



Committee on Economy, Finance and Anti-Corruption

REPORT AND OPINION
Proposed Law No. 37/II
FIRST AMENDMENT TO LAW No. 15/2009, of December 23, WHICH
ADOPTED THE STATE BUDGET FOR 2010
(AMENDING THE STATE BUDGET)

21 June 2010

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1. PRELIMINARY CONSIDERATIONS

The Proposed Law No. 37/11 "*First Amendment to the Law No 15/2009 of 23 December, approving the State Budget for 2010*" was filed in the National Parliament on June 1, 2010, having been admitted on the same day and sent to the Committee of Economy, Finance and Anti-Corruption as well as all the specialized standing committees as prescribed in paragraph 2 of Article 163 of the Rules of Procedure of Parliament.

The Government introduced this legislative initiative in terms of Article 95.3 paragraphs d) and e), Article 97.1 and Article 145.1, of the Constitution of the Democratic Republic of Timor-Leste;

We appreciate that the draft law appears to satisfy the requirements of Article 98.1 of the Rules of Procedure of Parliament.

The draft law is drafted in Portuguese, is presented in the form of articles, contains a title that reflects its central object and is accompanied by a justification or statement of reasons and are satisfied the four formal assumptions incorporated in the regulations.

The Bill, in its Article 4 calls for a withdrawal from the Petroleum Fund of 811 million U.S. dollars. This value exceeds, as recognized by his own PPL, the limit of the Estimated Sustainable Income (ESI), as defined in Law No 9/2005 of 3 August (Petroleum Fund Act), which is for year 2010 \$502 million, already authorized by Law 15/11/2009, 23 December (OGE 2010).

When the ESI limit is exceeded Law No 9/2005 requires the Government to submit the following to the National Parliament:

- a) a report specifying the estimated sustainable yield in Fiscal Year in which the transfer is made;
- b) a report specifying the estimated sustainable income for the preceding Fiscal Year;
- c) An estimate of the amount by which the Estimated Sustainable Income for fiscal years subsequent to the Fiscal Year to which the transfer is made will be reduced as a result of the transfer of the Petroleum Fund in an amount greater than the Estimated Sustainable Income Fiscal Year for which the transfer is made;
- d) Independent Auditor's report certifying the estimates of the reduction of the Estimated Sustainable Income referred to in subparagraph c);
- e) Detailed explanation of why it is in the long term interests of Timor-Leste a transfer greater than the Estimated Sustainable Income.

The government presented all of the above except the Independent Auditor's Report (line d). The Government, however, undertook to do so at the beginning of the discussion and vote on the PPL.

The Committee considers that the Detailed Explanation, addressed to the President of the National Parliament through the letter No 0711/GPM/V/2010 provided in line e) is insufficient, by not being properly grounded in accordance with Article 9. Law No 9/2005.

The Committee appointed Mrs Cipriana da Costa Pereira (FRETILIN) as rapporteur.

Noting the provisions of Article 34 of the Rules of Procedure of the National Parliament, we report describes the following:

2. MACROECONOMIC PERSPECTIVE

According to the Committee's Macroeconomic analysis, which is annexed to this report, we highlight the following points:

The main impact of the global economic crisis which began in the second half of 2008 on the Timorese economy is reflected in lower prices for oil. Consequently, the oil revenues of Timor-Leste have decreased, affecting fiscal policy, which pursues economic growth, combat unemployment and low inflation.

In 2007 and 2008, the Timorese economy showed a faster growth rate. However, the Non-oil Gross Domestic Product (GDP) fell in 2009, expecting a similar negative growth in 2010.

The inflation rate has remained below 10% from mid-2008 and 2009, and is therefore under control. Although there is an increasing trend of inflation, this should not exceed 5% in the second half of 2009 en 2010, according to IMF projections.

The non-oil fiscal balance (deficit) is quite high: in 2006 represented 21% of non-oil GDP in 2007 46%, and 97% in 2008.

Despite this outstanding macroeconomic performance, the authorities face a myriad of social and economic problems to solve. To emphasize that poverty continues to affect about 50% of the Timorese population.

The Government has pursued an active policy to support growth, despite high levels of budget execution, efficiency and effectiveness of public expenditures were significantly lower. Note that these public expenditures were financed through the Petroleum Fund (91% in 2009)

Domestic tax revenues were always low last year, representing only 21% of total revenues. Note that both the high level of economic growth or the existence of an attractive Tax Law since 2008 has not translated into higher tax revenue collection.

