

**THE DEMOCRATIC REPUBLIC OF
TIMOR-LESTE
COMBINED SOURCES BUDGET
2005-06**



Draft Budget/Background Paper

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PETROLEUM REVENUE

Box 4.1 Methodology and Assumptions

The petroleum revenue estimates cover revenues from the Elang Kakatua Kakatua North and Bayu Undan fields, as these are the only petroleum fields that have submitted Development Plans, have had those plans approved by the Timor Sea Designated Authority and are in operation. Other potential revenues could arise from future development of the Sunrise, Jahal Kuda Tasi or Pheonix fields. They could also arise from a settlement of maritime boundaries. However, no Development Plans have been submitted or approved for these new fields and so the timing and magnitude of any potential revenue is uncertain. Accordingly, no estimates for these potential new revenues are included.

The methodology used to generate estimates for the Timor Sea revenue estimates for the 2005-06 Budget over the next four years (2005-06 to 2008-09), was to meet with the project operator to get information about their production estimates, and to make assumptions about world oil prices and other important parameters. Officials from the Macroeconomic Unit, Timor Sea Designated Authority, Timor Sea Office and the Timor-Leste Revenue Service participated in meetings to analyse the available information and to generate the best possible estimates. Information given by the operator provided the base for estimates of Timor-Leste revenue.

The Timor Sea revenue estimates were updated using the latest information for Bayu Undan from the operator, including on;

- prices of petroleum products sold;
- upstream investment costs;
- LNG plant investment cost (including changing exchange rates);
- pipeline investment costs;
- production volumes;
- upstream operating costs;
- exchange rate on pipeline payment from Australia; and
- model refinements based on new data.

The Timor Sea revenue estimates are conservative. The world oil price assumption is based on market (NYMEX) prices, but discounted by \$5. Table 4.2 shows the world oil price assumptions used for West Texas Intermediate (WTI) oil in each calendar year.

Table 4.2
World Oil Price Assumptions (\$ per barrel)

2005	2006	2007	2008	2009	2010
40.62	37.72	36.02	35.02	34.39	33.99

The reservoir volumes are based on the conservative “proven” estimates of the Operator. A further 15 per cent discount is applied to revenues to account for other risks, such as production problems, bad weather, exchange rates, the timing of pipeline and LNG plant construction, the cost of downstream investments, the price of Bayu Undan specific products and other factors that cannot be quantified or identified.

As these petroleum revenue estimates are conservative, the actual outcomes are more likely to be higher than the estimates than lower than the estimates. Nevertheless, the risk that petroleum revenues will be lower than expected is very real. For example, unforeseen drilling problems in 2003 with the Bayu Undan field led to estimated increases in costs, delays in production and reductions in estimated revenue. While many of these problems were eventually resolved successfully and rising world oil prices have more than offset the remaining problems, the risk of future problems is still very real.

The risk that is easiest to identify and quantify is the risk to revenue caused by changing world oil prices. This risk is illustrated using scenario analysis of different world oil price assumptions. In the last ten years world oil prices have moved within a \$46 band, from \$10 to \$56, and in 2004 alone they moved within a \$24 band, from \$32 to \$56. Given these large historical movements, the \$15 difference between the High Case and the Low Case is modest. The High Case and Low Case do not reflect the maximum or minimum revenues possible, but rather indicate the likely fluctuations that could occur.

**Table 4.3
Estimated Petroleum Revenue (\$m)**

	2004-05	2005-06	2006-07	2007-08	2008-09	Total
	Act	Est	Est	Est	Est	4 Yrs
Taxes	193.8	112.0	135.0	127.3	113.0	487.3
FTP and Profit Oil/Gas	48.7	41.1	42.2	40.5	86.1	209.9
Other (incl EMRD)	0.1	1.0	0.0	0.0	0.0	1.0
Petroleum Fund Interest	0.0	4.6	8.5	13.4	19.4	45.9
Total	242.6	158.7	185.7	181.2	218.5	744.1

In the financial year 2005-06 Timor Leste revenue is expected to decrease in comparison with the previous financial year. In 2005-06 it is predicted that world oil prices will drop.

