), work accidents and occupational and unemployment under the contributory social security system.

## **Culture and Heritage**

2.77. The Government is committed to the conservation, protection and preservation of historical and cultural heritage and the development of arts and culture, as well as in the protection of rights relating to artistic and literary creation.

2.78. The main interventions that will be carried out in 2023 include the continuation of the initial steps for the implementation of the National Library and the identification of artifacts for the future establishment of the National Museum and the construction of the "Garden of the Eternal Flame", a memorial of high symbology, which is intended to the recognition of all those who perished in the struggle for national liberation. National Liberation.

2.79. The Government also continues to invest in the development and promotion of cultural activities, actions and practices, in particular in the creation of creative industries generating income and employment, and that defend and enhance the cultural heritage, which has unique characteristics of great interest.

### **State Reform**

2.80. State Reform is divided into four major institutional reforms ongoing - the Reform of Public Administration, the Reform of Tax and Finance Reform, Judicial Reform and the Administrative Decentralization Process.

### **Decentralization Process.**

2.81. These four reforms are interconnected and have the common objective of improving the management and functioning of the public sector, as well as to ensure that the State operates within a framework of legality and legal security in a more efficient and effective manner.

2.82. For 2023, the Government remains committed to ensuring the implementation the initiatives set out in the policy documents of the four institutional reforms.

### **Defense and National Security**

2.83. The development of transparent, efficient, competent and professional defense and security institutions efficient, competent and professional defense and security institutions is fundamental democracy and the consolidation of stability and peace at the national and international levels.

2.84. For the 2023 fiscal year, the Government remains committed to strengthening the coordination and close cooperation between the Defence Forces (F-FDTL) and the Security Forces (PNTL) and ensure clarity and engagement in accordance with their respective responsibilities and responsibilities and missions, as well as to ensure territorial integrity, the normal functioning of democratic institutions, freedom and protection of the assets of the State and the citizens.

### **International Relations and Foreign Policy**

2.85. Foreign policy actions are crucial to support national development and development and improve Timor-Leste's participation in the international arena and its integration in regional and international economies.

2.86. The Government continues to conduct a foreign policy that promotes bilateral and multilateral cooperation, promoting cultural, economic and commercial partnerships with other countries, essential for attracting investment.

2.87. For the year 2023, the Government will continue to promote efforts so that Timor-Leste to become a full member of ASEAN and the World Trade Organization and to promote the definitive delimitation of land and maritime borders.

### **Gender Sensitive Budgeting and Social Inclusion (GESI)**

2.88. The promotion of gender equality and social inclusion remains the core of the VIII Constitutional Government to achieve a more inclusive society where no one is left behind, regardless of their gender, disability, social background, sexual orientation or faith.

2.89. Since 2017, the Government has strengthened the Gender Sensitive Budget (GSB) to be adopted as a strategy in developing programs and sub-programs to achieve a positive impact in promoting gender equality, empowerment of women and girls and social inclusion.

2.90. The 2023 State Budget preparation circular underlines the importance of looking more closely at the impact of budgetary measures and policies on gender equality and inclusion and ensuring that the needs and interests, priorities and challenges of women, girls, boys and men in different social situations, class, location, etc. are adequately addressed in the annual plan.

2.91. To implement this vision, in 2023 the Government allocated \$259 million to implement the Gender Equality and Social Inclusion program (Program 980), and is the third largest program by total budget amount, accounting for 8.2% of total State Budget expenditure.

2.92. Specifically, under this program, \$796,083 was distributed to implement the three national gender policies, specifically the National Action Plan against Gender-Based Violence (\$240,178), the National Action Plan on Women, Peace and Security (\$349,448) and the Maubisse Declaration (\$206,457), addressing the issues of gender-based violence, women in peace and security and women's economic empowerment, respectively.

2.93. In addition, the Government has allocated \$19.2 million to implement the Mother's Purse program. Of this amount, \$5.3 million is intended to continue the original program and \$13.7 million has been allocated for the introduction of the Bolsa da Mãe-Nova Geração measure (Decree Law No. 22/2021) which aims to support and improve child health and nutrition during the early childhood years. Special support is also provided for children with chronic illness or disability, through an increase in the value of the respective allowance. The remaining resources are earmarked for operating costs.

2.94. The new subsidy for mothers establishes an allowance of \$15 per month for pregnant women, \$20 per month for each child up to 6 years old, and a surcharge of \$10 for children with disabilities.

2.95. The Government also continues to invest in measures to combat poverty, reduce inequality and improve well-being by increasing the budgetary allocation for nutrition support.

2.96. For 2023, the Government intends to improve the quality of meals in the School Meals program to meet the nutritional needs of children by increasing spending per child per meal from \$0.25 to \$0.42. A total of \$22.4 million has been allocated to execute this measure covering 13 municipalities and the RAEOA.

2.97. In addition, the Government has also set aside \$10 million annually for the next five years to implement the National Health Sector Nutrition Strategic Plan. This is expected to address the micronutrient deficiency responsible for malnutrition in children and have a positive impact on the lives of children.

2.98. In addition, the Government intends to invest in facilitating universal access to education through social protection measures, such as providing scholarships to the children of National Liberation Fighters and merit scholarships awarded to the best students in primary and secondary education.

2.99. In this context, for 2023, the Government has allocated \$1.7 million to the scholarship program for the children of the National Liberation Fighters and \$7.5 million to the best students in primary (3 best students) and secondary education (5 best students).

2.100. The Government also intends to continue the home-schooling program, with the allocation of \$2.1 million to support the education of students in their place of residence, namely for pre-school and 1st grade children, in all sucos and villages of Dili, as well as the provision of Mobile Libraries to the entire student community.

2.101. With the State's financing of the referred activities, which are understood to be complementary to each other, it is expected to increase the participation rate of children and girls in the school process, at all levels and modalities of education, and an increase in the school success rate.

2.102. Finally, the Government is also committed to upholding the rights of persons with disabilities to have equal access and opportunities to be active citizens in all spheres of public life and to participate in decision-making processes in all areas of the country's development to contribute to sustainable development.

2.103. Various financial incentives to improve socio-economic status and economically empower vulnerable and elderly groups will also be implemented as part of the non-contributory social security scheme.

2.104. The Social Security Reserve Fund will begin to be invested in 2023, with an initial capital of \$162 million, generating revenues that will ensure the sustainability of the Social Security System for the future.

2.105. The table below illustrates the State General Budget by Functional Classification for Social Protection.

**Table 7: Distribution of the State Budget by Functional Classification for Social Protection, US\$**

10	Social Protection	306,836,925
01	Sickness and Disability	5,941,710
02	Old Age	61,497,349
03	Survivors	6,818,150
04	Family and children	6,061,333
06	Housing	72,624,508
07	Social exclusion	14,690,950
08	R&D social protection	2.264.020
09	Social protection ne	136.938.905

Source: Timor-Leste Planning and Budgeting System (Dalan Ba Futuru), September 2022. \*\*\*

## Budgetary Transparency and Accountability

2.106. The 2023 Budget proposal includes the following markers to hold the Government accountable on a number of cross-cutting issues, such as gender equality gender and social inclusion, nutrition, climate, and value chain.

### Gender marker

2.107. To monitor the proportion of the General State Budget allocated to the promotion of gender equality and the commitments made to eliminate existing inequalities, the existing inequalities, the Government has established a Gender Marker, with the Principal (P), Significant (S) and Not Targeted (NT) levels in the budgeting and planning system. It is a mandatory tool to be used by all Ministries and autonomous agencies in their Annual Action Plan and applied at the sub-program level. The Gender Marker contains three (3) markers, namely:

#	Marker	Definition
1	Main (P)	The main expected outcome of the subprogram is to reduce gender inequalities. The sub-program would not have been carried out without this objective of gender equality and social inclusion.
2	Significant (S)	The gender equality and social inclusion aspect is an important and deliberate expected outcome, but not the main reason for the reason for carrying out the subprogram. The sub-program, in addition other expected results, the sub-program is designed to have a positive impact on positive impact on inclusion and the advancement of gender equality and/or the empowerment of women and girls (gender mainstreaming). For a subprogram to be considered "Significant" by the Gender Marker, there must be at least one of the criteria below: <ul style="list-style-type: none"> <li>• There is at least one activity focused on gender issues in the sub-program</li> <li>• In at least one of the ends, the expected result is indicated to achieve gender equality</li> <li>• Objectives, baselines, targets and performance indicators performance indicators are clearly defined to address gender inequalities, and data are disaggregated by sex.</li> </ul>
3	Not Targeted (NT)	The sub-programme does not aim to reduce gender inequalities nor address the needs and concerns of vulnerable and vulnerable and marginalized groups.

2.108. As can be seen from the chart below, the adoption of gender-sensitive budgeting goes beyond the implementation of a specific gender equality program (Program 980) and covers all public policies financed through the General State Budget, adopting the inclusion of gender marking at the level of the sub-programme.

2.109. A total of \$205 million (6% of the OGE) was distributed to subprograms considered “Major” in the application of the Gender Marker, while \$307 million (10% of the OGE) was allocated to sub-programs considered “Significant” (gender mainstreaming strategy) in the application of the (gender mainstreaming strategy) in the application of the Gender Marker.

2.110. However, there is still room for improvement, since much of the funding does not consider gender perspectives. It is important to note that gender equality enters as a main or significant objective in many activities in all government programs. This is especially relevant when it comes to functions with a strong social component, such as social protection education, sports, nutrition and health, and water and sanitation.

2.111. The table below shows the distribution of the 2023 General State Budget by Gender Marker.

**Table 8: Distribution of the State Budget for 2023 by Gender Marker, in \$**

Gender Marker	Amount
Major	205,044,385
Significant	306,724,933
<b>Total</b>	<b>511,769,318</b>

Source: Timor-Leste Planning and Budgeting System (*Dalan Ba Futuru*), September 2022.

### Child Marker

2.112. To effectively identify and monitor activities with budget allocations budget allocations that support the realization of children’s rights, the Democratic Republic Democratic Republic of Timor-Leste (RDTL) adopted a Child Marker for planning and planning and budgeting on October 27, 2021.

2.113. The Child Marker applies to all government entities that receive funds from the General State Budget, showing which activities, and how much budget is specifically directed to children’s rights (0-17 years), thus enhancing transparency and accountability. The Children’s Marker includes three categories that assess the focus on the realization of the rights of the children and apply at the activity level, namely:

#	Marker	Definition
1	Specific (E)	This category applies to activities that specifically aim to address children’s rights (survival, development, protection and participation).
2	Extended (A)	The “Extended (A)” category applies to activities that provide goods and services that directly benefit people, including children.
3	Indirect (I)	This category refers to activities that only indirectly contribute to the development and well-being of children.

2.114. The table below illustrates the distribution of the 2023 State Budget by Child Marker, with \$231 million (7%) allocated to activities that specifically aim to address children’s rights while \$411 million (13%) was distributed to activities that provide goods and services that directly benefit people, including children.

**Table 9: Distribution of the General State Budget for 2023 by Child Marker, in US\$**

Child Marker	Amount
Specific	231,229,438
Enlarged	411,412,463
<b>Total</b>	<b>642,641,901</b>

Source: Timor-Leste planning and budgeting system (*Dalan Ba Futuru*), September 2022.

## Nutrition budget marker

2.115. The Government is committed to institutionalizing the nutrition budget marker (NBT) through the planning and budgeting system.

2.116. The NBT aims to identify, classify and mark nutrition-related expenditures in the public finance management system, making it possible to estimate, monitor and track critical nutrition expenditures of different government entities, and to analyze the extent to which the composition of the State Budget allocates funds for interventions aimed at eliminating all forms of malnutrition among the population.

2.117. There are two (2) nutrition budget tags that will be included in the planning and budgeting system in 2023 and will be applied at the activity level, namely:

#	Marker	Definition
1	<b>Nutrition-specific interventions (NE)</b>	This category applies to activities that address the immediate causes of malnutrition and deficiencies in the physiological development of the population, such as those that provide for the provision of vitamin A supplements, deworming, or dietary diversification to pregnant women.
2	<b>Nutrition Sensitive Interventions (NS)</b>	This category refers to activities that address the underlying causes of malnutrition, such as improving agriculture and food security, social protection, early childhood development and education, water sanitation and hygiene, etc.

