Introduction to the Laws of Timor-Leste

Petroleum Fund Law

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TABLE OF CONTENTS

PREFACE TO THE SERIES 3
THE PETROLEUM FUND LAW 5
I. PETROLEUM WEALTH AND DEVELOPMENT 6
1. The Unique Nature of Petroleum Revenues 7
2. Identifying and Defining the "Resource Curse" 8
3. Summary 11
II. THE PETROLEUM FUND LAW OF 2005 12
1. Goals and Policies of the Act 12
2. The Mechanics of the Budget Process 14
3. Estimated Sustainable Income 16
4. The Role of the Courts 17
5. Management Structure of the Fund 20
6. The Fund's Portfolio 25
7. Transparency 26
8. Summary 31
III. THE PETROLEUM FUND AMENDMENTS OF 2011 32
1. Permanence Versus Flexibility in Legislation 32
2. Changes to the Fund's Investment Rules 35
3. Changes to the Institutional Structure 37
4. Summary 41
IV. REVIEW 41
GLOSSARY 44

THE PETROLEUM FUND LAW

Preface to the Series: *Introduction to the Laws of Timor-Leste*

Timor-Leste has enjoyed a decade of formal independence. The country's democratic institutions have grown during this period. But, as thoughtful Timorese are quick to point out, much remains to be done. Building viable and professional state institutions takes time. And growing the human resource capacity within those institutions is always a major challenge to new states.

The capacity building imperative in Timor-Leste is both striking and compelling. Establishing state agencies in the first instance is relatively much easier than filling those agencies with effective professionals that uphold their duties and responsibilities. Building the capacity of a pool of Timorese who hold, or may hold, positions within legal and other state institutions is crucial. Likewise, building an educated understanding and awareness of the obligations and responsibilities of key actors within legal institutions, and government institutions more broadly, contributes to setting demands and expectations for performance among the polity. Encouraging professionalized capacity within state institutions, on the one hand, and thoughtful and calibrated demands for performance by citizens, on the other hand, are essential dynamics for the development of the rule of law and a democratic state in Timor-Leste. Institutions of higher learning, such as universities and professional training centers, can and should play a key role in stimulating and sustaining this dynamic. Indeed, education is foundational.

This paper is part of the *Introduction to the Laws of Timor-Leste* series of papers produced by the Timor-Leste Legal Education Project (TLLEP). This series seeks to critically engage the reader in thinking about the laws and legal institutions of Timor-Leste, and is based on a model of educational writing first introduced in TLLEP's *Introduction to Professional Responsibility in Timor-Leste* textbook, published in 2011. Founded in March of 2010, TLLEP is a partnership between The Asia Foundation and Stanford Law School. Working with local actors in the Timor legal sector, the project's goal is to positively contribute to the development of domestic legal education and training in Timor-Leste. USAID provided funding for this series through its Timor-Leste Access to Justice Program.

The authors of the legal working papers focused on writing in clear, concise prose, and on using hypothetical legal situations, discussion questions, and current events. Through this style of writing and pedagogy, the aim is to make these texts accessible to the largest possible audience. The texts are designed to be broadly accessible to experienced Timorese lawyers and judges, government officials, members of civil society, Timorese students in law, and the international community. They cover topics ranging from constitutional law to inheritance law to the Petroleum Fund Law.

These working papers represent the dedicated efforts of many individuals. Stanford Law School students authored the texts and subjected each working paper to an extensive editing process. The primary authors for this series were Peter Broderick, Daniel Cassman, Margaret Hagan, Brian Hoffman, Lexi Shechtel, and Anne Johnson Veldhuis, all Class of 2013, Jessica Fox, Hamida Owusu, and Samuel Saunders (all Class of 2014) edited the series under the guidance of Stanford Rule of Law Fellow Megan Karsh ('09). The students benefitted from the substantial and extensive guidance provided by Brazilian lawyer Dennys Antonialli (LLM '11) and Geoffrey Swenson ('09), TLLEP's former in-country director and legal advisor to the Asia Foundation's Dili office.

The program has also received extensive support from Kerry Brogan, previous Country Representative Silas Everett, current Country Representative Susan Marx, Juliao de Deus Fatima, and a host of other Asia Foundation staff. USAID Timor-Leste provided vital financial and programmatic support to the program. We especially thank USAID Director Rick Scott and USAID staff Ana Guterres and Peter Cloutier. The US Embassy in Dili, especially Ambassador Hans Klemm and Ambassador Judith Fergin, have been incredibly supportive. I would be remiss if I did not thank the former and current deans of Stanford Law School, Deans Larry Kramer and Liz Magill, for their unwavering support of this project.

Finally, this series of papers simply would not have been possible without the many thoughtful and critical insights from Timorese judges, educators and lawyers, and those who work within Timorese institutions. Prosecutor General Ana Pessoa, Public Defender General Sergio de Jesus Hornai, and President of Court of Appeals Cláudio Ximenes were extremely gracious in clarifying issues related to their respective organizations and offering constructive suggestions. The textbooks received vital input from National University of Timor-Leste (UNTL) faculty and staff throughout the drafting and review process including comments from Rector Aurelio Guterres, Law Deans Tome Xavier Geronimo and Maria Angela Carrascalão, Professor Benjamin Corte Real, and Vasco da Cruz of the Portuguese Corporation. Feedback from UNTL students themselves on draft text was immensely helpful for the final text. The Judicial Training Center (CFJ) has also been a source of wisdom throughout the drafting process, particularly CFJ Director Marcelina Tilman, Erika Macedo, and Bernardo Fernandes. The text benefited as well from the contributions of Charlie Scheiner and La'o Hamutuk, the staff of the Ministry of Justice Legislation Unit, AALT Executive Director Maria Veronika, Judge Maria Netercia, Judge Jacinta Coreia, JSMP Executive Director, Luis de Oliveira, JSMP Legal Research Unit Coordinator, Roberto da Costa, ECM director Lino Lopes, and Sahe Da Siliva. We are also grateful to Gualdinho da Silva, President of the National Petroleum Authority, for two wonderfully engaging meetings.

In addition to this series and the already-published texts on professional responsibility, constitutional rights, and contracts, TLLEP has plans to complete the first edition of a new textbook in 2013 entitled *An Introduction to Criminal Law in Timor-Leste*. All texts are updated as the legal landscape changes. The most recent versions of all published texts are always available for download online free of charge on TLLEP's website: www.tllep.law.stanford.edu.

To the students, educators, legal and government professionals that use this book, we sincerely hope that it sparks study and debate about the future of Timor-Leste and the vital role magistrates, prosecutors, public defenders, private lawyers, and government officials will play in ensuring the country's future is bright.

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THE PETROLEUM FUND LAW

CHAPTER OBJECTIVES

- To understand the implications of Timor-Leste's petroleum on future development and what the "resource curse" is.
- To become familiar with the Petroleum Fund and the legal regime that established it and governs the collection, management, and distribution of wealth from the Petroleum Fund.
- To understand the 2011 amendments to the Petroleum Fund Law and how they will affect the Fund.