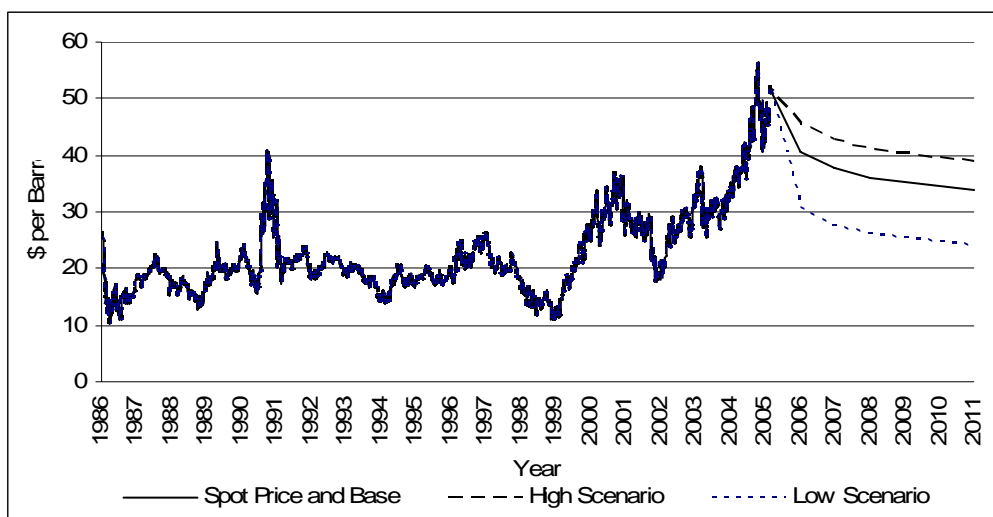
Petroleum Revenue is expected to experience a significant increase over the medium term. The increase in Timor Leste revenue is due to:

- An increase in world oil prices (NYMEX)
- Progress in the development process of the Bayu Undan Project and
- Sound Administrative Management.

However compared with the MYR 2004-05, Estimated Timor Sea Revenue started to indicate an upward shift due to an increase in world oil prices, as shown in Chart 4.1. This is positive for Timor Leste in designing and supporting a sustainable, sound development plan program. The increase in world oil prices is due to a number of factors;

- Oil stocks are decreasing in the world market
- Oil production in several oil producing countries is not yet running smoothly
- China is experiencing growth in the development of its economy.

**Chart 4.1
Changes in World Oil Prices – WTI basis (\$ per barrel)**

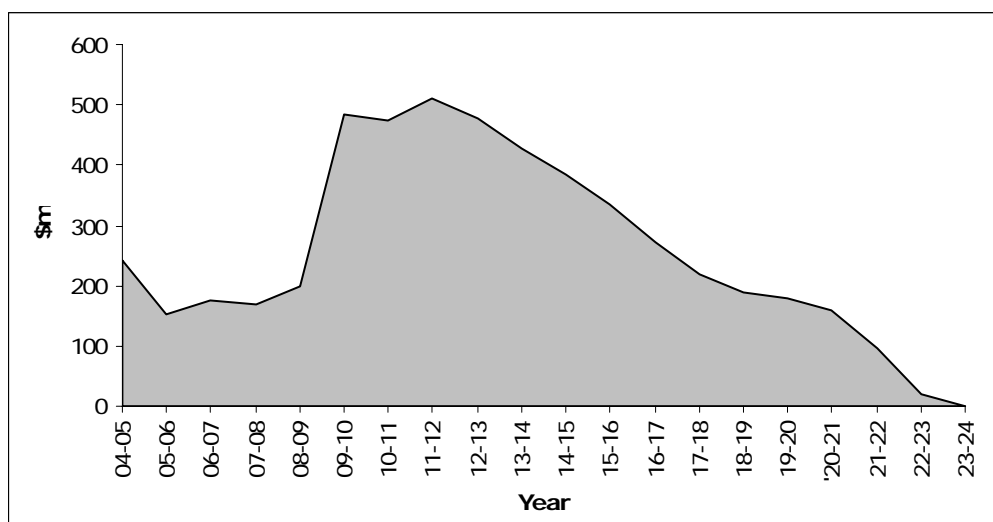


Therefore, estimated Petroleum Revenue for the medium term will be significant. It will amount to a total of \$744.1m, in comparison with the estimated revenue in the 2004-05 MYR of \$546.6m (and the original Budget 2004-05, which estimated a mere total of \$269.7m originating from the Timor Sea).

In the following years, estimated Timor Sea Revenue is expected to increase, including when LNG production and Profit Oil payments will start.

Chart 4.2 shows the long term estimate of petroleum revenue over the next twenty years.

**Chart 4.2
Timor-Leste Petroleum Revenue 2004-05 to 2022-23**



Risks

World oil prices are the key risk for oil producing countries. Currently oil producing countries are currently delighted with the receipt of revenue in excess of predicted targets due to high oil prices which will continue in the medium term.