2.118. In 2023, in a pilot phase, the nutrition budget marker will be applied to the budgets of eight (8) government entities namely; Ministry of Health, Ministry of Education, Youth and Sports, Ministry of Social Solidarity and Inclusion, Ministry of Agriculture and Fisheries, Ministry of Tourism, Commerce and Industry, Ministry of Public Works, National Water and Sanitation Authority and Secretary of State for Equality and Inclusion (See Informational Elements for list of activities and implementing entities identified for the nutrition budget marker).

2.119. During the development of the Annual Action Plan for 2023, these entities should analyze, plan and budget for nutrition-related interventions and identify each activity as nutrition-specific (NE) or nutrition-sensitive (NS).

2.120. The table below presents the specific distribution of the 2023 State Budget by Nutrition Marker, with \$13 million allocated to activities that specifically aim to address the immediate causes of malnutrition and deficiencies in the physiological development of the population, while \$67 million was allocated to activities that improve agriculture and food security, social protection, early childhood development and education, water sanitation and water hygiene, etc.

**Table 10: Distribution of the 2023 General State Budget by Nutrition Marker, in \$**

Nutrition Marker	Amount
Nutrition-specific interventions	13,177,174
Nutrition sensitive interventions	67,333,991
<b>Total</b>	<b>80,511,165</b>

Source: Timor-Leste planning and budgeting system (*Dalan Ba Futuru*), September 2022.

## Climate budget marker

2.121. The Government has decided to introduce the Climate Budget Marker (CBT) into the public financial management system to ensure that Timor-Leste is adequately prepared to adapt to and mitigate the impacts of climate change.

2.122. The CBT is a tool for identifying, classifying, weighting and marking of expenditures relevant to climate change and nature conservation in the budget system, making it possible to estimate, monitor and track these expenditures.

2.123. There are two Climate Budget Markers that will be included in the Government's planning and budgeting system for the year 2023 and will be applied at the activity level, namely:

#	Marker	Definition
1	<b>Highly Relevant (H)</b>	This category applies to activities with a clear primary objective of producing of producing specific results that improve climate resilience or contribute to climate change mitigation and the sustainable use of natural resources. Examples are expenditures aimed at reducing the risk of natural disasters, supporting the energy transition, preventing overexploitation of fishery resources, etc.
2	<b>Medium Relevant (M)</b>	This category applies to activities with secondary objectives related to building climate resilience or contributing to climate change mitigation and sustainable use of natural resources. An example is irrigation extension activities that, although they are implemented livelihoods, also result in increased protection against droughts.

2.124. In 2023, on a pilot basis, the Climate Budget Marker will be applied to the budgets of 3 entities, namely: Ministry of Public Works, Secretary of State Secretariat for Environment and Ministry of Agriculture and Fisheries (See Informative Elements for list of activities and implementing entities identified for the Climate Budget climate budget marker)

2.125. For the preparation of the 2023 Annual Action Plan, the MOP, SEA and MAP should analyze their activities to identify whether they are climate resilient, i.e. i.e., whether or not they match the impacts of climate change.

2.126. As of the year 2024, the Climate Budget Marker will cover all Ministries. This phased implementation will provide the opportunity to fine-tune the system and will also provide the space for capacity building focused capacity building at the Ministry level.

2.127. The table below illustrates the specific distribution of the State Budget for 2023 by Climate Budget Marker with \$46 million allocated to activities with a clear primary objective of producing specific results that improve climate resilience or contribute to climate change mitigation climate change mitigation and the sustainable use of natural resources, and \$13 million allocated to activities with secondary objectives related to building climate resilience or resilience or contributing to climate change mitigation and the sustainable use of natural sustainable use of natural resources.

**Table 11: Distribution of the 2023 General State Budget by Climate marker, in \$**

Climate Marker	Amount
Highly Relevant	46,788,840
Medium Relevant	13,036,269
<b>Total</b>	<b>59,825,109</b>

Source: Timor-Leste Planning and Budgeting System (Dalan Ba Futuru), September 2022.

### Value Chain Marker

2.128. In 2023, the Government will introduce a Value Chain Marker in the Public Finance Management System to ensure the implementation of the “Timor-Leste Value Chain” policy that focuses on the potential domestic products and the essential needs of Timor-Leste.

2.129. These interventions will focus on four main areas, namely stimulating demand, encouraging production/supply, improving the business environment and promoting strategic investment. They are aimed at improving market and identified problems related to allocating resources efficiently and effectively.

2.130. On May 6, 2022, the Council of Ministers approved a Resolution of the Government to create an Interministerial Commission for the Coordination of the Value Chain to promote and encourage domestic production.

2.131. This will help sectoral ministries focus their resources and work together to ensure food and nutrition sovereignty, which will help strengthen the country’s economic independence. The GPM and

the MCAE are responsible for coordinating with the relevant entities to identify key measures related to building the Value Chain and reporting to the Ministry of Finance.

2.132. For this purpose, there are the following five (5) activity level markers:

#	Marker	Definition
1	<b>Production (P)</b>	The Production (P) category applies to activities that directly or indirectly aim to increase national production, either by increasing the productivity of the national economy and/or import substitution, such as labor training activities, support for the internationalization of Timorese companies, or the modernization of the fishing fleet.
2	<b>Industry/ Processing (I/P)</b>	The Industry/Processing (I/P) category applies to activities that aim directly or indirectly to favor the development of local industry and/or processing of raw materials and intermediate goods, such as activities supporting the development of agribusiness.
3	<b>Distribution (D)</b>	The Distribution (D) category applies to activities that directly or indirectly aim to improve the movement of raw materials, intermediate products and final products within and outside the national territory, such as the construction or improvement of basic infrastructure for trade, such as airports and ports.
4	<b>Wholesale/ retail trade (CGR)</b>	The Wholesale/Retail trade (CGR) category applies to activities that directly or indirectly aim to boost trade of national production or of products partially processed in the national territory, especially through exports, such as programs to support business competitiveness; activities related to the organization of fairs of traditional products, or the integration of Timor-Leste in international trade circuits.
5	<b>Consumption (C)</b>	The Consumption (C) category refers to activities that contribute to increase consumption inside and outside the national territory of national production or products partially processed in the national territory, such as public purchase programs for locally produced food, national export subsidy programs, or conditional transfer programs for households to purchase local products.

2.133. In 2023, on a pilot basis, the Value Chain marker will be applied only to the budgets of 21 government entities, including 13 municipalities (see the Informational Elements for lists of activities and implementing entities identified for the Value Chain marker).

2.134. The table below illustrates the distribution of the State Budget for 2023 by Value Chain Marker with \$48 million allocated to activities that will improve the movement of raw materials, intermediate and final products in and out of the national territory, such as the construction or improvement of basic infrastructure for trade, such as airports and ports. With regard to intervention in consumption, \$45 million were distributed to public purchase programs for locally produced food, subsidy programs for national exports or conditional transfer programs for families to buy local products, while \$18 million were allocated to intervention in production, for labor training actions, support for internationalization of Timorese companies or modernization of the fishing fleet.

**Table 12: Distribution of the State Budget for 2023 by Value Chain, in US\$**

Value Chain Marker	Value
Production	18,492,954
Industry/Processing	593,441
Distribution	48,068,076
Wholesale/Retail	1,750,710
Consumption	45,527,978
<b>Total</b>	<b>114,433,159</b>

Source: East Timor Planning and Budgeting System (Dalan Ba Futuru), September 2022.

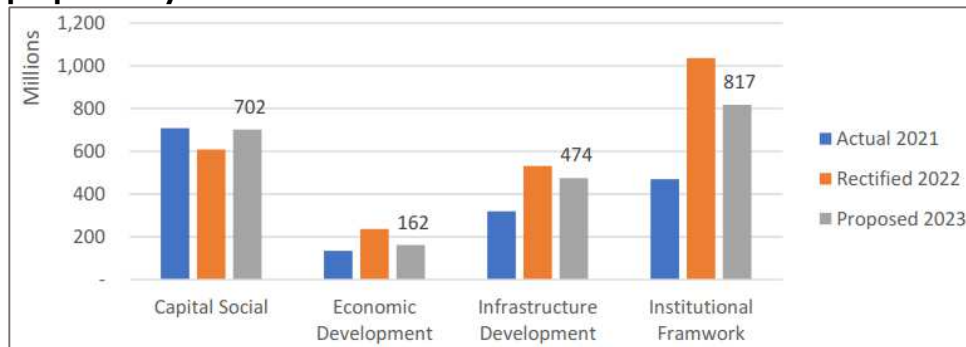
## Comparative Analysis

2.135. Due to the implementation of program budgeting and the consequent reduction in the number of programs (from 145 to 49) starting in 2021, the comparative analysis was conducted with data at the institutional level to allow a consistent comparison for all three years under consideration, but the subsequent year's analysis should be done at the program level. As a measure to increase budget transparency, the draft General State Budget for 2023 now includes Social Security in the budget ceiling.

2.136. The Strategic Development Plan of Timor-Leste (PED) is organized around four pillars: Institutional Framework, Social Capital, Economic Development and Infrastructure Development.

2.137. The General State Budget for 2023 allocates the largest share of expenditure to the Institutional Framework (38%), followed by Social Capital (33%), Infrastructure Development (22%) and Economic Development (8%). Figures include loan disbursements and transfers to the RAEOA.

**Figure 9: Comparison of 2021 Expenditure, rectified 2022 GSB and 2023 GSB proposed by the PED**

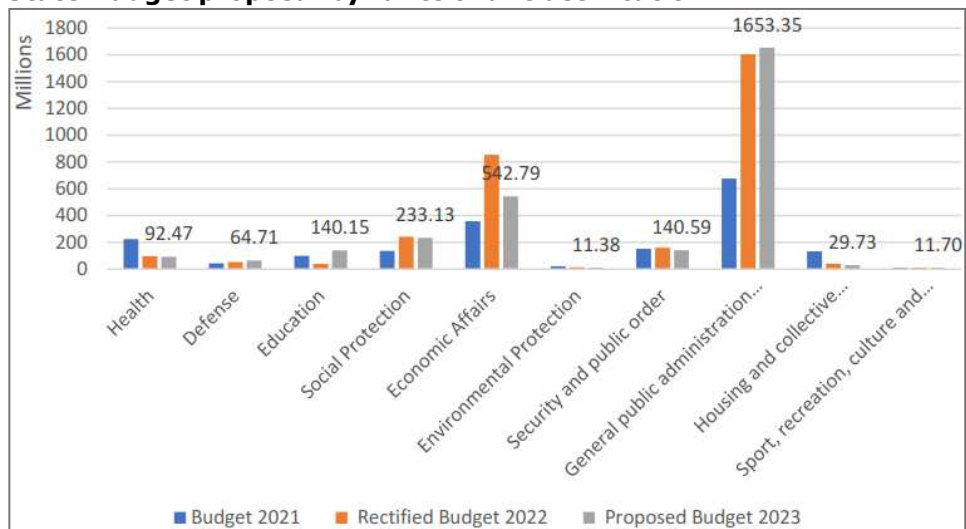


Source: General Directorate of Planning and Budget, Ministry of Finance, September 2022

2.138. Following the functional classification (COFOG) developed by the OECD, the data suggests that the General Public Services function has the largest allocation (in line with the previous year) followed by the Economic Affairs function.

2.139

**Figure 10: Comparison of the 2021 State Budget, 2022 State Budget and 2023 State Budget proposal by functional classification**



Source: General Directorate of Planning and Budget, Ministry of Finance September 2022. These data do not include INSS and FRSS data.

2.140. The decrease in the health function can be attributed to the phasing out of the COVID-19 Fund. The increase in funding for Education and Social Protection can be explained by the introduction of the new GOP priorities.

### Municipal Allocation

2.141. In municipalities there is an increase in the current year's budget, with the largest increase in Viqueque Municipal Administration (50%) and the smallest in Dili Municipal Authority (8%), although AM Dili still has a budget equivalent to two or three times that of any other municipality. The 1% cut for the RAE OA becomes a 42% increase when we account for the RAE OA Special Development Fund. It should also be noted that a Special Development Fund was created for Ataúro with an initial allocation of \$13 million, making for a 523% increase in the total budget for that municipality.

