

Income and Transfer of Timor-Leste Petroleum Fund toward annual State Budget

By:

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Timor Leste as a new emerge nation of this century, have becoming center of attention toward many of welfare states, since colonialism era of Portugal. Aspect which becomes attractive for these nations is like tourism where line of beautiful mountains and beaches are dominating this country landscape. However, the most attractive aspect is country's natural resources especially oil and gas. Timor Leste became as a nation after won from referendum in 1999, and recently starts to develop its nation gradually.

From that time, developing a new nation considered as difficult since every aspect should started from zero and needed for hard works, in order to strengthen the nation. There was time when this nation should to face political problem which create such tension and end up with political crisis in 2006. However, this nation successfully maintained its integrity and move forward which signify as good indication for us, people of Timor Leste that we are able to encounter such challenge.

There are important factors and must consider as a principal foundation which contribute to the nation's endurance. Political maturity among the people, even when leaders haven't practice such character, we notice that people have such experience already to stand by their own feet and to be responsible with their rules, since they have been through such difficult situation during occupation era (they resisted and won). This experience had forced them to try resolving problems by their own.

People of Timor Leste using their own capabilities and knowledge, though still within their limitedness had successfully saved their natural resources, oil and gas. Despite of its early age, this nation had adopted international system of practice to reassure state's revenue from oil and gas called "Timor Leste's Petroleum Fund System". To remind as well that Timor Leste also adopt International Practice called "Extractive Industry Transparency Initiative-(EITI) which completing Petroleum Fund aim to guarantee transparency process within payment and revenue which conducted between the government and Oil and Gas Companies. The system has been sufficient enough to guarantee transparency within oil and gas sector. However, other system and institutions are still needed to develop transparency process and the sustainability of natural resources in the future.

A part of Timor-Leste Petroleum Fund system revenue source?

Based on Petroleum Fund, Article 6 of Petroleum Fund Receipts, (6.1) The following amounts are Petroleum Fund gross receipts,

- a) the gross revenue, including Tax Revenue, of Timor-Leste from any Petroleum Operations, including
- b) prospecting or exploration for, and development, exploitation, transportation, sale or export of petroleum,
- c) and other activities relating thereto;
- d) any amount received by Timor-Leste from the Designated Authority pursuant to the Treaty;
- e) any amount received by Timor-Leste from the investment of Petroleum Fund Receipts;
- f) any amount received from direct or indirect participation of Timor-Leste in Petroleum Operations; and
- g) any amount received by Timor-Leste relating directly to petroleum resources not covered in paragraphs
(a) to (d) above.”(1)”

This law explains that all income coming from oil and gas activities such as exploration, exploitation, and production of oil including investment should to transfer into Timor-Leste Petroleum Fund account. The income of the Petroleum Fund itself are coming from; taxes paid by the company, income net, Designated Authority/Petroleum National Authority, investments and direct and indirect income from TL’s participation within operation of Oil”(2)” The taxes which coming from company are composed from: Income Tax, Additional Profit Tax (APT/SPT), Value Added Tax (VAT), Withholding Tax (WHT) toward worker salary (Resident & Non Resident employee), Withholding Tax (WHT) toward company (Resident non PE & Non Resident non PE)”(3)”

INCOME WITHIN RESERVE BANK OF UNITED STATE OF AMERIKA

Based on Petroleum Fund Law, in order to contribute toward adequate management of the operation of Petroleum Fund, therefore bring significant benefits toward present and future generation, this law then objected to manage income from oil exploration activity within Bayu Undan, which during this time, have been invested trough Petroleum Fund at the Federal Reserve Bank, New York-America. Such investment had made since 2005, and until trimester II of 2014, Timor-Leste had reached its Investment income comes out at US \$ 421,726 million, a given time period Petroleum Fund has been transferring in to state budget from 2006/2007 until 2014, the fund being transferred during that time had reached around US\$ 6.335 billion, the transfer was coming from Petroleum activities in BAYU UNDAN, and being invested into Petroleum Fund.