The Committee noted that the State Budget for 2010 provided for the level of domestic revenue - Indirect Tax - 48.3 million U.S. dollars, and in the Amending Budget reduced the same section to 19.5 million dollars. The committee does not understand why the estimates of tax revenues are down 28.8 million, or more than half the originally envisaged when the

Government itself estimates economic growth of around 12%.

Despite the low public spending tax collections have grown to unsustainable levels.

It is important to bear in mind that interest on the Petroleum Fund is likely to decline due to low interest rates worldwide, particularly in interest payments on U.S. public debt. The world economic recovery has been based on the use of the increasing public debt. As debt service is financed through taxes, which does not want to see increased, probably the economic recovery will take. A faster recovery take place only with the use of or reduction in interest rates, or the delays in payment of debts, or by a combination of two factors.

Anyway, to enable a less traumatic recovery in the global economy, interest rates should remain low for a long time in international markets. In this scenario, capital accumulation of the Petroleum Fund will decrease, unless the annual withdrawals start to be below the current fiscal envelope and programs are restructured to ensure a real reduction in poverty by channeling public investment to areas of health, education and agriculture.

The Committee was also asked about the impact of amending budget in the following areas: Employment, Agriculture, Food Safety and Building Construction and Transportation.

As regards employment, the budget does not provide sufficient detail for an informed analysis of the impact this variable. However, it seems likely that the expenditure may result in increased employment in the following areas:

Infrastructure projects, including the Comoro Power Station, the new docks at Hera, the rehabilitation of the airport, the renovation of churches and works consequent to the creation of new diocese of Maliana. While these projects have a significant cost, it is unlikely that the jobs generated will affect the unemployment rate significantly, although they may come to create jobs not specified in the state budget. Note however, that most of these jobs are temporary in nature.

Agriculture

The purchase of machinery and tractors to hand within the investment program in agriculture, carry a potential for employment growth.

There is, however, no comment from the Government about the impact on jobs as a result of the distribution of about 700 tractors in previous years. It is not yet explained what the impact on agricultural growth and distribution of these tractors.

Food Security and Building Construction

Although the government justifiably reiterates the importance of food security, the budget does not articulate a comprehensive strategy for achieving this goal. One may infer that the investment in agriculture (tractors and seeds) and subsidies for rice provided for in this budget are the key to this strategy, but there is little information about the increased production and productivity of the crop in each row. It is not yet explained the impact of these policies on job created, in the support given to the marketing of current production, the creation of mechanisms for reducing post-harvest losses, as well as support for the storage and distribution of local products..

Second, while school feeding is acknowledged by the Government, it is unclear how much of the \$1.125m Budget Rectification is intended for school feeding and how much is for education in mother tongue.

Transmission and Distribution in Timor-Leste

Amending the Budget seems to have investments in infrastructure and construction to improve the transportation and distribution of goods and services in the country, including the distribution of rice harvested in the food security program among the most vulnerable networks. Moreover, \$0.151 million is assigned to the Ministry of Social Solidarity for this purpose. Is this amount sufficient?

Finally, the Committee calls the attention and consideration of the Government to the

conclusions and recommendations contained in paragraphs 1-7 of the report on the economic analysis of Timor-Leste, which is annexed to this report.

3. PUBLIC HEARINGS

The Committee decided to make the following public hearings:

Minister of Finance;;
Secretary of State for Natural Resources;
National Petroleum Authority
Banking and Payments Authority (BPA)
Faculties of Economics, National University of Timor-Leste and Dili Institute of Technology (DIT);
Minister of Economy and Development;
Minister of Tourism, Commerce and Industry;
Petroleum Fund Consultative Council - CCFP;
Luta Hamutuk
La'o Hamutuk
Chamber of Commerce and Industry;
National Consortium of Timor-Leste.
Deputy Prime Minister, Eng. Mário Carrascalão
Minister of State Administration

The minutes of those hearings are attached to this report, making it an integral part.

4. New Measures presented in Rectification Budget

The Government introduced this Bill, a set of measures and programs not covered in the budget for 2010, arguing its necessity and urgency.