2.142. A similar situation arises when comparing the proposed General State Budget for 2023 with the actual expenditure for 2021. All municipalities see an increase in their budget ranging from 20% in Baucau Municipal Authority to 77% in Viqueque Municipal Administration. The RAE OA sees an increase of 244% which is actually 392% when we include the FED.

**Table 13: Proposed Allocation for Municipal Authorities, \$**

Municipal Authority	Actual 2021	Rectified in 2022	Proposed 2023	Change from 2021 actual	Change from 2022 rectified
RAEOA Authority	24,383,698	84,436,784	84,000,000	244%	-1%
AM Dili	6,816,419	10,231,640	13,362,483	62%	8%
AM Baucau	4,813,128	4,931,124	7,564,824	20%	17%
AM Bobonaro	4,215,429	4,727,883	6,733,806	32%	18%
AM Ermera	3,904,589	4,662,818	7,417,275	42%	19%
AM Aileu	2,811,826	3,034,303	4,509,206	38%	27%
AM Ainaro	2,976,385	3,243,066	4,894,112	37%	26%
AM Ataúro		2,574,860	2,257,645	N/D	19%
AM Covalima	3,985,211	3,990,360	5,738,515	21%	21%
AM Lautém	3,699,987	4,056,049	5,826,107	32%	21%
AM Liquiçá	2,577,632	3,186,810	4,942,552	56%	26%
AM Manatuto	2,994,422	3,815,911	5,727,621	55%	22%
AM Manufahi	3,724,390	3,666,128	5,167,358	21%	23%
AM Viqueque	3,395,558	4,005,625	6,925,794	77%	50%
FED Atauro			13,400,000	N/D	N/D
FED RAE OA			36,000,000	N/D	N/D

Source: General Directorate of Planning and Budget, Ministry of Finance, September 2022.

### Budget Management Streamlining Measures

2.143. The adoption of program budgeting has brought new tools to rationalize budget management. Program-based budgeting allows us to focus on results, reallocating resources from activities that are not achieving the previously agreed-upon goals to those that are actually providing benefits to the public.

2.144. Unfortunately, due to the early stage of adoption of program-based program budgeting, the monitoring and evaluation functions are still consolidated and it is difficult to evaluate the performance of the different programs. Nevertheless, by 2023 the Government is committed to operationalizing the monitoring and evaluation of results-oriented programs.

2.145. Funding for specific development priorities and critical functions of the critical functions of the State has been ring-fenced with the creation of special funds, with the objective of ensuring long-term financing immune from the risk of a fiscal cliff (see the section on Budget Sustainability).

2.146. The Atauro Special Development Fund (FED) (\$13.4 million) and the Development Fund of the Special Administrative Region of Oe-Cusse Ambeno (\$36 million) replicate the structure of the Infrastructure Fund, although focusing on building physical and social capital necessary for the sustainable development of these territories.

2.147. The National Liberation Fighters Fund (FCLN) was created with a billion dollars, which will be invested in a portfolio of stocks and bonds following the model of the Petroleum Fund, but with the objective of financing the benefits to which veterans and their families are entitled.

2.148. Finally, the Social Security Reserve Fund, constituted with the assistance of the Portuguese Authorities, receives the annual surplus balance from the Social Security Budget and is administered on a capitalization basis. The generated by the fund will be used to pay the benefits due under the contributory social security regime, when the annual contributions from active workers are not sufficient to pay the pensions.

2.149. The measures to rationalize budget management on the expenditure side focused on establishing new procedures to identify priority expenditures and avoid duplication.

2.150. Priority expenditure was identified in 16 areas (Agriculture, Livestock, Fisheries and Forestry; Economy and Employment; Tourism; Rural and Housing; Environment; Petroleum and Minerals; Electricity and Renewable Energy; National Renewable Energies; National Connectivity; Water and Sanitation; Education and Training Health; Social Inclusion and Protection; Culture and Heritage; State Reform; Defense and National Security; International Relations and Foreign Policy) resulting in the adoption of a total of 275 policy measures to be implemented between 2023 and 2027.

2.151. This exercise, materialized in the Major Planning Options Law (GOP), which set a total budget ceiling of \$3.16 billion for 2023, resulted in a savings of \$264 million or 8% in relation to the General State Budget for 2022.

2.152. Given the multi-year nature of the GOP policy package, a baseline expenditure exercise was conducted with the collaboration of Services and Extended Financial Autonomy Entities (SEAFAs) to determine the budgetary space available to implement the measures in 2023. The budget ceiling of \$3.16 billion was allocated to SEAFAs considering their obligations for 2023 and their relevance to implement the GOP policy package.

2.153. To avoid duplication and other inefficiencies in budget allocation, the Ministry of Finance supported SEAFAs in the preparation of their budget for 2023. Importantly, a methodology was developed to assess the quality of budget proposals and their alignment with Government priorities. A sample of budgets submitted by SEAFAs was evaluated. SEAFAs' technicians worked together with Ministry of Finance technicians for one month to implement the recommendations for improvement.

2.154. Currently, the Ministry of Finance is setting up a taskforce to conduct a spending analysis, assessing execution trends by economic classification and comparing them with trends in other countries in the Southeast Asia and Pacific region. The goal of this exercise is to identify further savings for future budget cycles.

### **One-off and permanent fiscal policy measures**

2.155. Ensuring better sustainability of public finances requires caution when deciding on the adoption of new fiscal policy measures. It is therefore important to differentiate between one-off and permanent new fiscal policy measures.

2.156. In particular, extending permanent fiscal policies as a consequence of the policy decision may deplete the resources available to react to unexpected shocks and needs in the future. This is particularly true for a country with high exposure to natural disasters such as Timor-Leste and which is still building the foundations of its economy and public administration system.

2.157. Monitoring permanent fiscal policies or fiscal rigidities is critical to ensure efficient and responsive management of public finances.

2.158. The General State Budget for 2023 pools resources to ensure that all permanent fiscal policies are implemented in 2023 with the necessary level of funding. Among the most important policy measures that fall into the permanent category, we identify:

- Public Administration personnel costs: \$445 million
- Ensuring social protection for veterans: \$103 million
- Contingency Reserve: \$66 million
- School feeding program (Merenda Escolar): \$22.5 million
- Human Capital Development Fund: \$18 million
- Annual grant to the Conference of Catholic Bishops: \$15 million
- New Generation Mother Grant Program: \$13.7 million
- Nutrition Program: \$10 million
- Mother's Grant Program: \$5.3 million
- Support for non-Catholic religions: \$5 million
- Scholarships for Children of National Liberation Fighters and Martyrs: \$1.7 million
- Support for social integration and rehabilitation of people with disabilities: \$1.4 million

Some subsidies granted by the State to public companies, although by nature discretionary measures, may be perpetuated over time, as they are necessary to finance the operating costs of these companies. However, should these companies achieve financial sustainability, the Government may reduce or eliminate these subsidies in the future. Subsidies to public companies include:

- Grant to EDTL: \$100 million
- Subsidy to TIMOR GAP: \$54 million
- BTL subsidy: \$18 million
- Grant to RTTL: \$2 million
- Establishment and Operationalization of Companhia Mineira de Timor-Leste, S.A.: \$1.3 million

2.159. The other activities funded by the 2023 Budget are transitory in nature, representing one-off expenses that do not burden future Budgets. Those with the greatest impact on the 2023 Budget are:

- National Parliament Elections: \$16 million
- Purchase of Timor-Telecom shares: \$14.5 million
- Elections of Suco bodies: \$10 million

### **3. Revenue and Financing**

3.1 There are important economic reasons for distinguishing between revenue items and financing items.

3.2 Revenue is considered to be the regular income of the Public Sector Administration that is permanently available to pay its expenses.

3.3 The new economic classification of budget revenues distinguishes between current revenues and capital revenues.

3.4 Current revenues are revenues that increase the assets of the Government Public Sector because it does not depend for its generation on the reduction of assets or the assumption of liabilities.

3.5. Capital revenues, on the other hand, represent an inflow of funds, but do not increase the assets of the Public Sector because this inflow is offset by the loss of assets or the assumption of liabilities that will have to be repaid in the future.

3.6. Domestic revenue results mainly from taxes, customs duties import duties, and fees paid by businesses and individuals.

3.7. Domestic revenue is classified as current revenue and represent an increase in the wealth of the Public Sector Administration, being the preferred means of paying for expenditures.

3.8. The Estimated Sustainable Income (ESI) is the sustainable level of use of petroleum revenues legally established, to ensure the continued existence of the Petroleum Fund. Therefore, transfers from the Petroleum Fund up to the limit of the ESI are also considered as current revenues.

3.9. Thus, the financing of expenditure with current revenues (domestic revenues and ESI) is a position that maintains fiscal sustainability.

3.10. This is a benchmark for understanding the long-term trend of public term trend of public finances and can be assessed by the calculation of the recurrent balance, discussed at the end of this section.

3.11. However, the lack of sufficient current revenues to pay all expenditures forces the Public Administrative Sector to finance the deficit with capital revenues, either through transfers from the Petroleum Fund above the ESI, or through loans.

3.12. These different types of income (current and capital) are treated differently, the former as revenue and the latter as financing.

3.13. Additionally, some current income, due to its inherently irregular nature, is also treated as financing, as is the case with donations from donors.

3.14. The informative elements of the Budget Proposal provide the full detail of the different sources of revenue, including revenue from the RAEOA and Social Security.

#### **Global and current balance**

3.15. The table below shows the overall and current balance of the General Budget of the State for 2023.

3.16. The overall balance of the State Budget is positive, as a result of the balanced budget of the Central budget balance of the Central Government and Social Security and a surplus in the RAEOA of \$1.2 million.

3.17. The current balance of the General State Budget, as well as of the Central Administration and the RAEOA is negative.

3.18. This results from the amount of current expenses exceeding the amount of current revenue.

3.19. This is because much of the current expenditure is financed by transfers from the Petroleum Fund above the ESI, as a result of the adoption by successive Governments of a policy of frontloading.

3.20. For this budget, the Government has identified a set of measures that physical infrastructure and human capital, essential to the long-term progress and development of the long-term development of the country, and which justify a transfer from the Petroleum Fund above the ESI.

3.21. Through the successful implementation of these measures, the Government expects to build sustainable sources of revenue through economic diversification, and ensure that the current balance reaches balance in the long term.

**Table 14: Budget Balances in \$**

Overall Balance	Amount
<b>General State Budget</b>	1,206,835
Central Administration	0
Social Security	0
RAEOA	1,206,835
<b>Current Balance</b>	
State General Budget	-773,567,897
Central Administration	-772,989,381
Social Security	52,624,971
RAEOA	-53,203,487

Source: General Direction of Budget and Planning, Ministry of Finance, September 2022

## Revenue

3.22. In 2023, total consolidated Central Administration revenue is projected at \$1.8 billion (excluding the \$1,000 million from FCLN).

3.23. Of this \$1.8 billion, \$1.35 billion corresponds to transfers from the Petroleum Fund. The remaining amount is made up of \$174 \$174.0 million in domestic revenues, \$4.9 million in direct budget support \$74.1 million in loans and \$200 million in treasury management the treasury.