However these estimates can be uncertain as world oil prices are always in a state of fluctuation. With a sustained increase in oil prices over each subsequent year then these countries can undertake development in sectors prioritized by their government and significant amounts of money can be placed in savings for the next generation. If world oil prices decrease to a low level, then oil producing countries will face difficulty in planning development in their respective countries.

Currently the Government of Timor Leste is preparing Estimates on Timor Sea Revenue through the use of three scenarios;

- Base Case Scenario,
- High Case Scenario and
- Low Case Scenario

These scenarios are based on oil prices in the world market (NYMEX) with estimates for the Base Case \$5 lower than NYMEX prices. The High Case is \$5 higher than the Base Case and the Low Case is \$10 lower than the Base Case. From these scenarios, the Base Case scenario is used each year in the Government Budget. However, the Base Case scenario used by the Government of Timor Leste still contains a discount of 15%, to provide security for the planning of the annual Government Budget of the State.

**Table 4.4
Scenarios for Timor Sea Revenue (\$m)**

	2004-05	2005-06	2006-07	2007-08	2008-09	4 Year total
Base Case	243	153	177	168	199	697
Low Case	214	82	89	75	77	324
High Case	256	185	211	197	351	944

There are two scenarios from the table above that will have significant implications for Timor Leste Revenue. The High Case Scenario indicates that an increase in oil prices will have a large impact on Timor Sea Revenue and the Government will be able to place significant savings in the Petroleum Fund account for the next generation. Whereas the Low Case Scenario shows low revenues so the Government will not have any surplus to place in savings as revenues would be lower than expenditure.

NON-PETROLEUM REVENUE

Timor Leste Domestic Revenue for the financial year 2005-06, is expected to decrease slightly from the MYR 2004-05. Overall estimates for the medium term will increase from year to year although this will only be a minor increase.

Table 4.5
Non-Petroleum Revenue (\$m)

	2004-05	2005-06	2006-07	2007-08	2008-09	Total
	Act	Est	Est	Est	Est	4 Yrs
Customs Duties	17.0	17.0	17.5	18.2	19.1	71.8
Other Taxes	10.1	9.9	10.2	10.6	11.1	41.8
User Fees and Charges and Interest	6.1	9.5	10.9	12.0	13.4	45.9
Total	33.2	36.4	38.6	40.8	43.7	159.5

However for the financial year 2005-06 there will be some movement within estimates of Domestic Revenue caused by several factors:

- The withdrawal of UNMISSET who will depart in 2005, which will cause a minor decline in some tax receipts in Timor Leste
- The withdrawal of UNMISSET will also result in associated businesses reducing their activities,
- The Customs Directorate is still centralising its ASYCUDA System which will provide an increased ability to combat evasion, it is still not completely installed in all main merchandise entry and exit points of the country
- The tsunami which struck several Asian countries may disrupt regional trade
- Despite these aforementioned problems, it appears that Domestic Small Businesses are developing in all Districts, especially in Dili, where numerous kiosks and restaurants are active. These are mostly relatively small taxpayers.

An additional risk to revenue is the possibility that the implementation of the Investment Law in Timor Leste will improve economic activities and increase revenue by more or less than the relative costs of the fiscal incentives.

Estimates of fees, user charges and other revenue for the 2005-06 Budget shows an overall increase over the next 4 years with a decline in a few areas, as shown in table 4.4.

Table 4.6
Fees, User Charges and Other Revenue (\$m)

	2004-05	2005-06	2006-07	2007-08	2008-09	Total
	Act	Est	Est	Est	Est	4 Yrs
Visa Fees	1.6	1.4	1.4	1.5	1.5	5.8
Land and Property Income	1.4	1.1	1.2	1.3	1.4	5.0
University Fees	0.4	0.5	0.6	0.8	1.0	2.8
Passport Fees	0.2	0.3	0.4	0.5	0.6	1.8
Land Transport	0.5	0.6	0.7	0.7	0.7	2.7
Business Registration	0.3	0.2	0.2	0.2	0.2	0.8
Postal Charges	0.1	0.1	0.1	0.1	0.1	0.5
Other	0.3	0.3	0.3	0.3	0.3	1.2
Interest	1.3	5.0	6.0	6.6	7.6	25.2
Total	6.1	9.5	10.9	12.0	13.4	45.9

- Visa revenue is expected to decline in the 2005-06 Budget if compared with estimates made in the 2004-05 review because in accordance with regulations in force Timorese citizens whose spouses are foreigners and foreigners who work in humanitarian sector in Timor Leste. are exempt from the payment of visa fees.
- Land and property revenue is expected to decline in the 2005-06 Budget. This is due to government policy not to continue to rent houses or government buildings in *Farol* area. After that, over the next three years revenue is expected to increase because many people in occupied houses or government buildings will be identified and are expected

to pay rent. A mobile office will set up next year in order to actively get people registered who occupied government houses or buildings.

