

# La’o Hamutuk

Timor-Leste Institute for Development Monitoring & Analysis

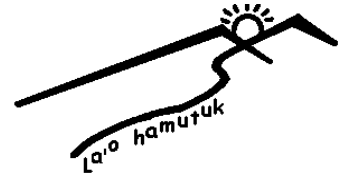
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## Submission to Commission C Timor-Leste National Parliament

From

**La’o Hamutuk**

Regarding

**Draft Law for the 2018 General State Budget**

**20 August 2018**

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## Introduction and Context

La'ó Hamutuk appreciates the opportunity to share our thoughts on the proposed General State Budget for 2018, as we have for many years. We hope that the information in this submission will help the distinguished members of parliament make evidence-based decisions in the best interests of all the people of Timor-Leste. We hope that the 'urgent' debate on the proposed 2018 budget will lay the foundations for a deeper discussion when the 2019 budget is proposed in a few months.

Before considering the contents of the 2018 proposed budget, we would like to summarize the current economic, social and environmental conditions in Timor-Leste.

More than 40% of Timorese people still live in poverty<sup>1</sup> and many households, especially in rural areas, still lack basic human rights, such as clean water and sanitation. Poor water access and sanitation makes people sick, as well as limiting children's ability to learn. These impacts disproportionately affect women and children, as they are usually the ones who must fetch water and children are more susceptible to disease.

Many children in Timor-Leste still do not receive enough nutritious food. According to the 2016 DHS, child wasting has been increasing and stunting remains high.<sup>2</sup> Childhood malnutrition and under nutrition can lead to chronic lifelong health problems, impact educational outcomes and limit the child's opportunities later in life.

Progress has been made in educational outcomes and literacy rates, however the Net Attendance Ratio for primary school is still only 80.8%<sup>3</sup>, the lowest in the region. Schools, especially in rural areas, also often lack adequate learning and teaching materials, books, well-trained teachers and infrastructure. Many schools have collapsed or leaking roofs, unsound structures, and lack enough classrooms and space for the growing number of students.

Unfortunately, Timor-Leste has never allocated enough funding to clean water, health, and education. In 2017, these three sectors together received less than 20% of the State Budget. La'ó Hamutuk is concerned about both the quantity and the quality of investment in these sectors, we should ensure that future increases in allocation to these sectors are targeted, well managed and transparent. These three sectors not only basic rights, but when we invest in them, we will increase the skills and knowledge of our people to better develop our nation.

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<sup>1</sup> Based on data from TLSLS - Timor-Leste Survey of Living Standards 2015.

<sup>2</sup> National Directorate for Statistics, Ministry of Planning and Finance and the Ministry of Health, *Demographic and Health Survey 2016*, April 2018. Using prior DHS reports, we can see the trend for wasting in children 5 and under: 12% (2004), 17% (2010) and 24% (2016); and for stunting: 49% (2004), 53% (2010) and 46% (2016).

<sup>3</sup> National Directorate for Statistics. Timor-Leste Population and Housing Census 2015, Thematic Report Volume 11, Education Monograph 2015, Pájina 32.

Timor-Leste has already received more than 98% of all revenues it will get from developed oil and gas fields. Our lands and seas have been thoroughly explored since the 1970's, and we are unlikely to find new oil and gas fields as large as Bayu-Undan. Although nobody can accurately forecast the value of Greater Sunrise, La'ó Hamutuk estimates that it could provide \$8 - \$20 billion in revenues to Timor-Leste, less than we have already received from Elang-Kakatua, Bayu-Undan and Kitan. Our population is growing and the Government plans to provide higher quality of services in the future while also ensuring long-term maintenance for infrastructure, From 2008-2017, 91.9% of state spending was paid for with petroleum revenues, while future revenues from Greater Sunrise might be able to finance half of the state budget during its two decades of production.