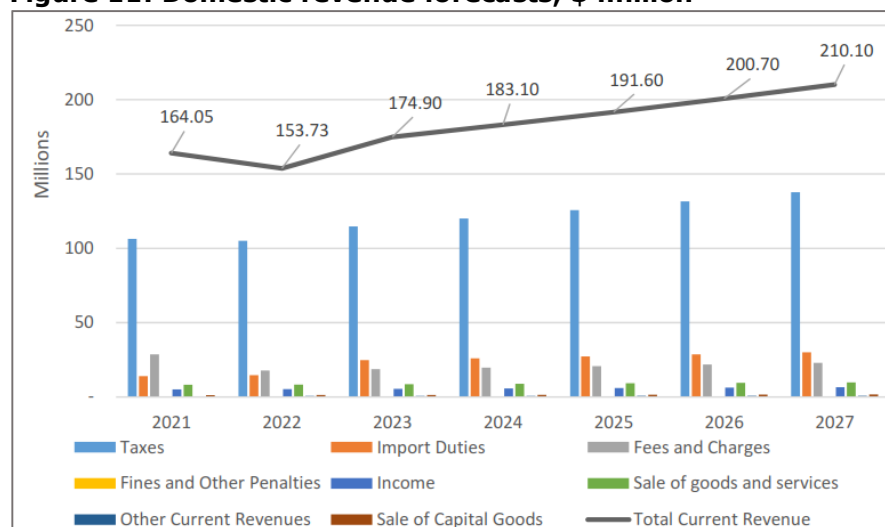
3.24. Domestic Revenues are comprised of tax revenues, customs taxes, customs duties, fees and charges, sales of goods and services, income (leases interest, dividends and stocks), sales of capital goods, fines and other penalties.

3.25. Tax revenues (not including customs duties) are the largest contributor to domestic revenues, at 71%, followed by taxes and charges and customs duties with 11% and 9%, respectively.

3.26. As set out in the Pre-Budget Statement, from 2017 to 2021 the domestic revenue has consistently decreased (by an average of 5% per year).

3.27. Political instability and the COVID-19 pandemic contributed to this drop in domestic revenue.

**Figure 11: Domestic revenue forecasts, \$ million**



Source: National Directorate of Economic Policy, Ministry of Finance, September 2022

3.28. In 2021 the economy began to recover from the above factors, however domestic revenues fell 17% to their lowest since 2012. This was due to Electricity of Timor-Leste (EDTL) and Bee Timor-Leste being transformed into Public Enterprises and therefore being excluded from the General State Budget which resulted in a 74% reduction in Fees and Charges.

3.29. Total domestic revenue is expected to increase in 2023 to \$174.9 million from \$153.7 million in 2022.

3.30. Domestic revenues are expected to increase primarily due to a combination of increased import customs duties and the introduction of new excise rates.

3.31. Import customs duties will rise from the current 2.5 percent to 5 percent. The increase in duties results in an increase in revenue and brings Timor-Leste closer to the global median level of import duties<sup>2</sup>.

3.32. Consequently, this alleviates some of the disparities that Timorese firms face in the export of goods and services relative to imports and thus promotes competitiveness.

3.33. The new excise tax rates to be introduced in 2023 include: 10%, 20% and 30% rate for passenger cars worth more than \$10,000, \$25,000 and \$50,000 respectively, an increase in the tobacco tax rate of tobacco tax of \$50 per kilo (from \$50 per kilo to \$80 per kilo); a new sugar tax of \$1 per kilogram and the introduction of a new tax of \$3 per liter on sugary drinks.

3.34. In addition, tax revenues are expected to be boosted by reforms in the tax collection systems, in particular the switch to SIGTAS (Integrated Standard System for Tax Administration), which aims to increase the Tax Authority's ability to ensure greater tax compliance.

3.35. Tax revenue has consistently been the largest contributor to domestic revenue, averaging about 70% of total revenue collection domestic revenue over the past 10 years.

3.36. The composition of revenue, i.e., the proportions coming from taxes fees and charges, or other sources, tend to be consistent over time, even if in some years the actual distribution of revenue is different.

3.37. However, tax revenue fell consistently from 2016 to 2020 (from \$133 million in 2016 to \$105 million in 2020), along with a decline in overall revenue collections. Tax revenue in 2021 began to increase again (reaching \$106 million), accounting for 65% of total revenue total revenue in that year.

3.38. Tax revenues may increase beyond the forecast due to the passage expected of a new tax law and a new tax procedure code next year.

3.39. The tax law aims to incorporate progressivity in tax rates and broaden the tax base, as well as review and harmonize income and payroll taxes. The tax procedure code will modernize the collection of taxes and will increase the powers of the tax administration to enforce tax laws and collect tax debts.

3.40. In addition, tax revenues can increase through the implementation of the VAT. However, the complexity of VAT implementation means that the collection of substantial revenues from this tax may not be achieved before the end of the current forecast period (i.e., around 2027).

3.41. The move towards greater decentralization of Government activity has also resulted in the introduction of some new revenue streams through fees on local advertising and parking services. Further decentralization, improvements and strengthening of collection mechanisms in ministries and the introduction of new non-tax instruments are expected to increase the collection of Fees and Charges. Revenues from autonomous entities, while having no planned changes or reforms, are expected to increase with improving economic conditions.

3.42. Although the ESI is a recurrent revenue under the new economic classification of budget revenues and shares similarities with domestic revenues, we have chosen to treat it together with the other Petroleum Fund revenues in the financing section for uniformity of treatment.

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<sup>2</sup> <https://data.worldbank.org/indicator/TM.TAX.MRCH.WM.AR.ZS>

## Financing

3.43. The total budgeted expenditure in 2023 is higher than the domestic revenue collected in the same period. This results in a non-oil deficit (domestic revenue minus expenditures).

3.44. This deficit is financed through various sources; withdrawals from the Petroleum Fund Petroleum Fund (PF), loans, use of balances and Budget Support Direct from the European Union and the Government of Australia.

3.45. Withdrawals from the PF may be within a sustainable amount, using the income of the fund, or in excess of that sustainable level (see next section). The table below shows the amount of income from each of the funding items.

**Table 15: Funding Source, 2023-2027, \$ million**

	2023	2024	2025	2026	2027
<b>Petroleum Fund Transfers</b>	1,346.09	1,426.39	1,448.25	1,514.50	1,575.25
ESI	490.15	464.09	429.40	393.15	353.96
Above ESI	855.94	962.30	1,018.85	1,121.35	1,221.29
<b>Domestic Revenue</b>	174.90	183.10	191.60	200.70	210.10
<b>Loans</b>	74.11	86.88	87.17	77.34	46.25
<b>Direct budgetary support</b>	4.90				
European Union	3.30				
Australia	1.60				
<b>Current Balance</b>	200.00	200.00	200.00	200.00	200.00
<b>Total</b>	1,800.00	1,896.37	1,927.02	1,992.54	2,031.60

Source: Ministry of Finance, September 2022.

## Petroleum Fund Revenue

3.46. The General State Budget of the Government is largely financed by the Petroleum Fund. The amount withdrawn is divided between the value of the Estimated Sustainable Income (ESI) and any excess withdrawals that are justified by the Government as being in the long term interest of Timor-Leste.

3.47. The calculation of the ESI requires the projection of the value of the Fund at the beginning of the budget year, together with the present value of future petroleum revenues.

**Table 16: Estimates for the Petroleum Fund (\$m)**

Item	Value
Opening Balance of Petroleum Fund in 2022	19,565.0
Estimated investment revenue in 2022	-1,418.5
Estimated petroleum revenue in 2022	631.1
Estimated government withdrawals in 2022	-\$2,552.6
Estimated ending balance in 2022 / opening balance in 2023	16,225.1
Estimated net present value of future oil revenues in 2023	113.1
Estimated Petroleum Wealth in 2023	16,338.2
<b>2023 ESI (3% of Oil Wealth)</b>	<b>\$490.1</b>
Withdrawals above ESI	855.9
Budgeted withdrawals in 2023	1,346.1

Source: Petroleum Fund Policy and Management Office, Ministry of Finance, September 2022.

3.48. The opening balance of the Fund in 2022 is \$19,565 million.

3.49. For 2022, petroleum revenues are estimated at \$631.1 million, the majority of which has already been received. The amount of actual revenues was substantially higher than the projections presented in the General State Budget for 2022 due to higher oil and gas prices.

3.50. Regarding investments, stocks and bonds have fallen in value this year because central banks sharply increased interest rates to contain persistently high inflation. As a result, the Fund has incurred significant investment losses so far this year, which has also happened to similar funds around the world.

3.51. This follows a very strong investment performance of the Petroleum Fund in the previous three years, and the Petroleum Fund over the previous three years, when investment income totaled about \$5 billion.

3.52. The financial investment return of the Fund is estimated to be negative by 7.89% in 2022, which translates into an annual loss of \$1,418.5 million.

3.53. To date, most of the loss has not been realized because the withdrawals have been funded by the liquidity portfolio of low-risk assets including cash. This portfolio was created in July 2021 to finance short-term withdrawals and has fulfilled its purpose by remaining stable in value during value during the recent market turmoil.

3.54. If the total amount of \$2,552.6 million provided in the General Budget of the State Budget for 2022 are withdrawn in 2022, the Petroleum Fund should end the year with \$16,338.2 million. Stocks and bonds will have to be sold in 2023 to supplement the liquidity portfolio balance and to cover the total projected of withdrawals for 2023 to 2025.

3.55. The Bayu-Undan field is expected to end production this year, therefore, oil revenue beyond 2022 is capped at a present value of \$113.1 million (with an estimated revenue value in 2023 of \$115.2 million)<sup>3</sup>.

3.56. Thus, total Petroleum Wealth is estimated at \$16,338.2 million as of January 1, 2023, resulting in an ESI for 2023 of \$490.1 million. This is \$37.9 million below the projection entered in the State Budget for 2022 and lower than the 2022 ESI of \$554.1 million.

3.57. Petroleum Wealth decreased as a result of the increase in withdrawals in 2022, particularly after the amendment to the State Budget approved by Law No. 6/2022, May 18, and the decrease in the value of the Fund's investments.

3.58. In terms of the 2023 projections, petroleum revenues are estimated at \$115.2 million, and expected investment income is \$577.4 million, reflecting higher expected long-term returns from the liquidity and growth portfolios.

3.59. Withdrawals to finance the General State Budget for 2023 are projected at \$1,346.1 million or 8.2% of Petroleum Wealth at the beginning of the year, exceeding the 2023 ESI by \$855.9 million.

3.60. The Information Elements of the Proposed Budget describe the key information about the Petroleum Fund and provide detailed information on the calculation of the ESI and the underlying assumptions.

3.61. The ESI is equivalent to 3% of net petroleum wealth and is estimated to be \$490.1 million in 2023. This is a decrease from the 2022 ESI (\$554.1 million) due to the decrease in the Petroleum Fund balance this year. More details on the ESI and petroleum wealth can be found in the Information Elements.

3.62. The government plans to transfer from the Petroleum Fund above the ESI \$855.9 million to the General State Budget for 2023.

3.63. This is a significant decrease from the excess withdrawals foreseen in the General State Budget for 2022, which totaled \$1,998.5 million, which included a transfer of \$1,000 million for the creation of the Fund for National Liberation Combatants.

3.64. However, it is an increase in actual surplus drawings in 2021, which were of \$600.0 million.

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<sup>3</sup> The legislation requires that the value of petroleum revenue be assessed at current value in 2022, which differs slightly from its value when actually collected in 2023.

3.65. The excess withdrawals are in line with the Government's policy of frontloading of the Government, since these withdrawals are being used to finance basic infrastructure and human capital, which is necessary for long-term growth.

### Cash balances

3.66. The total actual revenue in the State Budget for 2021 was \$1,881.6 million, comprising domestic revenues of \$217.3 million, transfers from the Petroleum Fund of \$1,147.9 million, management balance (from Treasury and RAEOA) of \$493.9 million, and loans of \$22.5 million.

3.67. During the year ended December 31, 2021, a total of \$1,147.9 million was transferred from the Petroleum Fund (which represents 83% of the expected transfer for the year 2021 and \$600 million above the ESI), in order to cover the operational needs of the Public Administrative Sector.

3.68. After accounting for 2021 expenditures and other equity adjustments, the balance total available cash (in both the Treasury Account and the RAEOA) totaled \$455.0 million, which does not include the Social Security cash balance and the cash balance in TL Cement's escrow account at the Central Bank of Timor-Leste (the balance of this account is \$50.3 million).

