VIII GOVERNO CONSTITUCIONAL

OGE

GENERAL STATE BUDGET 2023

PRODUCTIVE INVESTMENT AND INCLUSIVE GROWTH FOR FUTURE GENERATIONS

REPORT

Table of Contents

Executive Summary 7

1. Fiscal Strategy and Public Finances 10

   A New Budget and Public Finance Management Framework 10

   Fiscal Strategy 11

   Macro-Fiscal Overview 12

2. Budgetary Policy 17

   Government Priorities and Measures for 2023 17

   Budget Transparency and Accountability 29

3. Revenue and Financing 40

   Revenue 41

   Financing 43

   Fiscal Sustainability Analysis 53

   Fiscal Risks and Contingent Liabilities Statement 56

Methodological Annex 62

Elements of the Budget Report by entity responsible

Elements	Entity
Budget strategy	GMF
Projections of the main macroeconomic indicators with influence on the OGE and its evolution	DGPO/DGE
Evolution of the financial situation of the General Government and its subsectors	DGT
Budget execution performance of the previous budget year	DGT
Evolution and sustainability of the Petroleum Fund	DGGMRE
Evolution and sustainability of public debt	GPRCGFP
Status of treasury operations and accounts of the treasury	DGT
Forecast of tax revenue and lost tax revenue	AA/AT
General lines of budget policy and programs	DGPO
Budget management rationalization measures	DGPO
Temporary and permanent fiscal policy measures	DGPO
Fiscal risk analysis	DGPO
Information on contingent liabilities of the General Government	DGPO
Annual and multi-annual expenses with public-private partnerships and the respective global indebtedness situation	DGGMRE
Information on late payments of the General Government	DGPO/DGT
Comparison between the macroeconomic and budget forecasts used and forecasts made by international reference bodies	DGPO
Comparison between the macroeconomic and budget forecasts used in the OGE law for the previous budget year and the actual evolution observed	DGPO

List of Tables and Figures

Table 1: Revenue and Expenditure Breakdown 7

Table 2: Macroeconomic Overview 7

Table 3: Economic Indicators, 2020-2027, % 12

Table 4: National Accounts 2016-2021 $m 12

Table 5: Growth Indicators, 2020-2023, % 14

Table 6: Global and Regional Inflation Rates (%) 14

Table 7: OGE Distribution by Functional Classifications for Social protection (US$) 29

Table 8: Distribution of Budget according to Gender Marker 30

Table 9: Distribution of Budget by Child Marker 31

Table 10: Distribution of Budget by Nutrition Marker 32

Table 11: Distribution of Budget by Climate Marker 33

Table 12: Distribtion of Budget by Value Chain Marker 35

Table 13: Proposed Allocation to Municipal Authorities, $ 36

Table 14: Budget Balances in US$ 41

Table 15: Details source of Financing to Central Administration, 2023-2027, $millions 44

Table 16: Estimates for the Petroleum Fund ($m) 44

Table 17: Central Government and RAEOA cash balance in the end of 2021 in US$'000 46

Table 18: Central Government and RAEOA cash balance in August 2022 in US$'000 47

Table 19: Amount of Public Debt as of August 2022 in $ million 48

Table 20: Cost of borrowing % 48

Table 21: Direct Budget Support in the 2023 General State Budget in US$ millions 50

Table 22: Government Program Support by Australia US$ millions 50

Table 23: 2023 Top 10 donor projects with highest scheduled non-lending disbursements in $US millions 52

Table 24: Changes in historic National Accounts /preliminary/ forecast figures in % 63

Table 25: GDP growth forecasts of different institutions in % 64

Figure 1: Real non-oil GDP growth rate (RHS, %) and levels (LHS, $m) 13

Figure 2: Recent Change in Consumer Price Index Timor-Leste Dec 2020-Aug 2022 (%) 15

Figure 3: Commercial Interest Rates and Credit 16

Figure 4: Employment 2010-2021, 000’s of people 16

Figure 5: OGE distributions in the social capital sector by class function (excluding FCLN) 18

Figure 6: Government spending on the real economy and productive infrastructure 19

Figure 7: Flagship programs to promote equitable and inclusive growth in 2023 20

Figure 8: Distribuição do OGE por Áreas Estratégicas do GOP (USD milhões) 22

Figure 9: Comparison of 2021 Expenditure, rectified 2022 Budget and proposed 2023 Budget by PED 35

Figure 10: Comparison of Budget 2021, Rectified Budget 2022 and Proposed 2023 Budget by COFOG 36

Figure 11: Domestic Revenue Forecasts, $millions 42

Figure 12: Development Partner Non-Lending Disbursements 2018-2025 in USD Millions 51

Figure 13: 2023 % Planned Non-lending Disbursements by Donor Group* 52

Figure 14: Estimated Petroleum Fund Balance under Current Trends, $millions 54

Figure 15: Estimated Petroleum Fund Balance with moderate Spending Cuts, $millions 55

Figure 16: Estimated Petroleum Fund Balance with moderate spending cuts and the introduction of VAT and Property Tax, $US millions 56

Abbreviations

Asian Development Bank	**ADB**
Autonomous Agencies	AA
Autonomous Service of Medicines and Health Equipment	SAMES
Capital Development	CD
Classification of the Functions of Government	COFOG
Council of Administration for the Infrastructure Fund	CAFI
Consolidated Fund of Timor-Leste	CFTL
Consumer Price Index	CPI
Dalan Ba Futuru (Timor-Leste)	DBF(TL)
Democratic Republic of Timor-Leste	RDTL
Development Partner	DP
Direct Budget Support	DBS
Timor-Leste National Police	ETNP
European Union	EU
Falintil - Defence Force of East Timor	F-DFTL
Financial Management Information System	FMIS
General State Budget/ Orsamentu Jerál Estadu	GSB/ OJE
Government of Timor-Leste	GoTL / GovTL
Gross Domestic Product	GDP
Human Capital Development Fund	FDCH
Infrastructure Fund	IF / FI
Integrated Financial Management Information System Unit	IFMISU
Integrated Municipal Development Program	IMDP (PDIM)
National Institute for Health	INS
International Development Agency	IDA
Laboratory National	LABNAS
Line Ministries	LM
Ministry of Agriculture and Fisheries	MAP
Ministry of Defence	MD
Minor Capital	MC
Ministry of Education including SEJD	MEJD
Ministry of Finance	MoF
Ministry of Health	MoH
Ministry of Interior	MI
Ministry of National Liberation Combatant Affairs	MACLAN
Ministry of Public Works	MoP
Ministry of Social Solidarity and Inclusion	MSSI
Ministry of Tourism, Commerce and Industry	MTCI
Ministry of Transport and Communications	MTC
National Communication Agency	ANC
National Development Agency	ADN
National Directorate of Budget	DNO

National Intelligence Agency	SNI
National Police of Timor-Leste	PNTL
Organization of the Petroleum Exporting Countries	OPEC
Petroleum Fund	PF
Planning, Monitoring and Evaluation National Agency	ANAPMA
Programme Budgeting	PB
Public Financial Management	PFM
Public Service Commission	PSC/CFP
Public Private Partnerships Unit	PPPU
Public Transfers	TP
Quarter 1	Q1
Quarter 2	Q2
Real Effective Exchange Rate	REER
Self-Funded Agency	SFA
Salaries and Wages	SW
Secretariat of State for Art and Culture	SEAC
Secretariat of State for Environment	SSE/SEA
Secretariat of State for Youth and Sport	SEJD
Social Security Fund	SSF
Special Administrative Region of Oe-Cusse Ambeno - Special Zones of Social Market Economy	RAEOA-ZEESM
Strategic Development Plan	SDP/PDE
United Nations Development Program	UNDP
World Bank	WB

Executive Summary

Fiscal Strategy

The theme of the 2023 General State Budget proposal is: ***Productive Investment and Inclusive Growth for Future Generations***

Considering that Timor-Leste relies heavily on the Petroleum Fund to finance the General State Budget and that the natural resources that contribute to the Petroleum Fund are finite, Timor-Leste's fiscal strategy endeavours to diversify the economy away from reliance on natural resources, while creating jobs, reducing poverty and promoting economic growth.

The government is adopting the following priorities:

• Mobilising domestic revenues and introducing new tax initiatives.

• Making increasing use of alternative sources of financing such as concessional and commercial loans and treasury bills.

• Focusing government expenditure on quality over quantity through moving from traditional line-item budgeting and improving annual and medium-term program budgeting which focuses on impact rather than execution.

For the 2023 General State Budget, the choice of expenditures has been selected in order to align with a sustainable fiscal strategy, through promoting productive investment in the real economy as the engine for inclusive growth, investing in social capital to guarantee the present and future welfare of Timorese people and prioritizing social inclusion and gender-sensitive policies to ensure nobody is left behind.

As set in the Grand Planning Options Law, the Government proposes, in the 2023 General State Budget, expenditure amounting to US$3,155,715,306.

Table 1: Revenue and Expenditure Breakdown

Subsectors	Revenue	Expenditure
Central Government	2,800,000,000	2,800,000,000
Social Security	235,715,306	235,715,306
RAEOA	121,206,835	120,000,000
Total	3,156,922,141	3,155,715,306

Source: General Directorate of Budget and Planning, Ministry of Finance, September 2022

Macro-Fiscal Overview

2021 saw a rebound in economic growth of 2.9% after negative growth in 2020. This was due to better-than-expected activity related with businesses and the private sector. The recovery in the economy is set to continue with stable and steady growth forecasts in the medium term.

Table 2: Macroeconomic Overview

Summary	Actual		Forecast					
	2020	2021	2022	2023	2024	2025	2026	2027
Real GDP (non-oil) %	-8.3	2.9	3.3	3.5	3.6	3.5	3.4	3.6
Inflation CPI %	0.5	3.8	7.2	5.5	3.3	2.8	2.6	2.4

Source: GDP/Inflation 2020- 2021= DG Statistics, National Accounts, GDP /Inflation Forecast 2022-2027= National Directorate of Economic Policy, Ministry of Finance, September 2022.

Domestic inflation is expected to reach 7.2% by the end of 2022. This is mainly due to the increase in world oil and food prices due to supply disruptions caused by the war in Ukraine. Despite this, the forecast has been reduced from 7.8% slightly following a recent easing in the world prices. Inflation is set to reduce in 2023 going forward, in line with the latest IMF estimates.

Budget Policies

The 2023 General State Budget proposal is formulated based on the following VIII Government Strategic Objectives aimed at providing to all citizens as a whole:

1. Opportunity to have a healthy, secure, and long life
2. Access to knowledge, technology, and innovation
3. Access to sufficient resources to guarantee life with dignity.

With these three strategic objectives and goals in mind, the Government's agenda for inclusive development aspires to promote holistic well-being for the people and foster an environment for its people to live, contribute and participate in the economic development of the country.

Such an ambition requires the development of liveable communities, which includes providing access to quality education, healthcare, water and sanitation, social protection, basic infrastructures, and major investments in the productive sector to recover and diversify the economy.

The 2023 General State Budget supports the development of public capital and infrastructure so that the Timorese economy can keep growing in a sustainable and inclusive way, connecting the country through an ambitious network of roads and bridges, taking electricity supply to every suco and village, and supporting the connectivity of Timor-Leste in the world economy through an expansion of ports and harbours, and the construction of a submarine cable to Australia for high-speed internet. This will be coupled with supporting growth of fledging industries such as agriculture, agroindustry, manufacturing and tourism.

Roughly 36% of the 2023 General State Budget will be allocated to the social capital sector, which includes health, education and social protection. This is equivalent to US$772 million and makes out of the social capital sector the largest recipient of budgetary resources in 2023, reflecting the importance given to universal access to quality education (US$137 million) and healthcare (US$92 million) and social protection (US$301 million), especially for vulnerable segments of society.

Revenue and Financing

The total budgeted expenditure for 2023 is higher than the domestic revenue that will be collected over the same period. This results in a non-oil deficit (domestic revenue minus expenditure). This deficit is financed through several sources: withdrawals from the Petroleum Fund, loans, the use of the cash balances (from many sources) and Budget Direct Support from the European Union and Government of Australia.

Domestic revenues are expected to reach US$153.7m this year. They are expected to rise to US$174.9m in 2023 as a result of the introduction of new tax rates.

The Estimated Sustainable Income (ESI) of the Petroleum Fund is estimated to be US$490.1 million in 2023. The Government plans to withdraw US$855.9 million in excess of the ESI for annual budget 2023. This is a significant decrease from the forecast excess withdrawals in the 2022 General State Budget, which totalled US$1,998.5 million.

Fiscal Sustainability

Timor-Leste is highly dependent on the Petroleum Fund to finance the fiscal deficit; therefore, this is the main focus of any fiscal sustainability analysis. The long-term sustainability of the Petroleum Fund is dependent not only on this year's choice of budget, but also the choices made for subsequent years.

The analysis shows that under the current expenditure trend, the Petroleum Fund will run out in 2034. At this point the gap between domestic revenues and government spending could be as high as US$1.6bn.

Gradual spending cuts can extend the lifetime of the fund until at least 2044. If such cuts are combined with the introduction of VAT and property taxes the fund could last until at least 2049. Further improvements to fiscal sustainability can also be ensured if the investment projects laid out in the budget are successful in leading to economic growth and prosperity.

Fiscal Risks and Contingent Liabilities Statement

This year's budget report contains the country's flagship fiscal risk statement. Fiscal risks are fiscal outcomes that deviate from expectations or forecasts. They can arise from macroeconomic shocks or as result of contingent liabilities. Contingent liabilities are spending obligations that arise when a particular event occurs to trigger them. For example, a natural disaster might lead to government spending obligations such as social assistance programs.

Timor-Leste has a few contingent liabilities including those stipulated by law such as contracts, such as PPPs, government backed guarantee schemes and legal awards and claims. These contingent liabilities could lead to legal obligations on the government to spend more than anticipated if they are realised. There are also contingent liabilities such as natural disasters where, the government may not have a legal obligation to increase spending but may face a moral obligation to do so.

The budget this year has allocated US$66m for the purpose of contingency funding. If fiscal risks lead to government spending increasing beyond this level, the government can rely on withdrawals from the Petroleum Fund.

1. Fiscal Strategy and Public Finances

A New Budget and Public Finance Management Framework

1.1. The draft budget 2023 is the first presented under the new public finance management rules approved by Law 2/2022, Budget and PFM Framework Law, publish on 10 February 2022, which replaced Law No 13/2009, on General State Budget and public finance management.

1.2. The new Budget and PFM Framework Law is the culmination of the PFM reform initiated in 2015 with the aim of aligning Timor-Leste's PFM regulations with the best international practices.

1.3. The new law enshrines programme budgeting as a means of preparing and organising the General State Budget, adding substantial elements of planning to all phases of the budgetary process.

1.4. Budget classifications were revised and expanded, namely through a new economic classification and the adoption of functional classification, based on the classification of the functions of government, abbreviated as COFOG, developed by the Organisation for Economic Co-operation and Development and published by the United Nations Statistical Division as a standard classification of government activities, ensuring comparability of Timor-Leste's accounts with those of other countries.

1.5. The new law adopts a "two-step" budget process, with a Grand Planning Options Law approving the budget ceiling at the start of the budget process in May and the General State Budget law approving the budget allocations in October, allowing the Parliament to have an early input on the budget ceiling and the main priorities of the budget.

1.6. A new budget calendar is implemented with the 2023 budget process, starting in May, and bringing forward the date of presentation of the General Budget Law from October 15th to October 1st, to avoid extending the previous year Budget Law, as it has happened four times in last six years.

1.7. The new law significantly increases transparency, responsibility, accountability and control of the Public Finances, providing more information to the National Parliament for a more informed decision.

1.8. Some changes impact the structure of the Budget law and the Budget tables, as well as the documents that accompany the Budget Proposal, namely, the budget law is streamlined, as much of the content that was previously feature in the law, like definitions, the financial regimes and the budget classification, are now included in the Budget and PFM Framework Law, as well as in secondary legislation, and the budget tables are now clearly defined and include three tables for the General Government revenue and expenditure, including by functional classification, and three tables each for the Central Government, Social Security and RAEOA revenue and expenditure, including by programme structure, organic and economic classification.

1.9. The new economic and functional classifications represent a considerable progress towards a more transparent and efficient budget. The classifications, regulated by Government Decree 19/2022, of 11th May, allow for a detailed organization of revenue and expenditure by type and function and follow the best international practices.

1.10. The documents that accompany the Budget Proposal were reorganized in three parts: the Report, the Budget Developments and the Informative Elements. The Report present budget policy and analyses the main variables with impact on the budget. The budget developments present the revenue and expenditure of each budget entity specified up to the maximum levels of disaggregation, according to the programme structure and by organic and economic classifications. Finally, the Informative Elements present all the additional relevant information necessary to understand the budget proposal and well and the financial situation on the General Government.

Fiscal Strategy

1.11. The Fiscal strategy lays out the main objectives and priorities of the General State Budget and gives the rationale for the path pursued by the fiscal policy, while conforming with sound fiscal management principles.

1.12. Considering that Timor-Leste relies heavily on the Petroleum Fund to finance the General State Budget and that the natural resources that contribute to the Petroleum Fund are finite, Timor-Leste's fiscal strategy endeavours to diversify the economy away from reliance on natural resources, i.e., the Petroleum Fund, while creating jobs, reducing poverty and promoting economic growth.

1.13. Timor-Leste has exceeded withdrawals of the Petroleum Fund beyond the Estimated Sustainable Income (ESI) since 2009, pursuing a policy of frontloading to finance infrastructure investments in an effort to kickstart economic growth.

1.14. However, petroleum revenue in diminishing and therefore sound fiscal plans are key to avoid a fiscal cliff in the short term, i.e., a dramatic fall in government expenditure if alternative sources of financing do not fill the gap.

1.15. The government is adopting the following priorities:

- Mobilising domestic revenues and introducing new tax initiatives.
- Making increasing use of alternative sources of financing such as concessional and commercial loans and treasury bills.
- Focusing government expenditure on quality over quantity through moving from traditional line-item budgeting and improving annual and medium-term program budgeting which focuses on impact rather than execution.

1.16. For the 2023 General State Budget, the choice of expenditures has been selected in order to align with a sustainable fiscal strategy, through promoting productive investment in the real economy as the engine for inclusive growth, investing in social capital to guarantee the present and future welfare of Timorese people and prioritizing social inclusion and gender-sensitive policies to ensure nobody is left behind.

1.17. Therefore, the theme of the 2023 General State Budget proposal is: ***Productive Investment and Inclusive Growth for Future Generations***

1.18. The draft budget takes a decisive step towards achieving the fiscal goals.

1.19. New revenue measures are established in the budget, namely and increase in the excise tax on sugar, sugary drinks, tobacco and luxury cars, as well as an increase on import duties.

1.20. We also anticipate that the new tax law and tax procedure code will be presented to Parliament in the next few months setting the stage for an overhaul of the tax revenue system.

1.21. In 2023 the Government plans to regulate and issue the first treasury bills, geared towards local institutions and funds, which will deliver a new source of revenue for the Government and lower the cost of financing.

1.22. The planned opening of Tibar Port and the conclusion on some major road developments show the success of PPPs and Concessional loans, allowing the Government to rely further on these tools for productive investment.

1.23. Finally, the draft budget moves away from traditional line-item budgeting and a purely quantitative view to a focus on quality and performance by adopting programme budgeting which values impact rather than execution to better monitor the effects of the budget on economic growth.

1.24. As the Covid-19 pandemic continues to dissipate in comparison with the previous years, the government is not complacent in protecting the most vulnerable and promoting productive investment.

1.25. The government will invest in the real economy in order to expand economic opportunities for Timorese people across the country and reduce economic dependence on the Petroleum Fund or emigration.

1.26. The 2023 General State Budget supports the development of public capital and infrastructure so that the Timorese economy can keep growing in a sustainable and inclusive way, connecting the country through an ambitious network of roads and bridges, taking electricity supply to every suco and village, and supporting the connectivity of Timor-Leste in the world economy through an expansion of ports and harbours, and the construction of a submarine cable to Australia for high-speed internet. This will be coupled with supporting growth of fledging industries such as agriculture, agroindustry, manufacturing and tourism.

1.27. Diversifying the economy and the tax base and ensuring productive investment and inclusive growth is the best strategy for ensuring that the medium- and long-term national goals are achieved.

