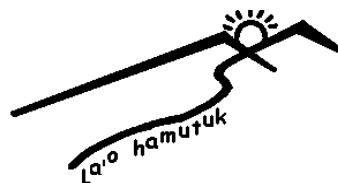


# La'ó Hamutuk

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## **Submission to Committee C, RDTL National Parliament**

**From  
La'ó Hamutuk**

**regarding the  
Proposed General State Budget for 2020**

**30 October 2019**

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## **Introduction**

La' o Hamutuk is a Timor-Leste civil society organization that has monitored development processes in Timor-Leste for almost 20 years. We express our thanks for the opportunity given to NGOs through FONGTIL to provide commentary to National Parliament on the proposed 2020 State Budget.

From the outset, La' o Hamutuk has believed in the important role of the National Parliament to conduct in-depth analysis and discussion of the contents of the proposed Budget before approving it. Through this submission, we offer our appreciation of the positive aspects of the proposed State Budget, as well as our concerns and recommendations, and highlight aspects that need improvement or further explanation.

We appreciate that Government transparency has improved in comparison to previous years, as reflected in the Ministry of Finance's publication of its Pre-Budget Statement, and that they shared some of the Budget Books several days before presenting them to the National Parliament. However, we consider transparency alone to be insufficient; participation is required that engages the citizenry, including civil society, academics, researchers, and other organizations.

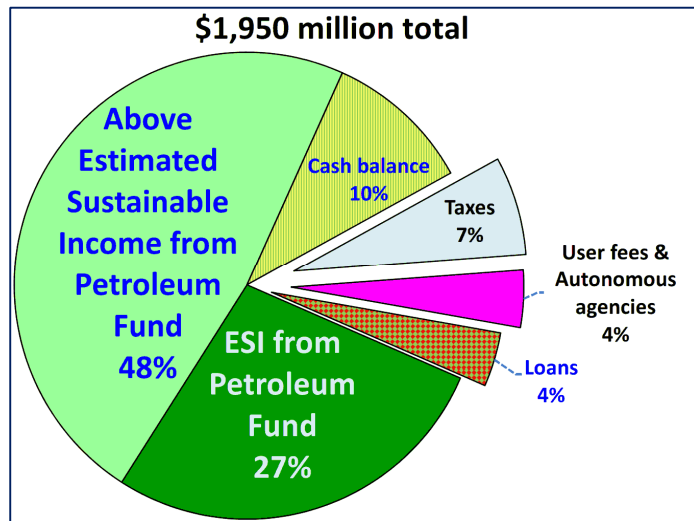
We are concerned that our state finances still show no vision for ending dependency on petroleum, while allocating large amounts to recurrent expenditures. We should not only consider the cost to build major projects, electricity, roads, ports, airports, offices and other construction projects, but also the costs of maintenance and operation, so as to have a realistic calculation of our fiscal obligations and capacity to ensure the sustainability of those projects.

Eighty-eight per cent of the proposed 2020 State Budget is financed by withdrawals from the Petroleum Fund. At \$1.95 billion, it is as large as any budget in the nation's history. We are concerned that the Petroleum Fund will be rapidly depleted, breaking its promise to provide for both present and future generations. The Ministry of Finance has said that if the trends of the 2020 budget continue, the Petroleum Fund will be empty in eight years, by 2027.

We agree with the Government's policy of allocating funds for local development, particularly for agriculture, education and water. However, there also should be a rigorous system of control and monitoring to ensure that spending is effective and accountable. We ask the Government to maintain a policy of focusing on local development to help respond to the urgent needs of the people and the nation. However, we believe that the Government cannot take two paths at the same time; non-urgent major projects should be suspended in order to concentrate on the most pressing issues, to ensure the future of the Petroleum Fund, and to make funding available to the people's basic needs.

## The 2020 state budget threatens the sustainability of the Petroleum Fund.

Eighty-eight per cent of the 2020 budget will be financed by the Petroleum Fund (PF).<sup>1</sup> The only remaining source of petroleum revenues, Bayu-Undan, achieved peak production seven years ago, and will cease production in 2021 when the reserves are exhausted. Returns on investing the PF are deposited into the Fund, but these returns depend on volatile markets. Sometimes the investments give good returns, but in other periods they do not. Even when investments



perform well, returns depend on the capital invested. If we fail to control spending and withdrawals continue to increase, the PF will be empty and the variations in markets will cease to matter. Even if we control withdrawals, unfortunately, Parliament has opened the way for TimorGap to take money directly from the Fund.