- The University of Timor Leste over the next four years (2005 - 2008) is expected to experience an increase in revenue for each year because many high school graduates will continue their studies and more students will pay fees.
- Civil registration is expected to increase revenue during the next four years (2005 – 2008). Currently most of these revenues are from the issue of passports. New revenue will be received from other services such as: birth certificates, marriage certificates, divorce certificates, and certificate of citizenship and identity cards.
- Land transport revenue estimates in 2005-06 expected to increase each year as various new systems are implemented for fines, transfer or registration.
- Business registration revenue estimates for the year 2005-06 are expected to decline. This decrease is as a result of the slow down in business activities arising from the contraction of the United Nations Mission in the country. However, with the projected better performance of the economy in the coming years coupled with the government commitment to provide the required incentives and environment for increased private sector participation more revenue will be generated as a result of the registration of new business.
- Postal revenue will be relatively stable over the next four years.
- Other revenue is relatively stable.
- Interest receipts outside the Petroleum Fund, will depend upon world interest rates and a future decision as to how much to transfer to the Petroleum Fund on 1 July, 2005.

NON-FINANCIAL PUBLIC AUTHORITY REVENUE

Table 4.7
Non-financial Public Authority Revenue (\$m)

	2004-05	2005-06	2006-07	2007-08	2008-09	Total
	Act	Est	Est	Est	Est	4 Yrs
Aviation	0.9	0.8	0.9	0.9	1.1	3.7
Port	1.3	1.2	1.3	1.4	1.4	5.3
Electricity	6.0	8.3	9.3	9.9	10.5	38.0
Total	8.2	10.3	11.5	12.2	13.0	47.0

In the financial year 05-06, total Estimated Agency Revenue is expected to increase in comparison with Estimates from the MYR 04-05.

However it is apparent from the sub Agencies that the Aviation Agency and Port Agency will experience a slight decline in 05-06. This decline will be due to the withdrawal of the UN from Timor Leste which will have a slight impact on the number of passengers entering or departing in order to take holidays in neighbouring countries.

In addition to this, the entrance of goods through the ports was reduced as more importers start to use the port of *Nusa Tenggara Timur* (West Timor) and to import merchandise through the land transport system.

PART 5 – PETROLEUM FUND

Many resource-rich developing countries have suffered from the “resource curse” where resources hinder rather than promote economic development. One mistake that these countries have made is to spend all their revenue as it arrives, which leaves them with no saving for the future and with expenditure levels that fluctuate with commodity prices.

The Government is determined to avoid repeating the mistakes of other resource-rich countries. Instead, it has adopted a savings policy and is creating a Petroleum Fund to hold and manage its savings of petroleum revenues.

BACKGROUND AND CONSULTATIONS

Timor-Leste commenced saving First Tranche Petroleum (FTP) revenues in 2000. These savings, which are estimated to total \$63m with accumulated interest by 1 July 2005, are still unspent.

In 2002, the Government asked for advice from the IMF on the establishment of a Petroleum Fund, it received a report in early 2003, and announced its intention to establish a Petroleum Fund for Timor Leste in mid 2003. A discussion paper on the key policy issues was released in October 2004, followed by broad public consultations. Building on the discussion paper and the comments made during the public consultations, a draft Petroleum Fund Act was prepared and released for public consultations in February 2005.

The Government has revised the draft law in light of comments and suggestions made by civil society and the public at large. The Council of Ministers has already approved the Petroleum Fund law, and submitted it to Parliament. It is then expected that after approval by the National Parliament and promulgation by the President of the Republic that it can be implemented from 1 July 2005, the beginning of the 2005-06 fiscal year.