Macro-Fiscal Overview

Table 3: Economic Indicators, 2020-2027, %

Summary	Actual		Forecast					
	2020	2021	2022	2023	2024	2025	2026	2027
Real GDP (non-oil) %	-8.3	2.9	3.3	3.5	3.6	3.5	3.4	3.6
Inflation CPI %	0.5	3.8	7.2	5.5	3.3	2.8	2.6	2.4

Source: GDP 2020= DG Statistics, National Accounts, GDP Forecast 2021-2027= National Directorate of Economic Policy, Ministry of Finance, September 2022.

1.28. Timor-Leste experienced GDP growth averaging 3.1% per year over 2001-2021. These growth rates were higher in the early 2010s and were driven by the government's economic strategy of fiscal frontloading to ensure that Timor-Leste has the necessary infrastructure to allow the private sector to flourish in the long run.

Table 4: National Accounts 2016-2021 $m

	2016	2017	2018	2019	2020	2021
Private Consumption	970.1	1000.3	1017.0	1054.8	1022.3	995.0
Public Consumption	926.6	872.8	870.3	897.9	941.6	974.9
Total Consumption	1896.7	1873.0	1887.3	1952.6	1963.9	1969.8
Private Investment	126.1	142.8	68.8	67.3	56.2	50.9

Public Investment	527.2	401.5	467.6	375.9	198.5	170.6
Total Investment	653.3	544.3	536.4	443.2	254.6	221.5
Other (*)	26.3	42.8	46.2	54.1	51.6	25.4
Total National Expenditure	2576.3	2460.2	2469.9	2449.9	2270.2	2216.7
Exports	52.6	32.1	37.4	31.0	15.1	38.2
Imports	980.6	894.3	920.3	860.8	799.5	726.7
Non-oil Real GDP	1648.4	1598.0	1587.0	1620.0	1485.8	1528.2
% Change GDP	**3.4**	**-3.1**	**-0.7**	**2.1**	**-8.3**	**2.9**

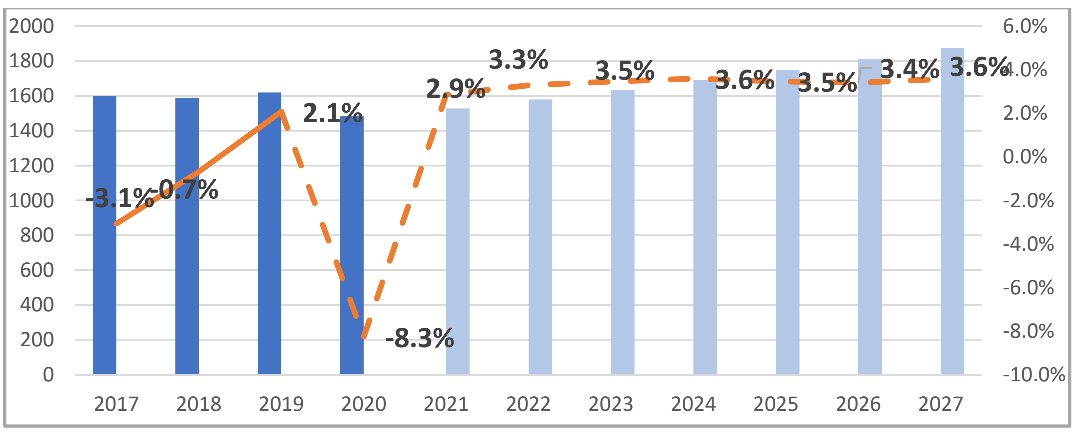
Source: National Accounts, Directorate General of Statistic, September 2022

1.29. Government investment has enabled a significant upgrade to road and electricity coverage throughout Timor-Leste, which has helped to improve both living standards and the business environment. However, negative economic growth in 2017, 2018 and 2020 have undermined the progress made.

1.30. Public sector investment in 2020 was constrained by the duo-decimal system, political uncertainty and the Covid-19 pandemic. In 2021, despite the Covid lockdown, the impact of Cyclone Seroja and a low execution of government capital and development, non-oil real GDP in Timor-Leste increased by 2.9% to US$1,528.2 million which was better than expected.

1.31. The Timor-Leste economy is forecast to return to positive stable growth rates over the medium term.

Figure 1: Real non-oil GDP growth rate (RHS, %) and levels (LHS, $m)



Source: Timor-Leste National Accounts 2000-2021, General Directorate of Statistics; 2022-2027 Economic Forecasts, National Directorate of Economic Policy, Ministry of Finance, September 2022.

1.32. The 2022 budget allocation is particularly large due to the increase in the budget ceiling following the rectified budget in May 2022 (US$3.4 bn). However, this will not have a significant effect on GDP which is forecast to grow 3.3%, as US$1bn will be reserved for the National Liberation Combatants Fund (FCLN), which will be invested in the financial markets for future revenue.

1.33. Growth forecasts has been adjusted up slightly to reflect more positive investment indicators. A main driver of growth for 2022 is the strong execution on Tibar Port which is a significant PPP project for the economy (For information why there are changes to historic National Accounts numbers and how GDP is forecasted please see Methodology Annex).

1.34. In 2023 GDP is due to grow 3.5% due to a return to pre-COVID private investment levels and political stability. 2024-2027 economic growth is expected to be stable and steady.

1.35. Global growth outlook is projected to slow from 3.2% in 2022 to 2.9% in 2023. In Advanced Economies and emerging and developing economies are forecast to grow at 2.5% and 1.4% respectively in 2022 and 2023. The War in Ukraine and the ongoing pandemic are the main factors that contributed to the significant slowdown in growth in 2022 and added to inflation. China is projected to grow at 3.3% in 2022 compared to 2021 which was 8.1%.

Table 5: Growth Indicators, 2020-2023, %

Region/Country	Actual		Forecast	
	2020	2021	2022	2023
World	-3.1	6.1	3.2	2.9
Advanced Economies	-4.5	5.2	2.5	1.4
Emerging and Developing Economies	-2.0	6.8	3.6	3.9
Emerging and Developing Asia	-0.8	7.3	4.6	5.0
China	2.2	8.1	3.3	4.6

Source: IMF World Economic Outlook, July 2022.

1.36. Consumer Prices are expected to increase, with global inflation forecast at 8.3% by the IMF in 2022 and 5.7% in 2023.

1.37. Rising inflation reflects the impact of higher demand and lower supply due to the war in Ukraine and sanctions on Russia.

1.38. The increase in oil prices, have contributed to the rise in inflation in advanced economies, however this is projected to recover in the coming years.

1.39. For emerging market economies, inflation has risen, reflecting the impact of currency depreciation and higher commodity prices which increases the prices of imported goods, but it is projected to moderate in 2023.

Table 6: Global and Regional Inflation Rates (%)

Country	Actual		Forecast	
	2020	2021	2022	2023
World	3.2	4.7	8.3	5.7
Advanced Economies	0.7	3.1	6.6	3.3
Emerging and Developing Economies	5.2	5.9	9.5	7.3
Timor-Leste*	0.5	3.8	7.2	5.5

Source: IMF World Economic Outlook July 2022. *Ministry of Finance forecast, September 2022.

1.40. Oil prices are important to Timor-Leste both for consumers, and as an oil exporting country. Global demand for oil drastically declined at onset of the Coronavirus pandemic down to US$21.0/barrel in April 2020 but then started to rise sharply and reached US$116.8 per barrel in June 2022 due to the war in Ukraine. Prices are expected to slowdown in the near future and already seeing some moderation.

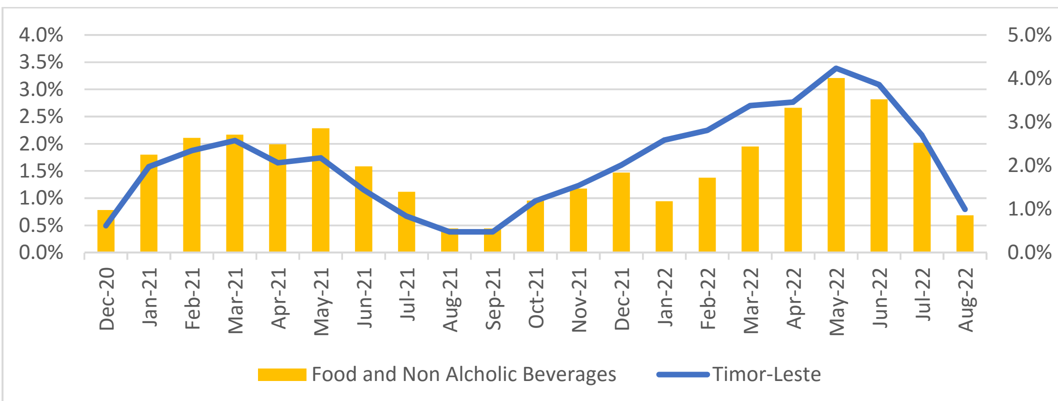
1.41. Due to the significant weight of food and non-alcoholic beverages in the CPI basket and the high proportion of food imported into Timor-Leste every year, international food prices remain one of the key drivers of the overall CPI rate, thus changes in international food prices can have a significant impact on both the rate of inflation and standard of living.

1.42. During 2022, the increase in commodity prices is in line with supply disruption, the war in Ukraine and sanctions on Russia, however, the World Bank is forecasting that the food prices index will moderate by December 2022. This will have a positive effect on poorer households where basic foods make up most of their spending.

1.43. Timor-Leste's level of inflation has seen a strong increase over the last year. In August 2022 YoY inflation in Timor-Leste was 7.9%; this means that a basket of goods and services that cost US$100.00 in August 2021 cost US$107.9 in August 2022.

1.44. YoY food and non-alcoholic beverage inflation in August 2022 was 8.3%, higher than the increase of 3.9% witnessed last August. This is mainly due to the strong increase in world oil prices, as a result of the war in Ukraine, pushing up import and food prices as explained above.

Figure 2: Recent Change in Consumer Price Index Timor-Leste Dec 2020-Aug 2022 (%)



Source: General Directorate of Statistics, Ministry of Finance, September 2022.

1.45. DNPE forecast inflation using the latest IMF World Economic Outlook annual forecast figures for global inflation and key indices and commodities such as food and oil as well as the monthly updated CPI data from DG Statistics.

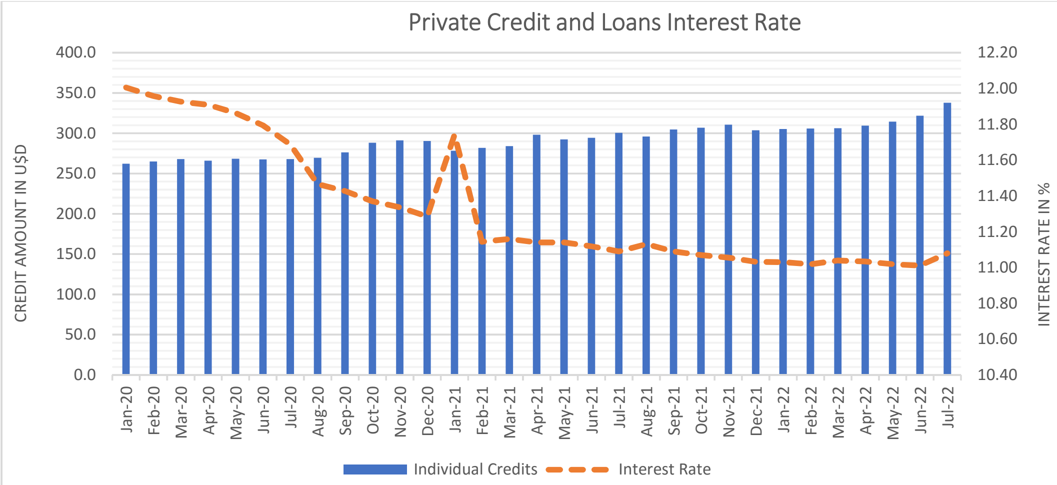
1.46. The effective exchange rate is the exchange rate of a country's currency, measured as the weighted sum of the exchange rates with its commercial partners. The real effective exchange rate (REER) is adjusted for the effects of inflation and is a better measure of competitiveness.

1.47. Between August 2021 and August 2022, the REER appreciated 5.7%. Over this period the REER appreciated by 3.7% against a weighted Thai Baht and Vietnamese Dong basket. This real appreciation places downward pressure on rice prices and inflation in Timor-Leste (as Thailand and Vietnam export large quantities of rice to Timor-Leste).

1.48. The amount and cost of credit to the private sector is an important indicator for private sector development.

1.49. The average interest rate on loans to private businesses has fallen since January 2020, averaging 11.1% in lasts 12 months. Total domestic credit, excluding general government, was US$337.7 million in July 2022 and private loans increased by 12.4% in July 2022 compared to July 2021, this indicates that the private sector is showing signs of recovery.

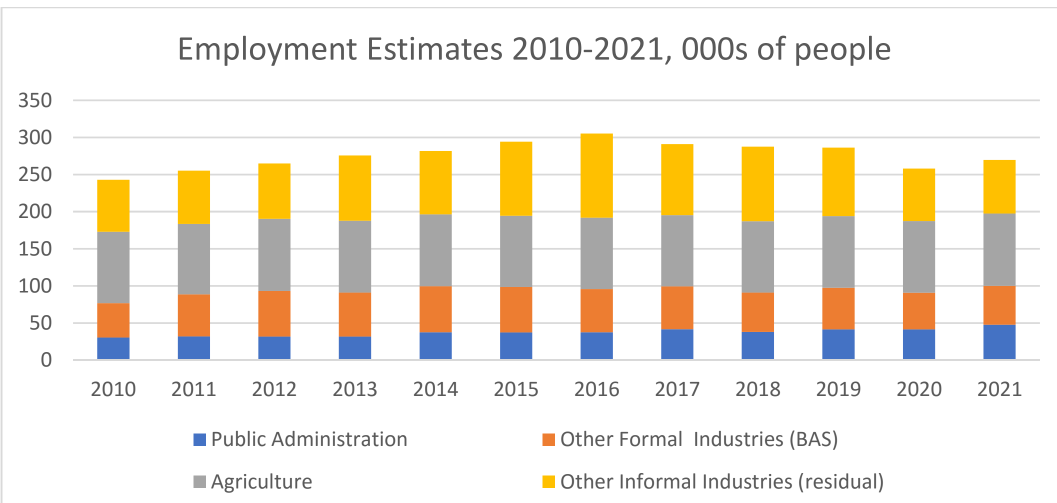
Figure 3: Commercial Interest Rates and Credit



Source: Banco Central Timor-Leste, 2022. Interest Rate (RHS, %), Credit (LHS, $m), August 2022.

1.50. Total employment (formal and informal) is around 9% higher in 2021 than it was in 2010, however today it is still 11% lower than its peak in 2016 with the informal sector accounting for around two-thirds of employment in Timor-Leste. Over time, informal employment in agriculture has been relatively flat. In 2021, it is estimated that formal employment increased around 10% since 2020- this is a historic high.

Figure 4: Employment 2010-2021, 000's of people



Source: General Directorate of Statistics, Ministry of Finance, September 2022.

1.51. Estimations of employment in Timor-Leste use several sources reconciliated by National Accounts, for example, the Labour Force Activity Survey, Business Activity Survey, and MoF Financial report. Please note, this is an internal estimation made by National Accounts and does not replace the Annual Labour Force Survey.

2. Budgetary Policy

Government Priorities and Measures for 2023

2.1. The 2023 General State Budget continues to put people at the centre of policy making and prioritizing citizen's well-being to ensure a fair and equitable distribution of the national resources to improve service delivery and economic recovery and resilience, to promote sustainable and inclusive economic growth in the medium term, and to guarantee Timor-Leste can became an upper-middle income country by 2030.

2.2. The 2023 General State Budget proposal is formulated based on the VIII Government Strategic Objectives aimed at providing all citizens: 1) The opportunity to have a healthy, secure and long life; 2) Access to knowledge, technology and innovation; and 3) Access to sufficient resources to guarantee life with dignity.

2.3. With these three strategic objectives in mind, the Government's agenda for inclusive development aspires to promote holistic well-being for the people and foster an environment for its people to live, contribute and participate in the economic development of the country.

2.4. Such an ambition requires the development of liveable communities, which includes providing access to quality education, healthcare, water and sanitation, social protection, basic infrastructures, and major investments in the productive sector to recover and diversify the economy.

2.5. The general characteristics of the 2023 budgetary policies and programs are designed to specifically invest in the social capital to guarantee the present and future welfare of Timorese people as well as promoting productive investment in the real economy as the engine for inclusive growth.

2.6. All these is done while upholding the core principle of social inclusion and gender-sensitive policies to leave nobody behind. A gender-responsive budgeting approach will also be undertaken when developing plans recognizing the differences in outcomes for all citizens, thus requiring potentially tailored approaches in key areas such as gender-based violence, social protection, health, education, leaderships, and women's economic empowerment programs.

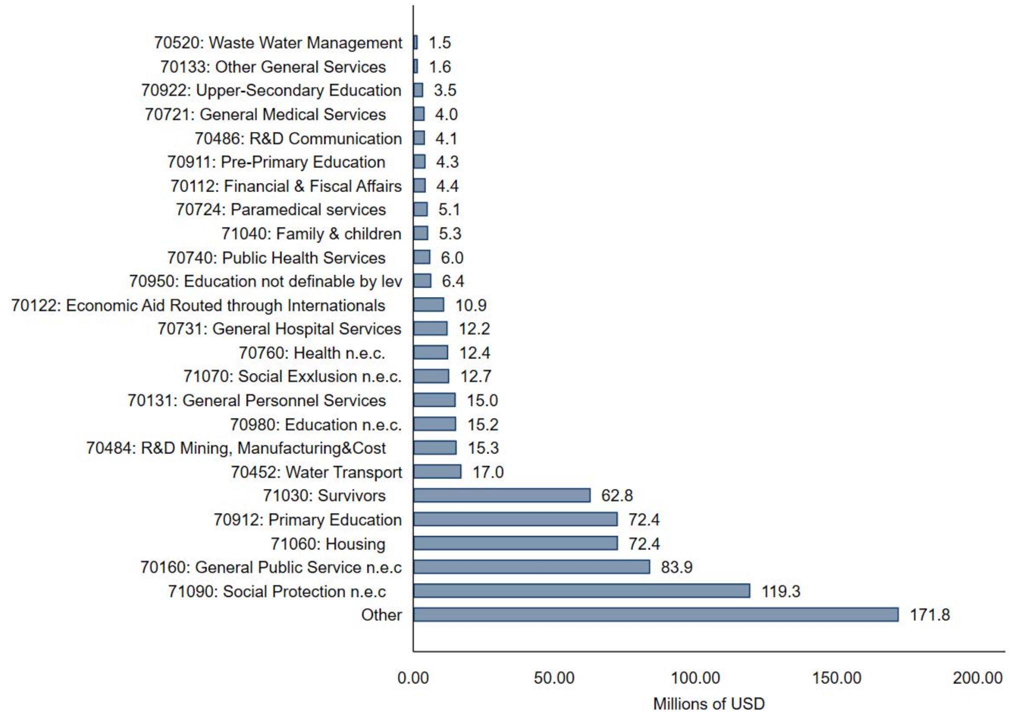
Investing in social capital to guarantee the present and future welfare of Timorese people

2.7. Although the Covid-19 pandemic has diminished throughout 2022, some of its social and economic impacts are deemed to be long-lasting and persistent.

2.8. Between 2020 and 2022 the Government had provided various financial incentives to families and businesses, absorbing the bulk of the fall in economic growth induced by Covid-19.

2.9. For the fiscal year 2023, the Government will continue to support the most vulnerable and award incentives for productive investment as the economy returns to grow, so that the recovery does not accentuate the inequalities triggered by the crisis.

Figure 5: OGE distributions in the social capital sector by class function (excluding FCLN)



Source: Timor-Leste planning and budgeting system (Dalan Ba Futuru), September 2022

2.10. Excluding the US$1 billion for the National Liberation Combatants Fund (FCLN), roughly 26% of the 2023 General State Budget will be allocated to the social capital sector, which includes health, education and social protection as shown on the graph above. This is equivalent to US$739 million and makes out of the social capital sector the second largest recipient of budgetary resources in 2023, reflecting the importance given to universal access to quality education (US$140 million) and healthcare (US$92 million) and social protection (US$301 million), especially for vulnerable segments of society.