The committee, after reviewing the recommendations of the specialized standing committees (transcribed below), and public hearings held with the Government and other bodies found, however, only urgent and necessary as the following new measures:

Salaries and Wages

- Payment of Wages - Office of Prime Minister and Chair of the Council of Ministers - \$32,000
- Payment of 13th month:
 - Secretary of State for Energy Policy - \$13,000
 - Secretary of State for Defence - \$13,000
 - F-FDTL - \$365,000;
 - Ministry of Justice - \$191,000
 - Ministry of Agriculture and Fisheries: \$388,000
 - Prosecutor-General's Office - \$75,000
- Payment of Wages to F-FDTL as a result of the implementation of Decree-Law of the Government - \$314,000

Totaling \$1,391,000 on the line Salaries and Wages.

Goods and Services

- Official visits of President of the Democratic Republic of Timor-Leste (\$400,000);
- Payment of wages (updated under the Act) and the residence of Proclamador Francisco Xavier do Amaral - \$430,000.
- Provision for students in Cuba - \$1,900,000;
- Continue to support education by strengthening the Food Program in schools and language program - \$1,125,000;
- Repair and maintenance of barracks, dining halls and kitchens in the barracks - \$200,000

- Defence Attaché in Jakarta (\$75,000);

Totalling \$4,130,000 under the heading Goods and Services.

Minor Capital

- 65 vehicles to enhance operations at the level of sub-districts, including vehicles for the police special unit built, since the vehicles of the GNR, dating back to 2001 are no longer able - \$1,200,000

Totalling \$1,200,000 under the heading Minor Capital

Capital Development

- The construction of barracks for the Naval Component - \$1,250,000;
- Hera Port, necessary for new patrol boats, which should be built as a permanent structure - \$7,100,000;
- Phase 1 rehabilitation of the runway at Dili airport - \$2,000,000;
- Construction of the Prosecutor General's Office - \$1,400,000;
- First phase of construction of Civil Service Commission Building (\$603,000).

A total of \$12,353,000 for the Capital Development Category.

Public transfers

- Payments to veterans - \$25,510,000, pursuant to law;
- Resolution of pending cases concerning IDPs - \$4,000,000;
- Natural Disasters - \$1,000,000;
- Medical treatment abroad \$2,000,000;
- Payment for the new diocese of Maliana (\$700,000).

A total of \$33,210,000 for Transfers.

The total of these new measures proposed by the Government and accepted by the Committee is \$52,284,000.

5. Analysis of Cash Flow (including New Measures recommended by Committee C)

Table 1: Sources and Uses of Funds	
	(US\$'000)
Sources of Funds:	
Beginning Treasury Cash Balance, 1 January 2010	162 558
Cash collections from domestic revenues	94 700
Transfers from Petroleum Fund	502 000
Total sources of funds	759 258
Uses of Funds:	
Cash Payments, January to February 2010 (2009 Budget) (2 months complementary period, modified cash basis)	84 464
First trimester cash payments 2010 Budget (January to March)	79 406
Estimated realizable cash payments from 1 April to 31 December 2010 (85% of obligations)	534 707
Total uses of funds	698 577
Cash Balance (Surplus), 31 December 2010	60 681

GENERAL BUDGET OF THE STATE 2010 MID YEAR BUDGET REVIEW

Table 2: Cash Receipts and Payments (US\$'000)

<u>Treasury Cash Balance</u>		CASH BALANCE AVAILABLE FROM 1 APRIL 2010	221 992
Beginning Treasury Cash Balance, 1 January 2010	162 558	ADD:	302 000
Less: payments 2009 Budget (January to February 2010, modified cash basis)	<u>-84 464</u>	Expected remaining transfers from Petroleum Fund	
Cash Balance Available for 2010 Budget	78 094	Estimated cash collections domestic revenues from April 1 to Dec 31, 2010	<u>71 396</u>
ADD:		TOTAL CASH RECEIPTS AVAILABLE FROM 1 APRIL TO 31 DECEMBER 2010	
Transferred from Petroleum Fund (March 2010)	100 000		595 388
Cash collections from domestic revenues	<u>23 304</u>	<u>ESTIMATED PAYMENTS FROM 1 APRIL TO 31 DEC. 2010</u>	
Cash Balance Available for First Trimester 2010	201 398	TOTAL OGE 2010 INCLUDING AUTONOMOUS AGENCIES	659 996
Less: payments first trimester 2010		Less:	
Jan to March 2010 (2010 Budget)	<u>-79 408</u>	payments first trimester 2010	-79 406
Cash Balance Available 31 March 2010	121 992	cancelled budget, Min. Tourism, Commerce and Industry, Directorate for Tourism	<u>-3 807</u>
<u>Transfers from Petroleum Fund</u>		Sub-total	576 783
Actual		Add:	
April 2010	50 000	Recommended new measures (by Comm. C)	<u>52 284</u>
May 2010	<u>50 000</u>		
Total.:	100 000	TOTAL	629 067
CASH BALANCE AVAILABLE FROM 1 APRIL 2010	<u>221 992</u>	ESTIMATED REALIZABLE PAYMENTS, CASH BASIS (85%) - (US\$629,067 x 85%)	<u>534 707</u>
		ESTIMATED CASH BALANCE, 31 DEC. 2010	60 681
		<i>Note: Total payments, cash basis, in 2010 are projected at US\$614,113,000</i>	
		First trimester (US\$'000)	79 406
		1 April to 31 December (US\$'000)	534 707
		Total (US\$'000)	614 113 86,7%