KEY DESIGN PRINCIPLES

The design of the Petroleum Fund and the corresponding draft Act is based on the following key principles:

- The Petroleum Fund shall be a tool that can contribute to the wise management of Timor-Leste’s petroleum resources, for the benefit of both current and future generations.
- The Petroleum Fund builds on international best practice and reflects the circumstances of Timor-Leste. It is based on the petroleum fund used in Norway, one of the few models internationally that is generally seen to function well and contributing to a wise management of the petroleum wealth. The proposed model for Timor-Leste is currently referred to as the “Norway Plus” model, reflecting additional accountability, transparency and information features that are judged appropriate for Timor-Leste’s circumstances.
- The Petroleum Fund builds on the Constitution. The Petroleum Fund Act lays down the key parameters for the operation and management of the Fund which seeks to meet with the constitutional requirement laid down in article 139 in the Constitution. According to this provision, petroleum resources “shall be owned by the State, shall be used in a fair and equitable manner in accordance with national interests, and the petroleum extraction should lead to the establishment of mandatory financial reserves”. The proposed Petroleum Fund builds on the constitutional framework, giving to the Parliament and the Government the powers that correspond to their competencies.
- The Petroleum Fund allows for a strengthening of the responsibilities, powers and capacity of key public sector institutions, such as Parliament, the Government, nominally the Ministry of Planning and Finance and the Central Bank. There will be an Investment Advisory Board advising the the Minister of the Finance portfolio to enhance the quality of advice preceding decision-making. There will also be an independent Petroleum Fund Consultative Council to advise Parliament on the operations of the Fund.
- The Petroleum Fund is to be a tool that contributes to sound fiscal policy, and thereby help deliver on a sustainable basis strong economic growth and improved public services. The design of the Petroleum Fund acknowledges that good planning and execution of public sector budgets is a key to avoiding the resource curse found in so many petroleum producing countries. The Petroleum Fund is to be coherently integrated

into the budget process, supporting a fiscal policy framework that strikes the right balance between current consumption, investing in physical assets (infrastructure and human development) and investing in financial assets.

- The Petroleum Fund is to be prudently managed, invested securely in low-risk financial assets abroad.
- The management of the Petroleum Fund shall be carried out with the highest standard of transparency and accountability. This is a key element in building public confidence and support for a wise strategy of managing the petroleum resources. This can allow Timor-Leste to avoid the negative experiences found in so many petroleum producing countries, where petroleum has proved to be a curse instead of a blessing.

KEY FEATURES OF THE PETROLEUM FUND

On the basis of the principles described above, the draft law which establishes a Petroleum Fund, and which has been approved by the Council of Ministers, has the following important features.

- The Petroleum Fund's income: all revenues emanating directly or indirectly from Timor-Leste's petroleum resources will flow into the Fund, as well as the return on the Fund's investments (net of management expenses). All the income of the Fund shall flow into an 'earmarked receipts account'. The Government's intention is that the Fund's opening balance on 1 July 2005 will include all the accumulated First Tranche Petroleum payments and increased by such amounts as are to be determined by the Government.
- The Petroleum Fund's expenditure: transfers from the Fund can only be made to a designated State Budget account, and the sum of all transfers in a fiscal year can not exceed a ceiling set by Parliament when approving the State Budget. This ceiling will as a general rule correspond to the amount necessary to finance the deficit on the State Budget excluding petroleum revenues.
- The Government has separately adopted a savings/expenditure policy of maintaining the real value of the petroleum wealth, which will serve as a reference to determine the amount of money that should flow out of the Fund over time. This policy translates to spending the estimated sustainable income from petroleum, which is the amount that can be spent each year forever establishing a good balance between the interests of current and future generations. On current calculations, this policy allows for a significant increase in Government spending in the medium term. The estimated sustainable income from the petroleum wealth is now calculated to be over \$100m as described below.
- Specific reporting requirements are imposed on the Government and the Consultative Council if the State Budget proposes to withdraw from the Petroleum Fund more than the estimated sustainable income from petroleum. While there at times may be good reasons to spend more than the estimated sustainable income, the provisions in the Act should contribute to making sure that such decisions are transparent and well informed. This Budget is proposing to withdraw from the Petroleum Fund less than the estimated sustainable income.
- The management of the Petroleum Fund: The Government has responsibility for the overall management of the Fund, and the head of the Ministry of Planning and Finance will exercise key functions and competencies. The operational management will be delegated to the Central Bank in accordance with a management agreement.
- The Investment Advisory Board is composed of five people, between which the Director of the Treasury, the head of the Central Bank and specialists in investment management will advise the head of the Ministry of Planning and Finance on material relative to the management of the Petroleum Fund.
- The investment of the Petroleum Fund: The Fund's savings will from the beginning be invested securely in low risk financial assets abroad. In the 2005-06 fiscal year, the management agreement will make clear that all of the Fund's investment will in practice mean investments mostly in government bonds, which means that the financial risk is seen to be limited and the expected investment return moderate. The investment

strategy in the Act shall be reviewed within five years, when a larger Fund and improved institutional capacity may suggest a different asset allocation.