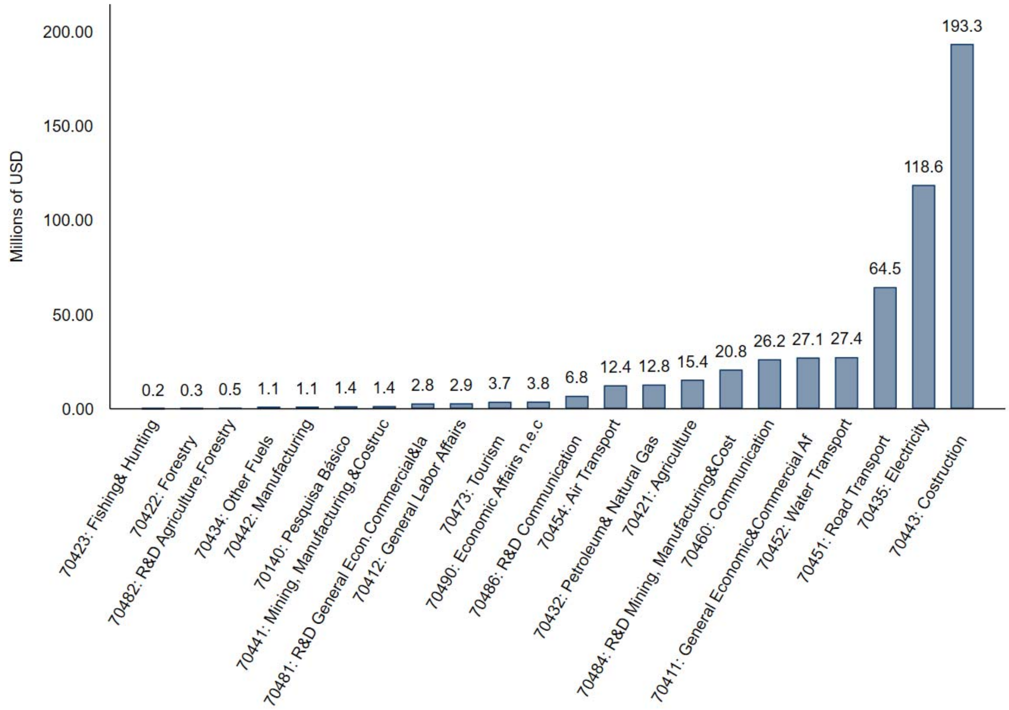
Promoting productive investment in the real economy as the engine for inclusive growth

2.11. The Government will invest in the real economy to create economic opportunities for Timorese people across the country and reduce economic dependency on imports and emigration.

2.12. The government believes that guaranteeing the political independence of our country must rely on supporting its economic independence.

2.13. Thus, for the fiscal year 2023, the Government will continue to support the development of public capital and basic infrastructure so that the economy can keep growing sustainably and inclusively, connecting the country through an ambitious program of roads and bridges, taking electricity supply to every village (suco), and fostering the inclusion of Timor-Leste in the world economy throughout an adequate network of ports and harbours, and supporting Timorese businesses in the economic sector where we have a competitive advantage like agriculture, agroindustry, manufacturing, mining, oil & gas, and tourism.

Figure 6: Government spending on the real economy and productive infrastructure



Source: Timor-Leste planning and budgeting system (Dalan Ba Futuru), September 2022

2.14. As shown on the graph above, the Government has allocated US$125 million[1] to develop an extensive network of quality and well-maintained roads, connecting communities, promoting rural development, industry and tourism and providing access to markets.

2.15. The Government will also invest US$17 million in the construction, rehabilitation, maintenance and conservation of rural bridges and roads, US$15 million in the construction of the National Road Pante Macassar, and US$7.8 million in the rehabilitation of 30 Km of municipal road in Laga-Baguia among other initiatives.

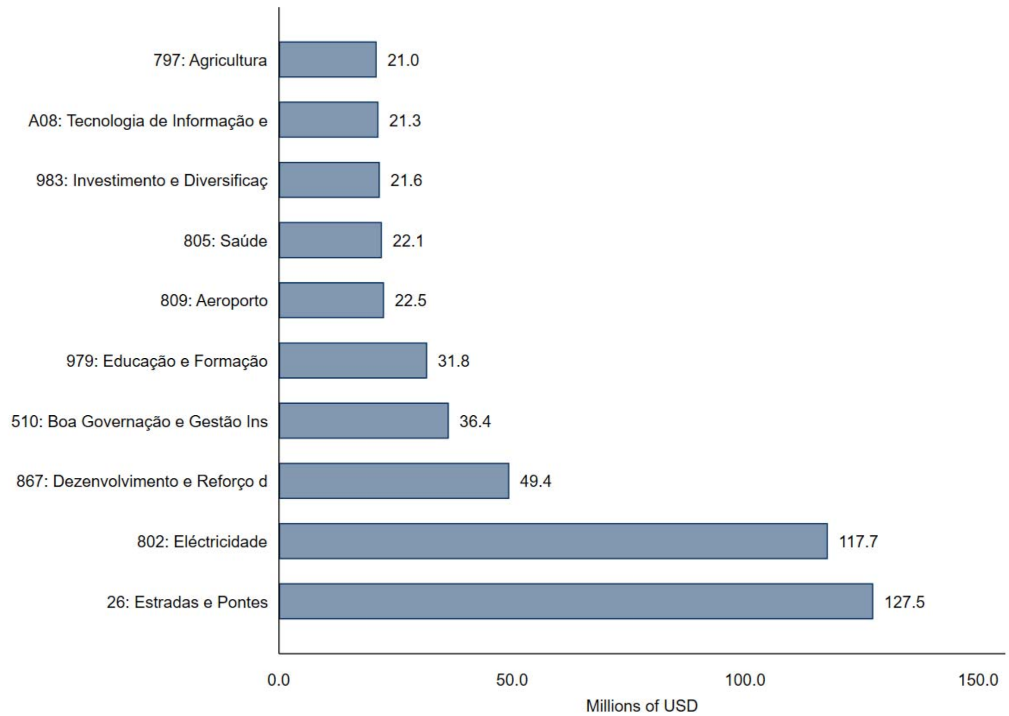
2.16. Making electricity available at a fair price for all households and businesses in the country is another pillar of the Government strategy to foster productive and inclusive growth. Access to electricity is a basic right and the foundation for our economic future.

2.17. In 2023, the government will invest US$119 million to ensure that by 2030 all Timorese households have access to electricity either through the expansion of the national power line system or using local small scale renewable energy systems.

2.18. A significant amount of that total will be employed in building new installations, with a focus on renewable energy sources, and US$100 million will contribute to directly supply electricity at affordable prices throughout the national territory.

[1] Some road investments have been included under construction.

Figure 7: Flagship programs to promote equitable and inclusive growth in 2023



Source: Timor-Leste planning and budgeting system (Dalan Ba Futuru), September 2022

2.19. Furthermore, the Government also aims to promote equitable and inclusive growth from a geographical point of view.

2.20. The 2023 General State Budget has increased the resources allocated to municipalities and special regions, like RAEOA. The region of Oe-Cusse Ambeno will be an example for the Timorese nation of a successful social market economy, where citizens can access quality healthcare, education, and basic services and opportunities for sustainable economic development in an urban and urban environment rural.

2.21. The region will implement a US$50 million program with a view to strengthening its economy. The program will finance multi-annual socio-economic projects (US$12 million), public works schemes (US$7 million), the construction of an administrative complex in Pante Macassar (US$5 million) and the construction and rehabilitation of rural roads (US$5 million) among other activities.

2.22. Action will be taken also to promote the diversification of the economy and to support the private sector in those areas where Timor-Leste presents comparative advantages to integrate into the world economy.

2.23. Thus, a US$21 million program within the agricultural sector will support a sustainable increase in production and productivity to improve economic returns, and competitiveness and gain efficiencies. A thriving agricultural sector is needed to reduce poverty, provide food security and promote economic growth in rural areas and our nation.

2.24. With this goal in mind, in 2023 the Government will expand irrigation systems in Laivai (US$3.6 million) and Galata (US$2.6 million), build new fishery infrastructure, including fishing ports (US$3.5 million), support agricultural extension and mechanization (US$2.6 million), and develop integrated agriculture zones in irrigated areas (US$2.1 million).

2.25. Lastly, acknowledging the potential and the important role that the agricultural sector shall play in the economic rise of the country does not mean limiting only to such economic activity. The Government believes that Timor-Leste has a huge potential to diversify and expand its economy to modern and technology-based sectors.

2.26. Nevertheless, to build the nation and provide jobs and income for people, Timor-Leste needs to attract investors to key industry sectors, partner with international firms in building infrastructure, and support local firms to start up and grow. Therefore, in 2023 the Government is investing US$25 million to accelerate economic diversification by investing in the telecommunication sector (US$14.5 million), promoting local products (US$ 6.4 million), creating a one-stop shop for business registration (US$2 million) and establishing industrial centres (US$1.3 million).

The Grand Planning Options for 2023

2.27. Following the promulgation of the new Budget and PFM Framework Law (Law No. 2/2022) which provides for the development of a budgeting model that represents a paradigm shift in the way public policies are planned and budgeted, containing information on their purposes and their impact on public accounts, the economy and society, the 2023 budgetary processes now adopt a “two-step” process namely the Grand Options Plan Law & General State Budget proposal.

2.28. The Grand Planning Options (GOP) is the document that bridges the gap between planning and budgeting which identified the planned measures that will be carried out that year and will have budgetary implications.

2.29. The GOP measures are obtained from the SDP, the medium-term plans, and the annual plans of the General Government services and entities, national and international commitments, as well as any other political and strategic documents of the Government.

2.30. The GOP constitutes the justification for budgeting the activities that will be included in the General State Budget, presenting both concrete and abstract measures that contribute to achieving the objectives and targets set out in the Annual Plan.

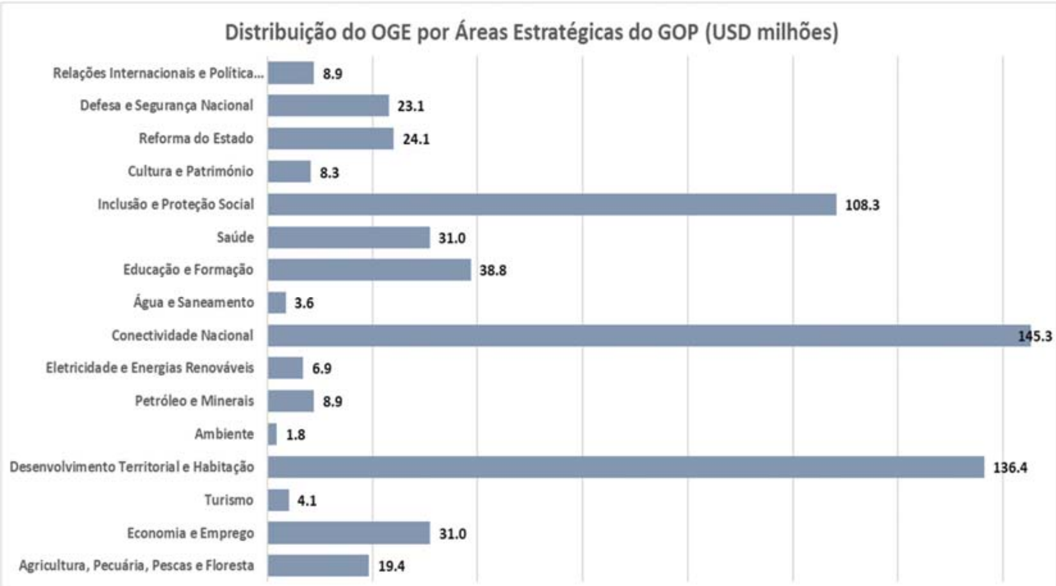
2.31. While the GOPs are not a Medium-Term Plan, they do provide concrete key measures focusing on large multi-year investments in the productive sector to recover and diversify the economy, as well as key measures in key strategic areas such as education, health, protection social security, water, and sanitation, etc., which will have budgetary implications.

2.32. The GOP will be reviewed and updated annually for each measure in the key strategic areas and submitted to the National Parliament on May 10th for discussion and approval.

2.33. For the fiscal year 2023, US$600 million (as shown in the graph below) has been distributed to finance 275 key measures from the GOP organized into around sixteen (16) strategic areas which aligns with subsectors of the National Strategic Plan (SDP): Agriculture, Livestock, Fisheries and Forestry; Economy and Employment; Tourism; Rural Development and Housing; Environment; Petroleum and Minerals; Electricity and Renewable Energy; National Connectivity; Water and Sanitation; Education and Training; Health; Inclusion and Social Protection; Culture and Heritage; State Reforms; Defence and National Security; International Relations and Foreign Policy.

2.34. The GOP measures will be implemented across the 30 national programs and contribute to the 28 national results as stated in the Grand Options Plan Law (Law No. 8/2022). The graph below shows the distribution of the 2023 General State Budget as per 16 strategic areas of the GOP.

Figure 8: Distribuição do OGE por Áreas Estratégicas do GOP (USD milhões)



Source: Timor-Leste planning and budgeting system (Dalan Ba Futuru), September 2022

2.35. In the graph shown above, the strategic area National Connectivity (US$145 million) is receiving the largest amount of the total General State Budget, aligning with the previously presented information by program and COFOG classifications. The aim of the government to prioritize equitable and inclusive growth, including from a geographical point, is reflected by the fact that the GOP strategic areas Territorial Development and Housing (US$136 million) and Social Protection and Inclusion (US$ 108million) are respectively the second and third largest recipients of General State Budget funding. The following highlights key information of concrete actions in each of the GOP strategic areas that will be implemented in the fiscal year 2023:

Agriculture, Livestock, Fisheries and Forestry

2.36. Agriculture, livestock, fishing, and forestry are strategic areas for the settlement of rural populations and the development country's economy.

2.37. For the 2023 fiscal year, the Government intends to consolidate measures and increase budget allocation to reinforce investment in this sector.

2.38. Key interventions in this area includes improving farming practices, and agricultural productivity and accelerating the transition from subsistence farming to a modern and market-oriented agricultural model that guarantees food security, diversification, and strengthening of domestic consumption.

2.39. Furthermore, the Government is also investing in the animal husbandry sector due to its great potential to contribute to the improvement of the nutrition of the Timorese people, both through access to and consumption of fresh meat and dairy products.

2.40. To improve this sector, thus, in 2023 the Government plans to invest in affordable and quality feed and ensure the vaccination and deworming of animals.

2.41. Similarly, the Government anticipates improving investment in the fisheries sector and expanding the sector to combat food insecurity and malnutrition, and contribute to economic growth, improved livelihoods, and job creation.

2.42. Lastly, for this sector, the Government continues to invest in the protection of the country's wildlife and biodiversity, promote investment in the forest sector, and carry out the demarcation and measurement of potential areas for the development of commercial sandalwood plantations and encourage and develop community forest nurseries.

Economy and Employment

2.43. The creation of new businesses and industries and investment in the private sector is the engine of growth, innovation, and job creation for the Timorese people and will enable the transition to a non-oil economy.

2.44. The Government is committed to diversifying the economy and creating the fiscal and bureaucratic conditions that allow a greater predisposition for national and international investors to invest in the country.

2.45. In this regard, for the fiscal year 2023, the Government proposes interventions in five key areas, trade, industry, private sector, employment, and cooperatives, to improve the business and investment environment, create conditions for entrepreneurship, stimulate active participation in the national economic system and increase the export of goods, which ultimately contributes to increasing state revenue through tax collection.

Tourism

2.46. Tourism is an important driver for the development of the national economy due to its impact on job creation and income, also contributing to the safeguarding of Timor-Leste's natural and cultural heritage.

2.47. With incomparable natural beauty, a rich history, and a unique cultural heritage, Timor-Leste has all the conditions to develop an original tourist sector, which mainly involves its people, religion, and culture.

2.48. In this sense, for 2023, the Government has identified key measures including promoting ecotourism, combining accommodation with coffee or rice plantations and suco-level tourist sites and empowering communities to develop and manage the sites, and increasing the number of tourists by increasing the number of cruise ships that dock at national ports as well as providing support to private companies that implement activities in the tourism sector.

Territorial Development and Housing

2.49. The Government aims to promote the quality of life of all Timorese, especially those who live in remote and difficult-to-reach areas, through various initiatives ranging from the municipal level to the village level, to create local jobs and raise the standard of living and well-being of the population.

2.50. In this sense, for 2023, some of the major priorities include continuing the implementation of the Integrated Municipal Development Planning (PDIM) program for new projects, the National Development Program Sucos (PNDS) and Road for Development (R4D) program, as well as promoting and developing community economic activities through the Post-Administrative Manpower - Mão-de-Obra Posto Administrativo Program (PMOPA) and community economic activities through the *Movimento Hafoun Aldeia* Program (PMOHA).

2.51. In 2023, the Government also intends to broaden the scope of intervention of the existing social housing program "*Uma ba Ema Kbiit Laek*" (abbreviated as UKL) integrated into the PNDS which started in 2021, to create an additional measure, called "*Uma ba Ema Kbiit Laek Plus*" (abbreviated as UKL+), which comprises of the provision of two new forms of support to vulnerable households such as the improvement of the current UKL project, and conservation or repair of houses in a poor state and supply of building materials for the replacement of roofing material house coverage.

Environment

2.52. Air pollution has grown substantially, especially in Dili, as a result of emissions from cars and motorbikes, in addition to smoke released by homes and forest fires.

2.53. The VIII Constitutional Government's Program places special emphasis on the need to promote and implement an environmental policy, ensure the protection and conservation of nature and biodiversity, control pollution, combat climate change, and strengthen licensing services and environmental education, as well as inspecting potentially harmful activities to flora and fauna and guaranteeing national development in an environmentally sustainable manner.

2.54. In this context, some of the key measures foreseen to be implemented in 2023 include improving the system of environmental licensing services, including the collection of environmental fees, preparing and passing the environmental tax law to increase revenue collection and promoting the identification of plants to be included in the carbon market as well as promote resilience to climate change through adaptation, mitigation, and substance control actions chemicals that damage the ozone layer.

Petroleum and Minerals

2.55. The oil sector has been the main source of revenue from the General State Budget to provide public services to the population and to build and maintain our Nation's infrastructure.

2.56. The Government remains committed to boosting oil and mineral revenues and achieving the balance of the Petroleum Fund, to ensure its sustainability for future generations.

2.57. The Government has identified key interventions that will be taken in 2023 to maximize investment in the oil and mining sectors including increasing study and research activities through the continuous promotion of onshore and offshore blocks to exploration to maximize investment in the oil and mining sectors and developing feasibility and sustainability studies on the use of natural gas for the production of electricity, making efforts to use energy that is less expensive and takes into account environmental issues.

Electricity and Renewable Energies

2.58. Access to regular and reliable electricity supply is a fundamental right and the basis of Timor-Leste's economic growth.

2.59. For the 2023 budget proposal, the Government, therefore, intends to continue investing in updating and improving the transmission and distribution of electricity and rural electrification programs, while investing in the expansion of renewable energies.

2.60. Investing in renewable energy sources can contribute to a less polluted environment and mitigate the impacts of climate change in accordance with the commitments assumed in international conventions.

National Connectivity

2.61. The Government is committed to improving national connectivity through the construction, rehabilitation, and maintenance of central and productive infrastructure that are resilient to climate and weather conditions to connect and create conditions for the movement of people and goods, for economic growth, the creation of jobs and the development of the private sector.

2.62. For the fiscal year 2023, the Government remains committed to investing in three priority areas in this sector namely: a) infrastructure (ports, airports, roads, and bridges); b) logistics (the system of land, sea, and air transport); and c) telecommunications (sea and terrestrial fibre optics).

Water and Sanitation

2.63. Access to clean, potable water and modern sanitation services is critical to protecting the health of all Timorese.

2.64. Improving the quality of water, sanitation and drainage in Timor-Leste will help build the resilience needed for the country to face future health challenges and grow the economy.

2.65. For 2023, some of the key interventions include initiating the project to modernize the water treatment, sanitation and drainage system in Dili in collaboration with the Millennium Challenge Corporation (MCC), increasing the coverage area of the drinking water supply service, and completing the emergency rehabilitation of damaged clean and potable water facilities.

Education and Training

2.66. The provision of quality education and training are essential to shape the personality, create conditions for employability and competitiveness of people of working age and ensure the economic development of the country, being a fundamental instrument for the exit from poverty.