CHAPTER OVERVIEW

- Large non-renewable resource reserves often appear to be associated with lower-than-expected development outcomes in some developing nations, a phenomenon known as the "resource curse."
- Timor-Leste's petroleum reserves are owned by the State and all revenues it collects from petroleum activities are paid into a single Petroleum Fund, to be used in accordance with the national interests. The Fund provides the revenue for nearly all government spending.
- The Fund is managed by the Government and invested internationally. The Petroleum Fund Law contains rules regarding how much of the Fund must be invested and which financial instruments it may be invested in.

THE PETROLEUM FUND LAW

I. PETROLEUM WEALTH AND DEVELOPMENT

SECTION OBJECTIVES

- To understand how petroleum wealth is unique from other kinds of natural resource wealth.
- To understand the problem of "resource curse" and the effects of natural resource wealth on development.

In another paper in this series, we look in depth at the domestic and international regime of laws that govern the exploration for, and extraction of, petroleum resources in Timor-Leste and the JPA. But that is only half of the story. We now turn to the law governing the dispensation of wealth created by petroleum extraction. You should read the material in this subchapter with an eye toward resolving the development challenges that Timor-Leste faces. Ask yourself how these laws affect Timor-Leste's dynamic development needs and what the various goals are that the laws attempt to advance. Do the laws actually advance these goals? What are some pitfalls that might arise from structuring wealth dispensation in particular ways? What are alternative ways of structuring the Government's control over petroleum wealth? Consider, as well, that there are several tensions at play in managing the fund. For example, in the realm of investment, return on investment is roughly proportional with the risk of the investment. Stability and predictability are important features for government budgeting and forecasting, but flexibility is also important so that governments can respond to unforeseen circumstances, such as natural disasters, economic crises, or new development opportunities.

The primary law concerning the use of petroleum revenues is the **Petroleum Fund Law, Law No. 9/2005 (13 July 2005) (Amended by First Amendment to Law 9/2005, Law No. 12/2011 (19 Nov. 2011) ("The Petroleum Fund Amendments of 2011"))**, enacted by the National Parliament in 2005. The law was significantly amended in 2011. This chapter will focus on the 2005 law to provide a basic understanding of the Petroleum Fund and the institutional structures that control and manage it. We will then turn to the 2011 amendments and examine how the law has been changed. Comparing the amendments against the original version of the law provides us with insight into how law is changed in Timor-Leste, and into the dynamic nature of the policy considerations and political forces that informed the Law. First, though, we

will provide a brief discussion of Timor-Leste's petroleum wealth, and of the influence of nonrenewable resource wealth on development, generally.

As you are well aware, petroleum wealth is the most important feature of Timor-Leste's economy, and Timor-Leste has accumulated several billion dollars worth of petroleum wealth to date. The estimated value of oil and gas produced in 2009 alone in current dollars in Timor-Leste amounted to approximately $1,910 per person. All taxes, fees, and royalties accruing to Timor-Leste from petroleum activities within its territory and the Joint Petroleum Development Area ("JPDA") are deposited into a single "Petroleum Fund." The total value of the Petroleum Fund as of 2012 is estimated to exceed $10 billion, which is enough to give citizens of Timor-Leste almost ten thousand dollars apiece. In 2009, oil and gas revenues financed 97% of the state budget; the percentage has decreased somewhat to approximately 89% in 2012.

1. The Unique Nature of Petroleum Revenues

Petroleum revenues, in particular, have some unusual qualities that have consequences for the size and nature of government, and the pace of development. Some scholars have observed similarities between states that have significant petroleum wealth, and have identified four characteristics that make oil revenues unique: their scale, source, instability, and secrecy. See Michael L. Ross, *The Oil Curse: How Petroleum Wealth Shapes the Development of Nations*, New Jersey: Princeton University Press (2012).

Scale: The petroleum industry produces more aggregate wealth than almost any other kind of industry, extractive or otherwise. This can lead to explosive growth over a short period of time in the size of revenue available to the government, leading, often, to an increase in the size of the government itself. Accordingly, oil-producing states tend to have governments that are, on average, 45% larger than non-producing states.

Source: Most states fund government expenditures through taxation. Taxation allows for the costs of government programs to be distributed among the populace and various beneficiaries. There are many types of taxation schemes, and determining tax policy—that is, allocating the tax burden among different groups of citizens—is often a much-debated political issue. However, in countries that are possessed of exceptional oil wealth, government expenditures are primarily funded by oil revenues, leading to a decreased reliance on taxation.

Instability: Petroleum is a relatively volatile commodity, leading to potentially unstable revenues. Circumstances beyond a state's control, namely, changes in supply or demand in world markets, can cause great fluctuations in oil prices. For example, between the years 2000 and 2012, the price of oil has seen a low of $30 per barrel, and reached a high of nearly $140 per barrel. Additionally, revenues may vary with changes in the rate of production. These factors can make it difficult for governments to develop accurate forecasts of future revenues, with implications for planning and development of long-term government projects.

Secrecy: Petroleum revenues can be easier for governments to conceal, and studies have shown that the finances of oil-producing states are less transparent than the finances of non-producing states. This is especially true in states that have established a national petroleum company. Financial opacity can lead to corruption, waste, and agency capture.

2. Identifying and Defining the "Resource Curse"

You may have heard the term "resource curse" arising in conjunction with public discussions about Timor's petroleum resources. What does it mean? Broadly speaking, resource curse refers to the phenomenon that developing countries with non-renewable natural resource abundance, *especially oil reserves*, tend to experience slower rates of economic growth and worse development outcomes than countries without natural resource abundance. In other words, controlling for size, population, Gross Domestic Product ("GDP"), and other variables, a country with vastly larger valuable non-renewable resource reserves is statistically likely to experience slower economic growth than a similar county that does not have such reserves. The phenomenon attracted the attention of development economists in the early 1990s. See Sachs, J. and A. Warner, 1995, "Natural Resource Abundance and Economic Growth," in G. Meier and J. Rauch (eds.), *Leading Issues in Economic Development*, New York: Oxford University Press. Since then, a growing body of empirical studies has both confirmed the existence of the resource curse and sought to identify the mechanisms by which it operates.

Illustration:

To illustrate this point more clearly, let's create an example. Two countries, A and B exist side by side on the imaginary continent of Gonwanda. They are extremely similar in size, population, geography, and their economies are roughly proportionate. The crucial difference between the two countries is that country A has just discovered vast copper reserves within its borders. Preliminary estimates indicate that the reserves contain copper that, when extracted, will be worth several billion dollars. Country B has no comparable reserves. What Sachs and Warner's

study showed (and later studies have confirmed), is that country A's economy will most likely *grow at a slower rate* than country B. Additionally, it is likely that country A will fare more poorly than country B in other important measures such as the level of domestic civil unrest and income inequality.

