

**MANAGEMENT OF NATURAL RESOURCES IN SUB-SAHARAN AFRICA
KINSHASA CONFERENCE, 21-22 MARCH 2012**

Session 2: Operational Aspects of Fiscal Policy in Resource-Rich Countries (21 March at 11.30am)

Fiscal policy stands centre stage in resource-rich countries because natural resource revenue is finite and highly volatile. This raises complex issues of sustainability and intergenerational equity, and financial management and the appropriate savings vehicles, including Sovereign Wealth Funds. This session explores the operational aspects of fiscal policy from a theoretical and practical perspective.

Chair: Matata Ponyo Mapon, Minister of Finance, Democratic Republic of Congo

Panelists:

Sanjeev Gupta, Deputy Director, Fiscal Affairs Department, IMF

Emilia Pires, Minister of Finance, Timor-Leste

Joe Asamoah, Managing Director, EnerWise Africa

Olgario De Castro

Chairman

Investment Advisory Board

Timor Leste Petroleum Fund

Before I start I would like first to introduce myself. My name is Olgario de Castro and I chair the Investment Advisory Board of Timor Leste's Petroleum Fund. I would first like on behalf of the Minister of Finance, Minister Emilia Pires to note that she sends her apologies for not being able to be here and has asked me in her place to share our experience with regards to the management of Timor's Leste's Petroleum Fund.

I would first start by outlining in brief five Principles that Timor Leste has established with regards to overall transparency and governance of our natural resources. These five principles are commonly referred to in Timor Leste as the Timor Leste Transparency Model. The primary objective is to transform resources from the earth, in our case oil and gas, into transparent and sustainable economic growth, fundamental pre-requisites for the long term well-being of our people.

The Model utilizes a combination of independent and interdependent institutional tools and mechanisms to ensure a 360 degree chain of fiscal accountability from the point of extraction of the resource to the time of investment of the oil and gas proceeds, through a reliable public and shared systems of information.

The five principles are as follows:

- (1) Adherence to Global Standards**
- (2) Best Practice with regards to Sovereign Wealth management**
- (3) Education and Information**
- (4) Accountability and Accessibility**
- (5) Communications and Good Governance**

Principle 1

Adherence to Global Standards

This in our case means full compliance to EITI (the Extractive Industries Transparency Initiative). The practical outcome is that **all receipts** with regards to taxes and royalties are banked in the Timor Leste Petroleum Fund exclusively with full accountability. The inflow of funds are monitored by a Board with representatives from developing countries, donors, extractive industry companies, civil society organizations, investors and other international organizations to provide full accountability in accordance with applicable guidelines.

Timor Leste is the first country in Asia and the third in the world to be granted full compliance with EITI.

Principle 2

Best Practice with regards to Sovereign Wealth management

The Timor Leste Petroleum Fund was established in 2005 with the assistance of Norway to receive all petroleum receipts (taxes and royalties), and invest those proceeds in an optimal way to maximize its objectives. The Petroleum Fund is governed by the Petroleum Fund Law (as amended in 2011 primarily for flexibility in asset allocation). Its investment strategy was initially a simple strategy deemed necessary to avoid exposure to risks and volatility whilst building capacity. It also allowed time to build public support and confidence by avoiding volatility with regards to losses until a degree of integrity, credibility, and professionalism was earned by the three parties in the management of Timor Leste's Petroleum Fund.

The Petroleum Fund is managed by three parties:

- (1) The Investment Advisory Board (IAB) develops overall strategy, investment mandates and benchmarks and risk management
- (2) The Executive being the Minister of Finance on behalf of the government, makes all decisions except external manager selection
- (3) The Central Bank executes the decisions of the executive (the Minister of Finance) and makes the external manager selection decision.

There are six (6) main points that need to be made with regards to Timor Leste's Petroleum Fund:

- (1) All petroleum receipts are banked into the Petroleum Fund
- (2) All transfers out of the Petroleum Fund must be approved by Parliament through the budgetary process
- (3) Transfers from the Petroleum Fund to Budget is guided by the 3% Sustainable Guideline.