2.67. To ensure that all children and young people have access to learning and essential qualifications for success in society, the Government remains committed to investing significantly in the rehabilitation of basic educational infrastructures, strengthening the quality of the national curriculum of formal education, and improving the opportunities for continuous training and professional development of current teachers and school leaders.

2.68. For 2023, some of the new initiatives in this sector include introducing reform in the school feeding program, ensuring access to the internet in all schools and universities, awarding a merit scholarship to the best students at the elementary and secondary education levels, continuing with the implementation of the home-schooling program and implementing a recruitment program aimed at the best students from national universities.

2.69. The Government also plans to initiate a pilot project for the establishment of day-care centres (creches) in the municipality of Dili, to support children aged 0-3 years, whose parents work and need this support.

2.70. Additionally, the Government also plans to conduct a design study to improve education by developing a centre of excellence that will provide pre-service training for future secondary school teachers and school leaders and provide continuous and professional training for current teachers and school leaders, in collaboration with Millennium Challenge Corporation.

Health

2.71. Equitable access to essential and quality health services that are well equipped and staffed with competent health professionals is a fundamental objective.

2.72. Thus, for 2023, the Government's intervention is oriented toward rehabilitating basic health infrastructures at both national and municipal levels, expanding the healthcare services, introducing public-private partnerships in Health Diagnostic Services, and improving the quality of health service provision through innovation of the primary health care system, promoting constant improvement in the development and deployment of human resources, strengthening efforts to combat malnutrition and improving the national response to outbreaks and emergencies of dengue, cholera and other diseases.

Social Inclusion and Protection

2.73. The Government is continually committed to assisting the poorest and most vulnerable citizens of Timorese society.

2.74. The 2023 budget proposal will provide a specific focus on consolidating a policy of social cohesion and guarantee of dignity and human rights to all Timorese, either through the improvement of the sustainability of the Social Security System or through the strengthening of social assistance to the most disadvantaged.

2.75. In this context, the Government has identified key interventions to ensure that women and children, young people, as well as the elderly and other vulnerable citizens, have access to the satisfaction of their fundamental needs and well-being, as well as access to opportunities to break out of their fragile state.

2.76. Some of the key Interventions include a set of reforms of the *Bolsa da Mãe* program, and the creation of protection in case of illness (temporary incapacity), family protection (family allowance), work accidents and occupational diseases, and unemployment within the scope of the contributory social security system.

Culture and Heritage

2.77. The Government is committed to the conservation, protection, and preservation of the historical-cultural heritage and the development of arts and culture, as well as the protection of rights relating to artistic and literary creation.

2.78. Major interventions that will be carried out in 2023 include proceeding with the initial steps towards the implementation of the National Library and the identification of artifacts to constitute the National Museum in the future and the construction of the “Jardim da Chama Eterna”, a memorial of high symbology, which is intended to concentrate the recognition of all those who perished in the struggle for National Liberation.

2.79. The Government also continues to invest in the development and promotion of cultural activities, actions, and practices, in particular the establishment of creative industries that generate income and employment, and at the same time defend and enhance cultural heritage, which has unique characteristics of great interest.

Reform of the State

2.80. The State Reform is divided into four major institutional reforms in progress – the Public Administrative Reform, Fiscal and Public Finance Management Reform, Judicial Reform, and the Administrative Decentralization Process.

2.81. These four reforms are interconnected and have the common objective of improving the management and functioning of the public sector, as well as ensuring that the State operates within a framework of legality and legal certainty more efficiently and effectively.

2.82. For 2023, the Government remains committed to ensuring the implementation of initiatives stated in the policy documents of the four institutional reforms.

Defence and National Security

2.83. The development of transparent, efficient, competent, and professional defence and security institutions is fundamental to the maintenance of democracy and the consolidation of stability and peace at the national and international levels.

2.84. For the 2023 fiscal year, the Government remains committed to strengthening coordination and close cooperation between the defence forces (F-FDTL) and security forces (PNTL) and ensuring clarity and commitment in accordance with their respective responsibilities and missions, as well as guaranteeing the territorial integrity, the normal functioning of democratic institutions, freedom and the protection of the State's and citizens' patrimony.

International Relations and Foreign Policy

2.85. Foreign policy actions are crucial to support national development and improve Timor-Leste's participation on the international stage and its insertion in regional and international economies.

2.86. The Government continues to conduct a foreign policy that promotes bilateral and multilateral cooperation, promoting cultural, economic, and commercial partnerships with other countries, essential for attracting investment.

2.87. For the fiscal year 2023, the Government will continue to promote efforts for Timor-Leste to become a full member of ASEAN and the World Trade Organization and promote the definitive delimitation of land and sea borders.

Gender and Social Inclusion (GESI) Responsive Budgeting

2.88. Advancing gender equality and social inclusion continues to remain at the heart of the VIII Constitutional Government to achieve a more inclusive society where nobody is left behind regardless of their gender, disabilities, social background, sexual orientation, or faith.

2.89. Since 2017, the Government has reinforced Gender-Responsive Budgeting (GRB) to be adopted as a strategy when developing programs and subprograms to achieve a positive impact on the promotion of gender equality, empowerment of women and girls, and social inclusion.

2.90. The 2023 budget circular underlines the importance to look more closely at the impact of budgetary measures and policies on gender equality and inclusion and ensure that the needs and interests, priorities, and challenges of women, girls, boys, and men in different age-conditioned social situations, class, location, etc. are adequately addressed in the annual plan.

2.91. To implement this vision, for the fiscal year of 2023, the Government has allocated US$259 million to implement the Gender Equality and Social Inclusion program (Program 980), being the third largest program by the total amount in the budget and represents 8.2% of the total General State Budget.

2.92. Specifically, under this program, US$ 796,083 has been distributed to implement the three national gender policies namely Plano de Ação Nacional contra a Violência Baseada no Género (US$ 240,178), Plano de Ação Nacional sobre Mulheres, Paz e Segurança (US$ 349,448), and Declaração de Maubisse (US$ 206,457), addressing gender-based violence, women in peace and security, and women's economic empowerment issues, respectively.

2.93. Furthermore, the Government has earmarked US$19.2 million to implement the *Bolsa da Mãe* program. Of this sum, US$5.3 million is allocated to continue the initial program and US$13.7 million has been allocated to introduce the *Bolsa da Mãe-Nova Geração* measure (Decree Law No. 22 /2021) which aims to provide support and improve health and maternal and child nutrition during the first childhood years. Special support is also given to children with chronic illness or disability, by increasing the value of the respective subsidy. The remaining funds are allocated to operational costs.

2.94. The new mother's allowance sets up a subsidy of US$15 per month for pregnant women, US$20 per month for each child up to age 6, and a $10 surcharge for children with disabilities.

2.95. The Government also continues to invest in measures to combat poverty, reduce inequalities and improve well-being by improving budget allocation for nutrition support.

2.96. For the fiscal year 2023, the Government intends to improve the quality of meals for the *Merenda Escolar* program to meet the nutritional needs of children by increasing the expenditure per child and per meal from US$0.25 to US$0.42. A total of US$22.4 million has been allocated to execute this measure covering 13 municipalities and RAEOA.

2.97. To complement this, the Government has also set aside US$10 million annually for the next five years to implement the National Health Sector Nutrition Strategic Plan. This hopefully addresses micronutrient deficiency related to poor nutrition in children and has a positive impact on children's lives.

2.98. Moreover, the Government intends to invest in facilitating universal access to education through social protection measures by providing scholarships for the children of the National Liberation Combatants and merit scholarships awarded to the best students at the elementary and secondary education levels.

2.99. In this context, for the 2023 fiscal year, the Government has distributed US$1.7million to the Scholarships program for the children of the National Liberation Combatants and US$7.5 million to the best students in the elementary (top 3 best students) and secondary education (top 5 best students) levels.

2.100. The Government also intends to continue the Home-Schooling program by allocating US$2.1 million to provide support to students at their respective place of residence in the teaching process and learning, particularly for children of the ages of preschool education and the First Year of Basic Education, in all sucos and villages in Dili, as well as the availability of Mobile Libraries to the entire student community.

2.101. Through the financing of the aforementioned activities by the State, which are understood to be complementary to each other, it is hoped to achieve an increase in the rate of children and girls' participation in the school process, at all levels and modalities of education and teaching, and an increase in the percentage of school success.

2.102. Lastly, the VIII Constitutional Government is also committed to defending the rights of persons with disabilities to have equal access and opportunities to be active citizens in all spheres of public life and to be involved in decision-making processes in all areas of the country's development to contribute to sustainable development.

2.103. Various financial incentives to improve the socioeconomic status and economically empower vulnerable groups and the elderly will also be implemented as part of the non-contributory scheme.

2.104. The Social Security Reserve Fund will start being invested, with a total capital of US$162 million, generating income that will guarantee the sustainability of the Social Security System for the future.

2.105. The table below illustrates General State Budget by Functional Classifications for Social protection.

Table 7: OGE Distribution by Functional Classifications for Social protection (US$)

10	**Proteção Social**		**306,836,925**
	01	Sickness and disability	5,941,710
	02	Old age	61,497,349
	03	Survivors	6,818,150
	04	Family and children	6,061,333
	06	Housing	72,624,508
	07	Social exclusion n.e.c.	14,690,950
	08	R&D social protection	2,264,020
	09	Social protection n.e.c.	136,938,905

Source: Timor-Leste planning and budgeting system (Dalan Ba Futuru), September 2022

Budget Transparency and Accountability

2.106. The 2023 budget proposal includes the following markers to hold the Government to account on various crosscutting issues such as gender equality and social inclusion, nutrition, climate, and supply chain.

Gender Marker

2.107. To monitor the proportion of the General State Budget allocated to the promotion of gender equality and the commitments made to eliminate existing inequalities, the Government established a Gender Marker namely Principal (P), Significant (S), and Not-Targeted (NT) in the budget and planning system. It is a mandatory tool that must be used by all LMs/AAs in their Annual Action Plan and applied at the subprogram level. The Gender Marker contains three (3) markers, namely:

#	Marker	Definition
1	Principal (P)	The principal expected result of the subprogram is to reduce gender inequalities. The subprogram would not have been undertaken without this gender equality and social inclusion objective.
2	Significant (S)	Gender equality and social inclusion aspect is an important and deliberate expected result, but not the principal reason for undertaking the subprogram. The subprogram, in addition to other expected results, is designed to have a positive impact on inclusivity and advancing gender equality and/or the empowerment of women and girls (gender mainstreaming). For a subprogram to be considered "Significant" by the Gender Marker, there must be at least one of the criteria below: • There is at least one activity focused on gender issues in the subprogram • At least one of the outputs is indicated the expected result to achieve equality between men and women

		• Objectives, baselines, targets, and performance indicators are clearly defined to address gender inequalities, and data are disaggregated by sex.
3	Not-Targeted (NT)	The subprogram does not intend to reduce gender inequalities nor address the needs and concerns of vulnerable and marginalized groups.

2.108. As shown in the graph below, the adoption of gender-responsive budgeting goes beyond the implementation of a specific gender equality program (Program 980) and embraces all public policies funded through the General State Budget, adopting the inclusion of gender tagging at the sub-program level.

2.109. A total of US$205 million (6% of the OGE) has been distributed to subprograms considered as "Principal" in the application of the Gender Marker whereas US$307 million (10% of the OGE) has been allocated to subprograms considered as "Significant" (gender mainstreaming strategy) in the application of the Gender Marker.

2.110. Nevertheless, there is still room to improve, since a large amount of state funding does not consider gender perspectives. Importantly, gender equality enters as the principal goal or significant in many activities across all Government programs. This is especially relevant when it comes to the functions with a strong social component, like social protection, education, sport, nutrition and health as well as water and sanitation.

2.111. The table below demonstrates the 2023 General State Budget distribution by Gender Marker.

Table 8: Distribution of Budget according to Gender Marker

Gender Marker	Budget (USD)
Principal	$205,044,385
Significant	$306,724,933
Total	**$511,769,318**

Source: Timor-Leste planning and budgeting system (Dalan Ba Futuru), September 2022

Child Marker

2.112. To effectively identify and monitor activities with budget allocations that support the realization of children's rights, the Democratic Republic of Timor-Leste (RDTL) adopted a Child Marker for planning and budgeting on 27 October 2021.

2.113. The Child Marker applies to all government entities that receive funds from the General State Budget, showing which activities, and how much budget, are specifically designed to address children's rights (ages 0 to 17), and thus reinforces transparency and accountability. The Child Marker includes three (3) categories that assess the focus on realizing children's rights and apply at the activity level, namely:

#	Marker	Definition
1	Specific (E)	This category applies to activities that specifically aim to address children's rights (survival, development, protection, and participation).

2	Extended (A)	The 'Extended (A)' category applies to activities that provide goods and services that directly benefit people, including children.
3	Indirect (I)	This category refers to activities that only have an indirect contribution to children's development and well-being.

2.114. The table below illustrates the 2023 General State Budget distribution by Child Marker with US$231 million (7%) has been allocated to activities that specifically aim to address children's rights whereas US$411 million (13%) has been distributed to activities that provide goods and services that directly benefit people, including children.

Table 9: Distribution of Budget by Child Marker

Child Marker	Orçamento (USD)
Extended	$411,412,463
Specific	$231,229,438
Total	**$642,641,901**

Source: Timor-Leste planning and budgeting system (Dalan Ba Futuru), September 2022

Nutritional Budget Tagging

2.115. The VIII Government is committed to institutionalizing nutritional budget tagging (NBT) through the Government's planning and budgeting system.

2.116. The NBT aims to identify, classify and mark nutrition-related expenditures in the public finance management system, allowing for the estimation, monitoring, and tracking of critical nutritional expenditures of different government entities, and analysing the extent to which the composition of General State Budget allocations for interventions aimed at eliminating all forms of malnutrition among the population.

2.117. There are two (2) nutritional budget tagging that will be included in the Government's fiscal year 2023 planning and budgeting system and will be applied at the activity level, namely:

#	Marker	Definition
1	Nutrition-Specific interventions (NE)	This category applies to activities that address the immediate causes of malnutrition and deficiencies in the physiological development of the population, such as those that provide for the provision of vitamin A supplements, deworming, or dietary diversification among pregnant mothers.
2	Nutrition-Sensitive interventions (NS)	This category refers to activities that address the underlying causes of malnutrition such as improving agriculture and food security, social protection, early childhood development and education, sanitation and water hygiene, etc.

2.118. In 2023, in a pilot phase, the nutritional budget marker will be applied to the budgets of eight (8) Government entities namely: Ministry of Health (MS), Ministry of Education, Youth and Sport (MEJD), Ministry of Social Solidarity and Inclusion (MSSI), Ministry of Agriculture and Fisheries (MAP), Ministry of Tourism, Commerce and Industry (MTCI), Ministry of Public Works (MOP), National Authority for Water and Sanitation (ANAS), and the Secretary of State for Equality and Inclusion (SEII).

(see Informative Elements for lists of activities and implementing entities identified for the nutritional budget marker)

2.119. During the elaboration of the Annual Action Plan 2023, these entities are required to analyse, plan, and budget for nutrition-related interventions and to identify each activity as nutrition-specific (NE) or nutrition-sensitive (NS).

2.120. The table below displays the 2023 General State Budget distribution by Nutritional Marker with US$13 million has been allocated to activities that specifically aim to address the immediate causes of malnutrition and deficiencies in the physiological development of the population whereas US$67 million has been distributed to activities that improve agriculture and food security, social protection, early childhood development and education, sanitation and water hygiene, etc.

Table 10: Distribution of Budget by Nutrition Marker

Nutritional Bugdet Tagging	Orçamento (USD)
Nutrition-Specific interventions	$13,177,174
Nutrition-Sensitive interventions	$67,333,991
Total	**$80,511,165**

Source: Timor-Leste planning and budgeting system (Dalan Ba Futuru), September 2022

Climate Budget Tagging

2.121. The VIII Constitutional Government has decided to introduce Climate Budget Tagging (CBT) in the public finance management system to ensure that Timor-Leste is adequately prepared to adapt and mitigate the impacts of climate change.

2.122. The CBT is a tool for identifying, classifying, weighing and marking relevant expenditures for combating climate change and nature conservation in a government's budget system, allowing the estimation, monitoring, and tracking of these expenditures.

2.123. There are two (2) Climate Budget Markers that will be included in the Government's planning and budgeting system for the year 2023 and will be applied at the level of activities, namely:

#	Marker	Definition
1	Highly Relevant (H)	This category applies to activities with a clear primary objective of producing specific results that improve climate resilience or contribute to climate change mitigation and the sustainable use of natural resources. Examples are expenditures aimed at reducing the risk of natural disasters, supporting the energy transition, preventing the over-exploitation of fisheries resources, etc.
2	Medium Relevance(M)	This category applies to activities with secondary objectives related to building climate resilience or contributing to climate change mitigation and sustainable use of natural resources. An example is the irrigation extension activities that, despite being implemented to improve livelihoods, also result in greater protection against droughts.

2.124. In 2023, on a pilot basis, climate budget marker will be applied to the budgets of three (3) Government entities, namely: the Ministry of Public Works (MOP), Secretary of State for the Environment (SEA), and Ministry of Agriculture and Fisheries (MAP). (see Informative Elements for lists of activities identified for the climate budget marker)

2.125. For the elaboration of the Annual Action Plan 2023, the MOP, SEA, and MAP are required to analyse their activities to identify whether they are climate resistant, which means that they correspond or not to the impacts of climate change.

2.126. Starting in the fiscal year 2024, the climate budget tagging will cover all Ministries. This phased implementation will provide the opportunity to fine-tune the system and will also provide the space for focused capacity development at the line ministry level.

2.127. The table below illustrates the specific 2023 General State Budget distribution by Climate Change Marker with US$46 million has been allocated to activities with a clear primary objective of producing specific results that improve climate resilience or contribute to climate change mitigation and the sustainable use of natural resources whereas US$13 million has been distributed to activities with secondary objectives related to building climate resilience or contributing to climate change mitigation and sustainable use of natural resources.

Table 11: Distribution of Budget by Climate Marker

Climate Marker	Budget (USD)
Highly Relevant	$46,788,840
Medium Relevance	$13,036,269
Total	**$59,825,109**

Source: Timor-Leste planning and budgeting system (Dalan Ba Futuru), September 2022

Value chain Marker

2.128. In 2023, the Government will introduce a Value Chain Marker in the Public Finance Management System to ensure the implementation of the "Timoriza Value Chain" policy which focuses on the potential national products and the essential needs of Timor-Leste.

2.129. These interventions will focus on four main areas namely stimulating demands, incentivizing production/supply, improving business environment, and promoting strategic investment. They are intended to improve the market and the problems identified related to the allocation of resources with efficiency and effectiveness.

2.130. On May 6th 2022, the Council of Ministers approved a Government Resolution to create an Inter-Ministerial Commission for the coordination of the Value Chain to promote and incentivise national production.

2.131. This will facilitate between sectoral ministries so that all can pool their resources and work together to ensure food and nutrition sovereignty, which will help strengthen the country's economic independence. GPM and MCAE are responsible for coordinating with relevant entities to identify key measures concerning building Value Chain and reporting to the Ministry of Finance.

2.132. To this end, there will be the following five (5) activity-level markers:

#	Marker	Definition
1	**Production (P)**	The Production category (P) applies to activities that directly or indirectly aim to increase national production, either through increasing the productivity of the national economy and/or substituting imports, such as labour training activities, support for the internationalization of Timorese companies, or the modernization of the fishing fleet.
2	**Industry/Processing (I/P)**	The Industry/Processing (I/P) category applies to activities that aim directly or indirectly to favour the development of industry and/or local processing of raw materials and intermediate goods, such as activities to support the development of agroindustry.
3	**Distribution (D)**	The Distribution (D) category applies to activities that directly or indirectly aim to improve the circulation of raw materials, intermediate products, and final products inside and outside the national territory, such as the construction or improvement of basic infrastructure for commerce such as airports and ports.
4	**Wholesale/Retail Trade (CGR)**	The Wholesale/Retail (CGR) category applies to activities that directly or indirectly aim to boost trade in national production or partially processed products within the national territory, especially through exports, such as programs to support business competitiveness; activities related to the organization of fairs for traditional products, or the integration of Timor-Leste in international trade circuits.
5	**Consumption (C)**	The Consumption (C) category refers to activities that contribute to increasing consumption inside and outside the national territory of national production or partially processed products within the national territory, such as public purchase programs for locally produced food products, subsidy programs for national exports, or conditional transfer programs for families to purchase local products.

