

## **Comments on the Timor-Leste Petroleum Fund Draft Act (February 2005)**

### **Submission to the Petroleum Fund Steering Group, Democratic Republic of Timor-Leste By Jennifer Drysdale<sup>1</sup>**

I thank the Petroleum Fund Steering Group for the opportunity to provide comments on the Timor-Leste Petroleum Fund Draft Act (February 2005). The development of Timor-Leste's Petroleum Fund model (which includes the Petroleum Fund Act and other petroleum revenue management mechanisms) is the most important instrument to ensure both current and future generations of Timorese people have the opportunity to live well.

My comments constitute an academic analysis of the Timor Leste's Petroleum Fund model from the perspective that Timor-Leste should avoid or mitigate the resource curse and ensure sustained development. The government of Timor-Leste's initiatives to establish the mechanisms to ensure wise management of petroleum revenue, to date, are highly commendable. However there are many challenges ahead and my comments are designed to constructively assist those making decisions in this difficult and very important task of establishing a Petroleum Fund model for Timor-Leste.

The attached table includes a list of features of a generic Petroleum Fund model generated from a review of the academic literature on petroleum funds and various petroleum fund models from other countries. The table has six parts under the following headings:

- Part I: The strength of institutions to avoid the resource curse
- Part II: Oversight mechanisms
- Part III: Public input and access to information
- Part IV: Audit reports
- Part V: Wise revenue management for current and future generations of Timorese
- Part VI: Fund mechanism detail

The table includes an assessment of which features are (✓) and are not (×) included in the Timor-Leste Draft Petroleum Fund Act. There are some features (-) the Draft Act does not clearly enunciate. Readers should note that some of the features marked × or - are not included in the Timor-Leste Draft Petroleum Act because they are beyond the function of this Act. However these features should be considered in the finalisation of this Act and the development of Timor-Leste's Petroleum Fund model.

It may be the intention of the Government of Timor-Leste to develop these features elsewhere, in the final Petroleum Act, through administrative decree or otherwise. This list is not intended to be exhaustive and the assessment and comments are meant to indicate to the Executive responsible for finalising the Act, parliamentarians debating the Act and the President, gaps in this draft Act and issues that may impact on Timor-Leste's ability to avoid or mitigate the resource curse. This document may also be useful to members of civil society in furthering their understanding of and options for petroleum revenue management.

I urge the Executive, the Parliament and the President to review my (and others') comments in revising this Draft Act. Public debate about petroleum fund model development and expenditure of petroleum revenue, particularly above the estimated sustainable income level described in the draft Act, should be highly encouraged. I would be pleased to assist anyone who requires further information on topics that are briefly raised in this document.

Sincere regards

Jenny Drysdale

1 March 2005

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**Part I: The strength of institutions to avoid the resource curse**