During the last two months, the public and our political leaders have nearly panicked over the need to take money out of the Petroleum Fund, because domestic revenues are inadequate to cover current government expenditures, even with curtailed spending under the duodecimal regime. Parliament acted "urgently" to authorize a transfer, and the President worried that it might not be Constitutional. But everyone knew that the money was there – that the oil wealth saved in the Petroleum Fund would allow state operations to continue. In about a decade, when the Petroleum Fund has been used up, where will Timor-Leste get the money to continue to employ teachers, operate health clinics, pay police salaries, provide pensions, build roads, subsidize electricity and pay for all the other essential services we have come to take for granted?

## **Oil revenues are nearly gone; the need for diversification is urgent.**

La'ó Hamutuk has urged decision makers to diversify our economy for more than a decade. We appreciate that the Exposição da Motivos for the 2018 Budget Proposal "underlines the importance that should be assigned in the future to increasing domestic revenue streams," and we hope to see this commitment implemented in future projects and programs. However, diversification is not only necessary to provide revenues to pay for public officials and services, but also to create a sustainable, equitable economy which offers good livelihoods for all of Timor-Leste's people.

Diversification is crucial given that Bayu-Undan is nearly empty, revenues from Greater Sunrise are uncertain and will not come for years, and few other petroleum reserves have been found during a half-century of oil exploration in our land and seas. Onshore mineral and oil exploration may not find significant deposits, but it carries serious social and environmental risks and may deepen our dependency on mineral wealth and deepen the resource curse. Additionally, the petroleum sector employs only a tiny fraction of our workers (less than 1%) and is never a significant source of jobs anywhere in the world. Every year Timor-Leste's working age population increases by more than 20,000 people, and we need to focus on creating long term, sustainable jobs

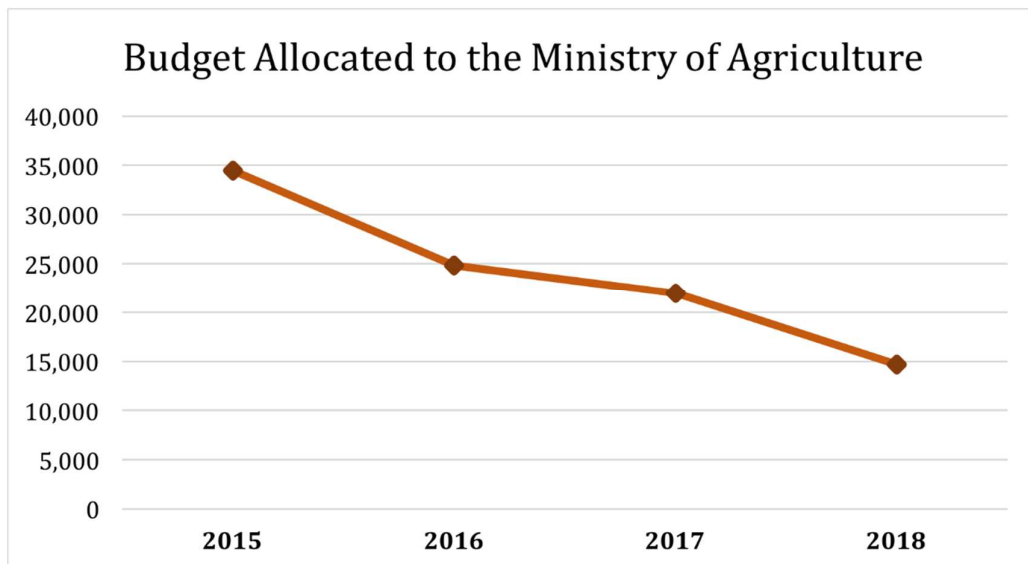
for them. Investments like Heineken or Tasi Mane Project will create hundreds of jobs, but the tens of thousands that Timor-Leste's workers need can only come from decentralized economic activities like agriculture, food processing, light industry and ecotourism.