2.133. In 2023, on a pilot basis, the Value Chain marker will be applied only to the budgets of twenty-one (21) Government entities including 13 municipalities. (see Informative Elements for lists of activities and implementing entities identified for the Value Chain marker)

2.134. The table below highlights the significance of 2023 General State Budget distribution by Value Chain Marker with US$48million has been allocated to activities that will improve the circulation of raw materials, intermediate products, and final products inside and outside the national territory, such as the construction or improvement of basic infrastructure for commerce such as airports and ports. In regards to the consumption intervention, US$45million has been distributed to the public purchase programs for locally produced food products, subsidy programs for national exports, or conditional transfer programs for families to purchase local products while US$18million has been assigned to production intervention for labour training activities, support for the internationalization of Timorese companies, or the modernization of the fishing fleet.

Table 12: Distribution of Budget by Value Chain Marker

Value Chain Marker	Budget (USD)
Produçtion	$18,492,954
Industry/Processing	$593,441
Distribution	$48,068,076
Wholesale/Retail Trade	$1,750,710
Consumption	$45,527,978
Total	**$114,433,159**

Source: Timor-Leste planning and budgeting system (Dalan Ba Futuru), September 2022

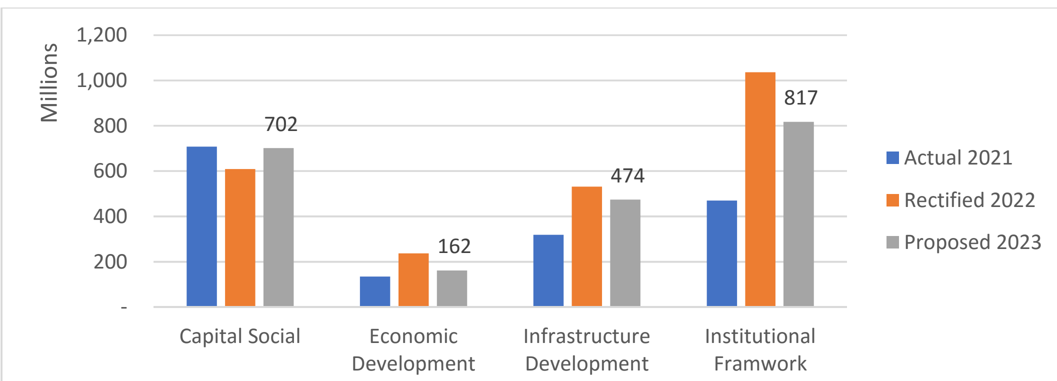
Comparative Analysis

2.135. Owing to the implementation of program budgeting and the subsequent reduction of the number of programs (from 145 to 49) from 2021, the comparative analysis has been carried out with institutional level data to allow for a consistent comparison for all three years under consideration, but subsequent year analysis with be done at a program level. As a measure to increase the transparency of the budget, the 2023 General State Budget proposal includes Social Security in the budget disaggregation ceiling.

2.136. Timor-Leste's Strategic Development Plan (PED) is organised around four pillars: Institutional Framework, Social Capital, Economic Development and Infrastructure Development.

2.137. The 2023 General State Budget allocates the highest share of expenditure to the Institutional Framework (38%) followed by Social Capital (33%), Infrastructure Development (22%) and Economic Development (8%). The figures include loan disbursements and transfers to RAEOA.

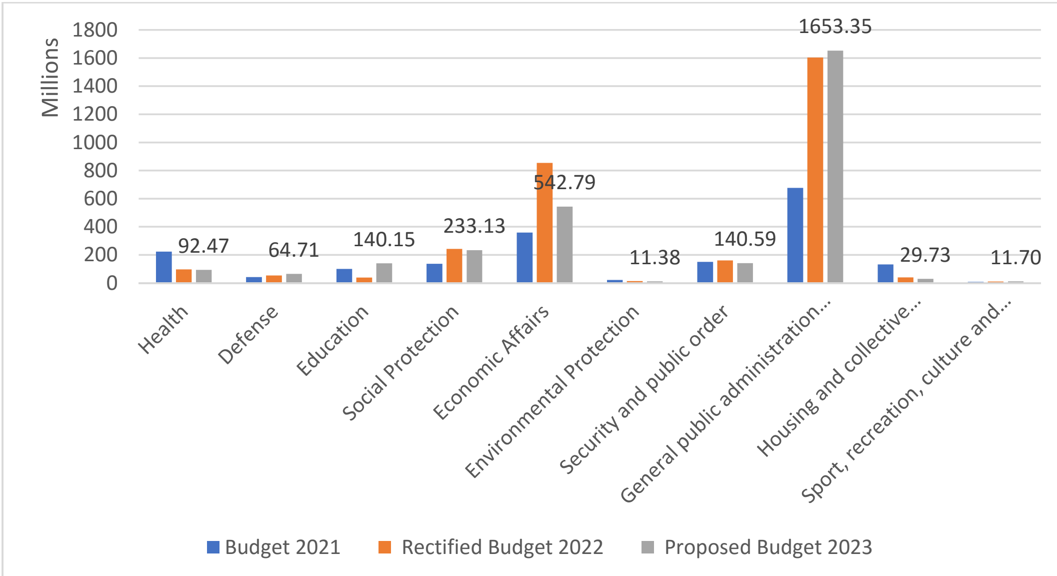
Figure 9: Comparison of 2021 Expenditure, rectified 2022 Budget and proposed 2023 Budget by PED



Source: General Directorate of Planning and Budget, Ministry of Finance, September 2022

2.138. Following the international COFOG (Classification of the Functions of Government) classification developed by the OECD, the First level COFOG data for Timor-Leste suggest the General Public Services function has the largest allocation (in line with the previous year) followed by the Economic Affairs function.

Figure 10: Comparison of Budget 2021, Rectified Budget 2022 and Proposed 2023 Budget by COFOG



Source: General Directorate of Planning and Budget, Ministry of Finance, September 2022. Please note that this data does not include the INSS and FRSS data.

2.139. The decrease in the health function can be attributed to the progressive phasing out of the COVID-19 fund. The increased funding for Education and Social Protection can be explained by introduction of the new GOP priorities.

Municipality Allocation

2.140. In the municipalities, there is an increase in the current year's budget with the largest increase for Administração Municipal de Viqueque (50%) and the smallest for Autoridade Municipal de Dili (8%), although AM Dili still has a budget equivalent to two of three times larger than any other municipality. The 1% cut for RAEOA becomes a 42% increase when we account for the creation of the FEDRAEOA. Also, to note that another special fund is created for Ataúro with a total appropriation of US$13 million, making a 523% total budget increase for that municipality.

2.141. A similar situation arises when comparing the 2023 General State Budget proposal with the 2021 actual expenditure. All the municipalities see an increase in their budget ranging from 20% for Autoridade Municipal de Baucau to 77% for Administração Municipal de Viqueque. RAEOA sees an increase of 244% that, in the reality, is 392% when we include the FEDRAEOA.

Table 13: Proposed Allocation to Municipal Authorities, $

Municipal Authority	Actual 2021	Rectified 2022	Proposed 2023	Change from 2021 Actual	Change from Rectified 2022
Autoridade RAEOA	24,383,698	84,436,784	84,000,000	244%	-1%
AM Díli	6,816,419	10,231,640	13,362,483	62%	8%
AM Baucau	4,813,128	4,931,124	7,564,824	20%	17%
AM Bobonaro	4,215,429	4,727,883	6,733,806	32%	18%
AM Ermera	3,904,589	4,662,818	7,417,275	42%	19%

AM Aileu	2,811,826	3,034,303	4,509,206	38%	27%
AM Ainaro	2,976,385	3,243,066	4,894,112	37%	26%
AM Ataúro	-	2,574,860	2,257,645	N.A.	19%
AM Covalima	3,985,211	3,990,360	5,738,515	21%	21%
AM Lautém	3,699,987	4,056,049	5,826,107	32%	21%
AM Liquiçá	2,577,632	3,186,810	4,942,552	56%	26%
AM Manatuto	2,994,422	3,815,911	5,727,621	55%	22%
AM Manufahi	3,724,390	3,666,128	5,167,358	21%	23%
AM Viqueque	3,395,558	4,005,625	6,925,794	77%	50%
FED Ataúro	-	-	13,400,000	N.A.	N.A.
FED RAEOA	-	-	36,000,000	N.A.	N.A.

Source: General Directorate of Planning and Budget, Ministry of Finance, September 2022.

Measures to rationalize budget management

2.142. The adoption of program-based budgeting has brought new tools for rationalizing budget management. Program-based budgeting allows to focus on results, hence reallocating resources from the activities that are not achieving the previously agreed targets to those one that are really delivering a benefit to the public.

2.143. Unfortunately, due to the early stage of adoption of the program budget, the monitoring and evaluation functions are still under development, and it is difficult to assess the performance of the different programs. Nevertheless, in 2023 the Government is committed to operationalise the monitoring and evaluation of the result-oriented programs.

2.144. Funding for specific development priorities and critical state functions have been earmarked with the creation of special funds, aiming to secure long-term financing away from the risk of a fiscal-cliff (refer to the section on Fiscal Sustainability).

2.145. The Ataúro Special Development Fund (US$13.4 millions) and the Special Development Fund of the Special Administrative Region of Oe-Cusse Ambeno (US$36 millions) replicate the structure of the Infrastructure Fund, although focusing on building the necessary physical capital and social capital for the sustainable development of these territories.

2.146. The FCLN (National Liberation Combatants Fund) was created with a capital of US$1 billion, which will be invested on a portfolio of equity and stocks following the model of the Petroleum Fund, but with the aim to finance the benefits to which veterans and their families have the right.

2.147. Finally, the Social Security Reserve Fund, established with the technical assistance of Portuguese Authorities, receives the annual surplus balance of the Social Security Budget and is administered under a capitalization scheme. The returns generated by the fund will be used to pay for the benefits that are due under the Social Security contributory scheme, when the in-year contributions from active workers is not enough to pay for pensions.

2.148. Measures to rationalize budget management from the side of expenditure had focused on the establishment of new procedures to identify priority spending and avoid duplicities.

2.149. Priority spending had been identified through 16 areas (Agriculture, Livestock, Fisheries and Forestry; Economy and Employment; Tourism; Rural Development and Housing; Environment; Oil and Minerals; Electricity and Renewable Energies; National Connectivity; Water and Sanitation; Education and Training; Health; Social Inclusion and Protection; Culture and Heritage; State Reform; Defence and National Security; International Relations and Foreign Policy) resulting in the adoption of a total of 275 policy measures to be implemented between 2023 and 2027.

2.150. Such exercise, materialized in the *"Grandes Opções do Plano"* (GOP) Law, which determined a total budget ceiling of US$3.16 billion for 2023, already resulting in a saving of $US264 million or 8% when compared with the 2022 General State Budget.

2.151. Given the multiannual nature of the GOP policy package, a baseline expenditure exercise was conducted with the collaboration of Services and Entities with Enlarged Financial Autonomy (SEAFAs[2]) to determine the fiscal space available to implement the measures in 2023. The US$3.16 billion of Budget ceiling were allocated to the SEAFAs considering their obligations for 2023 and their relevance to implement the GOP policy package.

2.152. In order to avoid duplicities and other inefficiencies in budget allocation, the Ministry of Finance supported SEAFAs in the elaboration of their 2023 budget. Importantly, a methodology to evaluate the quality of budget submissions and their alignment with government priorities was developed. A sample of SEAFAs submitted budgets was evaluated. SEAFAs' officers worked together with Ministry of Finance technical assistants for one month to implement the evaluation recommendations for improvement.

2.153. Currently, the Ministry of Finance is setting a task force to conduct an expenditure analysis, assessing the trends of execution by economic line item, and benchmarking them against other countries' trends in the South-Asia Pacific region. The objective of this exercise is to identify further savings for future budget cycles.

One-off and permanent budgetary policy measures

2.154. Ensuring better sustainability of public finances requires caution when deciding on the adoption of new budgetary policy measures. It is therefore important to differentiate between one-off and permanent new budgetary policy measures.

2.155. Specially, scale-up of permanent budgetary policies, as a consequence of political decision, might drain up the resources available to react to unexpected shocks and needs in the future. This particularly applies to a country with a large exposure to natural disaster like Timor-Leste and that is still building the foundations of its economy and public administration system.

2.156. Keeping an eye on permanent budgetary policies or budget rigidities is crucial in ensuring efficient and reactive public financial management.

- The 2023 General State Budget pulls resources together to ensure that all permanent budgetary policies will be implemented in 2023 with the required level of funding. Among the most important policy measures falling within the permanent category, we identify:
- Public Administration Labour Costs: US$445 million
- Ensure social protection for veterans: US$103 million
- Contingency Fund: $US66 million

[2] In Portuguese, Serviços e Entidades com Autonomia Financeira Alargada.

- School feeding program (Merenda Escolar): $US22.5 million
- Human Capital Development Fund: $US18 million
- Annual Subsidy Concordat with the Timorese Episcopal Conference: $US15 million
- Bolsa da Mãe Jerasaun Foun: $US13.7 million
- Nutrition Program: US$10 million
- Bolsa da Mãe: US$5.3 million
- Supporting non-Catholic religions: $US5 million
- Scholarships for the Children of National Liberation Combatants and Martyrs: $US1.7 million
- Supporting the social integration and rehabilitation of people with disabilities: $US1.4 million

Some subsidies granted by the State to SOEs, despite being discretionary measures by nature, may be perpetuated over time, as they are necessary to finance the operating costs of these companies. However, if these companies reach financial sustainability, the Government will reduce or eliminate these subsidies in the future. Subsidies to SOEs include:

- EDTL subsidy: US$100 million
- TIMOR GAP subsidy: $US54 million
- BTL subsidy: $US18 million
- RTTL subsidy: $US2 million
- Establishment and Operationalization National Mining Company: $US1.3 million

2.157. Other activities funded by the 2023 General State Budget have a transitory nature, representing one-off expenditures that do not pose any burden for future budget allocations. The ones with the largest impact on 2023 General State Budget are:

- National Parliament Elections: $US16 million
- Purchase of Timor-Telecom shares: $US14.5 million
- Suco Elections: $US10 million

3. Revenue and Financing

3.1. There are important economic reasons for distinguishing between revenue and financing items.

3.2. Revenue is considered regular income of the General Government that is readily available to pay for its expenditure.

3.3. The new economic classification of budget revenue distinguishes between recurrent and capital revenue.

3.4. Recurrent revenue is revenue that increases the wealth of the General Government because is not dependent on a reduction of assets or the assumption of liabilities.

3.5. Capital revenue, on the other hand, represents an influx of capital but does not increase the wealth of the General Government, because that influx is compensated either by the loss of assets or by the assumption of liabilities that will have to be repaid in the future.

3.6. Domestic revenue results mostly from taxes, duties and fees paid by companies and individuals.

3.7. Domestic revenue is classified as recurrent revenue and represents an increase in the wealth of the General Government, being the preferred way to pay for expenditure.

3.8. The Estimated Sustainable Income (ESI) is the legally established sustainable level of use of petroleum revenue, to ensure the continued existence of the Petroleum Fund. Therefore, transfers from the Petroleum Fund up to the ESI are also considered recurrent revenue.

3.9. Therefore, financing expenditure with recurrent revenue (domestic revenue and ESI) is a position that maintains fiscal sustainability.

3.10. It is a benchmark level of spending for understanding the long run trend of government finances, and can be assessed by the recurrent balanced, discussed at the end of this section.

3.11. However, the lack of enough recurrent revenue to pay for the full amount of the expenditure, forces the General Government to finance the deficit with capital revenue, both through transfers from the Petroleum Fund above the ESI or by taking loans.

3.12. These different types of income are treated differently, the first as revenue and the second as financing.

3.13. Additionally, some recurrent revenue, because of its inherently irregular nature are also treated as financing, as it happens with grants from donors.

3.14. The informative elements of the Budget Proposal provided a full breakdown of the different revenue sources, including revenues for RAEOA and the Social Security.

Global and recurrent balance

3.15. The table below shows the global and recurrent balance for the 2023 General State Budget.

3.16. The global balance of the General State Budget is positive as result of balanced budgets in Central Government and Social Security and a surplus in RAEOA of a US$1.2 million.

3.17. The recurrent balance for the General State Budget, as well for Central Government and RAEOA is negative.

3.18. This results from the amount of recurrent expenditure exceeding the amount of recurrent revenue.

3.19. This happens because much of recurrent expenditure is financed by transfers from the Petroleum Fund above the ESI, as a result of successive Governments adopting a policy of frontloading.

3.20. For this budget, the Government has identified a series of measures that aim to build physical infrastructure and human capital, which are essential to the long-term progress and development of the country, and that justify a transfer from the Petroleum Fund above the ESI.

3.21. Through the successful implementation of these measures, the Government hopes to build up sustainable revenue sources through economic diversification and ensure that the recurrent balance is zero in the long term.

Table 14: Budget Balances in US$

Global Balance	Amount
General State Budget	1,206,835
Central Government	0
Social Security	0
RAEOA	1,206,835
Current Balance	
General State Budget	-773,567,897
Central Government	-772,989,381
Social Security	52,624,971
RAEOA	-53,203,487

Source: General Directorate of Budget and Planning, Ministry of Finance, September 2022

Revenue

3.22. In 2023, total consolidated revenue for the Central Government is projected to be $1.8bn (excluding $1bn from the FCLN).

3.23. This $1.8bn is comprised of $1.35bn of withdrawals from the Petroleum Fund. The remaining sum is comprised of $174m in domestic revenue, $4.9m in direct budget support, $74.1m loans and $200m in treasury cash balance.

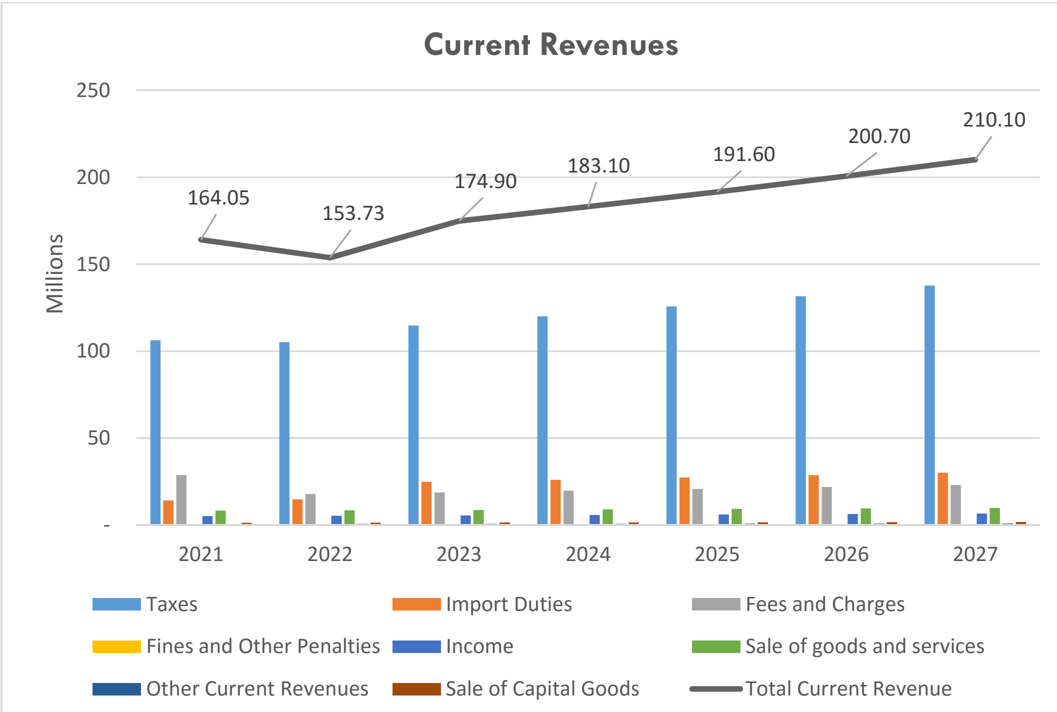
3.24. Domestic Revenues is comprised of tax revenue, customs duties, fees and charges, sales of goods and services, income (income from rents, interest receipts and dividends and shares), sales of capital goods, fines and other penalties.