Projections for withdrawals from the Petroleum Fund in the next few years also cause concern, and may cause the PF to fail to achieve its objective to benefit current and future generations.

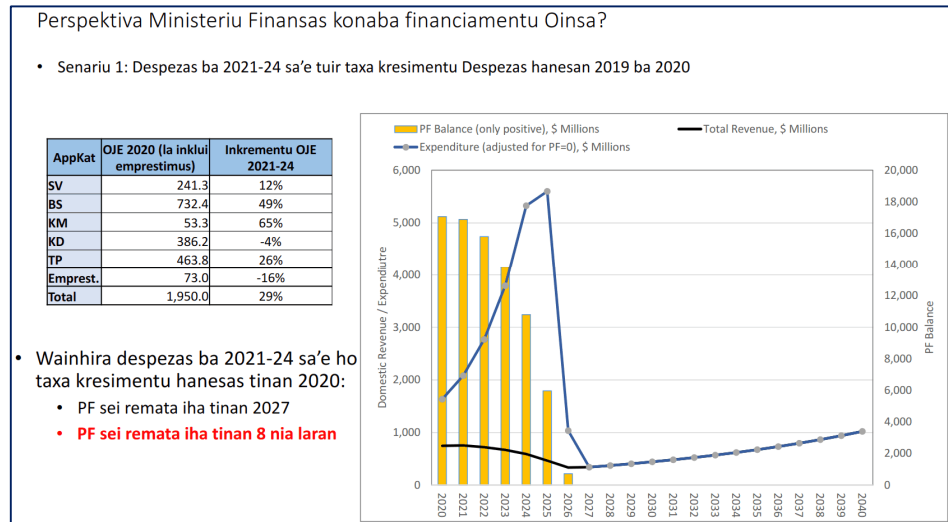


Figure 2. Scenario one, from the Ministry of Finance

One scenario presented by the Ministry of Finance to FONGTIL is that future governments will continue to increase the budget by the same percentage as was done in the 2020 budget. According to their presentation on 3 October 2019, this would exhaust the Fund by 2027.

Last year, Parliament amended Petroleum Activities Law no 13/2005, and this year has attempted further changes. Although the Court of Appeals advised that the proposed amendments were unconstitutional and the President of the Republic vetoed them, the

<sup>1</sup> If we assume that the carryover in the Treasury came from the Petroleum Fund, and that loans will be repaid with the same proportion from the PF as the current budget, 88% of the 2020 Budget is financed by the Fund.

Parliament again considered and passed the amendments and they were sent back to the President. These amendments aimed to make it easier for TimorGap to use the Petroleum Fund for its projects. This shows that leaders continue believe that petroleum will be an ongoing source of revenue to sustain Timor-Leste, and to neglect other productive sectors. There has been a sharp increase in public transfers through the Ministry of Petroleum and Minerals (MPM), which have grown seven-fold in two years. In the 2020 budget allocation, they request \$87 million, without thorough explanation or clear reasoning. Budget Book 1 explains that \$64m of this is for TimorGap, with the remainder for institutions (including TimorGap). The National Parliament needs to with this carefully before approving it.

## Suspend projects which are not viable.

The capital expenditure for major projects like roads, ports, airports, highways, electricity and office construction is only paid once, but the operational and maintenance costs continue and increase. Historically, Governments have requested funds for building without much consideration of whether this spending will resolve the problems faced by the nation or threaten the Petroleum Fund. For example, spending on electricity in 2020 will increase to \$196 million, whereas in 2019 electricity expenditure was just \$108m. This includes \$32m for maintenance and operation, \$148m for fuel, and \$17m for infrastructure. When the Governments plans to build new offices or other infrastructure, they should make a complete cost estimate, so that we don't only know the capital costs, but also the maintenance and operating costs, so that Parliament can make an appropriate decision.