We must concentrate on developing alternative and sustainable sources of revenues to support the State when oil money inevitably runs out. Therefore, we should diversify the economy by investing heavily in productive sectors with high employment opportunities, such as agriculture, light industry and ecotourism. These sectors can provide employment, nutrition and food security, as well as decrease our dependency on imports. They are considered more closely below.

### **Alternative sectors: agriculture, light industry and ecotourism**

Currently, our nation's domestic agricultural production is very worrying. Our cultivated land area is decreasing and young people are not interested in farming. Rice production, the subsector that has received the most attention from government and donors (through construction of large irrigation systems, distribution of more than 4 thousand of tractors, and the introduction of new foreign bred seeds), has been decreasing since 2012. In 2012 Timor-Leste produced approximately 139 thousand tonnes of rice, however since then it has continued to decrease, until in 2017, it fell by 37,000 tonnes and the Ministry of Agriculture projected a record low production decrease to 30,000 tonnes in 2018.

The budget allocated to the Ministry of Agriculture has been declining in recent years, which combined with a stigma that farming is only for those who cannot get a better job and increasing imports of cheap, non-nutritious processed food from abroad has made it difficult to make the agriculture sector more productive and job-producing.



We believe that Timor-Leste needs to change its agricultural sector development model so that it can address the most pressing problems faced by the majority of the population, such as hunger, malnutrition, and low household income. About 2/3 of Timorese households make their livelihoods are from agriculture, so investment in this sector will have far reaching impacts. We should further improve farmers' capacity to manage their crops and animals and we should keep our farming organic, while encouraging the growth of light industries to process our agricultural products. Organic systems are not only good for our health and environment, but also add value when we compete in the global market. As a small country we may not be able to compete in mass-produced price or quantity, but we can compete in quality.

Organic farming will also make our tourism sector more attractive when we develop ecotourism, agricultural tourism and other tourism models that rely on the natural and cultural wealth of the nation, without damaging our environment. If we shift away from organic farming to artificially increase agricultural production, we will damage our land, increase pollution and destroy our nature. This will indirectly cripple our tourism sector. We cannot compete with neighbouring countries whose tourism sector has been running for decades by building luxury hotels and massive entertainment centres; however, we can attract tourists who are seeking natural tranquillity, freedom from city crowds, and a breath of fresh air.

## **Government spending should focus on access to basic services.**

The Eighth Constitutional Government has announced that strengthening the health system and ensuring universal access to clean drinking water are top priorities for the government. Although the government has prioritized investment in basic services through their speeches, these sectors have all received reduced allocations in the 2018 budget. Allocations to the education sector decreased by 16%, and health and clean water have also been cut.

### **Health**

According to La'o Hamutuk's analysis, the 2018 budget only allocates 6% of the total State Budget to the health sector, about half of the global average, 11.7%<sup>4</sup>. The proposed 2018 budget allocates less money to health than we did in 2017, including a \$1 million decrease in the allocation to the Ministry of Health. This trend is dangerous for a nation which still suffers from inadequate services, malnutrition, maternal mortality and lack of adequately equipped health facilities and trained health officials.

The budget to the Ministry of Health through the Infrastructure Fund and Human Capital Development fund also decreased, by \$100 thousand and \$1.5 million

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<sup>4</sup> According to WHO global data on Percentage of Government Expenditure Allocated to Health

respectively. This means the Ministry will have less money to spend on improving infrastructure, buying materials and training health officials than it did in 2017.

### **Education**

According to the UN, good international practice allocates a minimum of 15% of the State Budget to the education sector.<sup>5</sup> The 2017 Budget allocated \$128 million to the education sector, which was 8% of the budget. Allocation to the education sector decreased from 2017 to 2018 by about 16%. La'ó Hamutuk is concerned about the drastic decrease of funding to the education sector, which was already underfunded.

However, we need to consider both the quantity and the quality of investment. We appreciate the reinstatement of the 2015 curricula (preschool and primary), after the VII government's moves to radically change it, and we hope that the VIII government will spend enough to effectively implement the curriculum, including investment in learning and teaching materials, teacher training, infrastructure and management systems.