3.25. Tax revenue (not including customs duties) is the largest contributor to domestic revenue making up of 71% and followed by fees and charges and customs duties of 11% and 9% respectively.

3.26. As set out in the Pre-Budget Statement, from 2017 to 2021 domestic revenue consistently declined (at an average of 5% a year).

3.27. Political instability and the COVID-19 pandemic contributed to this fall in domestic revenue.

Figure 11: Domestic Revenue Forecasts, $millions



Source: National Directorate for Economic Policy, Ministry of Finance, September 2022

3.28. In 2021 the economy began to recover from the aforementioned factors, however domestic revenues declined by 17% to their lowest total since 2012. This was due to Electricity of Timor-Leste (EDTL) and Bee Timor-Leste becoming State Owned Enterprises and therefore being excluded from the General State Budget which resulted in a 74% decline in Fees and Charges.

3.29. Total domestic revenues are expected to increase in 2023 to US$174.9m from US $153.7m in 2022.

3.30. Domestic revenues are mainly projected to increase due to a combination of an increase in import duties and the introduction of new rates of excise taxes.

3.31. The import duties will increase from the current 2.5% to 5%. The increase in import duty raises revenues and brings Timor-Leste in line with the global median for average import duties[3].

3.32. As a result, this reduces some of the disparities that Timorese businesses face when exporting goods and services relative to importing them, and therefore promotes domestic competitiveness.

3.33. The new excise taxes to be introduced in 2023 will include: excise on tax rate of 10%, 20% and 30% for passenger cars with values that exceed $10,000, $25,000 and $50,000 respectively, an increase on the excise duty on tobacco and other tobacco products of $50 per kilogram (from $50 per kilogram to $100 per kilogram);

[3] https://data.worldbank.org/indicator/TM.TAX.MRCH.WM.AR.ZS

a new $1 per kilogram sugar tax and an introduction of a $3 per litter excise duty on sugary drinks.

3.34. Furthermore, tax revenues are expected to be boosted by reforms in the tax collection systems, in particular the shift to SIGTAS (Standard Integrated Government Tax Administration System), which aims to increase the Tax Authority's capacity to enforce greater tax compliance.

3.35. Tax revenue has been consistently the largest contributor to domestic revenue, averaging around 70% of total domestic revenue collection across the last 10 years.

3.36. The composition of revenue i.e., the proportions that come from tax, fees and charges, or other sources tend to be consistent over time even if some years overall revenue is different.

3.37. Yet tax revenue had fallen consistently from 2016 to 2020 (from $133m in 2016 to $105m in 2020), alongside a decline in overall collections. Tax revenue in 2021 started to increase again (rising to $106m), making up 65% of the total revenue in that year.

3.38. Tax revenues could increase beyond what has been forecasted due to the planned approval of a new tax law and a new tax procedure code next year.

3.39. The tax law aims to incorporate progressiveness in the tax rates and broadening the tax base, as well as revising and harmonising the income and salary taxes. The tax procedure code will modernise tax collection and give increase powers to the tax administration to enforce tax laws and collect unpaid taxes.

3.40. Additionally, tax revenues could increase through the implementation of VAT. However, the complexity of VAT implementation means that the collection of substantial revenues from this tax might not be achieved before the end of the current forecasting period (i.e., around 2027).

3.41. The move towards increased decentralization of government activity has also seen the introduction of a few new revenue streams through local advertising and parking services. Further decentralization, improvements and reinforcement of collection mechanisms in line ministries and the introduction of new non-tax instruments are expected to boost collections of Fees and Charges. Autonomous Agency collections, while they have no planned policy changes or reforms, are expected to rise with the improved economic conditions.

3.42. Although ESI is a recurrent revenue according to the new economic classification of budget revenue and shares similarities with domestic revenue, we choose to treat it together with other Petroleum Fund revenues in the financing section for uniformity purposes.

Financing

3.43. The total budgeted expenditure for 2023 is higher than the domestic revenue that will be collected over the same period. This results in a non-oil deficit (domestic revenue minus expenditure).

3.44. This deficit is financed through a number of sources; withdrawals from the Petroleum Fund (PF), loans, the use of the cash balances (from many sources) and Budget Direct Support from the European Union and Government of Australia.

3.45. Withdrawals from the PF can be either within a sustainable amount, using the revenue of the fund, or excess withdrawals above this sustainable level (see next section). The table below shows the amount drawn from each of the financing items.

Table 15: Details source of Financing to Central Administration, 2023-2027, $millions

	2023 $m	2024 $m	2025 $m	2026 $m	2027 $m
Total Withdrawals from Petroleu Fund	***1,346.09***	***1,426.39***	***1,448.25***	***1,514.50***	***1,575.25***
Estimated Sustainable Income (ESI)	*490.15*	*464.09*	*429.40*	*393.15*	*353.96*
Excess Withdrawals	*855.94*	*962.30*	*1,018.85*	*1,121.35*	*1,221.29*
Domestic Revenue	***174.90***	***183.10***	***191.60***	***200.70***	***210.10***
Loans	***74.1***	***86.8***	***87.1***	***77.3***	***46.2***
Direct Budget Support (DBS)	***4.9***				
European Union	*3.30*				
Australia	*1.60*				
Treasury Cash Balance	***200.00***	***200.00***	***200.00***	***200.00***	***200.00***
Total	***1,800.0***	***1,896.3***	***1,927.0***	***1,992.5***	***2,031.6***

Source: Ministry of Finance, September 2022.

Petroleum Fund Revenue

3.46. The Government's General State Budget is largely financed from the Petroleum Fund. The amount withdrawn is divided between the Estimated Sustainable Income (ESI) amount and any excess withdrawal that is justified by the Government to be in the long-term interests of Timor-Leste.

3.47. Calculating the ESI requires projecting the Fund's value at the beginning of the budget year, along with the present value of future petroleum revenue.

Table 16: Estimates for the Petroleum Fund ($m)

Item	Value
Beginning balance of the Petroleum Fund in 2022	19,565.0
Estimated investment income in 2022	-1,418.5
Estimated petroleum revenue in 2022	631.1
Estimated government withdrawals in 2022	-$2,552.6)
Estimated ending balance in 2022/ beginning balance in 2023	16,225.1
Estimated net present value of future petroleum revenue in 2023	113.1
Estimated Petroleum Wealth 2023	16,338.2
2023 ESI (3% of Petroleum Wealth)	**$490.1**
Withdrawals in excess of the ESI	855.9
Budgeted withdrawals in 2023	1,346.1

Source: Petroleum Fund Policy and Management Office, Ministry of Finance, September 2022.

3.48. The beginning balance for the Fund in 2022 is US$19,565 million.

3.49. For 2022, petroleum revenue is estimated to be US$631.1 million, most of which has already been received. This was much higher than the projections in the 2022 Budget because of higher oil and gas prices.

3.50. With respect to investments, equity and bonds have fallen in value this year because central banks have sharply raised interest rates to curb persistently high inflation. As a result, the Fund has incurred significant mark-to-market losses for the year to date, which is also the experience of similar funds around the world.

3.51. This follows very strong investment performance for the Petroleum Fund in the previous three years when investment income totalled about US$5 billion.

3.52. The Fund's financial investment return is estimated to be negative 7.89% in 2022, which translates to an annual loss of US$1,418.5 million.

3.53. To date, most of the loss is unrealised because withdrawals have been financed from the liquidity portfolio of low-risk assets, including cash. This portfolio was created in July 2021 to finance near-term withdrawals and has fulfilled its purpose by remaining stable in value during the recent market turbulence.

3.54. If the full US$2,552.6 million in the Rectification Budget 2022 is withdrawn in 2022, the Petroleum Fund is projected to end the year at US$16,338.2 million. Equities and bonds will need to be sold in 2023 to top-up the balance of the liquidity portfolio to cover the total of withdrawal projections for 2023 to 2025.

3.55. Bayu-Undan field is expected to end production this year so petroleum revenue beyond 2022 is limited to a present value of US$113.1 million[4] (the estimated petroleum revenue is US$115.2m in 2023).

3.56. Therefore, total Petroleum Wealth is estimated to be US$16,338.2 million on 1 January 2023, resulting in an ESI for 2023 of US$490.1 million. This is US$37.9 million lower than the projection in the 2022 Budget, and lower than the 2022 ESI of US$554.1 million.

3.57. Petroleum Wealth has declined as a result of the increase in withdrawals in the Rectification Budget and the decline in the value of the Fund's investments.

3.58. In terms of the projections for 2023, petroleum revenue is estimated at US$115.2 million, and the expected investment income is US$577.4 million, reflecting higher longer-term expected returns from the liquidity and growth portfolios.

3.59. Withdrawals to fund the 2023 Budget are projected to be US$1,346.1 million or 8.2% of Petroleum Wealth at the beginning of the year, exceeding the 2023 ESI by US$855.9 million.

3.60. The Informative Elements of the Budget Proposal describe the key information about the Petroleum Fund and provides detailed information on the ESI calculation and the underlying assumptions.

3.61. The ESI is equal to 3% of the net petroleum wealth and is estimated as US$490.1 million in 2023. This is a decrease from the ESI in 2022 (US$554.1 million) due to the decline in the Petroleum Fund's balance this year. Further details on the ESI and petroleum wealth can be found in the Informative Elements.

3.62. The Government plans to withdraw US$855.9 million in excess of the ESI for annual budget 2023.

[4] The Law requires the value of petroleum fund revenue to be evaluated in its present value in 2022 which differs slightly from the time of collection in 2023.

3.63. This is a significant decrease from the forecast excess withdrawals in the 2022 Rectification Budget, which totalled US$1,998.5 million and includes a US$1,000 million transfer to create the National Liberation Combatants Fund.

3.64. However, it is an increase on the actual excess withdrawals in 2021, which were US$600.0 million.

3.65. Excess withdrawals are in line with the Government's frontloading policy, as these withdrawals are being used to finance core infrastructure and human capital, which is necessary for long-term growth.

Cash Balances

3.66. The total actual revenue of the General State Budget for 2021 was US$1,881.6. million, comprising domestic revenues of US$217.3 million, transfer from the Petroleum Fund of US$1,147.9 million, end of year balance (from the Treasury and RAEOA) of US$493.9 million and loans of US$22.5 million.

3.67. During the year ending on December 31, 2021, a total of US$ 1,147.9 million was transferred from the Petroleum Fund (which represents 83% of the transfer forecast for the year 2021 and US$ 600 million above the ESI), in order to cover the operational needs of the General Government.

3.68. After accounting for 2021 expenses and other equity adjustments, the total cash balance available (both in the Treasury Account and RAEOA-ZEESM) amounted to US$455.0 million, which does not include the cash balance held by Social Security and the cash balance in the TL-Cement Escrow Account at the Central Bank of Timor-Leste (the Balance in the TL-Cement Guarantee Account at the Central Bank of Timor-Leste is US $50.3 million).

3.69. The Treasury Cash Balance and RAEOA until December 31, 2021, is indicated below.

Table 17: Central Government and RAEOA cash balance in the end of 2021 in US$'000

Account	Value
FCTL	155.046
FI	32.255
FDCH	1.491
Fundo COVID-19	17.743
Autonomous Agencies	36.035
Municipalities	8.609
Total Central Government	251.180
RAEOA	203.863
Total Central Government + RAEOA	455.043

Source: Directorate General of Treasury, Ministry of Finance, September 2022

3.70. By the end of August 2022, the total domestic revenue collected and deposited in the Consolidated Fund of Timor-Leste (FCTL) and other accounts of the Central Bank of Timor-Leste was US$107.2 million (64%) of the total estimate for the year 2022 (US$166.8 million).

3.71. As of August 31, 2022, a total of US$854.0 million (33% of the total allowable transfers in 2022 of US$2,552.6 million) had been transferred from the Petroleum fund to the Treasury account to cover the budget execution needs of the state.

3.72. Subtracting total expenditure to the revenue derived from Petroleum Fund transfers, end of year balance, domestic revenue and external through August 2022 results in a total cash balance of US$535.3 million (which consists of Treasury and RAEOA) at the end of August of 2022.

Table 18: Central Government and RAEOA cash balance in August 2022 in US$'000

Account	Value
FCTL	269.231
FI	17.892
FDCH	1.715
Fundo COVID-19	26.891
Autonomous Agencies	45.107
Municipalities	12.556
Total Central Government	373.392
RAEOA (Excluding FED)	161.949
Total Central Government + RAEOA	535.341

Source: Directorate General of Treasury, Ministry of Finance, September 2022

Loans

3.73. The Strategic Development Plan 2011- 2030 aims to transition Timor-Leste from a low income to upper middle-income country where extreme poverty has been eradicated and established a sustainable and diversified non-oil economy.

3.74. Without sustainable infrastructure development, however, the vision is more difficult to reach. Poor access to basic infrastructure services has been a serious obstacle to build a diversified economy and transform Timor-Leste into a modern nation with private sector being the engine of growth.

3.75. Increased investment in high quality infrastructure facilities such as road, water, electricity, telecommunications and the airport, to name a few, is, therefore, necessary in improving conditions for private investments both domestic and foreign investors in support of various productive sectors development essential for achieving inclusive and sustainable growth for future generations.

3.76. To meet this objective, however, substantial financing resources are needed, and loans are one way of supporting such projects which have potential economic benefits to the country. A key benefit of long-term loans is that it is cheaper than withdrawing money from Petroleum Fund. If the cost of borrowing is less than cost of financing from Petroleum Fund, it helps preserve sustainability in the Petroleum Fund over a long run.

3.77. So far, government borrows money from International Financial Institutions and as of August 2022 it has accumulated $852.58 million.

3.78. Of this, Government has heavily invested on a safer national road infrastructure network nationwide. Road transport infrastructure improvements gradually improved the quality of life not only for city populations but also rural populations by increasing safety and connectivity of economic activities of different municipalities in the country.

3.79. In the last few years,, Government has also expanded and increased its public debt investment on social infrastructure including healthcare, education, housing & water and sanitation.

Table 19: Amount of Public Debt as of August 2022 in $ million

Item	Amount
Signed Amount	852.58
Disbursed Amount	265.83
Undisbursed Balance	548.43
Principal Repayments	20.37
Interest Payments	9.87
Debt Stock	245.47
Debt to GDP	15.5%

Source: General Directorate for External Resource Mobilisation, Ministry of Finance, September 2022

3.80. The amount of disbursement seems to be low as several projects with significant budget amounts are relatively new programs or about to commence their implementation stage including Dili and Baucau Water Supply projects, President Nicolau Lobato International Airport Development Project and Improvement to Basic Education System Project.

3.81. In terms of debt sustainability, by using DNPE forecast on real GDP figures, the external debt/GDP would stand at around 15.5% still well below 30% to 40% thresholds recommended by IMF for Low Income Countries.

3.82. Total external debt is projected to remain below the thresholds over next 3-4 years.

3.83. Furthermore, the Petroleum Fund's return over the past ten years has on average been 4.28% while the loans have an average interest rate of around 1.21%. Therefore, Timor-Leste has saved more than 3% of return on the amount of money it takes out in loans, which helps to boost market confidence in the Government's ability to repay debt as far as concessional loan are concerned.

Table 20: Cost of borrowing %

Description	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Cost of borrowing (effective rate)				1.02	1.42	1.68	2.06	2.34	2.03	1.50
PF historical return	4.1	4.4	4.2	3.8	3.8	4.4	3.8	4.5	4.84	4.91

Source: General Directorate for External Resource Mobilisation, Ministry of Finance, September 2022

Public Private Partnerships

3.84. In general terms, the Public Private Partnership (PPP) refers to arrangements in which the private sector builds infrastructure assets and provides services that traditionally have been provided by the State.

3.85. The underlying rationale for PPPs in Timor-Leste stems from the fact that, this arrangement may potentially allow the Government to benefit from the private sector's expertise, experience and financing, which then results in higher quality and efficiency, as well as lower risk borne by the Government.

3.86. Timor-Leste began exploring PPPs as a modality for project implementation over the last 8 years and started out by establishing a PPP Policy, PPP legislation and a dedicated PPP Unit under the Directorate General for External Resource Mobilization and Management, Ministry of Finance.

3.87. Currently, one PPP project is in the Implementation and Operation Stage (Tibar Bay Port PPP), one in the Procurement and Negotiation Stage (Medical Diagnostics) while others are in the Feasibility Stage (Affordable Housing, Cristo Rei, Dili Port and Presidente Nicolau Lobato International Airport/PNLIA). Note that the PNLIA project is currently in the procurement stage for the phase one runway extension.

3.88. The PPP modality chosen for Tibar Bay Port was a 30-year concession, including the design, partial financing, construction, operation and maintenance of the port infrastructure. Construction started on 30 August 2018 and expected to be completed by 30 November 2022. The Escrow Account is earning interests. As of 31st August 2021, interest earned amounted to $8.829m.

3.89. Medical diagnostics PPP is in the early steps in the procurement and negotiation Stage, with the project specific decree law having been recently approved by the Council of Ministers.

3.90. The Presidente Nicolau Lobato International Airport Project is being developed through PPP Hybrid modality - that refers to a combined financing arrangement whereby some components of the airport infrastructures are taken on by public investment through loans, grants and state financing, while some other components are taken on through private sector investment.

3.91. The Feasibility study for several Airport components such as extension of the runway to 2.1 Km, aprons, partial parallel taxiway and a control tower has been completed and the loan negotiation (in the amount of US$165 million inclusive government counterpart) for these components have also been concluded in May 2021.

3.92. Meanwhile, preparatory studies for Terminal development and its sub-components started in Q1 2022 and financed through the Japan International Cooperation Agency (JICA) grant for $44 million while other support infrastructures are still subject to discussion with Department of Foreign Affairs and Trade (DFAT) of Australia and other donors.

3.93. The Cristo Rei PPP has finalized its pre-feasibility study through Grant financing from the USAID's Tourism for All (USAID's TFA) program. After approval of CAFI was secured for the Pre-FS in November 2020, the project is now in the next phase, which is the Feasibility Study preparation phase. It is estimated that the project will cost US$3.115 million including the plan to move the parking area to Area Branca site.

Direct Budget Support

3.94. With the development of Foreign Aid Policy, the Government of Timor-Leste has made clear its preference for direct budget support (DBS) assistance, reducing potential duplication, overlap and the transaction costs of managing and/or coordinating with several fragmented donor supported activities.

3.95. DBS is considered as financing for 2023 General State Budget because it uses Government system (the money is in a Treasury sub-account) and is executed on-budget, following budget execution regulations.

3.96. Timor-Leste has been receiving Direct Budget Support (DBS) from the European Union since 2014. In this context, the funds are directly given to the country's government without prior earmarking. However, a variable tranche depends on specific Key Performance Indicators (KPIs) agreed upon by the Ministry of Finance and the EU. While the funds are not separate or additional to the Ministry's core allocation, they must support clearly stated.

3.97. In 2021, the Government of Australia committed to US$8.2 million in Direct Budget Support to be allocated over the next two years. The funding is linked to the National Suco Development Program (PNDS) and the expansion of the Bolsa Da Mae social assistance programme to include pregnant women and early childhood (Bolsa Da Mae Jerasaun Foun).

3.98. The PNDS investment will focus on funding new community investment programmes, particularly those focused on improved sanitation, draining and irrigation channels and local road rehabilitation. The Bolsa Da Mae Jerasaun Foun investment will concentrate on directly funding cash transfers as well as supporting the operational costs of the programme delivery.

Table 21: Direct Budget Support in the 2023 General State Budget in US$ millions

Donor	Program	Amount
EU	Budget Support to Deconcentration and Decentralization	1.1
EU	Nutrition programme	2.2
Australia	Bolsa de Mae Jeresaun Foun	1.6
Total		**4.9**

Source: General Directorate for External Resource Mobilisation, Ministry of Finance, September 2022

3.99. In addition, the Government of Australia intends to further increase their existing budget support arrangements for three Government programs in 2023. Below is a table of the indicative amounts that have been committed. Please note that the specific arrangements have yet to be finalized, therefore these should be considered indicative as of this time.