TRANSFER OF PETROLEUM FUND INTO STATE GENERAL BUDGET

Based on Petroleum Fund Law Article 7, no 7.1 - 7.3 “(7.1) Subject to Section 6.3, the only debits permitted to the Petroleum Fund are electronic transfers made in accordance with this present article, as well as Articles 8 to 10, to the credit of a single State Budget account. (7.2)

The total amount transferred from the Petroleum Fund for a Fiscal Year shall not exceed the appropriation amount approved by Parliament for the Fiscal Year. 7.3. Subject to Article 8 to 10, transfers from the Petroleum Fund by the Central Bank in the Fiscal Year, shall only take place

after publication of the budget law, or any subsequent changes thereto, in the Journal da República, confirming the appropriation amount approved by Parliament for that Fiscal Year”

According to Petroleum Fund Law; Budget from Petroleum fund could only being transferred into “State General Budget” account. The transferring Petroleum Fund, which have been conducted since 2007 until June 2014, that budget being transferred during 8 years and the transferred through the Timor-Leste Central Bank of Timor Leste, had reached US\$ 6.335 billion. Transfer of Petroleum Fund into State General Budget has been started since 2007. Such budget were coming from petroleum activities within BATU UNDAN BAYU UNDAN, which then transferred into Petroleum Fund then being invested into Bank Federal reserve in New York-United States of America. Below are transfers of Petroleum fund into State General Budget:

Future Income and the Operation of Petroleum Fund

Oil and gas income until 2014 was coming only from Bayu Undan. Future income of Petroleum Fund has been predicted by the government from 2011-2015 as follow:

Total of Income Projection 2011-2015 “(4)”

	2011	2012	2013	2014	2015
Revenues	2,288.0	2,398.6	2,159.8	2,460.9	2,443.0

This prediction is fluctuating based on oil and gas prices, informed by Information Energy Administration (IEA). During 2007 until 2010 the government used West Texas Intermediate as a guideline for calculation; however within the next five year IEA will replace it.”(5)” This estimation made by the government is based on such reason that the demand of oil and gas still increasing, therefore the prices will increase as well. The production of oil in 2011 and 2012 will increase up to 62 million barrel and 60 million barrel from 57 million barrel in 2010; below is the graphic from such explanation:



Graphic 1. Alterações Histórica e Projecções Futuras do Preço do Petróleo

Fontes: Direcção do Fundo Petrolífero, Ministério das Finanças, 2010

Based on such information, seems that the government is optimistic with such prediction, that optimism is needed, however should follow with prudence and such conscience that the price of oil is fluctuate and could end up with situation called volatility price. The impact of such optimism among the government could be seen within Revenue Sustainability Estimation (RSE) 2014, where the number reached US\$ 632.2 million is due to Bayu-Undan expected production to be lower than previously thought. The Sources of income, based on 5 yearly projections, are coming from: FTP Income, Royalty Income, Taxes (pipeline tax, withholding tax, Resident Tax, Value Added Tax) and Income from Investment

Income for Petroleum Fund in Timor Leste is coming from petrol activity in Timor Sea and from taxes paid by International Oil Company toward government. Such income from petrol activities and taxes from oil and gas industry have been transferred into Petroleum Fund, and mainly coming from Bayu Undan, considered being resource of revenue toward Petroleum Fund. Future incomes for Petroleum Fund are the investment of such fund and those which are calculated to be coming from oil and gas reserve within onshore area. The calculation of such income from oil and gas reserve is within Bayu Undan. Up to this day, the income for Petroleum Fund is still coming from JPDA area such as Bayu Undan. This block is within production process and continually gives such income toward Timor Leste. Based on calculation of income, this block could contribute toward the state's income until 2023. The Timor-Leste Petroleum Fund has been gained such profit estimated as US\$ 16.6billion. This calculation is a result from such estimation toward oil and gas reserve within onshore area as well as income from oil activities during 23 years. Calculation change toward oil price and production volume brings significant impact toward Petroleum Wealth, from US\$ 16 billion into US\$ 24 billion, whenever the production is terminated.