We recommend suspension of the Tasi Mane project, because it could eat up the entire Petroleum Fund, as well as and other resources that could be used for more productive, sustainable and realistic development. In the proposed Infrastructure Fund allocation, the Government has allocated \$5.5m to relocate people in Betano, the area around the second phase of the highway, and in Beacu, although there is no allocation for construction or operations in these areas. The Tasi Mane project in total could cost more than \$18 billion, without counting maintenance and operations. We ask that the Parliament do deeply discuss the allocations which will be required in future years to implement the Tasi Mane project.

Money spent, budgeted and required to build the Tasi Mane project (millions of USD)								
Component	Location	Status	Spent through 2018	Budgeted 2019	Budgeted 2020	Budgeted 2021-2024	Estimated total capital cost	Percent budgeted
Airport	Suai	Constructed	70	10	9	4	100	93%
Supply base	Suai	Tender pending	6	10	5	705	850	85%
Highway	Suai-Fatukai	Mostly built	267	50	4	4	340	96%
Highway	Fatukai-Beacu	Not started	3	-	4	18	1,320	2%
Airport	Viqueque	Not started	-	-	-	-	75	0%
Oil refinery & pipelines	Betano	Pending design	3	-	2	6	1,500	1%
Gas pipeline, LNG plant & port	Sunrise-Beacu	Pending design, seeking financing	12	-	2	19	6,000	1%
57% share of Greater Sunrise Joint Venture	Offshore	Borrowed directly from the Petroleum Fund	-	650			650	100%
57% of Sunrise upstream capital expenditure	Offshore	Pending design, seeking financing	-	-	-	-	6,840	0%
Administrative and other costs	Dili	Ongoing	49	12	50	50	500	32%
<b>TOTAL</b>			<b>410</b>	<b>732</b>	<b>75</b>	<b>804</b>	<b>18,175</b>	<b>11%</b>

Table by La'o Hamutuk from 2018, 2019 and 2020 budget books, transparency portal and our estimates. October 2019  
Table 1. Estimated Costs for Tasi Mane Project

## **Strengthen monitoring systems before allocating more money.**

We note that Government plans and programs for forthcoming years will require major increases to budget allocations, and we are concerned about monitoring and evaluation systems for this expenditure. Allocations for some ministries have risen sharply, with little explanation of the reasons for the increase. For example, the Whole of Government allocation has risen from \$108 million (excluding allocations for the Oecusse special economic zone) to \$239m. The appropriation for the Counterpart Fund in Whole of Government, has risen from \$5m to \$92m without clear explanation. The National Parliament should determine the details of these increases before deciding to approve them. La'o Hamutuk appreciates increases in allocations to certain programs. However, we need to strengthen capacity to implement, monitor, and evaluate and improve accountability systems to ensure that large allocations to municipalities and local governments really benefit the people.

## **We should not leave debt burdens for the next generation.**

The 2020 Budget Books contain more detailed information on loans than previous budgets. However, the books still leave out key information about the Government's plan to increase the ceiling to \$750m for new loans which may be contracted in 2020 (Budget Book 1, p51). This amount is twice as much as the total of all loans Timor-Leste has contracted to date. Borrowing has a huge impact on the economy, and unsustainable borrowing threatens fiscal sustainability. For this reason, it's essential to include accurate information and projections. Without such information, we cannot know the consequences or make wise decisions.

Although the Government has declared that its debt level is sustainable, its projections do not reflect reality. Part 2.6.3.3 of Budget Book 1, on future loans, fails to mention the Government's plan to accrue substantial additional debt and the impact of \$750m in loans in future budgets. If we borrow an additional \$750m in the future on terms similar to those of current loan agreements, Timor-Leste will have to pay about \$78 million each year in debt service once the grace periods expire. This means that the debt service-to-revenue ratio would reach 35%, almost twice the 18% maximum recommended by the IMF/World Bank Debt Sustainability Analysis mentioned in Budget Book 1. The National Parliament should ask the Government to clarify the objectives of this future borrowing (including the lender, the purpose, and the repayment terms). Although Figure 18 (Book 1) shows the sectors that will be funded with these loans, there is unfortunately no explanation of what specific projects will be funded. We suggest that Parliament not approve the proposed new loan ceiling.

## **Invest in human resources and basic services.**

Timor-Leste has started making important progress in education and health, such as the elimination of polio and malaria. Rates of school attendance have increased. However, the quality of primary and secondary education is challenged by teacher capacity, which can have long-term impacts on education quality. Most Timorese live in rural areas, and do not have access to clean water. We hope that with the 2020 Budget, the Government can prioritize basic services to ensure health, nutrition, and long lives for all of our people.