This provides a benchmark/ guideline on which to gauge the sustainability of the Petroleum Fund—an intergenerational check. The 3% Guideline is 3% not of our Petroleum Fund Balance which currently stands at USD \$10 Billion but on Petroleum Wealth. Petroleum Wealth is defined as Petroleum Fund Balance Plus the Present Value of Estimate Future Receipts into the Petroleum Fund. The estimates are prudent /conservatively calculated. Parliament has the authority to withdraw more than the 3% guideline and in our case we are doing that for our Strategic Development Plan by frontloading expenditure for public investments and human capital.

(4) Accordingly the investment strategy/policy over the long run needs to be aligned with the 3% transfer Guideline

(5) In the event that the Executive makes a decision that differs from Advice provided by the Investment Advisory Board (IAB) an explanation by the Executive needs to be provided to Parliament.

(6) The Petroleum Fund invests exclusively internationally. Domestic investments are made via the Budget and Parliament through the Infrastructure and Human Capital Funds and the General Budget via line Ministries.

(6) Adherence to the Santiago Principles. In Kuwait in 2008 Timor Leste and other countries established the International Forum of Sovereign Wealth Funds. The Forum has established generally accepted principles and practices that reflect appropriate governance, accountability, and investment guidelines and practices that are referred to as the Santiago Principles. Timor Leste adheres in full to these Principles.

(7) Annual Audit by Internationally Accredited Auditors of the Petroleum Fund financial statements and books with certification by the auditors of the 3% sustainable guideline.

Principle 3

Education and Information

Each year the Minister of Finance presents a Budget to National Parliament with each Minister

proposing and defending departmental budgets discussed with Parliamentary Committees. As approximately 50% of our people are illiterate the Government live telecasts to the Nation the 13 day Parliament Debate on the Budget through both radio and television. This provides institutional accountability and transparency and provides an avenue where the People can be educated and inform about the Budget process and outcome.

Principle 4

Accountability and Accessibility

The Government of Timor Leste has established the Timor Leste Transparency Portal (www.transparency.gov.tl). It is a gateway allowing interactive access to financial and non-financial information on the Government's ongoing efforts to Nation Build.

There are four (4) specialized portals:

- (1) Budget Transparency Portal
- (2) eProcurement Portal
- (3) Government Results Portal
- (4) Aid Management Portal

(1) **Budget Transparency Portal** (www.budgettransparency.gov.tl)

Allows the general public to access all budget and expenditure information from 2002 to date. This interactive site shows real-time data with daily automatic updates of all:

- (a) Budget
- (b) Commitments
- (c) Obligations
- (d) Actuals

expenditure for the current fiscal year. A useful feature is the exporting function that allows direct export from the portal to Excel, Word, XML and PDF formats.

(2) **eProcurement Portal** (www.eprocurement.gov.tl)

Allows the general public access to all currently open tenders being procured and lists all contracts from January 2010 to June 2011. It is being currently being updated. Aim is to obtain "Value for Money" of all goods and services being procured by the Government of Timor Leste by allowing international bids worldwide including National.

(3) **Government Results Portal** (www.governmentresults.gov.tl)

Allows the general public to access financial and physical progress to date on major projects currently underway in accordance with the national priorities outlined in the Strategic Development Plan. This portal is being constructed and will be operational in May 2012.

(4) Aid Management Portal (www.aidtransparency.gov.tl)

Allows the general public access to information on past, current and future Donor/Development Partners support to Timor Leste. Aim is to improve coordination between the Government of Timor Leste and Development Partners so as to reduce overlap/wastage and addressing better national priorities. This portal is being constructed and will be operational in May 2012.

Principle 5

Communications and Good Governance

The Council of Ministers in Timor Leste is the highest decision making authority and comprises the following:

- (a) Prime Minister
- (b) Vice-Prime Minister
- (c) Ministers with Portfolio
- (d) Secretaries of State.