Future Operation of Petroleum Fund Investment

In order to secure the sustainability in the future, good investment is needed therefore brings significant benefits toward future generation; especially when oil and gas resource is dry and the exploration stop. Within the preamble of Petroleum Fund Law, it stated that this fund consider as an instrument for good financial management and as a bridge to finance national development. This law also content such rules to regulate such investment therefore bring significant impact and reflect International best practices. International best practice applied within Petroleum Fund System in Timor Leste; Balance of control or distribution of power to guarantee such fund therefore does not concentrate within one person or institution. Distribution of role is:

Money/income which is coming from exploration and exploitation activities of oil and gas, directly transfer into Petroleum Fund within Bank of Federal Reserve America through the Authority of National Petroleum. Such proposal of State General Budget's plan should to make by the government whenever withdraw this fund, and submit to Ministries Council to be discussed before get its approval from National Parliament. National parliament in respect of approval, should to conduct consultation with Consultative Council of Petroleum Fund and civil society. Petroleum Fund in Timor Leste has been established in accordance with RDTL Constitution, and based on article 139 of this constitution, it stated that:

1. “Os recursos do solo, do subsolo, das águas territoriais, da plataforma continental e da zona económica exclusiva, que são vitais para a economia, são propriedade do Estado e devem ser utilizados de uma forma justa e igualitária, de acordo com o interesse nacional.
2. As condições de aproveitamento dos recursos naturais referidas no número anterior devem servir para a constituição de reservas financeiras obrigatórias, nos termos da lei.
3. O aproveitamento dos recursos naturais deve manter o equilíbrio ecológico e evitar a destruição de ecossistemas” “(5)”

The constitution of The Democratic Republic of Timor Leste, also stated that natural resources including oil and gas is state's property, and this property locate within onshore and offshore area based on continental platform and Economic Exclusive Zone of timor sea. It stated also that such resource should to utilize with justice, transparent and equity based on international interest. Petroleum Fund is established to manage and invest the entire income which is coming from petroleum activities within Timor Sea area as well as onshore area. In order to guarantee the sustainability of Petroleum Fund, based on petroleum fund law, sufficient and prudence of management as well as investment are needed. Therefore, in order to manage Petroleum Fund, income/money should to be invested out of the country, where the risk is minimum. Minister of Finance is the one who responsible in making such investment policy and receive certain advises from Accessory Committee of Investment and the Timor-Leste Central Bank which then making its operational management. The investment policy is made by the government trough Minister of Finance, and such investment should in accordance with International Practices. Based on Investment rule, written within Law of Petroleum Fund articles 14 and 15, it stated that: at 15.2 not less than ninety per cent (50%) of the amounts in the Petroleum Fund shall be invested only in qualifying instruments described in Article 15, shall be invested in eligible investments in the form of deposits or debt instruments that bear interest, namely fixed and variable rate bonds and fixed income securities, or other assets with a fixed return equivalent to interest, the article 15.3 mention that not more than ten per cent (50%) of the amounts in the Petroleum Fund shall be invested in eligible investments in the form of variable income investments, namely listed equities, in accordance with all procedures laid down in this Act, invested in financial instruments

Current Investment of the Timor-Leste Petroleum Fund

Investment which, recently being conducted is based on Law of Petroleum Fund, article 14 and 15. Since the amendment of the Petroleum fund law, the investment has diversify in to a variety of investment, up to now the diversification investment are 65% is within United States Treasury Bonds of America, meanwhile diversification of investment had just been conducted in 2009, with 94,4% of investment within United State Treasury Bonds managed by The Timor-Leste

Central Bank. Estimated as 5.6% or around 6% of investments have been diversified into other currency

The Timor-Leste Central Bank manage 80% within Global Portfolio, 27 from 5,6% of investment within currency like Euro, Japanese Yen, dollar Australia, and Pound Sterling UK. Now Timor-Leste Petroleum Fund stated that from 66% has invested in bond in US treasury bonds and 43% then being invested within Global Equities “(6)”.

External Manager of Bank of International Settlement manages 9.97% of investment in bonds index, Gestor de Transição, manages 10, 07% from portfolio global. Barclays global, ex: US, 30% Euro zone e 10%; Schroder Investment management limited, manage 5,73% from global portfolio and invest 100% in “Global Equities listed in developed market Exchange-MSCI Word Index Net dividend Reinvested”; State Street Global Advisors, manage 19,25% from the global portfolio. Global equity listed in developed market Exchange-MSCI Word Index Net Dividend Reinvested 100% and Black Rock manager, manage 9,15% of global portfolio in Global equity listed in developed market Exchange-MSCI Word Index Net Dividend Reinvested 100%. According to Petroleum Fund report of second trimester, income from such investment up to June 2014 counted as US\$ 16,6 billion.