- External independent audits will be carried out by an internationally recognized accounting firm, contracted through a competitive process internationally to bolster confidence that money going to, from or remaining in the Petroleum Fund are not misappropriated.
- The mandate of the Petroleum Fund Consultative Council will be to advise Parliament on the operations of the Fund, observing the operations and contributing to an informed public and the sound management of the petroleum wealth.
- There are accountability, transparency and information features to contribute to a sensible management of petroleum wealth. There will be a high degree of transparency in operations including accessible and all-inclusive reporting – both on the management of the Fund and on whether the spending of petroleum revenues is consistent with long-term considerations. There are also information requirements on payments made by companies’ Petroleum Fund receipts, which is a core element of the Extractive Industries Transparency Initiative. The Government has also established a separate transparency website, which includes a large number of documents relating to the petroleum sector, the Petroleum Fund and the State Budget.

An illustration of how the Petroleum Fund is envisaged to operate is shown at Diagram 5.1 and Table 5.1, and Chart 5.1 shows the expected growth in the Petroleum Fund.

Diagram 5.1
How the petroleum fund of Timor-Leste is envisaged to operate

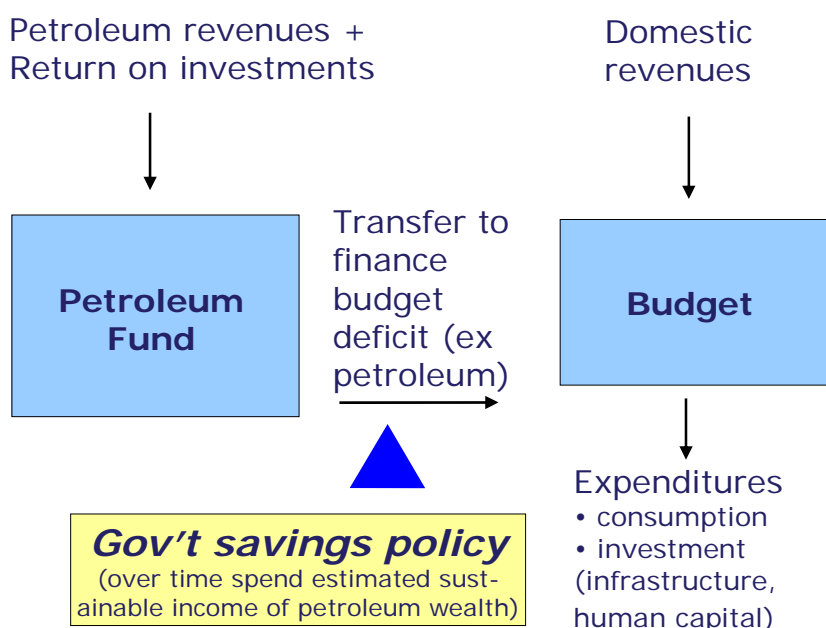


Table 5.1
The Petroleum Fund

	2004-05	2005-06	2006-07	2007-08	2008-09
Balance (start of year)	14	63	153	291	424
+ FTP/Petroleum Revenue	49	159	186	181	219
- Withdraw als	0	73	57	61	65
+ Interest	0	5	9	13	19
= Balance (end of year)	63	153	291	424	597

SAVINGS POLICY

The Petroleum Fund does not guarantee wise management of the petroleum wealth, but it can be a useful tool – provided it goes hand in hand with a fiscal policy framework that strikes the right balance between spending now and saving in financial assets. The Government has adopted such a fiscal framework in its savings policy.

The key to the Timor-Leste savings policy is that expenditure levels will not fluctuate with revenues. Instead, expenditures should adjust over the medium-term to the sustainable level of expenditure. This sustainable level is based on estimated current and future petroleum revenues, and the current level of savings. It is the level of expenditure that can be sustained indefinitely, including increasing with inflation.