3.69. The Cash Balance of the Treasury and RAEOA through December 31, 2021, is indicated below.

**Table 17: Central Government and RAEOA cash balance at the end of 2021 in \$'000**

Account	Value
CFET	155,046
FI	32,255
FDCH	1,491
COVID-19 fund	17,743
Autonomous Agencies	36,035
Municipalities	8,609
<b>Total Central Government</b>	<b>251,180</b>
<b>RAEOA</b>	<b>203,863</b>
<b>Total Central Government + RAEOA</b>	<b>455,043</b>

Source: General Directorate of the Treasury, Ministry of Finance, September 2022

3.70. At the end of August 2022, the total domestic revenues collected and deposited in the Consolidated Fund of Timor-Leste (CFET) and other accounts of the Central Bank of Timor-Leste was \$107.2 million (64%) of the total estimated for the year 2022 (\$166.8 million).

3.71. As of August 31, 2022, a total of \$854.0 million had been transferred from the Petroleum Fund to the Treasury account to cover the State's budget execution needs (33% of the total 2022 estimated transfers of \$2,552.6 million).

3.72. Subtracting total expenditures from revenues resulting from transfers from the Petroleum Fund, the management balance, domestic and external revenues until August 2022, results in a total cash balance of \$535.3 million (which includes Treasury and RAEOA) at the end of August 2022.

**Table 18: CA and RAEOA cash balance at August 2022 in \$ '000**

Account	Value
CFET	269,231
FI	17,892
FDCH	1,715
COVID-19 fund	26,891
Autonomous Agencies	45,107
Municipalities	12,556
<b>Total Central Government</b>	<b>373,392</b>
<b>RAEOA (excluding FED)</b>	<b>161,949</b>
<b>Total Central Government + RAEOA</b>	<b>535,341</b>

Source: General Directorate of the Treasury, Ministry of Finance, September 2022

## Loans

3.73. The Strategic Development Plan 2011-2030 aims to transition Timor-Leste from a low-income country to an upper-middle income country where extreme poverty has been eradicated and a sustainable and diversified non-oil economy has been established.

3.74. However, without infrastructure development, this vision will be difficult to achieve. Poor access to basic infrastructure has been a serious obstacle to building a diversified economy and transforming Timor-Leste into a modern nation with the nation with the private sector as the engine of growth.

3.75. Increased investment in high-quality infrastructure, such as roads, water, electricity roads, water, electricity, telecommunications, and airports, to name a few examples, is, therefore, necessary to improve the conditions for private investment private investment, both domestic and foreign, to support the development of various productive sectors essential to achieving inclusive and sustainable growth for future generations.

3.76. To achieve this goal, however, substantial financial resources are needed, and loans are one way to support these projects that bring potential economic benefits to the country. A key benefit of long-term is that it is cheaper than taking money from the Petroleum Fund. If the cost of borrowing is lower than the cost of funding from the Petroleum Fund, this helps preserve the long-term sustainability of the Petroleum Fund.

3.77. So far, the State has contracted loans with international financial institutions international financial institutions and by August 2022, had accumulated a contracted amount of \$852.58 million.

3.78. Of these, the Government has invested heavily in a national network of safer road infrastructure nationwide. The improvements in the road transport infrastructure have gradually improved the quality of life not only of urban populations, but also of rural populations increasing the safety and connectivity of economic activities in different municipalities of the country.

3.79. In recent years, the Government has also expanded and increased its investment financed by public debt in social infrastructure, including health, education housing, and water and sanitation.

**Table 19: Amount of Public Debt as of August 2022 in \$ millions**

Item	Amount
Signed Amount	852.58
Amount Disbursed	265.83
Balance Not Disbursed	548.43
Principal Repayments	20.37
Interest payments	9.87
Debt stock	245.47
Debt in relation to GDP	15.5%.

Source: Directorate General of External Resource Mobilization, Ministry of Finance, September 2022.

3.80. The amount disbursed is relatively low in relation to the contracted amount, as several projects with significant budget amounts are relatively new programs or about to start their implementation phase, including the Dili and Baucau Water Supply projects, the Presidente Nicolau International Airport development project and the Improvement of the Basic Education System.

3.81. In terms of debt sustainability, using the DNPE's forecast on the real GDP figures, the external debt as a percentage of the GDP would be around 15.5% still well below the limits of 30% to 40% recommended by the IMF for low income countries.

3.82. Total external debt should remain below these limits for the next 3-4 years.

3.83. Moreover, the return on the Petroleum Fund over the last ten years has averaged of 4.28% while the contracted loans have an average interest rate of about 1.21%. Thus, Timor-Leste has saved more than 3% return on the amount of money it receives in loans, which helps to increase market confidence in the government's ability to repay the debt on the contracted loans.

**Table 20: % Cost of Borrowing**

Description	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Cost of borrowing (effective rate)				1.02	1.42	1.68	2.06	2.34	2.03	1.50
PF historical return	4.1	4.4	4.2	3.8	3.8	4.4	3.8	4.5	4.84	4.91

Source: General Directorate of Mobilization of External Resources, Ministry of Finance, Sept. 2022

## Public Private Partnerships

3.84. Broadly speaking, a Public-Private Partnership (PPP) refers to arrangements in which the private sector constructs infrastructure assets and provides services that were traditionally provided by the state.

3.85. The rationale behind PPPs in Timor-Leste stems from the fact that this arrangement potentially allows the government to benefit from the skills, experience and financing from the private sector, resulting in higher quality and efficiency as well as lower risk borne by the Government.

3.86. Timor-Leste has begun to explore PPPs as a modality of implementation of projects in the past 8 years and began by establishing a PPP policy, PPP legislation and a dedicated PPP Unit under the Directorate-General for Mobilization and General Directorate of Mobilization and External Resource Management in the Ministry of Finance.

3.87. Currently, one PPP project is in the Implementation and Operation Phase (Tibar Bay Port PPP), one is in Procurement and Negotiation Phase (Diagnostic Medicine) while others are in the Feasibility Assessment Phase (Affordable Housing, Cristo Rei, Port of Dili and Presidente Nicolau Lobato International Airport). It should be noted that part of the Airport project is already in the procurement for phase one of the runway extension.

3.88. The PPP modality chosen for the Tibar Bay Port was a 30 year concession, including project design, partial financing, construction, operation and maintenance of the port infrastructure. Construction began on August 30, 2018 and is expected to be completed by November 30 2022. The PPP's escrow account is earning interest. As of August 31, 2021, the interest earned totaled \$8,829 million.

3.89. The medical diagnostics PPP is in the early stages of contracting and negotiation phase, with the Council of Ministers having recently approved the specific decree law for the project was recently approved by the Council of Ministers.

3.90. The Development Project of the Presidente Nicolau Lobato International Airport is being developed in the Hybrid PPP modality - which refers to a financing arrangement in which some components of the airport infrastructure is funded by public investment through loans, grants and state financing, while other components are funded through financed through private sector investments.

3.91. The feasibility study for several components of the Airport Project, such as the runway extension to 2.1 km, staging areas, partial parallel taxiway and control tower, has been completed and the negotiation of the loan (in the amount of \$165 million inclusive of counterparty investment) for these components was also completed in May 2021.

3.92. Meanwhile, preparatory studies for the development of the Terminal and its sub-components began in the first quarter of 2022, funded by the \$44 million grant from the Japan International Cooperation Agency (JICA), while funding for other supporting infrastructure is still subject to discussion with the Department of Foreign Affairs and Trade (DFAT) of Australia and other donors.

3.93. The Cristo Rei PPP has finalized its pre-feasibility study funded by a grant from USAID's Tourism for All program. The project is now in the Feasibility Study preparation phase. The project is estimated to cost \$3.115 million, including the plan to move the parking lot to the Areia Branca site.

### Direct Budget Support

3.94. With the development of the Foreign Assistance Policy, the Government of Timor-Leste has made clear its preference for direct budget support (DBS) assistance, reducing potential duplication, overlap and the transaction costs of managing and/or coordinating with various fragmented donor-supported activities.

3.95. The DBS is considered to be funding from the 2023 General State Budget because it uses the Governmental public finance system (the money is deposited in a Treasury sub-account) and is executed within the Budget following the rules of budget execution.

3.96. Timor-Leste has received Direct Budget Support from the European Union since 2014. In this context, funds are delivered directly to the G without prior allocation to a particular expenditure. However, a variable portion depends on specific Key Performance Indicators (KPIs) agreed between the Ministry of Finance and the EU. While the funds are not separate from the Ministry's budget allocation, they must support clearly defined priorities.

3.97. In 2021, the Government of Australia has committed \$8.2 million in Direct Budget Support to be allocated over the next two years. The funding is linked to the National Suco Development Program (PNDS) and the expansion of the Bolsa Da Mãe social assistance program to include pregnant women and early childhood (Bolsa Da Mãe - New Generation).

3.98. The PNDS investment will focus on financing new community investment programs, particularly those focused on improving sanitation, drainage and irrigation canals, and rehabilitation of local roads. The Bolsa Da Mãe - Nova Geração investment will focus on direct funding for cash transfers as well as supporting the operational costs of program implementation.

**Table 21: Direct Budget Support in 2023 in \$million**

Donor	Program	Amount
EU	Budget Support to Deconcentration and Decentralization	1.1
EU	Nutrition Program	2.2
Australia	Bolsa Da Mãe - Nova Geração	1.6
<b>Total</b>		<b>4.9</b>

Source: Directorate General of External Resource Mobilization, Ministry of Finance, September 2022.

3.99. In addition, the government of Australia intends to increase the amount of its financial support for three government programs in 2023. Below is a table of the indicative amounts that have been committed. It should be noted, however, that the specific agreements have not yet been finalized, so they should be considered indicative at this time.

**Table 22: Government programs supported by additional support from Australia**

Government program supported	GoTL Agency	AUD	Estimated US\$
Mother Grant Jerasaun Foun	MSSI	10,500,000	7,000,000
Nasional Suku Development Program	MSA	7,000,000	4,800,000
Labor Mobility and Capacity Building	SEFOPE	1,300,000	900,000
<b>Total</b>		<b>18,800,000</b>	<b>12,700,000</b>

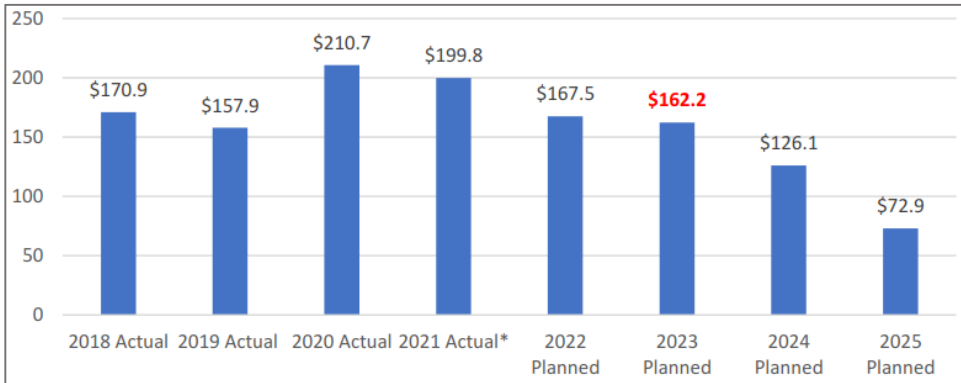
Source: Directorate General of External Resource Mobilization, Ministry of Finance, September 2022.

## Development Partners

3.100. The amount of Official Development Assistance (ODA) to Timor-Leste has exceeded \$150 million annually since 2016.

3.101. Development partners have committed to disburse a total of \$162.2 million in 2023 (\$152.9 for Public Sector related activities; \$9.2 non-government activities). This may be an indication that levels of support from development partners are stabilizing after increased funding during the COVID-19 pandemic and as a result of the destruction caused by Tropical Cyclone Seroja in 2021.

**Figure 12: Non-loan disbursements from development partners 2018-2025 in millions of dollars**



Source: Aid Transparency Portal, September 2022. \*figures should still be considered preliminary

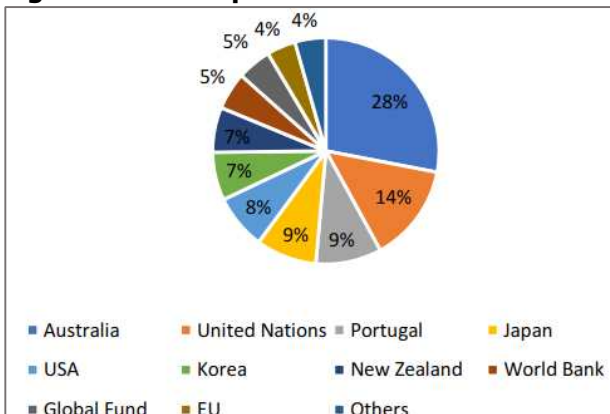
3.102. In addition, it is important to note that the amount of funding is difficult to predict more than a year in advance. This is because funding often depends on the appropriations entered in donors' annual budgets.