The idea is counter-intuitive. One would expect that countries that benefit from resource abundance would be able to translate it into advantageous economic growth. Higher national wealth and increased purchasing power could be used to develop infrastructure and development projects and could be invested in social welfare programs like education and healthcare. However, the opposite seems to be true. In addition to slower rates of economic growth, further studies have demonstrated correlations between abundant natural resources in developing countries and other factors, such as:

- increased violence and civil conflict
- weaker state institutions
- increased corruption
- increased wealth disparity
- decreased economic diversification
- increased rates of inflation

While the resource curse has been recognized as a recurrent phenomenon, debate is vigorous over how it operates and even stronger over what might prevent developing countries with abundant natural resources from suffering from its ill effects.

The Case of Nigeria

Nigeria is an example of a developing nation that has struggled to transform petroleum wealth into favorable development outcomes. The modern history of the country has been a source of scholarly interest for development economists trying to understand the resource curse, and has been pointed to as a classic example of the phenomenon. Offshore petroleum reserves, later determined to be some of the largest in Africa, were discovered in Nigeria in the 1950s and extraction began in the early 1960s. Crude oil quickly became the country's number one export. In 1971, in an attempt to secure more control over the industry and a larger share of the profits, the Nigerian government created a state-owned oil company and nationalized the industry. In the following decade, production and exploration increased and petroleum revenues soared, accounting, eventually, for approximately 95% of the country's total revenues. Nigeria's current crude oil exports average nearly 2 million barrels per day.

Despite its vast oil wealth, Nigeria's performance along most development metrics has been halting, at best. Though oil revenues per capita have increased by a factor of ten since 1965, per

capita GDP has remained at 1965 levels. Poverty levels have risen by nearly 100 per cent since 1970, and income disparity has been steadily rising since that time. Nigeria's GDP has expanded at less than the average growth rate for the past fifty years, and its economy has been less stable. The past twenty years have seen violence erupt periodically between an increasingly militarized police force and ethnic groups.

Some scholars consider Nigeria's oil reserves to have had a detrimental impact on its development, while others argue that, without the reserves, Nigeria may have fared similarly. In any case, it is clear that oil wealth has not had the beneficial effect on development that one might otherwise expect. It appears that the benefits of its oil have been offset by increased political corruption, wasteful spending, and impaired institutional growth. While Nigeria's experience is not determinative of development in Timor-Leste, it provides a cautionary tale, and a concrete illustration of the resource curse.

Source: Sala-i-Martin, Xavier and Subramanian, Arvind, *Addressing the Natural Resource Curse: An Illustration from Nigeria*, NBER Working Paper No. 9804, National Bureau of Economic Research (2003).

As you have seen, the story of development over the past fifty or so years indicates that large reserves of natural resource wealth can correlate negatively with desirable indicators such as economic growth, low levels of domestic conflict and violence, low levels of corruption, and other positive indicators. Much empirical data, including case studies and comparative analyses seem to confirm this. However, there is rigorous debate about the *ways* in which natural resource abundance can produce negative outcomes (or slow positive ones), and accordingly, much discussion about how to thwart the resource curse. In Timor-Leste, these debates are at the forefront of national discussions about the proper way to acquire, save, invest, and spend revenues generated from its oil and gas wealth. As you read through the following material on Timor-Leste's Petroleum Fund Law, challenge yourself periodically to step back from the specifics of the Law, and to reflect on how it is designed to counteract or prevent the effects of the resource curse, and whether it has been successful in doing so. You are encouraged always to think critically about the law, and to be creative by asking yourself what you would change about the law and why.

THE PETROLEUM FUND LAW

3. Summary

Timor-Leste possesses sizeable petroleum deposits that have generated billions of dollars of wealth for the country. According to the **Constitution of Timor-Leste**, all subsoil natural resources, including petroleum, are owned by the State, to be used to benefit the citizens of Timor-Leste. This state-owned wealth constitutes nearly all government spending and has the potential to spur the country's economic growth and development. The nature of petroleum resources—specifically their size, scale, price-instability, and potential for secrecy—has led some scholars to the conclusion that countries with petroleum reserves are especially prone to the effects of the "resource curse." This term is used to describe a phenomenon observed in developing states whereby those states with considerable non-renewable natural resource reserves fare more poorly along many measures of development than similar countries that do not possess such reserves. Although Timor-Leste's laws do not mention the resource curse explicitly, much thought was given to this issue when the country's institutions for acquiring, managing, and spending its petroleum wealth were designed.

II. THE PETROLEUM FUND LAW OF 2005

SECTION OBJECTIVES

- To understand the purpose, structure, and operation of Timor-Leste's Petroleum Fund.
- To develop an understanding of the Petroleum Fund Law of 2005, and the rules governing the receipt, management, and expenditure of petroleum revenues.
- To learn about the institutional management structure of the Petroleum Fund.
- To understand the concept of Estimated Sustainable Income and the budget process.

1. Goals and Policies of the Act

The Law of Petroleum Extraction, that **Article 139 of the Constitution of Timor-Leste** specifies that petroleum resources "shall be owned by the State."

Constitution of Timor-Leste

Section 139: Natural Resources

(1) The resources of the soil, the subsoil, the territorial waters, the continental shelf and the exclusive economic zone, which are essential to the economy, shall be owned by the State and shall be used in a fair and equitable manner in accordance with national interests.

(2) The conditions for the exploitation of the natural resources referred to in item 1 above should lend themselves to the establishment of mandatory financial reserves, in accordance with the law.

(3) The exploitation of the natural resources shall preserve the ecological balance and prevent destruction of ecosystems.

Subsection (2) provides for the establishment of "mandatory financial reserves in accordance with the law." The Constitution does not elsewhere make provisions for these financial reserves, and instead contemplates that Parliament or the Government will establish the law governing the reserves. Parliament passed the Petroleum Fund Law of 2005, on June 20, 2005, and it was signed by the President and entered into force on August 3, 2005, nearly five years after Timor-Leste received its first petroleum royalties. Planning for the legislation was

extensive. The Ministry of Planning and Finance released an early Draft, and held numerous public meetings and workshops, in which it solicited public comments on the Draft Law and received them from citizens, national and domestic non-governmental organizations, and academics and development economists. The Petroleum Fund Law was passed unanimously by the Parliament, which served as a symbol of unity on the issue.

The underlying goals of the Petroleum Fund Law are contained in its preamble:

Petroleum Fund Law of 2005

Preamble

> This Act establishes a Petroleum Fund which seeks to meet with the constitutional requirement laid down in Article 139 of the Constitution of the Republic. Pursuant to this provision, petroleum resources shall be owned by the State, be used in a fair and equitable manner in accordance with national interests, and the income derived therefrom should lead to the establishment of mandatory financial reserves.
>
> The Petroleum Fund shall contribute to a wise management of the petroleum resources for the benefit of both current and future generations. The Petroleum Fund shall be a tool that contributes to sound fiscal policy, where appropriate consideration and weight is given to the long-term interests of Timor-Leste's citizens.