It is also important to spread investment equitably across all levels of schooling. Primary, secondary and tertiary education are all important for the continued development of our country and improving the lives of our people. Primary and secondary education are vital for instilling basic skills and comprehension, and tertiary education is important for teaching higher level skills and specialization. Investment should not disproportionately go to tertiary education (i.e. sponsoring scholarships abroad, at the expense of primary and secondary education, which have far more students). The people of Timor-Leste are our biggest asset, and with half of the population under the age of 19, primary and secondary education are essential to giving our young people the skills and knowledge they need to prepare for their futures.

### **Clean water**

In 2017, the execution rate for spending on clean water was only 21.7%, meaning that most of the money allocated towards improving people's access to clean water was never properly implemented. This execution rate was likely to have been affected by the political impasse and uncertainty of the second half of 2017; we hope the VIII government will be able to properly implement and execute the programs in improving access to clean water.

According to the 2016 DHS, only 36% of households have safe water piped into their house, yard, or neighbour's yard. Therefore, the majority of households have to walk at least some distance to access drinking water and this burden most commonly falls on the women and children. Additionally 21% of households in Timor-Leste are using an "unimproved source" for drinking water, meaning the water is likely contaminated and

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<sup>5</sup> The UN takes this recommendation from the report of Education for All (EFA) that allocation to education should be between 15% to 20% of the total state budget.

unfit to use safely for drinking or cooking. We recommend that the government prioritizes investment in improving universal access to clean water, especially in rural communities, as they promised when first taking office<sup>6</sup>. Quality investments in this sector will lead to health and education benefits, as well as improve lives, particularly for women and children.

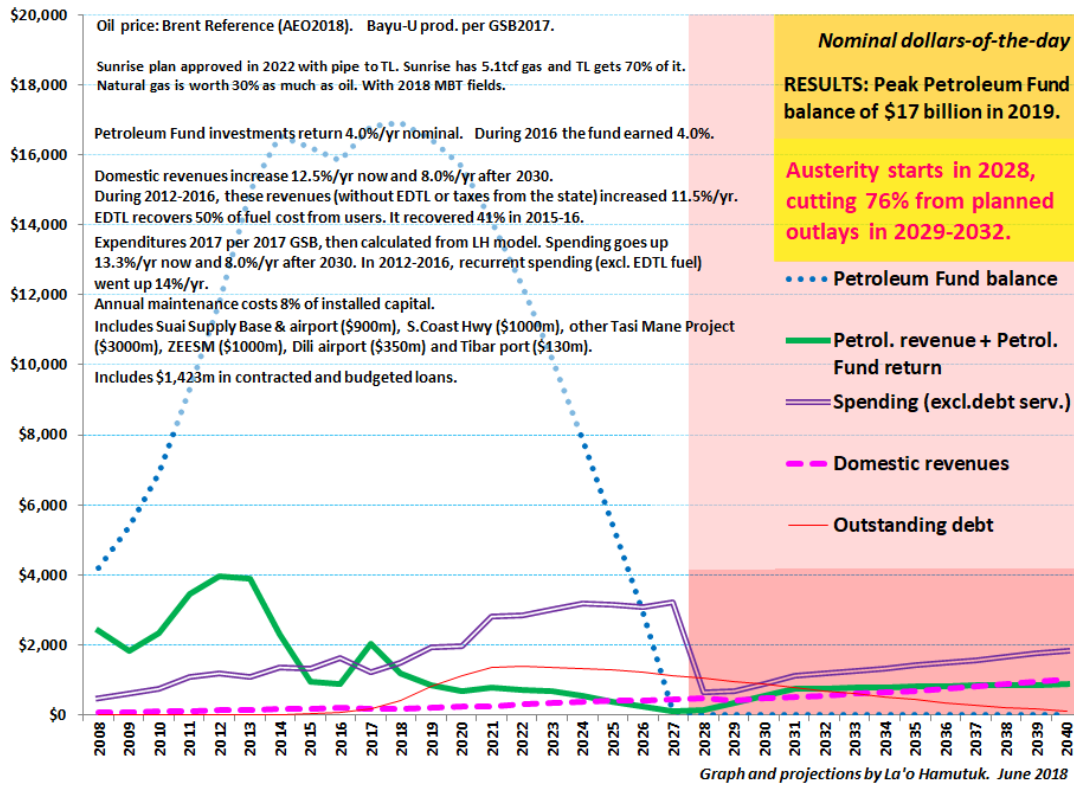
## **Unsustainable levels of spending will have negative consequences for our future generations.**