Petroleum Fund Transparency

Timor-Leste established Petroleum Fund as a model of transparency and become as an instrument to manage natural resource. Transparency within Petroleum Fund is important, especially within certain process like exploration, exploitation and transfer toward state Account. This is also important, to guarantee that all information within this industry have been given correctly, as oil and gas resource itself has its limit of reserve, and when it happened we should knew the number of money which obtained from oil and gas exploration activity. Transparency within Petroleum Fund is necessary, since such fund have been in close connection with State General Budget process, therefore prevent from natural resource’s curse.

Transparency within Petroleum Fund investment have been conducted in accordance with petroleum Fund law No 9/2005, and based on such law the management system within Petroleum Fund of Timor Leste consider as third best in the world after Norwegian and New Zealand. Such honor toward Petroleum Fund system of Timor Leste gained as its implement power separation within its management; therefore do not concentrate within one institute however, among all entities who work in managing the sustainability of Petroleum Fund. In order to guarantee transparency within Petroleum Fund, Timor Leste had adopted international initiative as an instrument to demand the government as well as Oil Company to complete transparency system within Petroleum Fund in Timor Leste. The process of transparency within oil and gas industry in Timor Leste is excellent, as well as transparency within transfer system of oil and gas income, conducted by Oil Company. Transparency also has been well practiced within payment given by the company toward the state, and such income has been automatically transferred into Petroleum Fund. Such achievement within transparency practice had promoted Timor Leste as Complaint Country for Extractive Industry Transparency Initiative (EITI). This then make Timor Leste become as best of nation within the globe and first nation in South East Asia region of EITI become Complaint Country, since it successfully made such report in respect

of transfer of payment and income which coming from Oil Company and received by the government. This report received reconciliation from international auditor.

Transparency within the management of petroleum fund is necessary since Timor Leste consider as nations which receive huge of income mainly from oil and gas activity. This is also important to prevent from such curse, since natural resource especially oil and gas have its limit and couldn't be renewable, therefore need for good and transparent of investment whenever withdraw certain amount from petroleum fund, reassure its sustainability to support future generation.

The investment of Petroleum Fund within OGE is aimed to finance development process within areas like "Infrastructure, Education, Health, and Agriculture." Though transparency have been practice within transfer toward OGE as this should through long of process, however the results from such investment haven't been able to illustrate significant interest since as it entering implementation phase, execution of OGE is a problem. This situation happened since the government didn't have adequate development plan which reflect with the necessities of people. In addition, the unavailable of control system toward execution process of OGE had made Timor Leste came into nations of corruption, collusion and nepotism category.

Future Investment

Begin in 2010 and up to 2014, the investment toward Petroleum Fund is has using the amendment of Petroleum Fund Law No 9/2005 (with amendments 20 June 2011). This investment also based on Petroleum Fund Law, which 50% should to invest within bond while 50% invest within Global Equity.

Based on plan of IV Government, Petroleum fund Law No 9/2005 amendment should to adjust aimed to conduct diversification of investment from Petroleum Fund. The objective of diversification is to increase income from Petroleum Fund investment. Diversification is conducted by put them into other currency, therefore negative performance of one's investment could be concealed by positive performance of other investment within its portfolio. Based on prediction/analysis from MERCER Company which created in respect of income from Petroleum Fund investment, which then showed that the income will below 3% of RSE, policy then made by IV government aimed to conduct diversification toward Petroleum Fund Investment, therefore could gained sufficient of income.

Future Investment which proposed by the government is to change percentage of investment into Bonds 50% and Equities 50%. Such change has huge of risk toward Petroleum Fund, as up to this day global financial crisis is still happened which won't be in accordance with the objective of long term investment.

Government's Policy toward Investment:

The government through Ministry of Finance has been set such plan to alter investment policy toward Petroleum Fund. The alteration is by conducted diversification of investment into other currency, both toward bonds and global Equity, indeed toward Petroleum Fund law No 9/2005.