. . .

In essence, the Petroleum Fund Law of 2005 creates a sovereign wealth fund, into which all petroleum revenues are deposited. The Fund is overseen and managed by the Minister of Finance and the Central Bank, who invest the Fund overseas. The interest on the investments funds the vast bulk of the Government's annual expenditures. The Government is required to provide, in its annual proposed budget, an accounting of the return it expects on the Fund's investments in the coming fiscal year, and is discouraged from making withdrawals in excess of that amount. By theoretically limiting Government expenditures an amount equivalent to the interest on the Fund, the Law seeks to preserve the Fund for future generations and fulfill its constitutional mandate. As we shall see, that goal is not always met.

Case Study: Alaska

Is the Constitutional mandate of "State" ownership of petroleum resources synonymous with ownership by the "people" of Timor-Leste? The distinction may be important with respect to how the benefits of petroleum wealth reach the citizenry. In Timor-Leste, all taxes, profits, fees, and other revenues from petroleum extraction that accrue to the State are deposited in the Petroleum Fund, to be invested, and, ultimately, to fund government expenditures. But the State of Alaska, an oil-rich state in the northern United States, has taken a different approach. In 1976,

Alaskan voters amended the state constitution to create the Alaska Permanent Fund, which, similarly to the Petroleum Fund of Timor-Leste, sets aside a share of petroleum revenues to continue benefiting current and all future citizens of the state of Alaska. The relevant constitutional provision reads:

Section 15. Alaska Permanent Fund
At least twenty-five percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the State shall be placed in a permanent fund the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for permanent fund investments. All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law.

As with the Petroleum Fund of Timor-Leste, the wealth of the Permanent Fund is invested, in that case, by a public state investment corporation. However, subsequent state law also created the Permanent Fund Dividend, which provides each citizen of the state with an annual *direct payment* from the Permanent Fund. Annual payments are tied to the performance of the fund, and vary slightly from year to year. In 2011, the Fund Dividend paid $1,174 to each citizen of the State of Alaska. This is an interesting approach to dispersing state-owned wealth. It may indicate citizens' skepticism of government's ability to make the best decisions regarding how to spend the Fund wealth. Economists debate the value of providing direct dividends to citizens. On the one hand, providing households with cash distributes the wealth evenly and encourages investment in the local economy. On the other hand, individual citizens generally cannot pool the wealth in order to make long-term investments in the types of goods that government provides. The Permanent Fund Dividend Program in Alaska is enormously popular, but comes at a price. While citizens continue to receive annual checks from the Permanent Fund, the State General Fund has run a deficit in recent years.

Consider whether you think a dividend program similar to Alaska's would be appropriate in Timor-Leste, if it would be consistent with the Constitutional mandate of Article 139, and what the pros and cons might be of establishing such a program in Timor-Leste.

2. The Mechanics of the Budget Process

In order to best understand the Petroleum Fund Law, it is necessary to understand bit of background on the budget process. This subsection will provide a brief summary. In 2009 the legislature passed Budget and Financial Administration, Law No. 13/2009 (15 Oct. 2009). State budgets are submitted annually by the Government to Parliament for approval by a majority vote. The Ministry of Finance begins preparing its proposed budget for the upcoming year by soliciting the individual budgets of the various Government ministries. The Ministry's Budget Review Committee reviews and analyzes each budget submission and invites the ministries to defend their individual budgets. Following this process, the Committee forms a proposed budget

encompassing all of the individual ministries' revised budgets, and submits it to the Council of Ministers. Following review, the Council of Ministers submits the proposed budget to the National Parliament on or before October 15 of each year. After an initial consideration, Parliament refers the Government's proposed budget to Committees, which interview the relevant ministers, and take comments from the community and interested parties. The Committees then prepare a report presenting their findings. The Parliament then reassembles and conducts parliamentary debate, including proposed amendments, which may be introduced and voted on. Finally, Parliament conducts an up or down vote on the proposed budget and amendments. If he budget passes, it is sent to the President to sign, and becomes law when it is published in the Journal of the Republic; ministries can then expend the funds allocated to them in the budget beginning on January 1 of the new year. As you can see, Parliament is accorded strong oversight powers regarding state expenditures.

In addition to identifying where money appropriated in the proposed budget will be allocated to (expenditures), the budget must also identify where the money comes from (revenues). The vast majority of state revenues in Timor-Leste are derived from petroleum wealth; other sources include contributions from foreign aid organizations, and taxes and fees collected from autonomous agencies, such as port and aviation authorities. The 2012 revised budget approved by Parliament in November of 2011, for example, included a total of $1.674 billion in expenditures, including $1.495 billion withdrawn from the Petroleum Fund.

Article 6 of the Petroleum Fund Law of 2005 stipulates that all revenue received by Timor-Leste from any petroleum operation, from the Designated Authority, from the indirect participation in petroleum activities, from a national oil company, and from any other source relating to petroleum resources, is, by law a gross receipt of the Petroleum Fund. The Fund is an earmarked receipts account held by the Central Bank. The revenues are then invested abroad in financial assets. Many other countries that rely heavily on petroleum wealth do not require that *all* taxes, fees, profits, and other revenues from petroleum extraction be paid into a single fund. Alternative models might provide for several different funds with varying purposes, and/or allow certain petroleum-related revenues to be appropriated without first being received into a fund.

Question

What do you think the benefits are of this "single fund" arrangement?

Answer

There are several. First, routing all petroleum revenue through a single fund prevents the Government from sidestepping an important oversight mechanism: Parliamentary approval. If funds could be appropriated before being received into the Fund, Parliament would have little or no authority in how those particular funds were used. Second, the single fund system promotes transparency and accountability and prevents funds from being siphoned off to fund pet projects or "secret" accounts. Third, allocations that have been routed through the Petroleum Fund and a Parliament-approved budget are more reliable because they are uncoupled from annual petroleum production rates and oil and gas prices. Finally, combining all petroleum revenues into a single consolidated Fund, rather than a variety of individual funds, helps achieve economies of scale in administration and management of the Fund. Can you think of any other benefits?

3. Estimated Sustainable Income

At the heart of the Petroleum Fund Law is the concept of Estimated Sustainable Income ("ESI"). Broadly speaking, ESI is like the annual interest on the principal of the Fund. It represents the maximum amount that can be withdrawn in any given year without diminishing the value of the Fund in the future. In theory, if the ESI is calculated correctly and withdrawals do not exceed it, and if the principal of the Fund is not otherwise diminished (by, say, investment losses), the Fund will continue to generate wealth indefinitely. In this way, the Fund is designed to provide for future generations.

