

Annex 9 Letter to the Parliament Regarding the Exceeding of Sustainable Income

[letter head – Office of the Prime Minister]

Official greetings for letter to Parliament

Transfer of Funds from the Petroleum Fund

The Government's 2009 Budget proposes an amount of funding greater than Estimated Sustainable Income from the Petroleum Fund. This additional funding is required to respond to the existing and emerging development challenges facing the state. Accordingly, in line with Article 9 of the Petroleum Law, this letter outlines the justification of why these additional funds are required in the long term interests of Timor-Leste and its citizens, as well as a detailed report on the impact of the larger transfer on calculations of ESI in future years (Annex A).

The Government accepts that it is important to ensure that the economic value of the nations mineral and petroleum assets are used for the benefit of both current and future generations. The Government recognizes the need to maintain a responsive and prudent management of the Petroleum Fund to ensure that future generations can also benefit from the nations endowment of non-renewable resources. At the same time it is evident that there is a minimum level of investment urgently required to alleviate poverty and create economic opportunity. Much of this investment is in human capital and physical infrastructure.

As the Government has demonstrated in 2008 it is possible to achieve both the need to invest now with the need to put aside revenues from a non-renewable resource for the future. Despite relatively heavy spending in 2008 the Petroleum Fund assets have grown from about 2 billion dollars in December 2007 to about 4 billion dollars in December 2008.

Our core aims remain as before, namely:

- Put aside sufficient revenue and invest it wisely to ensure that the recurrent budgetary needs of the country can be met in perpetuity.
- Spend part, but in a disciplined and accountable manner in the national interest, on investments such as infrastructure, health, rural development, education and training. These investments cover social, physical and economic infrastructure that will have economic returns in future years.

Much of the nations infrastructure was severely damaged in 1999. In the years that followed the limited resources of the donors and previous Governments were used to basically maintain essential Government services. It was left to the private sector to develop core national infrastructure. However, the ensuing instability meant that the nation never received that investment and our infrastructure continued to decline to a state where it is now a major obstacle to economic growth and poverty alleviation.

In addition to these inherent problems we also face a new external global threats that are also damaging national development. The global economic recession now affecting much of the world means that we cannot rely on external investment to develop our nation. Like many countries we will have to embark on a fiscal expansion, this means using Government funds, to make the necessary investments in our country.

We cannot afford for our economy to shrink like those of our neighbours without risking a recurrence of the instability that we saw in 2002 after the UNTAET left or such as we experienced in 2006. We need to

increase investment in both social and physical capital now. We need to rapidly build our institutions and core infrastructure and to do this will require immediate investment. We cannot repeat the mistakes of the past by failing to react to the wide range of social, institutional and economic needs of our people. We need to invest the revenue from the resources which belong to the people for the benefit of the nation. We need to do this now if we are to continue with the nation building process we began in a faltering fashion after independence.

We need to create the foundation for the Timor-Leste described in Vision 2020, a country in which all citizens participate in a modern, expanding and equitable economy, confident of their security and future. To achieve Vision 2020 requires investing in our agriculture and rural sectors, building our country's human resource base, identifying and removing infrastructure bottlenecks that restrict growth, and establishing systems of operation that encourage private sector participation.

With our rapidly growing population, Timor-Leste's economy must grow and grow quickly if it is to raise people's incomes. The Government has targeted an 8% or higher growth rate for the country over the coming 5 years. Growth comes from investments and increases in productivity, and, today, investment is heavily reliant on public sector spending financed by natural resource revenues. Only about one fifth of our overall investment comes from non-government sources. This must change. We must prepare for a time when Timor-Leste can no longer rely on large revenue inflows from oil and natural gas. Sustainable improvements in our people's wellbeing can only come through an economy whose growth is primarily in sectors other than natural resources, and not driven by public sector spending.

As the Government works to meet the immediate needs of our citizens, we must continue and accelerate our efforts to build the country's foundation for future growth. Most critically, we must put in place the prerequisites for non-oil private sector growth. In addition to a stable macroeconomic environment, the basic elements of such growth are a productive labour force, cost effective infrastructure, and a good business environment, including a functioning financial service sector and effective regulatory environment. With our large rural population, we need to pay special attention to the development of our agriculture sector.

No country can be internationally competitive unless its private sector has the infrastructure it needs to produce and perform. Timor-Leste's infrastructure is among the poorest in the world. The country's needs range from telecoms to power to airports to ports to roads. The question we face is not which infrastructure to fix, but which infrastructure to fix first.

In terms of large-scale infrastructure needs, the quality and size of our air transport system and our ports remain well below what is needed to encourage investors and tourist to come to Timor-Leste, and to allow businesses to import the supplies and equipment they need, and to export their products. Our telecommunications network is weak and underdeveloped.

Setting priorities with respect to infrastructure needs requires identifying the most serious constraints that can be most readily removed. Timor-Leste is small economy, distant from major markets. While it cannot change its geography, our country can affect our "economic distance" to suppliers and markets. To do this, we must improve our telecommunications and transport facilities, and do so quickly.

However, all of the planned infrastructure is dependant on having a reliable source of power in far greater quantities than we can currently generate. Lack of access to a reliable source of power is not only a major cause of hardship for our people, but it is also slowing the potential growth of the economy. This is why it makes sense to invest now in power generation to make sure that the people are able to access this power and improve the quality of their lives – whilst at the same time enabling larger investments to go ahead.

Investment in power generation has to be the priority as reliable access to power is a pre-cursor to all the other essential investment mentioned above.

This is why the Government intends to spend \$87mn in the 2009 budget on the power plant and commit a further \$26 mn for the re-appropriation of core infrastructure requirements as identified in the national capital plan.

Investment however is not just roads and bridges, it is also about people. We made a commitment to our people last year to ensure that every person had access to rice at a price that they could afford. At the same time we also made a commitment to resolve the IDPs issue. We have been successful in both regards and intend to complete these programs in 2009 using the 2009 budget. (\$45m and \$31m respectively).

It is these essential investments that have required the Government to exceed the ESI amount as determined by the Article 9 of the Petroleum Law, however, as we have demonstrated, these withdrawals are investments in the long term future of all our people. In that light we maintain the core principals of investing in the long term future of all our people, we recognise and embrace this concept fully. We also understand that in order to fully achieve this we will need to invest heavily into the medium term in our core infrastructure and that this will necessitate investment in our nation greater than the level in the ESI. However, as we have demonstrated this in no way moves us away from the core principal of using the nations mineral wealth to invest in the long term future of all of its citizens both today and into the future.

This will require 2009 and future spending levels to exceed the Estimate of Sustainable Income as attached in the Deloitte Touche Tohmatsu report below at [Annex 10](#).

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Office of the Prime Minister]