Alteration toward article 2.1.i Petroleum Funds Law no 09/2005; “Operational Manager within Petroleum Fund” based on government’s plan toward this article; stated that: “Operational Manager” means the Central Bank or any other public entity established by the National Parliament to manage the Petroleum Fund.”(7)”

In order to gain sufficient of income from such investment in the future, Ministry of Finance had set such plan to replace Operational Manager with Public Institution to become as manager. As interest is declined during this time, therefore Timor Leste needs such institution aimed to manage the investment from such fund. Based on reality, Timor Leste had established many of Public Institution however; transparency and accountability haven’t been performed correctly. In order to prevent from natural resource’s curse and to guarantee transparency and accountability within investment policy, Timor Leste has been supported by institution like Timor-Leste Central Bank which during this time become as Operational Manager for petroleum fund. This institution, has been showed its excellent of capacity and integrity during 5 years of service in respect of managing Petroleum Fund investment. In order to guarantee transparency and accountability within petroleum fund, detail explanation and justification is needed, therefore government had set such plan to alterate article 9.d.; proposal of alteration made by the government stated that: ‘Justification as to the reason why it is in the long term of Timor Leste to transfer an amount exceeding the Estimated Sustainable Income’.

As an alternative for amendment of the Petroleum Fund Law that there are two alternatives to be considered in order to maintain transparency and accountability: 1). Maintain article 9 Law No 9/2005 of Petroleum Fund and do not necessary to alterate it, since financial contribution from Petroleum Fund toward State General Budget is domestic investment itself. Therefore, detail of explanation and justification is needed in respect of interest prediction after such withdrawal through RSE. Withdrawal Criteria based on Estimate Sustainable Income (EIS)/Rendimento Estimadu Sustentavel (RSE) consider as practice of transparency and accountability toward the sustainability of petroleum fund. Such income from the investment could be within aspects of social and economic. Therefore, such withdrawal through RSE need for detail clarification since this could give information in respect of interest gained from petroleum fund investment. 2). The other alternative is to replaced point ”d” from article 9, or replace Rendimento Sustentavel Estimadu (RSE) into 3% - 4%. This article causes many of interpretation, depend on ones interest. Replace RSE into 3% or 4 % depend on real income from such financial investment and the capacity to execute State General Budget.

Meanwhile, in order to maintain the investment of Petroleum Fund, External Manager is needed as well, along with its excellent of qualification and performance, as well as credibility to manage such fund. Legal Collective Person is preferred than Legal Person, therefore guarantee that external manager could perform its duty and reassure that such fund wouldn’t be missing. External manager of Legal Person itself haven’t been able to manage this fund, since it is in contrary with transparency system of petroleum fund. Therefore in respect of decision to make, External Manager should through Legal Collective Person, since Legal Collective Person automatically coming from credible Institution thus able to justify transparency within such investment.

The policy toward Investment of Petroleum Fund made by the government should consist of equal percentage. Based on government's policy toward the investment, in order to get sufficient of interest diversification is needed as follow: 50% will be invested within Bonds and 50% will be invested within Global Equity. In order to get excellent of interest, diversification is strongly needed, however good of investment should to consider and always based on financial market situation. This signifies that, investment should to conduct with balance, transparent and accountable. Investment policy with equal percentage would bring huge of risk toward Petroleum Fund, since recently global financial crisis is still happened. Therefore Luta Hamutuk proposed options in respect of investment: maintain investment policy 90% into bonds and 10% into equity. In the same time, in order to get good of income, diversification should to conduct by put such investment into other currency. Excellent of income could be also gained by putting such investment into percentage like 75% into bonds and 25% into Equity. However, investment within equity should to perform gradually; therefore we will be able to follow its progress. The importance is that the investment into equity could be conducted within commercial banks which operate inside the country, therefore easy for Central Bank to conduct control function.

Luta Hamutuk's Opinion for the amendment of the law, appreciates such efforts which have been conducted by the government in making Petroleum Fund Law; therefore could bring benefits toward national development, though it should always reflect International Best Practices. The system of Petroleum Fund which recently applied inside the country have been reflected control balancing and power distribution, therefore didn't concentrate within one person or institution.

Fine sample of reality is when Petroleum Fund Law got its approval on 2005, after through such open consultation with many entities, including communities, thus finally get its approval from National parliament. Recently consultation has been conducted only with elite group; therefore do not reflect spirit of consensus. This is means that the Government didn't consider good of practices that is been done is the first legislature.

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