ESI is calculated according to a formula laid out in Schedule 1 of the Petroleum Fund Law. It is set at 3% of the current value of the Fund, plus the net present value of future revenue. This appears to be a very simple formula, and ESI appears to be difficult to manipulate without amending the law. But is that really the case? Though the formula for calculating ESI is established by law, the size of the ESI is influenced by the nature of the variables and the estimates used in the calculation. For example, in 2010 the government approved a change in the methodology used to calculate the ESI, mainly by switching the oil price assumption from the "low case" forecast produced by the US Energy Information Administration (EIA), which the government believed to be overly conservative, to an average of the EIA's low case and less conservative "reference case" forecasts. This caused an increase in the ESI in 2011, to $734 million from $502 million in the 2010 budget. Thus, the government drew 46% more revenue as ESI from the Fund—without amending the Petroleum Fund Law or deviating from the calculation established in Schedule 1.

Withdrawals from the Fund that exceed the ESI are restricted, but not entirely prohibited, by Article 9 of the Petroleum Fund Law:

Petroleum Fund Law of 2005

Article 9: Transfers Exceeding the Estimated Sustainable Income

No transfer shall be made from the Petroleum Fund in a Fiscal Year in excess of the Estimated Sustainable Income for the Fiscal Year unless the Government has first provided Parliament with:

(a) the reports described in paragraphs 8(a) and 8(b) [specifying ESI];

(b) a report estimating the amount by which the Estimate Sustainable Income for Fiscal year for which the transfer is made will be reduced as a result of the transfer from the Petroleum Fund of an amount in excess of the Estimated Sustainable Income of the Fiscal Year for which the transfer is made;

(c) a report from the Independent Auditor certifying the estimates of the reduction in Estimated Sustainable income in paragraph (b) above;

(d) a detailed explanation of why it is in the long-term interests of Timor-Leste to transfer from the Petroleum Fund an amount in excess of the Estimated Sustainable Income.

Look at the above language closely. Just how strong is the general prohibition on transfers from the Fund beyond the ESI? In order conduct such a transfer, the Government must submit to Parliament several reports, and, most importantly, it appears, "a detailed explanation of why it is in the long-term interests of Timor-Leste." This would appear to be a very vague standard, and open to interpretation. The law does not otherwise define "long-term interests of Timor-Leste."

4. The Role of the Courts

What role should the Courts play in ensuring that Government budgets and expenditures are consistent with the Petroleum Fund Law? In 2008, several members of Parliament brought a case against the Government, alleging that the budget it had submitted to Parliament was not compliant with the budget requirements contained in Article 9, section (d) of the Petroleum Fund Law of 2005, and the **Constitution of Timor-Leste**. The Parliamentarians relied on **Section 150(e) of the Constitution of Timor-Leste** to bring their case, which allows one-fifth of

Parliament to request a review of constitutionality by the Supreme Court. They alleged, among other things, that the Government's budget, while exceeding the ESI for 2008, failed to include a detailed explanation of why these withdrawals from the Fund were consistent with the long-term interests of Timor-Leste. The court agreed. On November 18, 2008, three judges of the Appeals Court (acting as the Supreme Court, which had not yet been established) issued a unanimous opinion. The Appeals Court found that the budget, which established an "Economic Development Fund" that would draw from the Fund beyond the ESI, violated **Section 145(s) of the Constitution of Timor-Leste**, which reads:

Constitution of Timor-Leste

Section 145: State Budget

(1) The State Budget shall be prepared by the Government and approved by the National Parliament.

(2) The Budget law shall provide, based on efficiency and effectiveness, a breakdown of the revenues and expenditures of the State, as well as preclude the existence of secret appropriations and funds.

(3) The execution of the Budget shall be monitored by the High Administrative, Tax, and Audit Court and by the National Parliament.

The Court also held that where the Petroleum Fund Law conflicts with any law of budget or financial management, the former shall prevail, relying on a combined reading of the Preamble and Article 4 of the Petroleum Fund Law. Article 4 reads:

Petroleum Fund Law of 2005

Article 4: Inconsistencies

For the purposes of this Act, in the event of any inconsistency between the provisions of the Act and the provisions in the law of Timor-Leste on budget and financial management, or between the provisions of the Act and the terms of a Petroleum Authorization, the provisions of the present Act shall prevail.

Additionally, the Court determined that Article 9(d) of the Petroleum Fund Law of 2005 had been violated because the Government's budget sought to transfer funds in excess of the ESI

without demonstrating that such a withdrawal was not harmful to future generations, and that the withdrawal was consistent with the long-term interests of Timor-Leste.

This appears to have been a very significant moment in the history of Timor-Leste's Judiciary, and a strong statement by the court regarding its jurisdictional and interpretive powers. Note that the opinion was very careful to rest its reasoning on constitutional grounds *as well as* citing to the Petroleum Fund Law. Why might this be? On one level, it is clear that the Court found a violation of both the **Constitution of Timor-Leste** and the Petroleum Fund Law. On another level, however, the ruling may indicate the Court's concern with establishing its jurisdiction to rule on the issue. The Parliamentarians that filed the case did so under a constitutional provision that allowed them to seek *constitutional* review of the Government's budget law. It is not clear that they would have had a remedy in the courts if their only claim had been that the budget violated the Petroleum Fund Law, and not the Constitution.

Accordingly, this case raises perhaps more questions than it answers. Not least of which is the question we encountered above: exactly the "long-term interests of Timor-Leste" are with respect to spending petroleum wealth. How long is long-term? What interests, exactly, are to be advanced? Which is more valuable to future generations of Timorese—continued revenue from the Fund or the benefits from long-term social-welfare and infrastructure projects such as road and telecommunication networks? These are difficult problems, and some might argue that these decisions are outside the technical competency of the judiciary and should be left to political leaders. Perhaps this was the reasoning behind the court's decision not to define "long-term interests" directly.

The court also indicated that the Government had not made the appropriate *demonstration*, required by Petroleum Fund Law of 2005 Article 9(d), that the budgeted funds in excess of the ESI were in the long-term interests of Timor-Leste. Setting the issue of what those interests are aside for a moment, consider that one function of an interpreting court is to provide clarity and remove ambiguity in the law going forward. Actors, including citizens and governmental entities alike, may look to a court's past rulings to guide their actions in the future. The opinion does not mention what a sufficient demonstration, for purposes of Article 9(d), might consist of. Need it include testimony from relevant Ministry officials? An exhaustive report of how the money will actually be spent? A forecast that predicts how much the extra-ESI withdrawals will reduce revenues from the Fund in five-, ten-, and twenty-year future?