Receipts

As seen from the tables above, the Government has at this time, \$759,258,000, of which \$502 million refers to transfers from the petroleum fund, to be done up to 31 December 2010.

In reaching this conclusion, the Committee took into account:

- a) transfers from the Petroleum Fund
- b) forecasting domestic revenue contained in OGE 2010;

All of these revenues should be taken into account in order to know the real financial situation of the state.

Expenditure

Also according to the tables above, the Committee believes that by the end of this year, the State will have a total expenditure of \$698.6 million dollars, taking into account the following facts and assumptions:

This figure included 84.464 million relating to payments and obligations made during 2010 but relating to the 2009 State Budget.

With regard to further execution of the first quarter of 2010, this was 28% (payments and obligations), and in the category "Capital Development" this was only 4% (including obligations).

It will be hard for the Government to execute more than 85% of the State Budget (plus the new measures supported by the Committee, a total of 52.3 million).

Compared with the year 2009, during the period June-December were just transferred from the Petroleum Fund \$362 million (a total of \$512 million authorized - ie 70% of the remaining authorized).

The government did not give any reasons for the Committee to believe that this year the level of budget execution can be different from the 2009 budget implementation.

Enough is therefore concluded that, in financial terms, the revenue available to the State, are sufficient to cover all expenses until the end of this year, including balance of the treasury to January 1, 2010 (\$759,258 million revenue to \$698.6 million expense), left over in cash, according to Committee estimates, 60.7 million cash fund in the treasury at the end of December 2010.

Note that the costs recorded by the Committee include:

- a) Execution of the 2010 State Budget, as approved by Law 15/2009, of December 23;
- b) Execution of new measures reported in the above point.

Note also that in this PPL the Government asks for an additional transfer of \$309 million from the Petroleum Fund, in addition to the \$502 million already authorized in OE2010.

These two values sum to \$811 million, which exceeds, by 1.85 percentage points, the 3% provided for in the Petroleum Fund Law, as the limit of transfer, having regard to ESI.

ESI aims to ensure that the Petroleum Fund has sufficient resources for an equal real value to be spent for the budget in all future fiscal years.

According to the law (Article 9 of Law 9/2005) it is possible to spend more than the limits of ESI, where it is in the long term interest to Timor-Leste.

Considering the economic framework described above, including the potential danger of a reduced price of crude oil in international markets and low interest rates, the Committee considers that the Petroleum Fund is in serious risk of seeing its value decreased if the Government continues to spend as if this fund were an unlimited resource.

To reinforce what the Government itself recognizes, as shown by the letter sent to the Prime Minister by Minister of Finance and sent to Parliament as an attachment to this PPL, this will result in an estimated reduction in ESI in each future year between 2011 and 2025 from 9 to 10 million dollars, according to the table in the letter mentioned.

It is therefore necessary, first of all, to amend the structure of expenditures to ensure that mineral resources of Timor-Leste are used to ensure sustained development of the country.

So the Committee is of the opinion that no justification for a further withdrawal of \$309 million from the Petroleum Fund, which it reached because:

- a) Financially it is not justified to consider the expected costs and revenues available (\$759.3 million in revenue for \$698.6 million expenses);**
- b) Withdrawals from the Petroleum Fund should be used only in cases of obvious long term interest of Timor-Leste, which does not seem to be the case to the Committee.**

5. RECOMMENDATIONS

5.1 Recommendations of the Sectoral Committees *[not yet scanned]*

5.2 Recommendations of the Committee on Economy, Finance and Anti-Corruption

- The proposed rectification the 2010 State Budget is characterized by the transfer of funds from the Capital Development category to the Categories of Goods and Services, and Minor Capital Transfers.
- The nearly \$31 million Decentralized Development Package (PDD) does not constitute an increase to the State Budget for 2010, but is a simple transfer of funds allocated to the headings "Capital Development" assigned from ministerial lines for the Ministry of State Administration and Regional Planning (MAEOT).