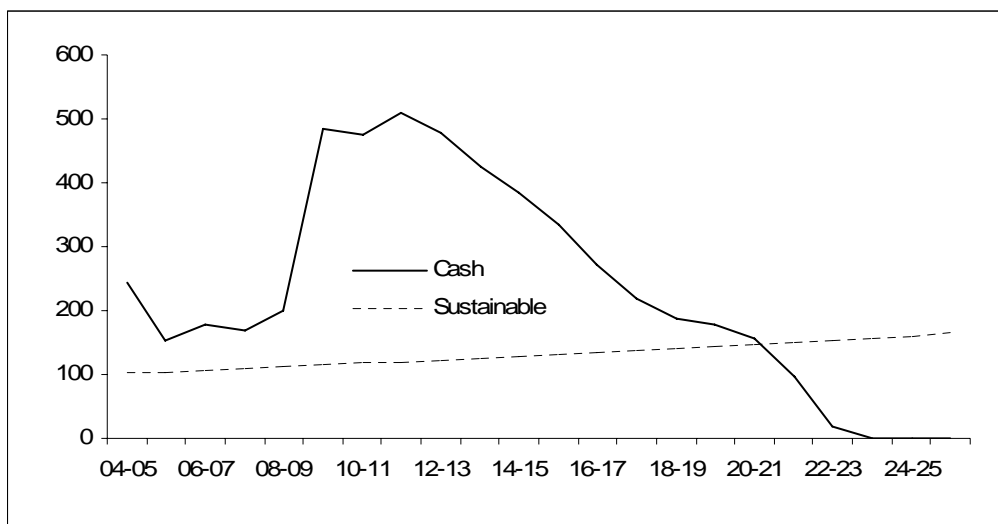
Any difference between total revenue and total expenditure will affect the balance of the Petroleum Fund. When revenues exceed expenditure then the surplus will be saved in the Petroleum Fund. When expenditures exceed revenues, as might happen if there is a temporary shortfall in revenue, then the required funding will be withdrawn from the Petroleum Fund so as to maintain expenditure at its sustainable level. Therefore, the Petroleum Fund will still play a useful role even when expenditure is at its long-term sustainable level.

This savings policy has the following advantages.

- The Petroleum Fund should accumulate significant levels of savings for the benefit of future generations of Timorese.
- The Petroleum Fund savings should generate significant interest income, including when petroleum revenues have ceased.
- Temporary fluctuations in world oil prices will have little effect on expenditure, as savings will be fluctuate instead.
- Permanent changes in revenue and the sustainable level of expenditure will result in adjustments of expenditure over the medium term, so as to minimize disruptive changes in expenditure plans.

Chart 5.1 shows the estimated petroleum revenue for Timor-Leste, excluding interest. It also shows the estimated sustainable expenditure from this petroleum revenue. The savings policy is for the budgeted level of expenditure to adjust to non-petroleum revenues plus this estimated sustainable petroleum income level over the medium term.

Chart 5.1
Estimated Petroleum Revenue and Sustainable Expenditure from Petroleum Income



CALCULATING THE ESTIMATED SUSTAINABLE EXPENDITURE LEVEL

The estimated sustainable income from the petroleum wealth is important for two purposes. First, the draft Petroleum Fund Act has specific reporting requirements imposed on the Government and the Consultative Council if the State Budget proposes to withdraw from the Petroleum Fund more than the estimated sustainable income from petroleum. Second, the Government's savings/expenditure policy of maintaining the real value of the petroleum wealth translates to spending non-petroleum income plus the estimated

sustainable income from petroleum, which means that the outflow from the Petroleum Fund over time should be close to the estimated sustainable petroleum income.

The concept of the sustainable level of expenditure can be thought of in different, but equivalent, ways.

- It is the expenditure level that can be continued indefinitely (indexed for inflation) given previous savings and estimated future revenues.
- The estimated sustainable expenditure for a fiscal year is equal to non-petroleum income plus the maximum amount that can be appropriated from the Petroleum Fund in that fiscal year and leave sufficient resources in the Petroleum Fund for an amount of equal value (indexed for inflation) to be withdrawn in all later fiscal years.
- The sustainable level of expenditure will maintain the real value of the petroleum wealth of Timor-Leste, where this real value takes account of savings already in the Petroleum Fund and estimated future petroleum revenues.

The calculation of the sustainable expenditure level derives from the following formula. It uses estimates of current non-petroleum revenues and the estimated sustainable income from petroleum revenues.

Estimated Sustainable Expenditure
 = Non-Petroleum Revenues
 + Estimated Sustainable Income from Petroleum Revenues

The estimated sustainable income from petroleum revenues is equal to three per cent of the value of petroleum wealth, where the value of petroleum wealth is the current balance of the Petroleum Fund plus the Net Present Value (NPV) of estimated future petroleum revenues. The definition of the estimated sustainable income from petroleum revenues is included in the draft Petroleum Fund Law, as shown in Diagram 5.1.