The Appeals Court ruling has not prevented the Government from drawing from the Fund in excess of ESI since 2008; total government expenditures have exceeded ESI annually each year since then. A relatively recent innovation that has vastly increased state expenditures is the creation of two "special funds." In 2011, the Government created the Infrastructure Development Fund to promote and finance large, multi-year infrastructure projects such as power grids, roads, hospitals, bridges and ports. In the same year, it also established the Human Capital Development Fund, with the purpose to finance education, training, and human resource development. The Government has argued that the new funds promote the interests of Timorese sufficient to meet the threshold for extra-ESI withdrawals under Article 9(d) of the Petroleum Fund Law of 2005. The 2011 and 2012 state budgets called for $600 and $700 million, respectively, for the special funds, leading to withdrawals in excess of ESI of over $320 million in 2011 and nearly $830 million in 2012. The funds have come under strong criticism from some groups, who argue that compared to the various ministries and agencies, the funds are opaque and have few mechanisms to ensure that their budget allocations are spent wisely.

5. Management Structure of the Fund

As of 2012, Timor-Leste's Petroleum Fund contained over $10 billion. The country's oil and gas reserves are finite, and likely to be depleted within a generation; revenues are expected to peak in 2011 or 2012, and to decline steadily thereafter. Therefore, the Fund must be invested if it is to continue yielding interest and generating wealth for future generations. As with any investment, the reward of high returns is coupled with the risk of underperformance, or an overall loss in value. This poses some difficult challenges for policymakers trying to guide investment decisions. In crafting the rules governing investment of the Fund, the drafters had to strike a balance. On the one hand, the law is a relatively rigid tool and cannot possibly anticipate future changes in the investment climate, or dictate day-to-day management decisions. A certain amount of responsibility must necessarily be accorded to managers with financial expertise, who bring their knowledge of the markets to bear and who can react to changing conditions. On the other hand, granting expert managers unconstrained discretion allows for the possibility that they will take undesirable risks or, less likely, that they will manage the Fund too conservatively.

The goal, then, is to create an institutional structure for managing and investing that sets appropriate parameters within which the managers of the Fund may operate. Transparency is a

key consideration as well; making management and investment decisions public is necessary in order to evaluate performance, hold decision-makers accountable, and periodically reevaluate investment strategy. The rules governing management and investment of the Fund are contained in Section III. Article 11 reads:

Petroleum Fund Law of 2005

Article 11: Management of the Petroleum Fund

(1) The Government is responsible for the overall management of the Petroleum Fund.

(2) The Minister shall not make any decisions in relation to the investment strategy or management of the Petroleum Fund without First seeking the advice of the Investment Advisory Board in accordance with Article 16.

(3) The Minister shall enter into an agreement with the Central Bank for the operational management of the Petroleum Fund and the Central Bank shall be responsible for the operational management of the Petroleum Fund.

(4) The Petroleum Fund shall be managed prudently in accordance with the principle of good governance for the benefit of current and future generations.

Notice that Parliament, which plays an active role in appropriating money from the Fund through the budget approval process, does not have responsibility for overall management of the Fund. That responsibility lies, instead, with the Government.

Let's begin by identifying the major institutional actors and their roles and responsibilities. The **Central Bank** is defined in Article 2 (Definitions) as "the authority to be established under Section 143 of the Constitution of the Republic, or until such authority is established, the Banking and Payments Authority ["BPA"]." The Central Bank of Timor-Leste was formally established on 13 September 2011 under **Organic Law of the Central Bank of East Timor, Law No. 5/2011 (13 Apr. 2011)**, in accordance with **Article 143 of the Constitution of Timor-Leste**. Previously, central banking functions in Timor-Leste, including Petroleum Fund management were carried out by the BPA, which was established under the United Nations Transitional Administration of East Timor (UNTAET). The Central bank is the monetary authority of Timor-Leste and is administratively and financially autonomous. It is responsible for operational management of the Fund under Article 11(3) of the Petroleum Fund

Law of 2005. In executing its responsibility, the Central Bank established the Petroleum Fund Management Department, headed by an Executive Director accountable to the Governor, and which comprises an Investment Division with responsibility for investment management, and a Risk Management Division responsible for performance measurement and to monitor and manage risks. Other divisions of the Central Bank provide additional support for the Fund's operations, including Accounting, Settlements, Information Technology and Internal Audits.

The **Minister of Planning and Finance** is responsible for drafting, executing, coordinating, and assessing the policies approved by the Council of Ministers in the areas of budget and finance. Its general structure and responsibilities of the Ministry of Finance are defined in **Decree Law 13/2009: Organic Law of the Ministry of Finance**. Article 11(3) of the Petroleum Fund Law of 2005 provides that the Central Bank and the Minister of Planning and Finance shall enter into an agreement for the operational management of the Fund. This "Management Agreement" contains the mandates that direct the actions of investment managers, including Managers. The Minister, in addition to being the overall manager of the fund, is responsible, under Article 11(2), for setting an Investment Strategy which reflects the manner in which the Government wishes to invest the Fund, including general investment principles based on its risk and return objectives, the classes of assets in which the Fund may be invested, and the strategic allocation of assets within those classes.

The **Investment Advisory Board** is established by Article 16 of the Petroleum Fund Law of 2005. Article 17 stipulates that it shall consist of five persons: (1) the Director of the Treasury; (2) the Head of the Central Bank; (3) two qualified persons appointed by the Minister; (4) one other person appointed by the Minister. Article 17 was amended slightly by the subsequent Petroleum Fund Amendments of 2011, and this amendment is discussed in the next Section, below. The Board is responsible for developing the policy framework through which the Minister implements the Investment Strategy. This policy involves recommending particular assets within each asset class that the Fund may invest in, recommending a particular management style (for example, passive or active), and establishing risk ceilings and performance benchmarks. The Investment Advisory Board may also advise the Minister of Finance of the need to make changes to the overall investment strategy or management of the Fund.

Article 12 permits the Central Bank, along with the Minister, to select and appoint **External Investment Managers**, private-sector professional portfolio managers. The Central Bank and the Minister declined to appoint an external manager until 2009, when it appointed the Bank of International Settlements (BIS) to manage 20% of the Fund, providing it with a mandate to invest in sovereign bonds. Schroer Investment Management Limited became the Fund's second External Investment Manager, when it was contracted to invest 4% of the Fund in equities (stocks).

Chapter V of the Petroleum Fund Law of 2005 establishes the **Consultative Council**. Article 25 reads:

Petroleum Fund Law of 2005

Article 25: Petroleum Fund Consultative Council

(1) There is hereby established a Petroleum Fund Consultative Council.

(2) The Petroleum Fund Consultative Council shall, of its own motion or at the request of Parliament:

(a) advise Parliament on matters relating to the performance and operation of the Petroleum Fund;

(b) advise Parliament on appropriations from the Petroleum Fund as set out in Section 30.2; and

(c) in the context of the budgetary process, advise Parliament on whether the appropriations of the Petroleum Fund are being used effectively to the benefit of current and future generations.

Subsequent Articles detail the composition of the Council, the appointment and tenure of its members, and limitations on who may serve on the Council. Barring bankruptcy, criminal conviction, or unfitness, Council members are accorded lifetime tenure. The Council serves as a repository of knowledge and expertise to be drawn on by the Parliament when the Parliament is considering matters related to the operation and management of the fund. It is an advisory body and has no authority to make decisions on behalf of Parliament. Although it may consider the performance of the Fund, the Council, unlike the Investment Advisory Board, does not play a

role in investment decisions; rather, it focuses its advice on Parliament's consideration of appropriations from the Fund.