Across the world the decisions made by similar bodies are made closed door with little known about the agenda, and the decision making process. The Government of Timor Leste with its transparency agenda has decided to publish all the decisions of the Council of Ministers within two days of the weekly Council Meetings. The decisions are published and archived on the official Government website and through Press Releases in English, Portuguese and Tetum to the public at large.

I would now like to share some of the ideas/vision and experience of our government to date.

The well being of Timor Leste and its people will ultimately be determined not by our natural resources but the productivity of our people. Today Timor Leste is one of the most oil dependent countries with the Petroleum Fund Balance of USD\$10 billion representing ten times our non-oil GDP. The country has a USD \$10 billion bank balance but is poor. The Government has launched the Strategic Development Plan with the aim of reducing our reliance on oil and to diversify our economy from oil to a non oil economy. It is a 20 year strategy, ambitious in objective as it projects on average double digit economic growth over that period in two stages:

Stage 1

First 10 years, economic growth driven primarily by public investments in infrastructure and human capital development through the Infrastructure Fund and Human Capital Fund.

Stage 2

Latter 10 years, economic growth driven primarily by Private Investment both foreign and National benefiting from regulatory reforms in Stage 1. The Strategic Development Plan has commenced with the electrification of the entire country with a national broadband. Other projects are on the pipeline.

In our Petroleum Fund management, an important feature is that the receipts from petroleum is separated from public spending via the Petroleum Fund and the 3% Transfer Guideline. This from a macroeconomic point of view allows for stability in government expenditure avoiding the volatility in expenditure associated with changes in oil prices and provides a platform for intergenerational wealth.

Spending too much may lead to high inflation (the so called Dutch Disease) resulting in waste, corruption and conflict. Establishing as we have an international acclaimed petroleum revenue framework we are committed as a government to use this windfall opportunity (the Petroleum Fund) to fast track infrastructure development and human capital. Most countries have failed in this endeavour, and we are conscious of this reality.

We have being fortunate in Timor Leste that we have the political will of our Prime Minister Xanana Gusmao to support us on this Road to ensure we shift the economic paradigm of our economy from oil to the non oil economy and in so doing change permanently the life outcomes of our people. We feel this permanent change to be sustainable must be driven by the productivity of our people, and transparency. It will not be our natural resources.

We believe full transparency assists political stability because it allows other stakeholders to have full information of our decisions avoiding mistrusts and misconceptions. It helps governance by containing mis-information from ambiguous sources and stakeholders. The Petroleum Fund investment policy is based on the principle of diversification and investing exclusively internationally.

The Petroleum Fund Law allows for 50% to be invested in equities, not less than 50% in bonds and up to 5% in alternatives. We have modeled our projected returns for the Fund and we have determined that a 40% Equity /60% Bond Asset Allocation will generate a 3% real rate of return comfortably, aligning the investment policy of the Petroleum Fund with our long term government fiscal policy, sustainably.

The Government appreciates the importance of macro economic stability as a premise of sustained economic growth. The dollarization of our economy removes monetary policy as a tool for governance and in so doing places greater reliance on fiscal policy as a tool to achieve our macro economic objectives.

The Infrastructure Fund and Human Capital Fund provide flexibility via multi-annual timelines giving the government the scope to bring forward or delay projects to assist macro economic policy and objectives, if required. The Infrastructure and Human Capital Funds, the main tools in the Strategic Development Plan (SDP) is aimed at creating a prosperous strong nation in the next 20 years. It covers three areas:

- (1) Social capital (education and training)
- (2) Infrastructure development (roads and electricity etc)
- (3) Economic development (agriculture, tourism, and oil and gas)

Main objectives: a strong, competitive diversified economy that is not dependant on oil income. Targeted public investments within a sound macro-economic framework is in our view the best way to improve the long term potential growth of our economy.

Non-oil growth has been strong since the government took office in 2007 driven by public expenditure. In the long horizon however Private Investment needs to be the driver of economic growth not public expenditure. Otherwise growth and prosperity is not sustainable. The Government of Timor Leste's strategy involves diversifying our economy from oil to non- oil ensuring sustainability. Transparency, accountability and productivity will be key ingredients for our success.