## **Education**

We appreciate the efforts of the Ministry of Education to implement the new primary curriculum, and we continue to encourage the creation of new curricula, increasing the supply of books and teacher training, especially at secondary and tertiary levels.

The Eighth Constitutional Government announced that its priorities are to strengthen the education and health systems and to ensure that the people have access to clean water, and its budget allocation to education has increased 5.6% from 2019. However, the UN recommends that states allocate 15% of their budgets to education,<sup>2</sup> but Timor-Leste's proposed 2020 budget allocates only 9.5% to education, including UNTL and scholarships. La'o Hamutuk continues to urge the Government to act on its stated priorities.

For many years, the Government focuses on foreign scholarships for students and civil servants through the Human Capital Development Fund (HCDF). La'o Hamutuk commends the HCDF for this initiative, but the time has come to put more focus on education within Timor-Leste to create and improve on education systems that can benefit everyone, rather than the relatively few students who go overseas. La'o Hamutuk believes that building schools in Timor-Leste is more effective and sustainable, and can generate more employment, than the provision of scholarships to just a few people.

## **Water and sanitation**

According to the 2016 Demographic and Health Survey (DHS), only 36% of households have access to safe water within their homes, fields, or neighboring properties. People in many households have to walk long distances to access water, and it's often women and children who bear this burden. Furthermore, 21% of households in Timor-Leste use water that is unsafe to drink or cook with because it may be contaminated. We suggest that the Government needs to prioritize investment in clean water, especially for rural communities, as the Government itself stated at the beginning of its term.<sup>3</sup> Investment in this sector will benefit health and education, and will improve lives, especially for women and children.

The issue of clean water continues to be a concern for all citizens, especially for those in rural areas. The proposed allocation for water in 2020 is \$32m. La'o Hamutuk regards investing in water to be a direct investment in human capital, because contaminated and unsanitary water causes health problems, including diarrhea. Diarrhea can cause malnutrition, particularly in children. Chronic diarrhea and malnutrition have a permanent impact on learning capacity and reduces the future productivity of the labor force.

To improve water provision to the community, development partners should align their programs with government policies. This is necessary to ensure sustainability of investments, monitoring and maintenance. The Government needs to ensure planning is integrated, inclusive, and sustainable, and plans must include public consultation to ensure that communities themselves have ownership over development.

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<sup>2</sup> The UN took this recommendation from its report *Education for All* (EFA), which recommended allocating between 15% and 20% of the total state budget for education.

<sup>3</sup> Government of Timor Leste (2019) *Linhas de Orientação para Elaboração de Proposta de Orçamento 2020-2023*, <http://www.laohamutuk.org/econ/OGE20/jornadas/LinaOrientasaunPMOJE2020-2023te.pdf>

## Health

Allocations to the health sector total \$104m, including \$2.6m for training and scholarships for medical professionals. Access to health-care is a human right, and so we recommend that the Government prioritize this sector to improve service quality through training health care professionals, investing in equipment and infrastructure (with appropriate training on their use), and training of professions to teach others these skills, rather than outsourcing diagnostic services to the private sector. Through this approach we can reduce our dependency on overseas hospitals.

The Government proposes a public-private partnership (PPP) in the health sector (a contract for diagnostic services that would last 11 years, with a one-year construction phase and 10-year operation period). However, we need to have a more detailed discussion of the consequences of deploying PPP models to provide basic services.

A further issue is the malnutrition rate - especially among children - which threatens the future of Timor-Leste. Forty six percent of children aged five and under have stunted growth and 24% experience wasting,<sup>4</sup> which is a very high rate that reflects malnutrition. The reality is that many children suffer malnutrition, and this shows the urgent need for large-scale, effective investment to combat it. Children are Timor-Leste's future; investment in their health is a direct investment in all our futures.