Question

You are working in the Petroleum Fund Management Department of the Ministry of Finance. Your research has led you to the conclusion that it would be advantageous to make some adjustments to the Fund's portfolio of U.S. Treasuries. Specifically, you think it would be wise to shift 1% of the Fund's current holdings of one-year Treasury bills into two-year Treasury notes instead. The Minister agrees with you and asks what steps she need take to enact your plan.

Answer

The Minister must first check for consistency with the Management Agreement between the Minister and the Central Bank. If your proposal is consistent with the Management Agreement, the Minister must then request the advice of the Investment Advisory Board, in accordance with Articles 16(2) and 11(2). If the Investment Advisory Board does not provide advice within 15 days, the Minister may proceed with the Decision (Article 18(1)), otherwise, the Minister must take into account the Board's advice (Article 18(4)). The Minister may then direct the relevant External Investment Manager to shift 1% of the Fund's holdings from one-year Treasury bills to two-year Treasury notes.

Recap: Management Structure

Investment Advisory Board: provides investment advice to the Minister upon request, develops performance benchmarks, advises Minister on the performance of the External Investment Managers and may make recommendations on their appointment and removal.

Minister of Finance: enters into Management Agreement with Central Bank, makes management decisions according to the Management Agreement, provides instructions to the External Investment Managers.

Central Bank: responsible for operational management of the Fund, proposes appointments to Minister for External Investment Managers, enters into Management Agreement with Minister.

External Investment Managers: private sector management professionals who operate under contract and manage a given portion of the fund in compliance with the instructions from the Minister of Finance and the requirements of the Management Agreement.

6. The Fund's Portfolio

In addition to laying out the management structure governing investment decisions, the Petroleum Fund Law of 2005 placed specific restrictions and requirements on what types of instruments the Fund may be invested in, and what percentage of the Fund may be invested in those instruments. These requirements were substantially altered by the Petroleum Fund Amendments of 2011, discussed below. We provide an overview here of the 2005 investment requirements here as a basis for comparison and because they represented applicable law until 2011.

The chief constraint on investments was the requirement in Article 14 that at least 90% of the Fund be invested in "qualifying instruments." Article 15 defined such "qualifying instruments" very narrowly as debt instruments denominated in United States Dollars bearing fixed interest, with a high credit rating, and issued by a sovereign state (other than Timor-Leste) or certain other banks. Effectively, this meant that 90% of the Fund had to be invested in U.S. Treasuries, or equivalent. U.S. Treasuries are a low-yield, fixed interest instrument. They are widely considered to be the safest and most reliable investments in the world, with a risk of default approaching zero. The 90% requirement therefore represents a very conservative investment strategy. Though Article 14 of the Petroleum Fund Law permitted up to 10% of the Fund to be invested in equities, The Fund remained 100% invested in U.S. Treasuries until 2009, when with the "first diversification" of the fund, the Minister authorized up to 4% of the Fund to be invested in equities.

Question

The Petroleum Fund Law requires that all qualifying investment instruments, whether Article 15 instruments (e.g. U.S. Treasuries or equivalent), or equities, be issued abroad. Why might this be the case? Wouldn't it be doubly-beneficial if the Fund were to be invested in domestic equities, thereby spurring economic growth by providing a source of investment funding for local businesses?

Answer

There are a couple of reasons why the offshore investment requirement is considered good policy. It prevents opportunities for corruption and cronyism that might arise if local business interests believed they could influence investment choices and/or elected officials stood to gain

personally from investment decisions. Additionally, the size of the Timorese economy and its lack of infrastructure and industry means that there are simply fewer opportunities for large-scale investments. Accordingly, domestic investment instruments carry a higher risk to return ratio than offshore instruments.
See Drysdale, Jennifer, "Five Principles for the Management of Natural Resource Revenue: the Case of Timor-Leste's Petroleum Revenue" in Journal of Energy & Natural Resources Law, vol. 26 no 1, 2008, at page 164.

7. Transparency

Government transparency is crucial for combating corruption, preventing waste and inefficiency, holding political leaders accountable for their decisions, and for encouraging public participation in and oversight of government activities, especially spending. The history of development in many petroleum-wealthy countries has been characterized by a marked lack of transparency. This fact was on the minds of the drafters of the Petroleum Fund Law, which contains several provisions intended to make information about the Fund public and to prevent or minimize conflicts-of-interest among decision-makers. Chapter VI of the Petroleum Fund Law of 2005 is devoted to promoting transparency, and Article 32(1) identifies it as a "fundamental principle" of the Law:

Petroleum Fund Law of 2005

Article 32: Transparency as a Fundamental Principle

(1) The management of the Petroleum Fund shall always be carried out, and the related duties of all relevant parties shall be discharged, with the highest standard of transparency.

. . .

The Law requires many of the institutional actors, such as the Minister of Finance, the Central Bank, the Investment Advisory Board, and the Consultative Council, to produce and publish annual or quarterly reports. The chief requirements are summarized here:

- **Central Bank:** must publish quarterly reports (Art. 13(1), 13(2)).
- **Minister of Finance:** must publish Independent Auditor's report (Art. 36(1)) and ensure that the Management Agreement and the report by the Government required by Article 9 (above) for transfers exceeding ESI, are published within 30 days of finalization (Art.

32(5)). The Minister must also publish a comprehensive Annual Report on the Petroleum Fund (Art. 24).

- **Investment Advisory Board:** advices to Minister are required to be published in the Annex to the Minister's Annual Report (Art. 24(1)(b); Art. 24(2)).
- **Consultative Council:** advice provided by the Council must be published by Parliament within 30 days of its having been provided (Art. 31(1)).

