Timor-Leste case study:

Review of the Petroleum Sovereign Wealth Fund

Overview

Since independence, Timor-Leste has come a long way towards reconstructing a war-torn country and providing basic services and security to its population. Oil has been the main source of Government revenues, successfully managed in a Sovereign Wealth Fund since 2005. The fund now holds $16.2 billion[1] in investments which are channelled towards much needed infrastructure spending through mechanisms such as the ESI[2] and the Infrastructure Fund. However, despite good management of oil revenues, their use towards capital expenditures has not been effective, with inadequate infrastructure provision and underspending of capital funds. If availability of funds is not the main constraint, one must therefore question why this money is not generating better results.

Using Oil Revenue for Infrastructure Development

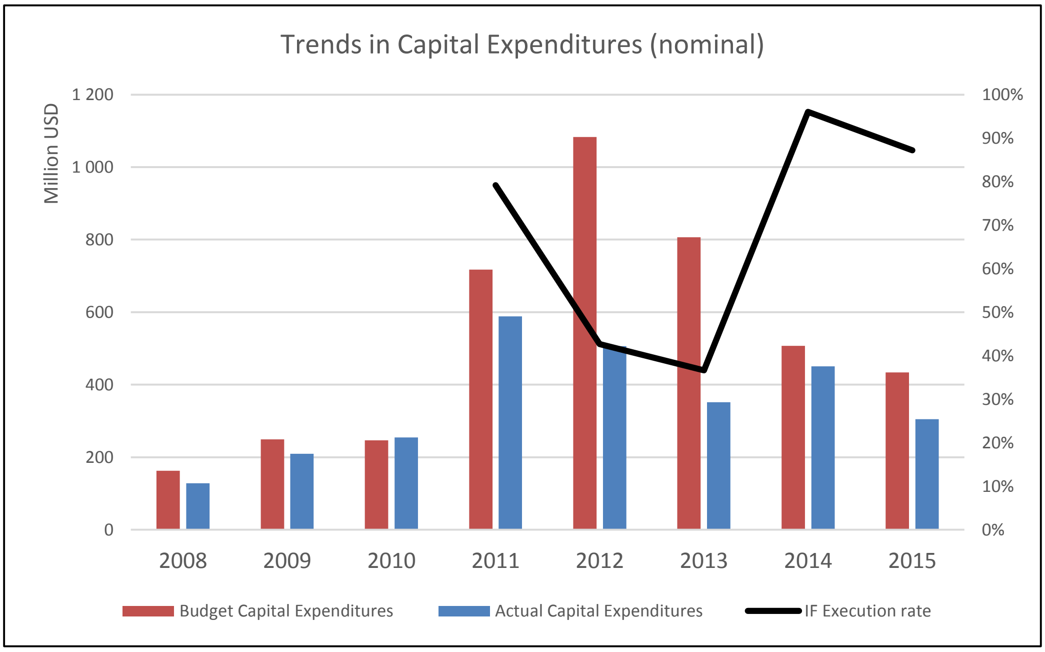
Upon independence in 1999, by some estimates 70% of Timor-Leste's previous stock of physical assets had been destroyed or was unusable and about 75% of the population was displaced (World Bank & GoTL, 2015). Oil extraction from the Timor Sea gave the Government access to a vast amount of resources which could be used to rebuild the state. Towards this end the Petroleum Fund was successfully established in 2005, now holding $16.2 billion dollars across equities, bonds and shares (equivalent to $13.5 thousand per capita). In terms of a statutory fiscal rule, 3% of the net petroleum wealth is transferred to the state budget every year (the ESI); however the Government can also withdraw funds in excess of the ESI for the purpose of necessary infrastructure with prior approval from Parliament.

The provision of infrastructure has been a core pillar of Government policy, resulting in some of the highest rates of infrastructure spending in the world, peaking at $534 million in 2011 (around half of total expenditure and non-oil GDP) (World Bank & GoTL, 2015). That same year the Government set up the Infrastructure Fund (IF), a multiyear, revolving fund which has since channelled more than 85% of public infrastructure expenditure (World Bank & GoTL, 2015). The idea of the Infrastructure Fund was to improve the management and allocation of resources towards large scale infrastructure projects. However, infrastructure spending has not been optimal and in 2012/13 the IF execution rate fell significantly as infrastructure budgets were underspent each year. The new power plants and related electrification projects implemented in 2012/13 increased access to electricity from 22% to 53% of the population in six years, but at a comparatively high cost to the Government. Spending on irrigation systems has not yielded much return on investment and the condition of the road network has not considerably improved in recent years (World Bank & GoTL, 2015).

The GoTL however recognising the under capacity to plan and spend efficiently on large capital projects resorted to reducing the planned infrastructure budget resulting in a more balance execution rate.

[1] As of the 31st December 2015.
[2] ESI is the Estimated Sustainable Income, equal to 3% of the net petroleum wealth.

With the large infrastructure projects implemented, albeit more slowly than anticipated, execution improved in recent years, however, planning for new ports, airports, refineries (as are being planned), could result in under expenditure of infrastructure budgets if the Government is not careful.



Source: Timor-Leste Transparency Portal

From a revenue management perspective there is an opportunity cost to misallocation of petroleum revenues and underspending of capital funds in 2012/13, resulted in foregone interest returns from the Petroleum Fund and rolling over of funds towards other Government accounts.[3]

Questions for discussion:

Based on the information provided in the case study above, consider the following:

1. What do you think are the important factors affecting Timor-Leste that have made the Petroleum Fund successful?
2. What are the important factors affecting Timor-Leste that have exacerbated the weak spending?
3. Could this situation have been improved if the absorptive capacity of the economy had been a more central issue when designing allocations for capital spending – ie. Does a successful sovereign wealth fund equate to a successful fiscal rule?

[3] World Bank and Government of Timor-Leste (2015): Timor-Leste Public Expenditure Review: Infrastructure. http://documents.worldbank.org/curated/en/2015/03/24527342/timor-leste-public-expenditure-review-infrastructure