## Promote productive sectors as a more sustainable route to achieve Government objectives.

The Government continues to orient its programs and budget allocations to try to achieve a GDP growth rate of 7%, reduce poverty by 10%, and create 60,000 new jobs by 2020.<sup>5</sup> La'o Hamutuk supports efforts to reduce poverty and unemployment, and believes that the way to achieve these objectives is through investment in productive sectors of the economy, such as agriculture, tourism, and small industries. Even though we are investing huge amounts in the petroleum sector, they may not contribute to sustainable poverty reduction. Many studies and experiences show that the sectors most able to create jobs, increase incomes and reduce poverty are productive sectors because there is a direct relationship between these sectors and the lives of most of the population, and they can create many employment opportunities.<sup>6</sup>

## Agriculture

Agriculture continues to be a priority for government programs and budgets, and the total allocation to agriculture for 2020 is \$30m, representing a 9% increase from 2019.<sup>7</sup> The Ministry of Agriculture and Fisheries has seen its budget increase from \$14m in 2019 to \$21m in the proposed 2020 budget. However this allocation is far outweighed by the allocation to the

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<sup>4</sup> Demographic and Health Survey, 2016.

<sup>5</sup> Proposed State Budget 2020, Book 2.

<sup>6</sup> Christiaensen, L., Demery, L. & Kuhl, J., 2011. The (evolving) role of agriculture in poverty reduction—an empirical perspective. *Journal of Development Economics*, [e-journal] 96, pp. 239-254. <https://doi.org/10.1016/j.jdeveco.2010.10.006>.

Laoyza, N. V. & Raddatz, C., 2010. The composition of growth matters for poverty alleviation. *Journal of Development Economics*, [e-journal] 9 (1), pp. 137-151. <https://doi.org/10.1016/j.jdeveco.2009.03.008>.

<sup>7</sup> Including allocations to the Ministry of Agriculture and Fisheries, Infrastructure Fund, Oecusse economic zone, municipal budgets, and the HCDF.

Ministry of Petroleum and Minerals, which is \$88m. Based on Labor Force Survey data, we know that employment in agriculture totals approximately 77,000 - roughly 64 times as many people as are employed in petroleum and minerals (1,200), and this number does not even include subsistence agriculture or fishers.

## **Tourism**

Regarding the tourism sector, La'o Hamutuk supports the Government's priority of creating a favorable environment for tourism and promoting Timor-Leste as a destination in the Asia-Pacific region. However this sector receives a small allocation compared to other productive sectors. The tourism allocation, consisting of both allocations within the Ministry of Tourism, Commerce, and Industry, and allocations from the Infrastructure Fund, amount to only \$3.7m. There is also money in the Prime Minister's allocation for participation in the Dubai International Fair, at a cost of \$2.1m. The minimal allocations to the tourism sector are not consistent with the National Strategic Development Plan 2011-2030, which considers tourism a key component of economic development.

In addition to these small allocations, other factors such as implementation of infrastructure projects without environmental licensing approval, plans to explore options for onshore petroleum and mining, and agricultural systems that rely on heavy machinery and chemical inputs also threaten the Government's objectives in tourism.

## **Conclusions and recommendations**

- We ask members of Parliament to carefully consider how spending is allocated in the 2020 budget. This applies particularly to large, non-specific increases such as the Counterpart Fund and public transfers through the Ministry of Petroleum and Minerals.
- The proposed 2020 State Budget will impact sustainability and threaten the future of the Petroleum Fund. We ask Parliament to carefully evaluate the proposed budget before making a decision.
- We need to strengthen and reinforce control and monitoring systems to ensure efficient and effective implementation of programs, to ensure maximum concrete benefits to the people of Timor-Leste.
- We recommend continuing to invest in productive sectors such as family agriculture, tourism and small industry in order to reduce poverty, malnutrition, unemployment, and import dependency.
- Invest in human resources by improving the quality of education, health, water, and sanitation to ensure that our people are healthy, smart and productive.
- Suspend spending on the Tasi Mane Project and conduct an independent evaluation of the costs, benefits, and risks of that project.
- We urge Parliament not to approve the ceiling of \$750 million for new loan contracts in 2020 if the Government fails to provide details on what the loans will be spent on, where they will come from and how they will be repaid.

These are La'o Hamutuk's analysis and recommendations on the proposed 2020 State Budget. We hope that they will help Members of Parliament in the debate on this budget, so that you can



make decisions which will benefit current and future generations of Timor-Leste's people. If you have any questions, we are available for deeper discussions.

Thank you very much for your attention.

Sincerely

Celestino Gusmão

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