The Petroleum Fund was created in 2005 to ensure long term sustainability of Timor-Leste's finances for generations to come. The Estimated Sustainable Income (ESI) is a benchmark to ensure the longevity of the Petroleum Fund, however, year after year withdrawals have been far above the ESI. The 2018 State Budget proposes to take \$434.4 million more than the ESI out of the Petroleum Fund this year, prolonging the pattern of unsustainable withdrawals.

La'o Hamutuk projects that if government spending remains high and planned projects are carried out, the Petroleum Fund could be empty by 2027, even if Greater Sunrise is being exploited. This would mean extreme austerity cuts in about a decade, slashing state spending by three-quarters. Since 2014, recurrent spending has been higher than domestic revenues; therefore, if we no longer had the Petroleum Fund to subsidize spending we could not even afford to pay our reoccurring expenses (e.g. salaries, pensions, goods and services, transfers, etc.) year on year.

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<sup>6</sup> <http://timor-leste.gov.tl/?p=20162&lang=en&n=1>



Future generations may have no oil money to support the unsustainable “front-loading” spending policies reflected in many State Budgets . Withdrawals from the Petroleum Fund, which have been above the Estimated Sustainable income every year since 2009. (The exception in 2013 was due to excessive withdrawals in 2012 that were carried over.) To ensure the financial security of future generations, we must stop withdrawing above the ESI. We can reduce our dependency on the Petroleum Fund, thereby prolonging its life, by investing in the productive sectors of our economy and boosting our non-oil domestic revenues.

## **We appreciate the Government’s initiative to decrease planned borrowing.**

The 2018 State Budget authorizes spending \$61.6 million in borrowed money to construct roads, as well as a ceiling for new loans of \$44 million. In comparison, the 2017 Budget allowed disbursement of \$101.8 million in loans and authorized a loan ceiling of \$500 million. La’o Hamutuk appreciates the Government’s initiative to lessen the debt burden on future generations by decreasing borrowing.

<sup>7</sup> This graph was prepared before the 2018 proposed budget was available. However, the projections for future spending in those documents are so incomplete we do not believe that they would add to its accuracy.



For the past few years, La'ó Hamutuk has warned against the Government's perspective of borrowing now to pay back later, especially considering the uncertainty of future petroleum revenues. We have advocated for responsible and sustainable Government spending, and have advocated against taking out large loans which will have to be paid back by future generations. We are glad to see that the 2018 State Budget reflects our recommendations.

The differences in projections for future loan disbursements in the 2017 State Budget vs. 2018 State Budget:

2017 State Budget (in millions)

	<b>Total</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>
Loans	1409.4	101.8	310.7	460.8	317.8	218.2

2018 State Budget (in millions)

	<b>Total</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
Loans	211.8	61.6	87.0	40.0	13.5	9.7

## **The Tasi Mane project should not continue without an independent and public cost-benefit-risk analysis.**

La'ó Hamutuk has serious doubts that the Tasi Mane Project will be good for Timor-Leste. In addition to requiring many billions of dollars in investment, it depends on having suppliers and markets for its feedstocks and outputs. It will take up valuable land, endanger our environment and disrupt many people's lives, but the promised benefits in revenues, jobs and subcontracts are highly dubious. Timor-Leste's decision-makers owe our people an independent, comprehensive, objective analysis of the project's total costs and full life cycle, to enable an evidence-based decision on whether to go ahead. We must not rely only on the promises and claims of people with a personal or institutional interest in promoting this project, but should thoroughly understand its reality. Too many other countries have found, to their dismay, that promises by petroleum advocates have not been achieved. We should anticipate problems with accurate analysis, not regret them after the money has been spent and the damage has been done.