Table 22: Additional Planned Government Program Support from Australia US$ millions

Government Program Supported	GoTL Agency	AUD	$US estimates
Bolsa de Mae Jerasaun Foun	MSSI	10,500,000	7,000,000
Programa Nasional Dezenvolvimentu Suku	MSA	7,000,000	4,800,000
Labour Mobility and skills training	SEFOPE	1,300,000	900,000
Total		**18,800,000**	**$12,700,000**

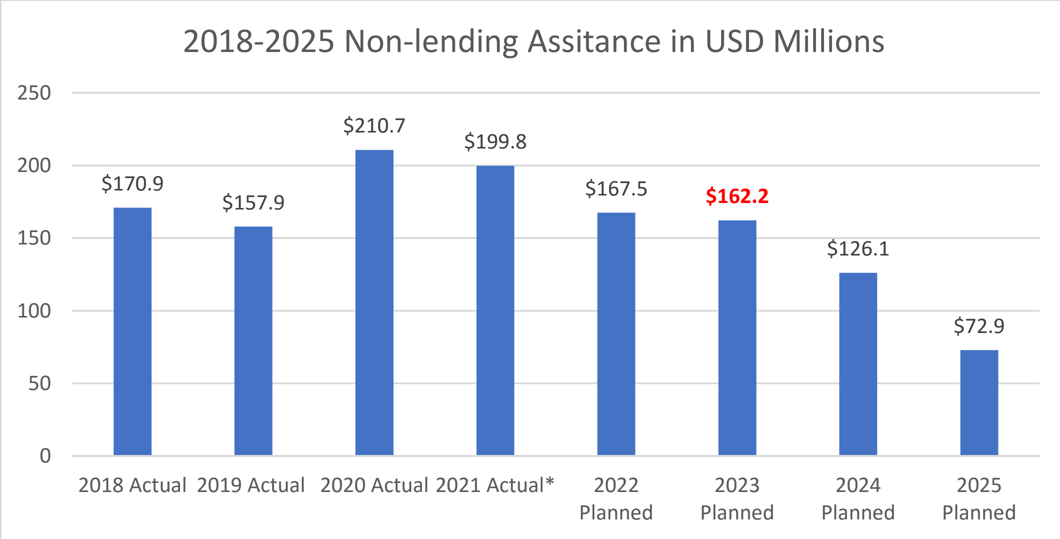
Source: General Directorate for External Resource Mobilisation, Ministry of Finance, September 2022

Development Partners

3.100. The amount of Official development assistance (ODA) to Timor-Leste exceeded US$150 million annually since 2016.

3.101. Development partners are reporting a total of $162.2 million to be disbursed in 2023 (US$152.9 towards Government sector related activities; US$9.2 non-government). This could be an indication that the levels of development partner support are stabilizing following the surge in spending throughout the COVID pandemic and to assist with the effects of Tropical Cyclone Seroja in 2021.

Figure 12: Development Partner Non-Lending Disbursements 2018-2025 in USD Millions



Source: Aid Transparency Portal, September 2022 *figures should still be considered preliminary

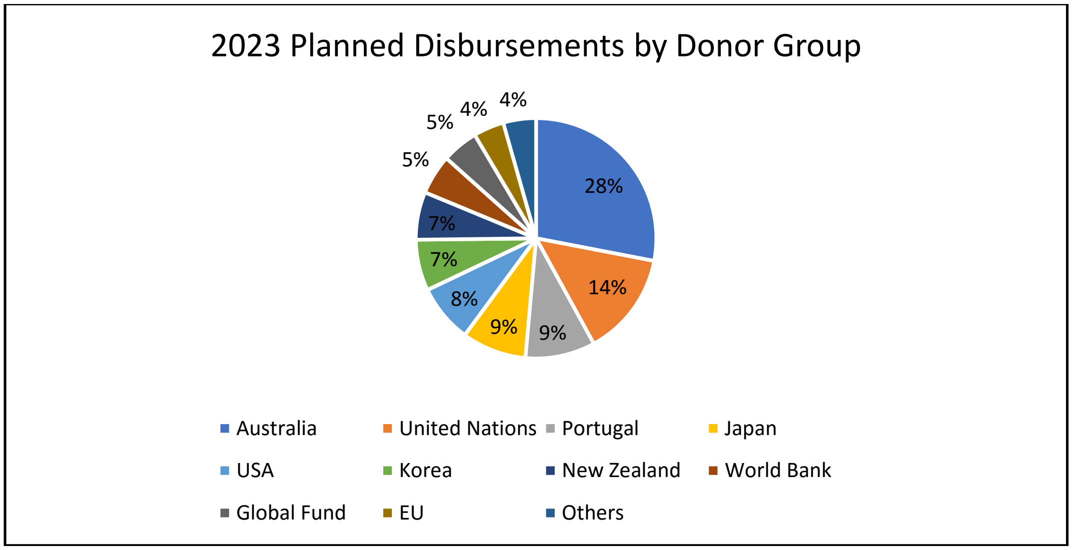
3.102. In addition, it is important to note that forecasted funding more than one year in advance is typically unreliable. This is due to several reasons, most notably since many donors operate on single year budgets.

3.103. The dramatic decline in funding shown in the future years above is based on data collected at the project level, thus it does not include donor's funding that has been secured yet not committed towards specific projects.

3.104. For example, the Millennium Challenge Corporation's upcoming Compact is not included in these figures even though they are likely to contribute significantly towards the donor funding landscape.

3.105. In 2023 the five donor groups that are scheduled to disburse the highest amounts of funding are as follows: Government of Australia ($44.3 million; 28.0% of total), the United Nations ($22.9 million; 14%) Portugal ($15.4 million; 9%), Japan ($14.2 million; 9%); and the United States of America ($12.8 million, 8%).

Figure 13: 2023 % Planned Non-lending Disbursements by Donor Group*



Source: Aid Transparency Portal, September 2022, *figures should still be considered preliminary

3.106. The table below provides a snapshot of the scheduled top funded donor projects and programs in 2023.

Table 23: 2023 Top 10 donor projects with highest scheduled non-lending disbursements in $US millions

Project Title	Donor	SDP Sub-pillars	Total
Australia - Timor-Leste Partnership for Human Development - Health Sector	Australia	Agriculture	8.2
5530-Escola Portuguesa Ruy Cinatti – Centro de Ensino e Língua Portuguesa	Portugal	Education and Training	7.8
Australian NGO Cooperation Program (ANCP)	Australia	Agriculture Health Social Inclusion Justice Water and Sanitation Public Sector Management and Good Governance Education and Training	7.5
10383 - Escolas de Referência de Timor-Leste - Centros de Formação	Portugal	Education and Training	6.2
Safeguarding rural communities and their physical assets from climate induced disasters in Timor-Leste.	UNDP	Education and Training	5.7
Partnership to Strengthen Village Development and Municipal Administration (PARTISIPA, formerly PNDS-SP)	Australia	Security	5.2

A partnership for Inclusive Prosperity / Parseria ba Prosperidade Inkluzivu (PROSIVU)	Australia	Education and Training	5.1
National TB Programme (NTP) and Resilient and Sustainable Systems for Health (RSSH)	Global Fund	Rural Development	4.8
Timor-Leste: Sustainable Agriculture Productivity Improvement Project (SAPIP)	World Bank	Education and Training	4.5
Health System Sustainability Project	USAID	Education and Training	3.8

Source: General Directorate for External Resource Mobilisation, Ministry of Finance, September 2022

Fiscal Sustainability Analysis

3.107. As set out in the Pre-Budget statement[5], over the past decade, the bulk of government spending has been financed by the Petroleum Fund[6]. This means that fiscal sustainability is closely tied to the longevity of the Petroleum Fund.

3.108. In this section we estimate the lifetime of the petroleum fund under the current expenditure trend.

3.109. Without fiscal reforms or a new source of Petroleum Resources, the Petroleum Fund is set to fully deplete by the end of 2034.

3.110. It is important to note, that this prediction does not factor in any negative economic consequences from when the Petroleum Fund balance comes close to depletion. It is highly likely that as the Petroleum Fund comes close to fully depleting, the associated fall in government expenditure could also lead to a collapse in consumer and private sector spending. This would likely cause an economic downturn that could cause a fall in domestic revenues and therefore further impact fiscal sustainability.

3.111. Further details on the model, including an explanation of the data used and assumptions made, are available in the Methodological Annex.

3.112. The figure below projects the life of the Petroleum Fund under the current expenditure trajectory. The blue dotted line shows total available revenues (this is the sum of the petroleum balance and domestic revenues and excludes funds through new loans or from development partners[7]). The red dotted line shows total expenditure. The large orange bars show the depletion of the petroleum fund which is projected to fully deplete by the end of 2034.

3.113. This scenario factors in the approved GOP ceiling for 2023 and assumes that beyond that expenditure will continue to increase in line with long run inflation and population growth (i.e., at 4% nominal growth a year).

3.114. Under this scenario by 2034, the country is at risk of facing a fiscal cliff where projected expenditure is likely to exceed total available revenues by $1.6bn. This means that under current spending plans in 2034, the government would have to cut spending by 60% and by a further 80% the following year. It should be noted

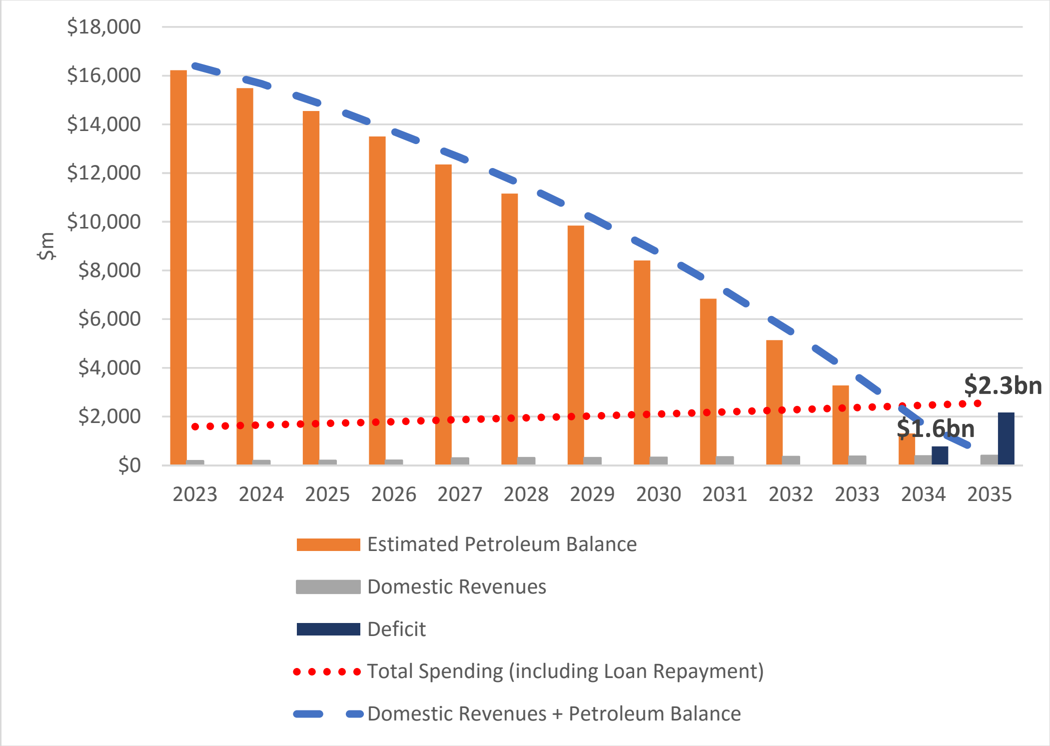
[5] Ministry of Finance Pre Budget-Statement 2023, https://assets.ctfassets.net/60pzqxyjaawg/6Ks1mXDBwdtD193M7N0JQp/7242c550152f5a7a386c579c46ccdf0f/The_Pre-Budget_Statement_2023.pdf

[6] Petroleum Fund Withdrawals have averaged over $1bn over the last decade, whereas domestic revenues are yet to exceed $200m a year.

[7] New Loans and Direct Budget Support are not included in the analysis due to uncertainty. Due to their small scale, they would have little impact on the overall results.

that the Petroleum Fund will deplete earlier than projected by this scenario if expenditure is increased beyond 4% a year.

Figure 14: Estimated Petroleum Fund Balance under Current Trends, $millions



Source: National Directorate for Economic Policy, Ministry of Finance, September 2022

3.115. Under the current spending trajectory, there is a risk of hitting a fiscal cliff in 2034 at which point around $1.6bn worth of spending cuts may be necessary. This would result in a large shock to GDP, likely resulting in large rises in unemployment and large falls in incomes, the provision of public services and ultimately living standards.

3.116. This eventuality also has implications for the country's ability to continue importing to the same scale and circulate currency internally. The country is currently able to sustain a dollarized economy since Petroleum Fund revenues guarantee a regular supply of US dollars. A large non-oil trade deficit (projected to be greater than $900m in 2022) is only possible with a dollarized economy because inflows of dollars from the Petroleum Fund can replace the large outflow of dollars that are spent on imports.

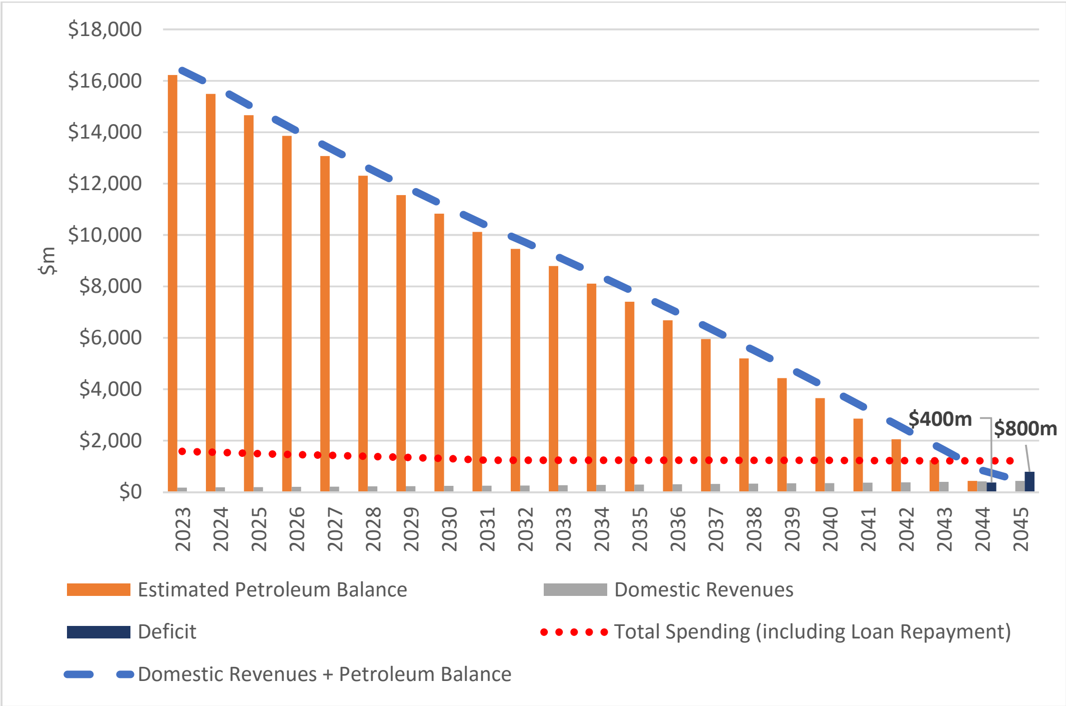
3.117. If a currency alternative is not in place well in advance of the point that the Petroleum Fund depletes, persistent trade deficits could spark a liquidity crisis. Without the use of Petroleum Fund inflows to finance the outflow of US Dollars from expenditure on imports, individuals and businesses could find themselves without the currency needed to finance day to day transactions.

3.118. Extending the lifespan of the Petroleum Fund would allow the country to have more time to build up alternative domestic revenue sources and prepare for implementing a new currency.

3.119. Below we present a scenario where the government gradually reduces spending to pre-COVID levels. The result would be to allow the country to have an extra decade in which it can continue to rely on Petroleum Fund withdrawals.

3.120. In the chart below, we model the impact of a gradual reduction in spending to $1.2bn followed by a spending freeze at that level. In this scenario the government reduces nominal expenditure (excluding expenditure financed by loans or by development partners) by 3% a year up until it reaches $1.2bn by around 2031. Fixing expenditure at $1.2bn at that point would mean that the Petroleum Fund would not deplete until 2045. By this stage Domestic Revenues are predicted to reach closer to $600m as opposed to less than $400m if the fund depletes by the end of 2034.

Figure 15: Estimated Petroleum Fund Balance with moderate Spending Cuts, $millions



Source: National Directorate for Economic Policy, Ministry of Finance, September 2022

3.121. If, in addition to the moderate spending cuts modelled above, the government can raise domestic revenues, the Petroleum Fund can last even longer.

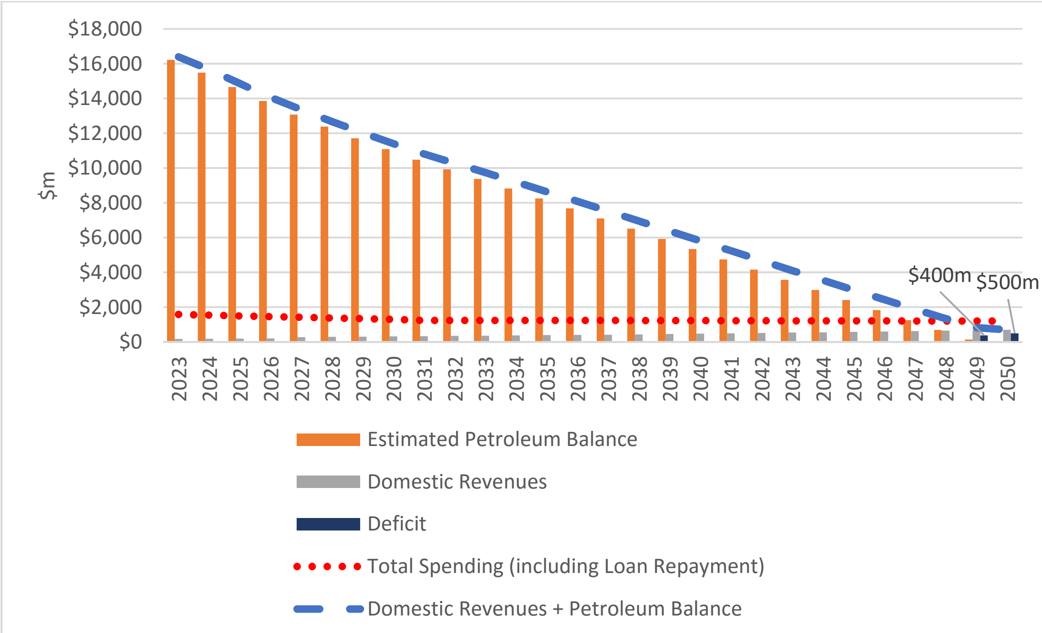
3.122. Using the Fiscal Sustainability Model, we demonstrate that if gradual spending cuts are implemented (as shown in expenditure scenario 2 above) alongside the implementation of VAT and property taxes by 2027 the Petroleum Fund can last till the end of 2049. Furthermore, under this scenario at the point that the fund depletes, the gap between spending and available revenues would be reduced to less than $500m.

3.123. The scenario is presented in the figure below. As with the previous scenario presented, here we assume that the government reduces spending (excluding new loan and development partner funded spending) by 3% a year until spending reaches $1.2 billion at which point spending is frozen.

3.124. Here we also assume that the government implements VAT and property taxes by 2027. Preliminary estimates from the National Directorate for Economic Policy at the Ministry of Finance suggest that these taxes could bring domestic revenues to around $285m by 2027.

3.125. Under this scenario, by the time the Petroleum Fund depletes, domestic revenues would be able to finance $740 million of spending. However, this figure could be greater if extra years of petroleum revenues are used to successfully diversify the economy and achieve further revenue growth.

Figure 16: Estimated Petroleum Fund Balance with moderate spending cuts and the introduction of VAT and Property Tax, $US millions



Source: National Directorate for Economic Policy, Ministry of Finance, September 2022

Preparing for the end of the Petroleum Fund

3.126. Above we presented results from our economic model where we showed how gradual cuts to expenditure and the implementation of a few new taxes can improve fiscal sustainability.

3.127. A complementary strategy is to seek alternative revenue sources. Aside from introducing new taxes such as VAT and property taxes, this can also include reforms that widen the tax base such as measures that help formalise the economy. The government can also look to increase revenues from existing taxes by introducing higher tax rates for larger businesses or those earning higher incomes.