3.103. The substantial decline in funding over the next few years above presented is based on data collected at the project level, so does not include donor funding that has been secured but not committed to specific projects.

3.104. For example, the forthcoming Millennium Challenge Corporation Compact is not included in these figures, although it probably contributes significantly to the total amount of donor funding.

3.105. By 2023, the five donor groups expected to disburse the largest amounts of funding are as follows: Government of Australia (\$44.3 million; 28.0% of total), United Nations (\$22.9 million; 14%), Portugal (\$15.4 million; 9%), Japan (\$14.2 million; 9%); and the United States of America (\$12.8 million, 8%).

**Figure 13: % of planned non-financial disbursements by donor group\* in 2023**



Source: Aid Transparency Portal, September 2022. \*figures should still be considered preliminary

3.106. The table below provides a summary of the main projects and programs donors financed in 2023.

**Table 23: Ten projects with largest non-loan disbursements in 2023 in \$ million**

Project name	Donor	SDP areas	Total
Australia - Timor-Leste Partnership for Human Development - Health Sector	Australia	Agriculture	8.2
5530-Portuguese School Ruy Cinatti - Portuguese Language and Teaching Center	Portugal	Education and training	7.8
Australian NGO Cooperation Program (ANCP)	Australia	Agriculture, Health, Social Inclusion, Justice Water and sanitation, Public Sector Management and Good Governance, Education and training	7.5
10383 - East Timor Reference Schools Timor-Leste - Training Centers	Portugal	Education and training	6.2
Safeguarding rural communities and their physical assets from climate induced disasters in Timor-Leste.	UNDP	Education and training	5.7
Partnership for Strengthening the Village Development and Municipal Administration (PARTISIPA, formerly PNDS-SP)	Australia	Security	5.2
A Partnership for Inclusive Prosperity (PROSIVU)	Australia	Education and Training	5.1
National TB Program (NTP) and Resilient and Sustainable Systems for Health (RSSH)	Global Fund	Rural Development	4.8
Timor-Leste: Agriculture Productivity Improvement Project (SAPIP)	World Bank	Education and Training	4.5
Health System Sustainability	YOU SAY	Education and training	3.8

Source: General Directorate of External Resource Mobilization, Ministry of Finance, September 2022.

## Budget Sustainability Analysis

3.107. As stated in the Pre-Budget Statement<sup>4</sup>, over the past decade, the bulk of public spending has been financed by the Petroleum Fund<sup>5</sup>. This means that fiscal sustainability is closely linked to the longevity of the Petroleum Fund.

3.108. In this section we estimate the lifetime of the Petroleum Fund according to the current spending trend.

3.109. Without fiscal reform or a new source of Petroleum Resources, the Petroleum Fund is expected to be fully depleted by the end of 2034.

3.110. It is important to note that this forecast does not include any negative economic consequences of when the Petroleum Fund balance approaches depletion. It is highly likely that as the Petroleum Fund is close to being close to being totally depleted, the associated drop in Government spending could also lead to a collapse in consumer and private sector spending. This would likely cause an economic slowdown that could cause a drop in domestic revenues and thus have an even greater impact on fiscal sustainability.

<sup>4</sup> Pre-Budget Statement of the Ministry of Finance 2023, [https://assets.ctfassets.net/60pzqxyjaawg/6Ks1mXDBwdtD193M7N0JQp/7242c550152f5a7a386c579c46ccdf0f/The\\_Pre-Budget\\_Statement\\_2023.pdf](https://assets.ctfassets.net/60pzqxyjaawg/6Ks1mXDBwdtD193M7N0JQp/7242c550152f5a7a386c579c46ccdf0f/The_Pre-Budget_Statement_2023.pdf)

<sup>5</sup> Withdrawals from the Petroleum Fund have averaged over \$1 billion in the last decade, while domestic revenues have yet to exceed \$200 million per year.

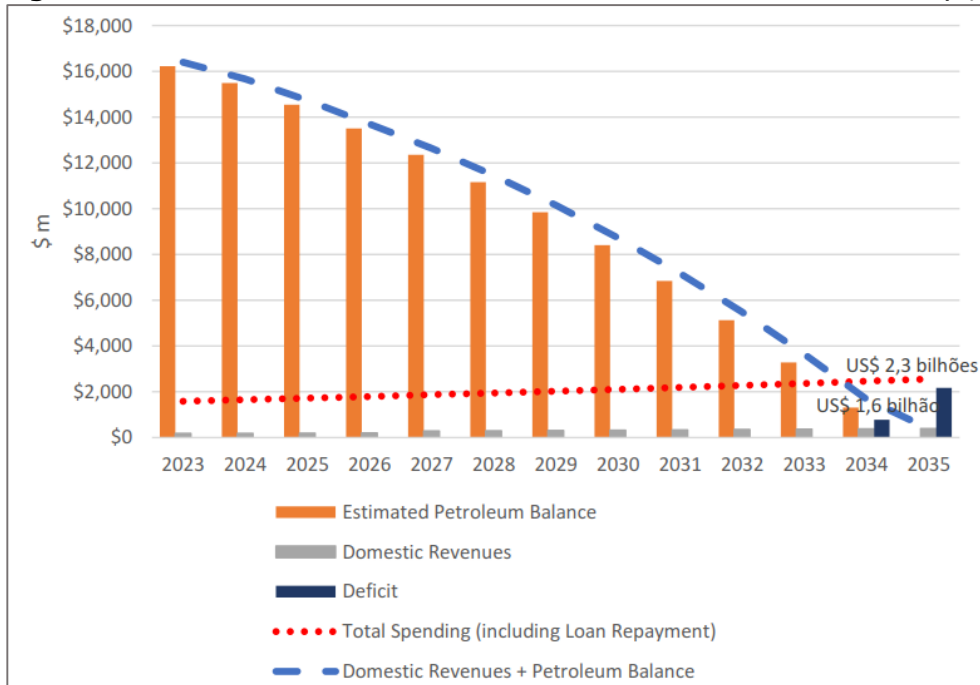
3.111. Further details on the model, including an explanation of the data used and assumptions made, are available in the Methodological Appendix

3.112. The figure below depicts the life of the Petroleum Fund on the current trajectory of expenditure. The blue dotted line shows total available revenues (this is the sum of the petroleum balance and domestic revenues and excludes funds resulting from new loans or from development partners<sup>6</sup>). The red dotted line shows total expenditures. The large orange bars show the value of the Petroleum Fund which is expected to be fully depleted by the end of 2034.

3.113. This scenario considers the ceiling of the General State Budget for 2023 defined in the GOP and assumes that, in addition, expenditures will continue to increase in line with long-term inflation and population growth (i.e., nominal growth of 4% per year).

3.114. Under this scenario, by 2034, the country risks facing a fiscal cliff, with projected expenditures likely to exceed total revenues by about \$1.6 billion. This means that under current spending plans, in 2034 the government would have to cut spending by 60% and by a further 80% the following year. Note that the Petroleum Fund could be depleted sooner than projected by this scenario if spending increases beyond 4% per year.

**Figure 14: Estimated Petroleum Fund Balance under Current Trend, \$ million**



Source: National Directorate of Economic Policy, Ministry of Finance, September 2022

3.115. Under the current spending trajectory, there is a risk of reaching an ornamental precipice in 2034, when about \$1.6 billion in spending cuts may be required. This would result in a large shock to GDP, likely resulting in large increases in unemployment and large drops in income, in the provision of public services and, ultimately, standards of living.

3.116. This eventuality also has implications for the country's ability to continue to import goods on the same scale and on the domestic circulation of currency. The country is currently able to sustain a dollarized economy, as revenues from the Petroleum Fund guarantee a regular supply of US dollars. A large non-oil trade deficit (projected to be over \$900 million by 2022) is only possible with a dollarized economy because US dollar inflows from the Petroleum Fund can replace the large US dollar outflow that is spent on imports.

<sup>6</sup> New Loans and Direct Budget Support are not included in the analysis due to uncertainty. Due to their small scale, they would have little impact on the overall results.

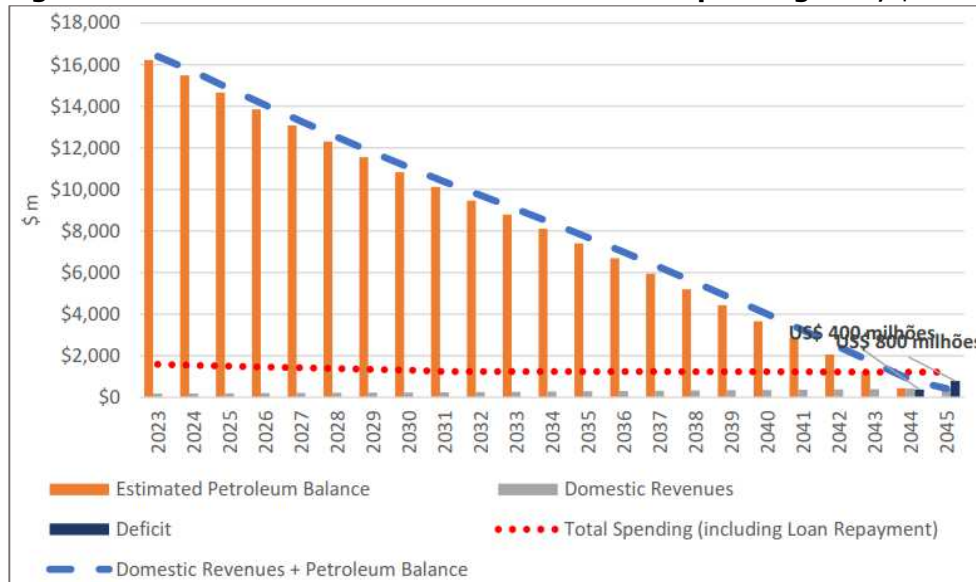
3.117. If a monetary alternative is not in place well before the point at which the Petroleum Fund is exhausted, persistent trade deficits could trigger a liquidity crisis. Without the use of the inflows of foreign exchange from the Petroleum Fund to finance the outflow of US dollars from import spending, individuals and businesses may find themselves without the currency needed to finance day-to-day transactions.

3.118. Extending the life of the Petroleum Fund would allow the country more time to build alternative sources of domestic revenue and prepare for the eventual implementation of a new currency.

3.119. Below is a scenario in which the government gradually reduces spending to pre-COVID-19 pandemic levels. The result would be to allow the country to have an extra decade in which it can continue to rely on withdrawals from the Petroleum Fund.

3.120. In the graph below, we model the impact of a gradual reduction in spending to \$1.2 billion, followed by a spending freeze at that level. In this scenario, the government reduces nominal spending (excluding spending financed by development partners) by 3 percent per year until it reaches \$1.2 billion by 2031. Setting spending at \$1.2 billion at that time would mean that the Petroleum Fund would not be depleted until 2045. By then, Domestic Revenues are projected to be close to \$600 million instead of less than \$400 million if the fund is exhausted by the end of 2034.

**Figure 15: Estimated oil balance with moderate spending cuts, \$ million**



Source: National Directorate of Economic Policy, Ministry of Finance, September 2022

3.121. If, in addition to the moderate spending cuts modeled above, the government manages to increase domestic revenues, the Petroleum Fund could last even longer.