<b>Point</b>	<b>GENERIC PETROLEUM FUND FEATURE<sup>2</sup></b>	<b>RDTL Petroleum Fund Model</b>	<b>COMMENTS</b>
1	The Petroleum Fund is established as an amendment to the Constitution	×	Although the draft Act states ‘the Petroleum Fund builds on the Constitution’, Timor-Leste’s ability to avoid the resource curse would be enhanced if the Petroleum Fund were enshrined in the Constitution.
2	The majority of civil society understands the proposed petroleum fund mechanisms	-	If this draft Act is amended to incorporate additional mechanisms to enhance civil society’s understanding and participation in decision-making with regard to the Petroleum Fund there will be less probability of conflict surrounding natural resource revenue.
3	All of the features of the petroleum fund are defined by law	×	This table shows that not all of the features that could be included in a generic petroleum fund model are defined in the Timor-Leste Petroleum Fund Draft Act, but the majority are.
4	Some of the features of the petroleum fund will need to be defined through administrative decree	✓	This table shows a number of features of the Petroleum Fund are not prescribed by the draft Act and if the Act is not amended, these features could be effected elsewhere through administrative decree (by regulation, policy or otherwise).
5	The relevant institutions have the capacity to manage the petroleum revenue	-	It is good the government of Timor Leste puts a high priority on human resource development. The Banking and Payments Authority and the Macroeconomics Unit require extensive and additional support to further develop the capacity to manage petroleum revenue wisely. The appointment of staff in the Macroeconomics Unit is most urgent.
6	All payments and revenues related to petroleum resource management must be deposited into the Fund	✓	It is good the draft Act outlines the meaning of Petroleum Fund Receipts in Article 6. However the meaning of tax revenue requires further explanation. As a hypothetical example: Is the tax paid by a cleaning company working on the Bayu-Udan platform considered petroleum tax revenue and how is that tax distinguished from their onshore business tax payments? Further, Article 17.1(a) could also be amended to ‘... that the Petroleum Fund be a fund of income from Petroleum Fund receipts as in Article 6’ so that it covers ‘all’ petroleum revenue.
7	All payments and revenues related to petroleum resource management are well defined and explained	×	
8	Payments of petroleum revenue to individuals or companies other than to the Petroleum Fund are prohibited by law	-	The draft Act does not specify what actions are prohibited by this Act or what the penalties are. However Chapter VI provides for these to be included.
9	Penalties for disobeying the Act are defined	-	
10	The life of the Fund is described	×	The term of the Fund could be stated so there can be no misunderstanding should the Fund’s existence come into question by future governments.
11	The Fund is ‘integrated’ with the budget process	✓	It is good the draft Act clearly integrates the Fund with the budget process.

<sup>2</sup> As described in the covering letter to this list, features include but are not restricted to those that can be accommodated by this law.

**Part II: Oversight mechanisms**

Point	GENERIC PETROLEUM FUND FEATURE	RDTL Petroleum Fund Model	COMMENTS
12	An oversight body is established	✓	It is good the Timor-Leste model proposes a 'Consultative Council' (CC). The proposed CC is a 'watchdog' to "contribute to an informed public debate and a sound management of the petroleum wealth". The CC does not have power of veto over the government, parliament, MoPF or the IAB and the rationale for this design does not appear to be explained in this draft Act or elsewhere; the CC may be useful in terms of maintaining transparency "on the operations of the fund" only. It is good the CC's advice can be made available to the public (Article 17.3).
13	The oversight body has power of veto over government or parliament decisions	×	
14	The oversight body can report to Parliament at any time in relation to any aspect of petroleum revenue management	-	Article 17.2 appears to limit the CC to advise only on appropriations of amounts greater than 'estimated sustainable income'.
15	The oversight body can report to Parliament only when expenditure is proposed above the withdrawal guideline	✓	
16	The oversight body's responsibilities include input into expenditure decisions	✓	It is good the CC has the opportunity to advise on the use of Petroleum Funds (expenditure) as stated in 15.2(c).
17	The oversight body is not solely appointed by government	✓	It is good non-government institutions can appoint members to the CC.
18	The oversight body is widely representative and includes membership from civil society	✓	It is good the CC is widely representative but Chapter V requires clarification. Members of the CC are appointed by a wide range of institutions however a total number of members is not defined and could vary depending on how many former VIPs choose to assume membership. The terms of appointment are confusing (e.g. a former President may be appointed for 10 years during which time several former Presidents may emerge and desire membership; may they all be appointed?). It is unclear why the CC includes representation from Parliament and Government or why the appointment of an international adviser for economic and financial matters requires separate approval from Parliament or how that adviser relates to the other members of the CC. Further, is the member appointed pursuant to article 16.6 eligible for re-appointment?
19	The oversight body represents women	-	The draft Act includes no obligation to appoint or represent women.
20	Members of the oversight body are remunerated	✓	It is good the draft Act provides for members of the CC to be remunerated
21	The oversight body is provided with resources to seek information and advice	✓	It is good the draft Act provides the CC with resources.
22	The oversight body is provided with resources to seek advice independent of government	-	The Parliament provides the CC with resources but it is unclear whether they will be sufficient to secure independent advice.
23	The oversight body is provided with an adequate time frame to provide advice	-	It is not clear whether the CC has adequate time to provide advice. For example, if a budget proposal is tabled for one month (this period has been less in the past) this leaves little time for the CC to review the proposal and have meaningful dialogue with parliamentary members thereafter.
24	The oversight body's responsibilities are well defined	×	It is good there is some definition of the function of the CC in articles 15 and 17, however further definition could be included. For example, the CC could be required to prepare a statement of their advice in the Annual Report.
25	The oversight body's responsibilities include to protect the interests of both current and future generations	✓	It is good this is explicit in 15.2(c). It could also apply to 15.2(a) & (b).