Parliament, Government and civil society need and deserve this cost-benefit-risk-alternatives analysis of the entire Tasi-Mane project, considering all plausible scenarios. We have already spent \$458 million of the people's money on a few initial components of the project. However, this is only a small fraction of the total investment which will be required, which could exceed \$15 billion. Before any more contracts or signed or money is allocated, Timor-Leste's people and decision makers require an in-depth, publicly available, evaluation of the probable and possible fiscal, social, economic and environmental costs and benefits to our people. This analysis should include realistic

projections of the spin-off benefits in jobs and contracts, as well as of the lost land and other economic opportunities resulting from this project, and the possible risks from supply chains, market opportunities, global economic conditions, competition, oil company and investor desires and performance, and other factors beyond our control which greatly affect the project's outcomes. It is not enough to wish for something and to consider the best possible scenario; Parliament needs realistic, hard data before you continue to approve public funds for the Tasi Mane Project.

The 2018 State Budget allocates \$100 million to the Tasi Mane project for three components: (1) the design, construction and supervision of the Suai Supply Base; (2) the Suai-Fatukai Highway, and (3) Water Supply in Dato Rua To Tolu. This allocation is 55% (\$35 million) more than the allocation to Tasi Mane in 2017, and the Budget projects that the yearly allocation will more than double in the next four years (see below).

2018	2019	2020	2021	2022
\$100,533	\$108,081	\$196,189	\$185,329	\$221,245

The future costs will be much higher than these numbers, because the 2018 Budget Book 3A leaves out all expenditures for the Betano refinery, most of the highway, the gas pipeline and Beaçu harbour and LNG plant and Suai port. Therefore, the actual costs of this project are probably 10-20 times more than the budget books claim. Timor-Leste should not continue to spend more of Timorese people's money on the Tasi Mane Project to justify the small percentage of total costs we have already paid.

To our knowledge, not one legitimate outside investor is willing to invest in these projects, and the international financial institutions will not finance it. If the Government continues with the project without any external investors, it will have to spend most of our nation's wealth on the project or take out extremely large, non-concessional loans, making it even less likely to be financially viable.

## Conclusions and recommendations

In conclusion, we once again want to thank Parliament for considering our thoughts and concerns on the proposed 2018 State Budget. La'ó Hamutuk encourages members of Parliament to put aside partisan politics and keep the needs of the people at the forefront of your decisions. In Timor-Leste, our people are our greatest asset; to ensure our people can reach their potential we must invest in education, health and clean water to provide them with a sufficient base for success.

Some of our specific recommendations to Parliament are:

- Allocate more of the State Budget to basic services, such as clean water, education and health. These sectors should be prioritized over the major

infrastructure allocations which have dominated State Budgets over the past few years.

- Prioritize productive sectors of the economy which will replace oil revenues and investment returns to drive our economy and provide State revenues in the future. Agriculture, light industry and ecotourism are sectors with high employment opportunities, and can improve the livelihoods of our people whilst causing minimal damage to our environment.
- Stop spending Timorese people's money on the Tasi Mane project until a thorough, independent cost-benefit-risk analysis has been conducted and made public detailing the full economic, social and environmental implications of the project.

We expect to continue communicating with members of Parliament during future budget processes . We will continue to provide our analyses, research and data, which we hope will help you make policies which are realistic, s evidence-based and contextualized.

Thank you.

Sincerely,



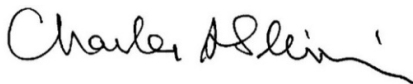
Berta Antonieta



Celestino Gusmão



Marta Da Silva



Charles Scheiner



Carly Munnelly