- Following the recommendations of several Specialized Committees, the Committee is of the opinion that the PDD should be implemented along ministerial lines and not by the MAEOT.
- Notwithstanding the previous recommendation, the Committee recommends that the sum of 31 million dollars now allocated to the MAEOT is the category of "Capital Development", shown separately, not in the category "Transfers." Pursuant to Article 8 of Decree-Law No. 2/2009 of 18 February, the outstanding payments are made under the fulfillment of contracts for development projects, concluded between the State (MAEOT, with delegated powers to the District Administrators) and local businesses.
- The Committee does not consider it right that the Government and other State institutions create debts other than those provided in the State Budget and covered by authorized revenues, and later to request payment from this Parliament. These acts may constitute unlawful administrative or and even criminal acts.
- Beyond these general considerations, the Committee considers that the way information was provided to the Members of Parliament in this case is difficult to interpret and lacks transparency.
- The Committee found several inconsistencies between the figures proposed in Annex II to the PPL and the values expressed in Annex A to PPL - "New Measures in Amending Budget 2010".
- There are also inconsistencies between the values proposed by the PPL and the information received in a number of meetings held by the standing committees with the Government Ministers. For example, the Minister of Tourism, Commerce and Industry said in a public hearing that although the budget will provide \$533,000 for the item "Maintenance and cleaning of the tourist areas of Christo Rei, Metiaut, Santana and Pope John Paul II in Comoro and the Congress Centre in Dili," the Minister said it only requires \$250,000.
- The Committee noted that the OGE in 2010, predicted the level of revenue - Indirect Tax – as \$48.3 million, and in the Amending Budget reduced the same item to \$19.5 million. The committee does not understand why these taxes fall by \$28.8 million, or more than half, when the Government itself claims economic growth of around 12%.
- The Committee questions why Annex I of the state budget anticipates \$2 million receipts in the category "Interest on Treasury Account" in the Report of the first Trimester of Fiscal Year 2010, there is also a income of \$11,000 also in respect of interest and is not now any interest contemplated in Annex I of the PPL.
- The Minister of Tourism, Commerce and Industry also said in public hearing, that the project of building the water park in Tasi Tolu (with a total cost of 4.030 million dollars) is cancelled.
- The Committee considers that the Government cannot continue to ask more and more transfers for Internally Displaced Persons, and this is the last time this issue is proposed.
- The Committee reiterates the recommendation of the Committee for Infrastructure requested the Government to evaluate the projects carried out under the " Referendum Package " in order to verify and ensure their quality and sustainability.
- The Committee considers that it should be an independent audit of the execution of the "referendum package" projects.

The Committee therefore believes that withdrawing an additional 309 million dollars from the Petroleum Fund is not justified, due to these considerations:

1. **Financially it is not justified taking into account the expected costs and revenues available** (\$759,258 million in revenue for \$698.6 million expense).
2. **Withdrawals from the Petroleum Fund should be used only in cases of obvious long term interest to Timor-Leste, which does not seem to be the**

case to the Committee.

Having regard to the said month, the Committee recommends to the National Parliament to suspend, after voting in general, for one day, the discussion in the specialty to allow, if the Government decides so, to reorganize the cost of Annex II of PPL in accordance with the recommendations of the Specialized Committees.

8. Adoption of Report

The Committee is therefore of the OPINION that the Proposed Law 37/11 "State Budget 2010" meets constitutional, legal and regulatory requirements, and is therefore able to be referred to the plenary for discussion and vote in general and Specific under the applicable constitutional terms and rules..

9. Adoption of Report

This report was discussed and approved on June 21, 2010, and the same was approved with 8 votes in favor, 0 votes against and 3 abstentions.

Explanations of Vote:

Deputy Fernanda Borges (PUN) said that she was voting in favor, because she is convinced that the Government will introduce amendments that go in accordance with the recommendations of special committees.

10. ANNEXES

Integral part of the report the following annexes:

Report of Hearings conducted by the Committee of Economy, Finance and Anticorruption in the debate in the wider Amending Budget. Reports of Economic Analysis.

Analysis of the Balance of Cash Treasury Account


Dili, June 21, 2010.

The Rapporteur



Cipriana da Costa Pereira

President of the Committee



Manuel Tilman