**Part III: Public input and access to information**

Point	GENERIC PETROLEUM FUND FEATURE	RDTL Petroleum Fund Model	COMMENTS
26	The details of revenue in the Petroleum Fund are accessible to anyone	✓	It is good that article 8.8 provides for the performance and activities of the Petroleum Fund to be publicly accessible.
27	The details of where and how the Petroleum Fund is invested are accessible to anyone	✓	
28	The details of any payments transferred from petroleum companies to the Government or individuals or companies are accessible to anyone	-	The draft Act provides for “details of all appropriations and transfers <i>from</i> the Petroleum Fund” to appear in the audited financial statement of the Annual Report [article 14.2(iii)] but it is not clear whether this includes payments <i>to</i> the Fund or <i>to</i> any individual or company outside of government. Article 6(d) does not specify ‘received <i>by Timor-Leste</i> ’; does this imply that individuals and companies who receive income from petroleum operations are also included as Petroleum Fund Receipts? See also point 47 in this document. It is noted that payments from petroleum companies are currently not reported in the Timor Sea Designated Authority’s Annual Report (ref: <i>TSDA for the JPDA Annual Report, 2003</i> )
29	Audit reports (as described in Part IV below) are accessible to anyone	×	Not all of the audit reports suggested in Part IV (e.g. performance of the Fund Manager and performance of investments) would be accessible to anyone under this draft Act.
30	Contracts between the government and petroleum companies are accessible to anyone	×	The draft Act does not mention contracts between the government and petroleum companies.
31	Reports of the body to advise on investment are accessible to anyone	✓	It is good that in this Draft Act the Investment Advisory Board report does not only report to the Minister for Finance; Article 14.2(b) states the Annual Report includes all advice provided by the IAB.
32	All of the information described in points 26-31 is available on the internet	×	It is good the government of Timor-Leste has informed civil society about their plans for petroleum revenue management through a variety of media to date. However, in this draft Act it is not specified that information described in points 26-31 would be made available through a variety of mediums and updated on a regular basis therefore there is no obligation on the government to do so in the future.
33	All of the information described in points 26-31 is presented on radio and TV	×	
34	All of the information described in points 26-31 is available in prescribed libraries	×	
35	All of the information described in points 26-31 is available from sub-district offices	×	
36	A commentary and notes for understanding the information described in points 26-31 is provided in several languages in all mediums	×	The draft Act does not state this will occur.
37	Commercially confidential information is protected	✓	It is good the draft Act protects commercially confidential information but what constitutes commercially confidential information could be defined.
38	What constitutes commercially confidential information is defined	×	
39	A commitment to the principles of the Extractive Industry Transparency Initiative (EITI) is made in Law	✓	There is currently no legal obligation for the Timor-Leste government to commit to the EITI however Article 18 outlines some of the principles of the EITI.

**Part III: Public input and access<sup>3</sup> to information *continued***

<b>Point</b>	<b>GENERIC PETROLEUM FUND FEATURE</b>	<b>RDTL Petroleum Fund Model</b>	<b>COMMENTS</b>
40	Civil society has an opportunity to participate in development of the Petroleum Fund	✓	It is good the draft Act allows for an annual forum on issues relating to the Petroleum Fund (Article 17.4).
41	Policies, procedures, practices and mechanisms for managing petroleum revenue are understood by the majority of civil society	×	Civil society's opportunity to participate in the development of the Petroleum Fund has been hampered by the majority of civil society's level of understanding of the policies, procedures, practices and mechanisms for managing petroleum revenue. The Government has the opportunity to continue to develop understanding by providing information as described in points 32-36.
42	Appropriate models have been considered in development of the Petroleum Fund	-	It has been widely reported the Government has considered the Norway model and I understand the Executive has now reviewed the São Tomé and Príncipe model. It is good the Government has considered a variety of models in the development of Timor-Leste's Petroleum Fund model. However further details of fund development are unknown because at present the advice provided by the International Monetary Fund is not accessible to civil society.
43	Other options for petroleum revenue management have been considered	-	It is not clear whether the Executive have considered other petroleum revenue management options (e.g. such as an option to pay a royalty to individuals in Alaska; note, this is just one example) as the advice from the International Monetary Fund is not accessible to civil society at the present time.