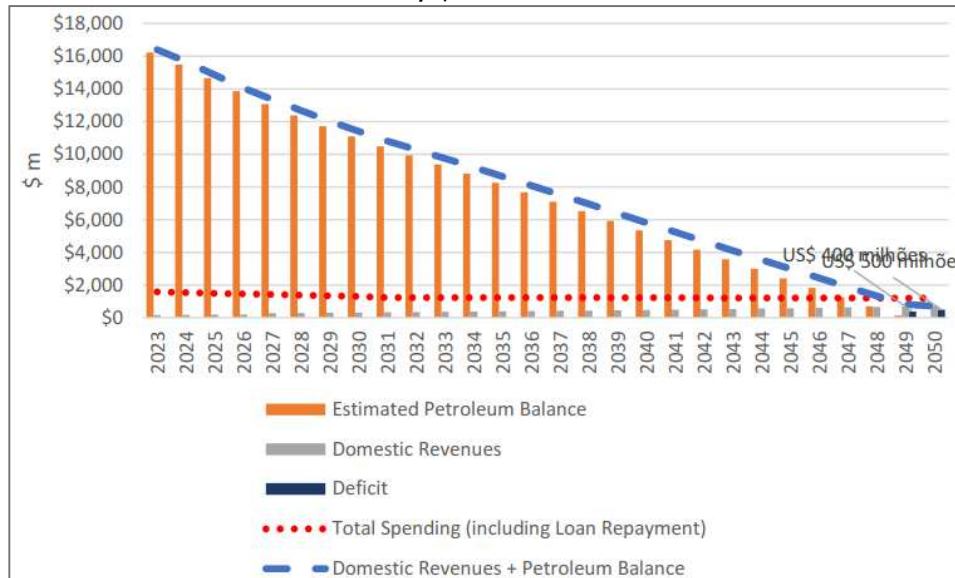
3.122. Using the Fiscal Sustainability Model, we show that if implemented gradual spending cuts (as shown in the scenario above) along with the implementation of together with the implementation of VAT and property taxes by 2027, the Petroleum Fund can last until the end of 2049. Furthermore, in this scenario when the fund is exhausted, the difference between expenditure and available revenues will be reduced to less than \$500 million.

3.123. The scenario is presented in the figure below. As with the previous scenario, here we assume that the government reduces spending (excluding new loans and financed by development partners) by 3 percent per year until it reaches \$1.2 billion, at which point the amount of expenditure is frozen.

3.124. Here we also assume that the government implements VAT and property taxes by 2027. Preliminary estimates from the Ministry of Finance's DNPE suggest that these taxes could bring domestic revenues to about \$285 million by 2027.

3.125. Under this scenario, when the Petroleum Fund is exhausted, domestic revenues could finance \$740 million in expenditures. However, this number could be higher if the extra years of oil revenues are used to successfully diversify the economy and achieve higher revenue growth.

**Figure 16: Estimated petroleum balance with moderate spending cuts and the introduction of VAT and IPTU, \$ million**



Source: National Directorate of Economic Policy, Ministry of Finance, September 2022

### Preparing for the end of the Petroleum Fund

3.126. Above we present the results of our economic model where we show how gradual spending cuts and the implementation of some new taxes can improve fiscal sustainability.

3.127. A complementary strategy is to seek alternative sources of revenue. In addition to introducing new taxes, such as VAT and property taxes, this can also include reforms that broaden the tax base, such as measures that help formalize the economy. The Government can also seek to increase revenues from existing taxes by introducing higher tax rates for larger companies or those making higher profits.

3.128. Prioritizing measures to diversify the economy, such as the measures approved in the GOP and explained in this Report, can also boost GDP growth. This can therefore lead to further increases in household revenues (increasing personal and business income) and help avoid a fiscal cliff. Economic diversification can also expand private sector investment opportunities and therefore reduce the need for government investment.

3.129. Finally, the government can also reduce the number of withdrawals in excess by financing through public debt instruments sustainable for long-term investments. The debt-to-GDP ratio in August 2022 is just under 16%, one of the lowest levels in the world. This means that there is some scope (albeit limited) to increase financing through debt and continue borrowing in debt and to continue borrowing at sustainable levels if the loans are used for long-term investments.

### Statement of Budgetary Risks and Contingent Liabilities

3.130. Budget risks are factors that may cause budget results to deviate from expectations or forecasts.

3.131. Budgetary risks may arise from macroeconomic shocks or from the realization of contingent liabilities - that is, obligations triggered by an unexpected event or whose realization during the fiscal year is uncertain.

3.132. Contingent liabilities are one type of budgetary risk, which are obligations to incur a public expense, but which do not materialize unless a specific event occurs in the future to trigger them.

3.133. In the case of Timor-Leste, this could lead to excessive withdrawals from the Petroleum Fund, accelerating its depletion, and is detrimental to fiscal sustainability and macroeconomic stability. Countries with stronger institutions can better control and manage the underlying risks, so that they are less exposed to triggering contingent liabilities.

3.134. The 2019 PEFA assessment of Timor-Leste highlighted some areas of possible improvement in relation to the production of a Timor-Leste Budgetary Risk Report and the Disclosure of Contingent Liabilities.

3.135. The Government is committed to improving the disclosure, analysis and management of the Budgetary Risk and Contingent Liabilities.

3.136. Budget Book 1 of the proposed State Budget for 2022 included for the first time a statement on Contingent Liabilities, and Law no. 9/2011, of August 17, Organic Law of the Chamber of Accounts of the High Administrative, Fiscal and Audit Court already requires the “Disclosure of the direct responsibilities, arising from the assumption of liabilities or recourse to public credit, or indirect, namely the granting of guarantees” [Article 29.1, points f) and g)].

3.137. However, with the approval of the LEO it is now necessary that the draft budget report to present an analysis of the budgetary risks and the disclosure of contingent liabilities of the General Government Sector.

3.138. In addition to this legal requirement, Timor-Leste has also committed to the “Development of a Budgetary Risk Statement and a Strategy for Risk Management” as part of the Public Finance Reform Strategy 2022- 2027.

3.139. According to the IMF, international best practices in managing budgetary risk and contingent liabilities involve a more complete understanding of potential risks, measures to quantify potential risks, measures to quantify risks, and measures to mitigate or provision for risks.

3.140. As Timor-Leste is taking its first steps in this regard, this statement describes the commitment to meet its commitments to better management and communication of better management and reporting of budget risks.

3.141. Below is an overview of Timor-Leste’s plan of action to better manage budget risks and contingent liabilities, this statement being the first step:

1. Disclosure: outlining the explicit and potential risks and the commitment to manage them.
2. Collection: data from budget entities and public companies on the risks specific risks.
3. Analysis: of risk concentration and correlation.
4. Manage, mitigate, and monitor: take measures to manage existing risks and increase; provision for contingencies; monitor stability or changes in risk.

### **Explicit Contingent Liabilities recognized by Law or Contract**

3.142. Judicial litigation is a major source of contingent liabilities and the cost to the State depends on the outcome of pending lawsuits.

3.143. Below are presented the current litigation cases in which the State is a party and their maximum potential cost if the case is decided in favor of the counterparty.

- Prosafe Rigs Ltd: Lawsuit in the Timorese courts relating to the income tax assessment 2004, with a maximum liability of \$1,156,826.91
- Eastlog Projects Limited: Litigation in the Hong Kong Court of Arbitration related to the alleged breach of the construction contract for the Suai Supply Base, with a maximum liability of \$5,305,338.08.
- Lighthouse Case: Court case in the Victorian High Court in Australia related to the purchase of generators for the Hera Power Station, with a maximum liability of about \$1,000,000.

3.144. To cover contingent liabilities arising from legal judgments and decisions, an appropriation of \$2,000,000 is included in the General State Appropriation. An additional appropriation is provided for fees in the amount of \$ 1,500,000.

3.145. The Small and Medium Enterprise (SME) Guarantee Scheme is an initiative to support business start-ups, whereby a government guarantee covers government covers up to 70% of the value of the business loan to SMEs in order to encourage the development of the private sector in the country, with a total budget of \$4 million. The Central Bank of Timor-Leste works with private banks to share and manage the risks. The maximum size of the individual guarantee is \$150,000, however, the total cost is already 100% budgeted, so it poses no additional risk if the loans default.

3.146. The “Soft Credit Guarantee Facility” is a loan guarantee system to provide low-interest loans to businesses and individuals. The loans are provided by financial institutions that enter into a contract with the Government to provide low-interest loans and which are guaranteed by the Government. The scheme had an initial budget of \$1,379,990, but was boosted with \$50,000,000 by Law No. 6/2022, First Amendment to the State Budget for 2022. However, this scheme is also 100% budgeted, so it poses no additional risk if the loans default.

### **Public Private Partnerships (PPPs)**

3.147. Public-private partnership contracts generally involve some form of contingent liability for of contingent liability for the government. These can be guarantees or indemnities on specific risk variables, with an agreement for the government to compensate the private party for lost revenue should a specific risk occur that is different from the level specified in the contract. The associated risk is therefore shared between the Government and the private sector.

3.148. By 2023, the government of Timor-Leste will have two PPPs under implementation: the Port of Tibar which is expected to complete construction by the end of 2022 and the Medical Diagnostics project. The contingent liabilities associated with the Port of Tibar refer to exchange rate fluctuations, occurrences of Force Majeure or fortuitous event, i.e. events for which no party can be held responsible, unforeseen political circumstances and agreements related to different contract term events.

3.149. The duration of each specific contingent liability is different and some are extinguished at the end of the construction phase. The contingent liabilities for the Government of Timor-Leste related to the Medical Diagnostics project refer to the obligatory payments at different contract termination events.

The liability will include the settlement of the outstanding debt plus the capital investment, depending on the type of event. More information is presented in the Informational Elements.

### **Implied Contingent Liabilities**

3.150. In addition to the explicit contingent liabilities mentioned above, the Government must also consider implicit contingent liabilities. These are contingent liabilities where there is no legal obligation for the Government to intervene, but this may be necessary to protect the economic well-being of citizens.

3.151. Such contingent liabilities in Timor-Leste are likely to occur as a result of environmental, social or economic crises. Any such crisis that loss of livelihood due to damage, displacement or unemployment or other economic other economic hardships can lead to unexpected costs.

3.152. Such costs would arise if the Government intervened through schemes of social assistance and economic stimulus packages. Below, we describe some of these contingent liabilities and explain how the Government can mitigate them.

3.153. Natural disasters are one of the main risks faced by Timor- East. The country is situated near the so-called “Pacific Ring of Fire”, an area that has some of the most volatile seismic and volcanic activity in the world. With the climate change, the country is also at increased risk of flooding and cyclones.

3.154. Analysis of budget execution data shows that Timor-Leste spent an average of \$4.2 million per year on expenditures related to natural disasters natural disasters since 2019, peaking in 2021, when the Government was required to spend \$6.2 million as a result of Cyclone Seroja.

3.155. External Economic Shocks are another source of implied Contingent Liabilities.

3.156. As demonstrated by the COVID-19 crisis, a public health and economic crisis can also be an important source of budgetary risk for Timor-Leste. Although pandemics are infrequent events, as a small open economy that relies heavily on imports, Timor-Leste is highly exposed to economic events in other countries.

3.157. A recent example of this was presented in the Macro section of this report, where we explained how the war in Ukraine and the subsequent impact on international trade contributed to the increase in inflation in Timor-Leste.

3.158. Since independence the COVID-19 public health crisis was the largest external shock to hit the Timorese economy. The crisis had the greatest impact on public expenditure in 2021, during which the Government spent \$201 million on measures to protect citizens from the economic and health impacts of COVID-19.

3.159. Political crises have also been a source of budgetary risks in recent years.

3.160. Delays in the approval of the General State Budget in 2017, 2018 and 2020 contributed to negative economic growth in those years. A negative economic growth can mean that there is a general drop in the income of businesses and individuals. In the short term, this leads to lower tax revenues. In the long run, it delays progress in the economic diversification that is needed to help the country secure its long-term fiscal sustainability.

3.161. Some contingent liabilities that pose large fiscal risks in other countries are less likely to materialize in Timor.

3.162. Many developing countries are exposed to risks due to volatile exchange rate movements. Since Timor-Leste uses the US dollar, which is among the most stable currencies in the world, such risks are less likely (though not completely unpredictable).

3.163. However, it should be noted that Timor-Leste can only maintain a regular supply of US dollars as a result of the Petroleum Fund. This means that this could become a greater risk in the next decade, as explained in the Budget Sustainability section of this report.