3.128. Prioritising measures to diversify the economy, such as the measures approved in GOP and explained in this Budget Report, can also boost GDP growth. This can therefore lead to further increases in domestic revenue (by boosting individual and business income) and help avoid hitting a fiscal cliff. Economic diversification can also broaden opportunities for private sector investment and therefore reduce the need for government investments.

3.129. Finally, the government can also reduce the number of excess withdrawals through sustainable debt financing for long term investments. The Debt to GDP ratio as of August 2022 is just under 16% which is one of the lowest levels at the world. This means that there is some (albeit limited) scope to increase financing from loans and continue to borrow at sustainable levels if loans are used for long term investments.

Fiscal Risks and Contingent Liabilities Statement

3.130. Fiscal risks are factors that may cause fiscal outcomes to deviate from expectations or forecasts.

3.131. Fiscal risks can arise from macroeconomic shocks or the realization of contingent liabilities - that is obligations triggered by an unexpected event or whose realization during the financial year is uncertain.

3.132. Contingent liabilities are a type of fiscal risks that are obligations for governments to pay out but that do not arise unless a particular event occur in the future to trigger it.

3.133. In the case of Timor-Leste this can lead to excess withdrawals, depleting the Petroleum Fund, and are detrimental to fiscal sustainability and macroeconomic stability. Countries with stronger institutions can better control and manage the underlying risks so that they are less exposed to contingent liabilities being triggered.

3.134. Timor-Leste's 2019 PEFA assessment highlighted some areas for improvement surrounding Timor-Leste's Fiscal Risk Reporting and Contingent Liabilities Disclosure.

3.135. The Government is committed to improving its disclosure, analysis and management of Fiscal Risks and Contingent Liabilities.

3.136. Budget Book 1 of daft Budget 2022 included for the first time a statement on Contingent Liabilities, and Law No. 9/2011, de 17 de agosto, Orgânica da Câmara de Contas do Tribunal Superior Administrativo, Fiscal e de Contas already required the "Disclosure of responsibilities of the state (direct & indirect) arising from assumption of liabilities namely, guarantees…' [Art 29, 1f), g)].

3.137. However, with the approval of the new Budget and PFM Law it is now required for the draft budget report to present an analysis of fiscal risks and disclosure of the General Government contingent liabilities.

3.138. Aside from this legal requirement, Timor-Leste has also committed to "Development of a Fiscal Risks Statement and Risk Management Strategy" within the PFM Reform Strategy 2022-2027.

3.139. According to the IMF, international best practices surrounding fiscal risk and contingent liabilities management involves a more complete understanding of potential risks, steps to quantify risks and steps to mitigate or provision for risks.

3.140. As Timor-Leste is in its fledgling steps in this regard, this statement outlines its intentions for fulfilling its commitments to better management and reporting of fiscal risks.

3.141. Below is an overview of Timor-Leste's action plan to better manage fiscal risks and contingent liabilities, with this statement being the first step:

1. Disclosure: outlining explicit and potential risks and commitment to manage them.
2. Collect: data from LMs and SOEs on their stock of risks.
3. Analysis: of concentration and correlation of risks.
4. Manage, mitigation and monitor: take steps to manage existing stock of risks and prevent from increasing; provision for contingencies; monitor crystallizations or changes in risk.

Explicit Contingent Liabilities recognised by Law or Contract

3.142. Judicial litigation is an important source of contingent liabilities and the cost for the State is dependent on the outcome of the litigation, which is still pending.

3.143. Below are the current litigation cases against the government of Timor-Leste, and their maximum potential cost if the case was to be decided in favour of the claimant.

- Prosafe Rigs Ltd: Judicial case in the Timorese courts related to the liquidation of income tax from 2004, with a maximum liability of US$1,156,826.91
- Eastlog Projects Limited: Litigation case in the Hong Kong Arbitration Court related to the alleged breach of the Suai Supply Base construction contract, with a maximum liability of US$5,305,338.08.
- Lighthouse Case: Judicial case in the Victoria Supreme Court in Australia related to the acquisition of generators for the Hera Power Plant, with a maximum liability of about US$1,000,000

3.144. To cover contingent liabilities derived from Legal awards and claims, an allocation of US$2,000,000 is included in Dotação Geral do Estado. An additional allocation for lawyers' fees amounts US$1,500,000.

3.145. The Credit guarantee system for MSME is an initiative aimed at supporting businesses starting out, whereby a government guarantee covers up to 70% of the value of the business loan to MSME in order to encourage the development of the private sector in the country with the total guarantee of USD 4 million. The Central Bank works with banks to share the risk and manage risks. The maximum size of the individual loan is $150,000, however it is already 100% budgeted for, so it poses no additional risk if the loans were to default.

3.146. Fasilidade Garantia Crédito Suave is a loan guarantee scheme to provide low interest loans for companies and individuals. The loans are awarded by financial institutions which celebrate a contract with the Government to provide low interest loans that are guarantee by the Government. The scheme had an initial budget of US$1,379,990, but that was reinforced with an additional US$50,000,000 by the Law No. 6/2022, Primeira alteração ao Orçamento Geral do Estado para 2022. However, this scheme is also 100% budgeted for, so it poses no additional risk if the loans were to default.

Public Private Partnerships (PPPs)

3.147. Public-Private–Partnerships contracts often involve some sort of contingent liabilities for the government. These can be guarantees or indemnities on particular risk variables, with an agreement for the government to compensate the private party for loss in revenues should a particular risk occur which is different from the level specified in the contract. The associated risk is therefore shared between the government and private sector.

3.148. In 2023 the government of Timor-Leste will have already approved 2 PPPs to date: Tibar Port which is due to finish construction at the end of 2022 and the Medical Diagnostic. The contingent liabilities associated with Tibar Port relate to currency fluctuations, occurrence of Force Majeur or acts of God ie events for which no party can be held account, unforeseen political circumstances and settlements related to different termination events.

3.149. The life of each particular contingent liability are different and some extinguish at the end of the construction phase. Contingent liabilities related to the Medical Diagnostic for the Government of Timor-Leste relate to the obligated payments under different termination events. The liability will include settlement of outstanding debt plus equity investment, depending on the type of termination event. More information is in the Informative Elements.

Implicit Contingent Liabilities

3.150. Aside from the explicit contingent liabilities that are stated above, the Government must also consider implicit contingent liabilities. These are contingent liabilities where there isn't a legal obligation for the government to intervene. Despite this, government intervention may be necessary to protect economic welfare of citizens.

3.151. Such contingent liabilities in Timor-Leste are likely to occur as a result of environmental, social or economic crisis. Any such crisis that leads to loss of livelihoods through damage, displacement or unemployment or other such economic hardships may lead to unexpected costs.

3.152. These costs would arise if the government intervened through social assistance schemes and fiscal stimulus package. Below we describe some of these contingent liabilities and explain how the government can mitigate for them.

3.153. Natural Disasters are one of the main risks faced by Timor-Leste. The country is situated close to the so called "Pacific Ring of Fire", an area which has some of the most volatile earthquake and volcano activity in the world. With the onset of climate change, the country is also at increased risk of floods and cyclones.

3.154. Analysing budget execution data shows that Timor-Leste has spent an average of $4.2m a year in natural disaster related expenditure since 2019. This peaked in 2021 when the government was required to spend $6.2m, primarily as a result of Cyclone Seroja.

3.155. External Economic Shocks are another source of implicit Contingent Liabilities.

3.156. As demonstrated by the COVID-19 crisis, health and economic crisis' can also be a major source of fiscal risks in Timor-Leste. Whilst Pandemics are infrequent events, as a small open economy that is heavily reliant on imports, Timor-Leste is highly exposed to economic events in other countries.

3.157. A recent example of this has been set out in the Macroeconomic Overview section of this report where we explain how the Russia-Ukraine war and subsequent impact on international trade has contributed to increased inflation in Timor-Leste.

3.158. Since independence the COVID-19 health crisis has inevitably been the largest external shock to hit the Timorese Economy. The crisis had the largest impact on government spending in 2021 during which the government spent $201m on measures to protect citizens from the health and economic impacts of COVID-19.

3.159. Political Crisis have also been a source of fiscal risks in recent years.

3.160. Delays to budget ratification in 2017, 2018 and 2020 contributed to negative economic growth in those years. Negative economic growth can mean that there is a general fall in incomes among businesses and individuals. In the short term this leads to lower tax revenues. In the long run it slows down progress in economic diversification that is needed to help the country guarantee its long-term fiscal sustainability.

3.161. Some contingent liabilities that pose major fiscal risks in other countries have a lower probability of materializing in Timor.

3.162. Many developing countries are exposed to risks through volatile exchange rate movements. Since Timor-Leste uses the US Dollar, which is among the most stable currencies in the world, such risks are less likely (although not completely unforeseeable).

3.163. However, it should be noted that Timor-Leste is only able to maintain a regular supply of Dollars as a result of the Petroleum Fund. This means that this could materialize as a greater risk over the next decade as explained in the Fiscal Sustainability section of this report.

3.164. Given the infancy of the banking system, and the fact that several of the banks that operate Timor are State Owned Enterprises in their respective countries and are subject to foreign lenders of last resort, there is also lower risk of a domestic financial crisis occurring in Timor-Leste as compared to other low- or middle-income countries.

3.165. Similarly, the debt to GDP ratio (approximately 13% in 2021) remains relatively low meaning there is a low risk of a debt crisis.

3.166. A contingent liability that is unique to Timor-Leste is the risk to Petroleum Fund Revenues from volatility in financial markets.

3.167. Factors that would affect the performance of the Petroleum Fund could be considered as contingent liabilities as losses in the Fund's investment portfolio could lead to the Fund depleting sooner than anticipated. As described earlier this would mean greater exposure to fiscal risks.

3.168. The falls in both equities and bonds this year – investment income for the year until June was negative $1.9 billion - demonstrates the market risk in the Fund's investment portfolio. As a long-term investor, the Fund's management was previously able to confidently withstand market volatility.

3.169. However, the investment horizon of the Fund has shortened given that the petroleum inflows from Bayu-Undan are ending and expenditure and withdrawals are expected to follow the current trend. Investment returns are not expected to fill the gap.

3.170. To adjust for the expected depletion of the Fund, a liquidity portfolio of low-risk investments was created in 2021 to finance the withdrawals over the next three years. This provides some protection against being forced to sell equities and bonds following a loss but is less effective when withdrawals significantly exceed projections. In addition, a prolonged period of poor investment performance would further shorten the Fund's expected life.

3.171. As well as financial markets, the Fund is exposed to the future of the Greater Sunrise project. In 2019, the Government decided on the Petroleum Fund lending $650 million to Timor Gap E.P. and its subsidiaries to finance the acquisition of participating interests in the Greater Sunrise development project.

3.172. These loans are independently valued each year for the Fund's audited financial statements. The repayments of the loans are linked to Timor Gap E.P.'s revenues from the petroleum project, meaning that the Fund is exposed to the success of the development project.

3.173. Depending on how the newly created FCLN is managed, there could be increased or decreased risk to the Petroleum Fund. The FCLN should be self-sustaining. That is to say, the spending that the Fund provides to veterans should come out of the funds' investment return. This would reduce the risk of withdrawal from the Petroleum Fund from any future spending commitments on veterans.

3.174. However, on the other hand, certain contingent liabilities could lead to losses in the FCLN. For example, there could be more claims than previously accounted for; the Fund's investment portfolio might also suffer unexpected losses. In such cases, the government could face pressure to further deplete the Petroleum Fund to provide further financing for the FCLN.

3.175. To finance unexpected expenditure derived from contingent liabilities and other fiscal risks, the government allocates a part of each year's budget for contingency funding.

3.176. To guarantee that the contingency fund has enough allocation to cover any materializing fiscal risks, the new Budget and PFM Framework Law enshrined a minimum threshold for the contingency fund, which must amount to a minimum of

2% of total expenditure of the Budget and a maximum of 5% of total expenditure.

3.177. In 2023 the government has allocated $66m for this purpose, which corresponds to 2.09%.

3.178. In a typical fiscal year, where there is no political or economic crisis, the biggest source of contingent liabilities is likely to arise from natural disasters. As explained earlier a major such example of this was in 2021 when $6.2m was spent on disaster responses, primarily as a result of flooding caused by cyclone Seroja.

3.179. A major economic shock may require the government to step in with much higher levels of economic support. If such a response requires spending levels that go beyond the contingency fund, the government can rely on withdrawals from the Petroleum Fund. However, this comes at a cost as consistent unforeseen withdrawals from the Petroleum Fund will mean that the fund depletes sooner.

3.180. However, this also demonstrates the importance of ensuring that fiscal policy can maximize the longevity of the Petroleum Fund. Under the current expenditure trend, the Petroleum Fund is projected to run out by the end of 2034. This means that at least until 2033, the government can rely on an additional source of revenues if fiscal risks materialize beyond any contingency funds.

3.181. Furthermore, if the Petroleum Fund depletes before domestic revenues are high enough to support contingency funding, contingent liabilities could pose greater fiscal risks.

Methodological Annex

Fiscal Sustainability Model Methodology

The Ministry of Finance conducts fiscal sustainability analysis for the budget ceiling chosen each budget cycle. Using modelling, the impact of the selected budget ceiling on the long-term sustainability of Timor-Leste can be estimated, specifically the overall balance of the Petroleum Fund.

In order to produce the analysis, we need to project expenditure, domestic revenues and the performance of the Petroleum Fund. Below we summarize the main data and assumptions in the model that are used to achieve this.

Actual Data

Expenditure – The model uses the latest planned expenditure figures as laid out by GOP 2023. We apply an execution rate on expenditure that is consistent with the GDP model and based on historical execution rates on government projects.

Petroleum Fund Data– The model uses data from the Petroleum Fund as of September 2022. This includes the Petroleum Fund balance, information on the asset split of the Petroleum Fund, and latest information on Withdrawals and Estimated Sustainable Income.

Loans Data – The model factors in Timor's existing debt commitments through the data on loans from the Ministry of Finance.

Assumptions/Projections

Due to uncertainty of future variables in the model, e.g., the budget of future years, the model uses a few assumptions.

Domestic Revenues: Unless specifically stated for an individual scenario, the model predicts that between 2022 and 2027 domestic revenues will rise in line with forecasts from the National Directorate of Economic Policy at the Ministry of Finance as published in GOP 2023. Details on how these forecasts were produced are available under the revenue section of the methodology annex.

Beyond 2027, domestic revenues are assumed to increase in line with long run inflation and population growth assumptions[8].

Petroleum Fund ROI - The model also uses up to date assumptions on the estimated rate of return on petroleum fund from the Petroleum Fund Unit in the Ministry of Finance. The Petroleum Fund is segmented into a growth and liquid component. As per assumptions from the Petroleum Fund unit as of September 2022, we assume that the growth component has an ROI of 4.1% whilst the liquid component is assumed to have an ROI of 2.5%. The liquid component of the fund is assumed to be sufficient to finance three years of withdrawals. To model this we assume that the liquid component each year is three times the amount of the withdrawal.

New Loans and Direct Budget Support - The model doesn't account for revenue from new loans or direct budget support as these revenue streams are highly unpredictable. Since direct budget support is a very small part of the government budget, including it is not likely to have any impact on the results. Given the low debt to GDP ratio, some level of borrowing could replace withdrawals from the petroleum fund, however repayments also create future spending commitments, so this is also limited.

[8] Long run population growth is assumed to be 2% Long run inflation is assumed to be 2% as well

Domestic Revenue Forecast Method

Revenue forecasts are produced using one of the methods described below:

Ideally, forecasts from collection agencies are used where these are reasonable and justifiable.

If the above process isn't feasible, we forecast revenues in line with historic trends, provided that these trends are consistent and a reliable indicator of future performance. If reliable information is unavailable to ascertain this, or if past trends are highly volatile, we assume that domestic revenues grow in line with economic growth.

If above options are not feasible or justifiable a 4% default growth (as recommended by the IMF) is assumed (this factors in long run inflation and population growth).

Forecasting GDP

Table 24: Changes in historic National Accounts / preliminary / forecast figures in %

	2020	2021	2022	2023	2024	2025	2026	2027
BB1 2022 (Jan 2021)	-8.6	1.6	2.7	2.8				
GOP 2023 (May 2022)	-8.6	1.5	2.9	3.1	3.4	3.5	3.1	3.0
PBS 2023 (July 2022)	-8.6	1.5	2.7	3.2	3.4	3.5	3.4	3.5
BR 2023 (September 2022)	-8.3	2.9	3.3	3.5	3.6	3.5	3.4	3.6

Source: Ministry of Finance, September 2022

Economic forecasts or projections aim to predict annual GDP growth rates and high-level macroeconomic figures. Making forecasts about what macroeconomic variables may be in the future is important to help governments and businesses make decisions about policies, planning and investment.

However, it is important to understand that in order to make these predictions we must make some assumptions about future conditions. Therefore, all projections always include an element of uncertainty. To inform forecasts we use some indicators or proxies to estimate the trends for certain sectors of the economy.

To forecast GDP, DNPE uses historical National Accounts data to analyse historical trends in different components of GDP e.g., consumption, investment etc. To forecast in-year GDP DNPE uses monthly data such as imports and export data as proxies to forecast how GDP will be by the end of the year. For further years we use historical trend analysis as well and information on the pipeline of future PPP projects and budget ceilings.

When there is no data available assumptions must be made. Where there is data, the numbers can be preliminary or final. That is why NA numbers can also change over time. The most significant change was the 2021 GDP increased from the preliminary April figure of 1.5% to 2.9% in September.

This was due to new information being available on Development Partner Expenditure and the Business Activity Survey (BAS) that was not available earlier in the year.

There is often a delay when Development Partners report their expenditure and BAS had more positive information of business activity than previously expected. In addition, the 2020 NA final GDP was also reviewed from -8.6% to -8.3%. This was due to higher-than-expected coffee production and an adjustment in deflators.

The forward projections are now slightly more positive to reflect this past changes. The main uncertainties in the forecast come from imports and government budget execution.

If government spending is particularly import-dependent, meaning that much of the new spending goes to goods and services from outside Timor-Leste, the GDP forecasts for future years may be reduced downwards as imports have a negative effect on final GDP.

In 2023 there will be parliamentary elections. The above forecasts assume smooth transition from the VIII to IX Constitutional Government; however, disruptions could cause delays to implementation of planned government projects and could lead to lower than expected execution.

In addition, if there is a large change in execution rates this may have a noticeable impact on the economy, especially given that the General State Budget makes up a large portion of Timor's GDP.

Execution rates differ each year for different reasons and depend on the absorptive capacity of the Timor-Leste economy. Absorptive capacity means how much money line ministries are able to spend despite how much money they have.

For example, even if the budget was increased by a large amount, line ministries may find it impossible to spend all that money. As with all forecasting, the more time and accurate data one has, the less assumptions we must make and the closer we move to the true value.

Finally, all institutions use different assumptions or data sources when making their forecasts and therefore there are often differences in projections between institutions. Often MOF will have more timely information related to public spending plans than other institutions.

Table 25: GDP growth forecasts of different institutions in %

Institution	2022	2023	2024	2025	2026	2027
MOF (DNPE)	3.3	3.5	3.6	3.5	3.4	3.6
IMF	2.0	3.6	2.6	2.4	2.4	3.0
World Bank	3.0	3.0	3.0			
ADB	2.3	3.0				
Central Bank Timor-Leste	5.8	2.0				

Source: Ministry of Finance; IMF; World Bank; ADB; CBTL, September 2022

National Liberation Combatants Fund

During the 2022 rectification budget, the government withdrew $1bn from the Petroleum fund to create the National Liberation Combatants Fund.

The fund is aimed at being self-sustaining, with the income from the Fund's investments used to finance spending on Veterans.

However, since the fund is part of the budget and is not exempt, as it happens with the Petroleum Fund, accounting rules determine that the total wealth of the Fund has to the included in the budget every year, as a revenue and as an expenditure (as it happens with the Social Security Reserve Fund).

This does not mean that there is any new withdrawal from the Petroleum Fund each year, or that the National Liberation Combatants Fund is being spent, but solely that the US$1 billion of the Funds' assets invested in equity must be budgeted each year.

This derives from the fact that as a cash basis budget, the General State Budget can only account for revenue and expenditure but not for assets and liabilities, and therefore to present the General Governments assets in the General State Budget, they are equated to revenue and expenditure for accounting purposes.

MINISTÉRIO DAS FINANÇAS

Halo ita nia mehi sai realidade