<sup>3</sup> Access includes but should not be restricted to internet  
[E] 28 February 2005

**Part IV: Audit Reports**

<b>Point</b>	<b>GENERIC PETROLEUM FUND FEATURE</b>	<b>RDTL Petroleum Fund Model</b>	<b>COMMENTS</b>
44	The Petroleum Fund is audited internally	✓	It is good the Petroleum Fund is audited internally every 6 months but an internal audit alone is not sufficient so it is good the Fund will also be audited independently and externally.
45	The Petroleum Fund is audited independently and externally	✓	
46	The external, independent auditor is chosen through a process of competitive tender	-	The draft Act does not clearly state the external, independent auditor will be chosen through a process of competitive tender.
47	The external, independent auditor will audit all payments relating to management of petroleum resources	-	It is good the draft Act states the independent auditor will audit all payments made as Petroleum Fund receipts (Article 20.1) however, as discussed in point 28, it is unclear whether 'Petroleum Fund Receipts' covers <i>all</i> payments. Further, Article 20.1 states 'all payments made as Petroleum Fund receipts' shall be audited and reported. Does 'all payments' include debits and credits? Is this report the same as the auditor's report for the Annual Report?
48	The external, independent auditor will audit the performance of investments	×	The draft Act does not state the independent auditor will audit the performance of investments or the Fund Managers.
49	The external, independent auditor will audit the Fund Managers	×	
50	The external, independent auditor will certify the calculation of the withdrawal guideline	✓	It is good the 'estimated sustainable income' calculation will be certified by the external, independent auditor (Article 7.3)
51	Audits will occur at least annually and be provided in an Annual Report	✓	It is good the draft Act states the Minister will submit an Annual Report (Article 14) and this contains the auditor's report, however as stated in points 48 and 49 some audited information is missing. The Annual Report could also contain a statement from the Consultative Council. Article 14 could also clearly state the Annual Report will be made publicly accessible in a variety of media.