3.164. Given the infancy of the banking system, and the fact that several of the banks operating in Timor-Leste are state-owned enterprises in their respective countries are subject to foreign lenders of last resort, there is also less risk of a domestic financial crisis occurring in Timor-Leste compared to other low- and middle-income countries.

3.165. Similarly, the debt-to-GDP ratio (approximately 13% in 2021) remains relatively low, meaning that there is a low risk of a debt crisis.

3.166. A contingent liability unique to Timor-Leste is the risk to Petroleum Fund from the Petroleum Fund arising from volatility in financial markets.

3.167. The factors that would affect the performance of the Petroleum Fund can be regarded as contingent liabilities because they could lead to the Fund being depleted ahead of schedule. As described above, this would mean increased exposure to budget.

3.168. The declines in stocks and bonds this year - investment income for the year to June was negative \$1.9 billion - demonstrates the market risk in the Fund's investment portfolio. With a long-term investment strategy, the Fund has so far been able to weather market volatility.

3.169. However, the Fund's investment horizon has shortened as revenues from the Bayu-Undan field are ending and expenses and withdrawals are expected to follow the current trend. Investment returns are not expected to be sufficient in the future to fill this gap.

3.170. To adjust for the expected depletion of the Fund, a liquidity portfolio of low-risk investments was created in 2021 to fund withdrawals over the next three years. This gives some protection against being required to sell stocks and bonds after a market downturn, but is less effective when withdrawals significantly exceed projections. In addition, a prolonged period of poor investment performance would further reduce the expected life of the Fund.

3.171. In addition to financial markets, the Fund is exposed to the future of the Greater Sunrise project. In 2019, the Government decided that the Petroleum Fund would lend \$650 million to Timor Gap, E.P., and its subsidiaries to finance the acquisition of interests in the Greater Sunrise development project.

3.172. These loans are independently evaluated each year for the Fund's audited financial statements. The repayments of the loans are linked to the revenues of Timor Gap, E.P. from the petroleum project, which means that the Fund is exposed to the success of the project.

3.173. Depending on how the newly created FCLN is managed, there may be an increased or decreased risk to the Petroleum Fund. The FCLN should be self-sustaining. That is, the Fund's expenditure on veterans' supports should be financed with income from the Fund's investments. This would reduce the risk of additional withdrawals from the Petroleum Fund to bolster the FCLN.

3.174. However, on the other hand, certain contingent liabilities could lead to losses in the FCLN. For example, there may be more claims by veterans than previously accounted for; the Fund's investment portfolio may also suffer unexpected losses. In such cases, the Government may face pressure to use the Petroleum Fund to provide more funding to the FCLN.

3.175. To finance unexpected expenses arising from contingent liabilities and other fiscal risks, the government allocates a portion of each year's Budget for contingency funding.

3.176. To ensure that the Contingency Reserve has sufficient allocation to cover expenses arising from possible budgetary risks, the LEO enshrined a minimum limit for the Contingency Reserve, whose allocation must amount to a minimum of 2% of total Budget expenditure and a maximum of 5% of total expenditure.

3.177. In 2023, the Government entered \$66 million in the Contingency Reserve, which corresponds to 2.09% of total State Budget expenditure.

3.178. In a typical budget year, where there is no political or economic crisis, the largest source of contingent liabilities is likely to arise from natural disasters. As explained earlier, a major example of this was in 2021, when \$6.2 million was spent primarily as a result of flooding caused by Cyclone Seroja.

3.179. A large economic shock may require the government to intervene with much higher levels of economic support. If such a response requires spending levels beyond the Contingency Reserve, the government can rely on withdrawals from the Petroleum Fund. However, this comes at a cost, as regular unforeseen withdrawals from the Petroleum Fund will mean that the fund will be depleted sooner than anticipated.

3.180. However, this also demonstrates the importance of ensuring that fiscal policy can maximize the longevity of the Petroleum Fund. On current spending trends, the Petroleum Fund is projected to be exhausted by the end of 2034. This means that at least until 2033, the Government can rely on an additional source of revenue if fiscal risks materialize beyond any contingency funds.

3.181. Moreover, if the Petroleum Fund is exhausted before domestic revenues are high enough to support contingency funding, contingent liabilities may become greater fiscal risks.

## Methodological Annex

### Methodology of the Budget Sustainability Model

The Ministry of Finance conducts a budget sustainability analysis for the ceiling defined in each budget cycle. Using modeling, the impact on the long-term sustainability of Timor-Leste of the selected budget ceiling can be estimated, specifically the overall balance of the Petroleum Fund.

To produce the analysis, we need to project expenditures, domestic revenues and the performance of the Petroleum Fund. Below, we summarize the key data and model assumptions that are used to achieve this.

### Actual Data

Expenditures - The model uses the latest planned expenditure figures, as established by the GOP 2023. We apply an execution rate on expenditures that is consistent with the GDP model and based on the historical execution rates of government projects.

Petroleum Fund data - The model uses Petroleum Fund data from September 2022. It includes the Petroleum Fund balance, information about the division of Petroleum Fund assets, and the most recent information on withdrawals and Estimated Sustainable Income.

Loan Data - The model considers existing debt commitments in Timor using loan data from the Ministry of Finance.

### Assumptions/Projections

Due to the uncertainty of future variables in the model, for example, the value of Budgets of future years, the model uses some assumptions.

Domestic Revenues: Unless specifically stated for an individual scenario, the model predicts that between 2022 and 2027 domestic revenues will increase according to the forecasts of the DNPE of the Ministry of Finance, as published in the GOP 2023. Details on how these forecasts were produced are available in the revenue section of this annex.

Beyond 2027, domestic revenues are assumed to increase in line with long-term inflation and population growth forecasts<sup>7</sup>.

Petroleum Fund Investment Rate of Return (ROI) - The model also uses updated assumptions about the rate of return estimated by the Ministry of Finance's Petroleum Fund Policy and Management Office. The Petroleum Fund is segmented into two portfolios, a growth portfolio and a liquidity portfolio. In September 2022, we assume that the growth portfolio has an ROI of 4.1%, while the liquidity portfolio has an ROI of 2.5%. The Fund's liquidity portfolio is assumed to be sufficient to fund three years of withdrawals. To model this, we assume that the liquidity portfolio each year is three times the withdrawal amount.

New Loans and Direct Budget Support - The model does not take into account revenue from new loans or direct budget support, as these revenue streams are highly unpredictable. Since direct budget support is a very small part of the Budget, it is not likely to have any impact on the results. Given the low debt to GDP ratio, some level of debt could replace withdrawals from the Petroleum Fund, however repayments also create future spending commitments, so they are also limited.

### Domestic revenue forecasting method

Revenue forecasts are produced using one of the methods described below:

Ideally, the forecasts of the public services that perform the collection are used when they are reasonable and justifiable.

If the above process is not feasible, we project revenue according to trends, provided these trends are consistent and a reliable indicator of future performance. If reliable information is not available to determine this, or if past trends are highly volatile, we assume that that domestic revenues grow in line with economic growth.

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<sup>7</sup> Long-term population growth is assumed to be 2% Long-term inflation is also assumed to be 2%

If the above options are not feasible or justifiable, we assume growth of 4%, as recommended by the IMF (related to long-term inflation and population growth).

## GDP Forecast

**Table 24: Variations in the historical/preliminary/national accounts forecasts, %**

	2020	2021	2022	2023	2024	2025	2026	2027
BB1 2022 (January 2021)	-8.6	1.6	2.7	2.8				
GOP 2023 (May 2022)	-8.6	1.5	2.9	3.1	3.4	3.5	3.1	3.0
PBS 2023 (July 2022)	-8.6	1.5	2.7	3.2	3.4	3.5	3.4	3.5
BR 2023 (September 2022)	-8.3	2.9	3.3	3.5	3.6	3.5	3.4	3.6

Source: Ministry of Finance, September 2022.

Economic forecasts or projections aim to predict annual growth rates of GDP and high-level macroeconomic data. Making forecasts about the macroeconomic variables in the future is important to help governments and businesses make decisions about policies, planning, and investments.

However, it is important to understand that in order to make these forecasts, we must make some assumptions about future conditions. Therefore, all projections always include an element of uncertainty. To inform the forecasts, we use some indicators or equivalents to estimate trends in certain sectors of the economy.

To forecast GDP, the DNPE uses historical data from the National Accounts to analyze historical trends in different components of GDP, e.g. consumption investment, etc., through the end of the year. For the coming years we also use analyses of historical trends and information about the timing of future PPP projects and forecasts of budget ceilings.

When data are not available, some assumptions must be made.

When data is available, the numbers may be preliminary or final. This is why the National Accounts figures can also change over time. The most significant was that the 2021 GDP increased from the preliminary April figure of 1.5% to 2.9% in September.

This was due to the release of new information on Expenditure of Development Partners and the Business Activity Survey (BAS) that was not available at the beginning of the year.

There is often a delay in updating the National Accounts when Development Partners submit their expenditures and the BAS has more positive information about business activity than previously expected. In addition, the final 2020 National Accounts GDP was also revised from -8.6% to -8.3%. This was due to higher than expected coffee production and an adjustment in the deflators.

Forward projections are now slightly more positive to reflect these changes. The main uncertainties in the forecast come from imports and government budget execution.

If public spending is particularly dependent on imports, which means that much of the new spending goes to goods and services from outside Timor-Leste. GDP forecasts for the coming years may be downwardly revised, as imports have a negative effect on final GDP.

In 2023 there will be parliamentary elections. The previous forecasts assume a transition from the 8th to the 9th Constitutional Government. However, the transition may cause delays in the implementation of planned government projects and may lead to lower than expected execution.

Moreover, if there is a large change in execution rates, this could have a noticeable impact on the economy, especially since the General State Budget represents a large share of Timor-Leste's GDP.

Execution rates differ each year for different reasons and depend on the absorptive capacity of the Timor-Leste economy. Absorptive capacity means the ability of ministries to execute projects that are financed by the General State Budget, if funding is available.

For example, even if the expenditure in the Budget has increased, ministries may not have the capacity to execute enough projects to spend all that money.

As with all forecasting, the more time and accurate data you have, the less assumptions you have to make and the closer you get to the real value.

Finally, all institutions use different assumptions or data sources when their forecasts and, therefore, there are often differences in the projections between institutions. Often, the Ministry of Finance will have more up-to-date information related to public spending than other institutions, which explains the differences between the forecasts of the Ministry of Finance and those of other institutions, such as the IMF, World Bank, Asian Development Bank or the Central Bank of Timor-Leste.

**Table 25: GDP growth forecasts from different institutions in %.**

<b>Institution</b>	<b>2022</b>	<b>2023</b>	<b>2024</b>	<b>2025</b>	<b>2026</b>	<b>2027</b>
MOF (DNPE)	3.3	3.5	3.6	3.5	3.4	3.6
IMF	2.0	3.6	2.6	2.4	2.4	3.0
World Bank	3.0	3.0	3.0			
ADB	2.3	3.0				
Central Bank of Timor-Leste	5.8	2,0				

*Source: Ministry of Finance, IMF, World Bank, BD, BCTL, September 2022*

### **National Liberation Fighters Fund**

Law No. 6/2022, First Amendment to the General State Budget for 2022, approved an additional \$1 billion withdrawal from the Petroleum Fund to create the National Liberation Combatants Fund.

The Fund aims to be self-sustaining, with the proceeds from the Fund's investments to be used to fund spending on veterans.

However, since the Fund is part of the General State Budget, unlike the Petroleum Fund which is excluded from the Budget, accounting rules dictate that the total wealth of the Fund must be included in the Budget each year, as revenue and as expenditure. (as is already the case with the Social Security Reserve Fund).

This does not mean that there is any new withdrawal from the Petroleum Fund every year, or that the National Liberation Fighters Fund is being spent, but only that the \$1 billion of Fund assets invested in financial securities must be budgeted every year.

This stems from the fact that as a cash budget, the General State Budget can only account for revenues and expenses, but not assets and liabilities, so in order to present the assets of the Public Administrative Sector in the State Budget, these are equated with revenues and expenses for accounting purposes.