Diagram 5.2 Calculating the Estimated Sustainable Income from Petroleum Revenues

Estimated sustainable income for a fiscal year is calculated according to the following formula:

$$r \times \text{petroleum wealth}$$

where *r* is the estimated average real rate of return, or real interest rate, on Petroleum Fund investments in the future and, for the purposes of these calculations, shall be 3.0%.

Petroleum wealth is calculated according to the following formula:

$$V + \text{present value } (R_0, R_1, \dots, R_n) = V + \sum_{t=0}^n \frac{R_t}{(1+i)^t}$$

where:

V is the estimated value of the Petroleum Fund at the end of the prior fiscal year

R₀, R₁, etc. are the published budget projections for expected annual Petroleum Fund receipts for that fiscal year (*R₀*) and future fiscal years (*R₁*, etc.)

i is the estimated nominal yield on a U.S. government security, averaged over the years in which Petroleum Fund receipts are expected

n is the number of years until no further Petroleum Fund receipts are projected to be received.

For 2005-06, the estimated sustainable expenditure level is about \$150m. This comprises non-petroleum revenues of \$47m plus estimated sustainable income from petroleum revenues of \$103m. The estimated sustainable petroleum income is equal to three per cent of petroleum wealth, where estimated petroleum wealth is \$3.4 billion.

Table 5.2 shows the steps involved in calculating petroleum wealth. It shows the petroleum revenues (excluding interest) for each year. It also shows the value of those revenues after discounting future revenues by 5.5 per cent for every year in which they lie in the future. Table 5.2 also shows the totals. The total of the discounted revenues is the value of the petroleum wealth of Timor-Leste.

Table 5.2
Discounted Petroleum Revenue

Year	Nominal	Discount	Discounted
05-06	154	0%	154
06-07	177	-5%	168
07-08	168	-10%	151
08-09	199	-15%	170
09-10	484	-19%	390
10-11	475	-23%	363
11-12	509	-27%	369
12-13	479	-31%	329
13-14	426	-35%	278
14-15	384	-38%	237
15-16	335	-41%	196
16-17	272	-45%	151
17-18	218	-47%	115
18-19	189	-50%	94
19-20	179	-53%	84
20-21	158	-55%	71
21-22	96	-58%	41
22-23	20	-60%	8
23-24	-	-62%	-
Total	4,922		3,369

PART 6 – EXPENSES²

Combined Sources expenditure (State Budget, TFET and bilateral/multilateral) is expected at the time of printing to be some \$234 million in 2005-06. This compares with forecast expenditure for 2004-05 of around \$197 million (refer table 1.5).

Total State expenditure, including self funded agencies, is budgeted to be \$129million, an increase of \$42 million over the 2004-05 Budget of \$87 million (refer table 1.4). This increase reflects a healthy growth in estimated Timor Sea Revenues and two key Government policies:

- Savings Policy – the Government will place all Petroleum revenues in the soon to be established Petroleum Fund and plans to utilise only the sustainable level of income from that fund for its annual budget; and
- Expenditure Policy – despite the significant rise in funding available from the estimated sustainable income of the Petroleum Fund, the Government will seek to maintain the quality of its expenditure – that is, through the annual Budget it will ensure that funds are only allocated for those purposes that are fully consistent with the National Development Plan and Sector Investment Programs and where the capacity to execute the Budget exists.

The increase in State Budget expenditure also reflects the movement onto the Government's Budget of a number of expenditures which are core and ongoing government activities and which would otherwise have been funded off-Budget. This move reflects the Government's desire to commence a move gradually to reflect all Government activity on-Budget and under national control. This is consistent with the approach discussed with Development Partners in framing the Consolidation Support Program (CSP), the successor to the highly successful TSP arrangements. It is hoped that the CSP will contribute \$30 million to State Budget revenue over the next three years.

At the time of preparation of this document, no decision has been taken by the UN Security Council on the continuation of support of UN Assessed assistance. No estimate has been included in the 2005-06 Combined Sources Budget estimates at this stage due to the uncertainty surrounding the UN's eventual decision. Readers should note that this may slightly affect comparisons of the 2004-05 Budget with 2004-05 figures throughout this document.

STATE BUDGET AND COMBINED SOURCES SECTORAL SHARES

Through the Sector Investment Programming process seventeen sectors have been identified, with fifteen programs having been approved by Government at this time. These are listed in table 6.2 along with the Organs of State that fall within each. These take into account key structural changes made by Government for the 2005-06 year.

² "In Part 6 – Expenses, SIPs expenditures are drawn from the individual SIP reports. See also footnotes in Part 1 – Overview."