**Part V: Wise revenue management for current and future generations of Timorese**

Point	GENERIC PETROLEUM FUND FEATURE	RDTL Petroleum Fund Model	COMMENTS
52	Expenditure of petroleum revenue is defined	×	It is good the CC has the opportunity to provide advice on expenditure [article 15.2(c)]. There are other options to ensure expenditure of petroleum revenue management will benefit both current and future generations. In their submission (November 2004), on the Timor-Leste Petroleum Fund Discussion Paper, La'õ Hamutuk referred to a constitutional obligation in Brazil "that the government invest a certain fraction of GDP in education, health and underdeveloped areas..." This could be considered by Parliament in Timor-Leste.
53	A withdrawal guideline is included	✓	It is good the draft Act specifies 'estimated sustainable income' (ESI) however the draft Act does not specify the consequences of spending more than the ESI clear. The Parliament could thoroughly investigate alternatives to this scenario (e.g. consider how much revenue above the ESI may be required in the early years and how larger withdrawals will affect the longer term ESI. How will the government fund these gaps? Parliament could be provided with the resources and time to conduct these calculations independently of government). Further, Parliament "setting a ceiling" and the relationship between that ceiling and the ESI requires clarification. Note also that articles 7.3 and 7.4 could read "...unless government has first provided Parliament <i>and the Consultative Council</i> with reports."
54	The principles of the Law include protecting the interests of both current and future generations	✓	It is good this principle is enshrined in the draft Act.
55	The Fund allows for contributions of petroleum revenue from exploitation of resources other than those in the area defined by the Treaty	×	This draft Act limits the fund to credits of Petroleum Fund receipts as described in Article 6 despite that the constitutional requirement stated in the draft Act (Article 139) states ' <i>natural</i> resources' and not just 'petroleum resources'. Article 139 is misquoted throughout the draft Act. Article 6 gives the impression petroleum operations are limited to those pursuant to the Treaty.
56	The Fund allows for contributions of natural resource revenue other than petroleum resource revenue	×	The draft Act could be amended to incorporate potential petroleum reserves other than those defined under the Treaty and to incorporate natural resource revenue other than petroleum resource revenue. In this case the name of the draft Act and all references to petroleum would be amended to natural resources and natural resources could be defined.
57	Revenue is invested offshore in low-risk financial assets	✓	It is good the draft Act specifies revenue will be prudently managed and invested abroad and not (for financial return) in Timor-Leste in the short term, and that the strategy will be reviewed in 5 years. Timor-Leste has the opportunity to reap the rewards of 'investing' through expenditure on human resource development and social infrastructure (such as health and education).
58	Revenue may be invested (for financial return) in Timor-Leste	×	
59	The investment strategy shall be reviewed periodically by the oversight body	×	The draft Act does not specify that the CC should review the investment strategy.
60	The investment strategy shall be reviewed periodically by the Executive	✓	It is good the investment strategy will be reviewed in 5 years (Article 9.6). The Act could stipulate a regular review rather than a one-off review.
61	Funds can not be encumbered	✓	It is good the draft Act states Funds can not be encumbered (Article 11).

**Part V: Wise revenue management for current and future generations of Timorese *continued***

<b>Point</b>	<b>GENERIC PETROLEUM FUND FEATURE</b>	<b>RDTL Petroleum Fund Model</b>	<b>COMMENTS</b>
62	A body to advise on investment is established	✓	It is good the draft Act proposes the establishment of an Investment Advisory Board (IAB) however the non-institutional members require further clarification.
63	The body to advise on investment is appointed independently	×	The Minister for Finance appoints the IAB. The IAB could be appointed by an independent entity such as the CC or the Parliament. It is also concerning there is provision under Article 10.3 for the Minister for Finance to make a decision without first seeking the advice of the Investment Advisory Board, despite Article 10.4.
64	Some members of the body to advise on investment are independent and external to government	×	The Draft Act does not oblige the government to appoint members that are independent and external to government. The membership is not well defined in the Draft Act.
65	The responsibilities of the body to advise on investment are defined	✓	It is good the responsibilities of the IAB are defined (Article 10).
66	Investment management is independent of government	✓	It is good there is a plan in the draft Act to appoint investment managers to the BPA specifically to manage the Petroleum Fund and that article 8.5 attempts to ensure those investment managers are of the highest professional standard and selected by tender.

**Part VI: Fund Mechanism Detail**

<b>Point</b>	<b>GENERIC PETROLEUM FUND FEATURE</b>	<b>RDTL Petroleum Fund Model</b>	<b>COMMENTS</b>
67	Withdrawals from the Petroleum Fund can be deposited into only one specified government account	✓	It is good Article 7 of the draft Act specifies that the only debits permitted to the Petroleum Fund are electronic transfers made in accordance with this article to the credit of a single State Budget account.
69	Return on the Petroleum Fund's investments will also be deposited into the Fund	✓	It is good the Fund's return (or interest) will be re-invested in the Fund
70	How tax revenue from the petroleum industry is distinguished from other tax revenue is defined	×	The draft Act does not clearly define petroleum tax revenue with respect to petroleum operations (as mentioned in points 6&7).
71	There is flexibility in access to revenue for specific purposes	✓	It is good there is flexibility to withdraw above the level of estimated sustainable income but further detail could be given in the Act as to the occasions when this might occur (e.g. disaster management)
72	The role of the Executive and reporting relationships is defined	×	The draft Act does not explain the membership of the Executive responsible for drafting decisions regarding petroleum revenue management on behalf of the Minister for Finance.