Arguably, the most important of these requirements is the Minister's Annual Report on the Petroleum Fund, which the Government must submit to Parliament concurrently with its annual financial statements, and which must be published within 15 days of its submission. Article 24 lays out in detail what the Annual Report must include:

Petroleum Fund Law of 2005

Article 24: Information Contained in the Annual Report

(1) The Annual Report for the Petroleum Fund shall be prepared in a manner that makes it readily adaptable for public information, and shall contain in particular the following information for the Fiscal Year for which the Report is prepared:

(a) audited financial statements certified by the Independent Auditor, comprising:
(i) an income and expenditure statement;
(ii) a balance sheet, including a note listing the qualifying instruments of the Petroleum Fund, valued at market value;
(iii) details of all appropriations and transfers from the Petroleum Fund; and
(iv)notes to the financial statements, as appropriate;

(b) a report signed by the Minister describing the activities of the Petroleum Fund in the year, including all advice provided by the Investment Advisory Board, any reports prepared by the Independent Auditor under Article 35 and drawing attention to particular issues or matters that may be of concern or interest to Parliament;

(c) a statement by the Director of Treasury drawing attention to any accounting issues or practices arising from the Report that may materially affect the interpretation of amounts or activities shown within it;

(d) the income derived from the investment of Petroleum Fund assets during the Fiscal Year compared with the income of the previous three Fiscal Years;

(e) a comparison of the nominal income on the investment of Petroleum Fund assets with the real return after adjusting for inflation;

(f) a comparison of the income derived from the investment of Petroleum Fund assets with the benchmark performance indices provided to the Minister pursuant to Section 16(1);

(g) a comparison of the Estimated Sustainable Income for the Fiscal Year with the sum of transfers from the Petroleum Fund for the year;

(h) in the event of Government borrowings, the liabilities shall be reflected in the presentation of Petroleum Fund accounts so as to give a true representation of the past and expected future development of the Government's net financial assets and rate of savings; and

(i) a list of persons holding positions relevant for the operation and performance of the Petroleum Fund, including:

(i) the Minister;
(ii) the Director of Treasury;
(iii) the members of the Investment Advisory Board;
(iv) the external Investment Managers;
(v) the Head of the Central Bank; and
(vi) the members of the Petroleum Fund Consultative Council.

(2) The sources of the information described in Section 24(1), whatever their form, and including all reports and statements, shall be annexed to the Annual Report in unedited form.

This is a virtually exhaustive and comprehensive list. Nearly all of the documents required by the Petroleum Fund Law to be published must also be compiled and published again in the Annual Report. The Minister of Finance must also provide a description of all activities of the Fund in the proceeding year. Notice, too, that the Annual Report must identify the persons holding positions relevant for the operation and performance of the Fund.

See For Yourself!

The Minister's Annual Reports on the Petroleum Fund are available on the Ministry of Finance's website. View them yourself by going to:

http://www.mof.gov.tl/category/documents-and-forms/petroleum-fund-documents/petroleum-fund-annual-reports/?lang=tl

All reports are published in English and Portuguese, but only the reports from the years 2007 and 2008 are published in Tetum. The Petroleum Fund Law does not specify what language(s) the Annual Report must be published in. One could argue that Article 21(4)'s requirement that it "shall be prepared in a manner that makes it readily adaptable for public information" means that the Ministry should publish a copy of the Annual Report in Tetum.

Independent oversight by a third party is also an important element of transparency. Ministry and Board reports are not valuable if the information contained in them cannot be verified. Article 34 requires the Government to appoint an Independent Auditor for the Fund:

Petroleum Fund Law of 2005

Article 34: Independent Auditor

(1) Without prejudice to the jurisdiction of any court, there shall at all times be appointed an Independent Auditor, which shall be an internationally recognized accounting firm, selected and appointed by the Government.

(2) The selection and appointment of the Independent Auditor shall be made in accordance with the procurement procedures established under Timor-Leste law.

(3) The Independent Auditor appointed under this Act shall remain in function for the contract period, unless the contract is terminated for serious misconduct or serious breach of contract, or if the Independent Auditor's conduct otherwise prejudices the perfomance of the Petroleum Fund.

The Government has selected Deloitte Touche Tohmatsu, Ltd., an international audit, tax, consulting, enterprise risk, and financial advisory services firm, to serve as the Fund's Independent Auditor. The Independent Auditor serves two main functions.

First, it must certify the Government's estimation of the ESI, and for any proposed withdrawals from the Fund beyond the ESI, an estimate of how much the future ESI will be reduced as a result of the withdrawal. See Article 9 of the Petroleum Fund Law of 2009, above. This oversight mechanism ensures that the Government, which may have an interest in increasing spending to fund its budget, is not overoptimistic in its calculation of ESI, or in its assessment of the effects of withdrawals from the Fund on the future ESI.

Second, Article 35 empowers the Independent Auditor to track payments made as receipts to the Petroleum Fund, and to require additional information, including facts and proof,

from parties making payments into the Fund. The Independent Auditor must also refer to the Minister any "discrepancies" between payments actually made to the Fund and payments required. These and other particular issues and matters that may be of concern or interest to Parliament are included in the Minister's Annual Report, as required by Article 24(1)(b) (see above).

The Extractive Industries Transparency Initiative

Timor-Leste has also reached beyond domestic law to promote transparency in the administration and management of the Fund. The Extractive Industries Transparency Initiative ("EITI") is a voluntary global standard for extractive revenue transparency. In order to become a candidate, a country must first meet several sign-up requirements. Once it has been granted candidate status, the country has one and a half years to publish an "EITI Report" that reconciles what extractive companies purport to pay in taxes, royalties, and fees, with what the government acknowledges that it has received. The reporting process is overseen by a multi-stakeholder group appointed by the government that must include members from industry, civil society, and the government. Once the report has been published, the country undergoes the EITI validation process. The multi-stakeholder group appoints a Validator from a list of international consulting firms accredited by EITI for that purpose. Following a methodology specified in EITI's rules, the Validator completes a report confirming the country's compliance with EITI's transparency requirements.

Timor-Leste completed the validation process in April of 2010, and on July 1, 2010, it was designated EITI Compliant by the EITI Board, becoming one of only 14 countries worldwide that have achieved EITI-Compliant status, and the first in Southeast Asia to do so. The process does not end there. In order to retain its EITI Compliant status, Timor-Leste must be revalidated within five years. Also, stakeholders in the validation process may call for a revalidation at any time if they are concerned that Timor-Leste has fallen below the requisite transparency standards. Though participation in the EITI is voluntary, it produces tangible benefits by providing assurance to investors and donor communities that minimum standards of transparency and good governance are being met.

Question

Citizens and non-governmental watchdog groups undoubtedly benefit from laws requiring increased transparency; can you think of any other groups that may benefit as well?

Answer

Private oil and gas extraction companies and investment companies may benefit from increased transparency, too. Transparency can be good for business. When all companies are required to disclose the same information, and when they have access to government information through public reports, it creates a more stable and predictable investment climate, and promote healthy competition by making the same opportunities available to multiple parties.

8. Summary

The Petroleum Fund Law of 2005 created a single, consolidated sovereign wealth fund, called the Petroleum Fund, into which all profits, taxes, fees, and other petroleum revenues belonging to the State are deposited. The Fund finances the majority of government expenditures. Each year the Government submits to Parliament a budget proposal which details how much it wishes to withdraw from the Fund for that year. Interest from the Fund's investments yields an annual Estimated Sustainable Income, or ESI, which, in theory, is the maximum amount that the Government may withdraw without decreasing the overall value of the Fund. Expenditures in excess of ESI are discouraged, but not prohibited, by Article 9 of the Petroleum Fund Law of 2005, which requires that the Government demonstrate that expenditures must be in the interest of the Timorese people. The Court of Appeal has found at least one such expenditure to be illegal where the Government did not provide adequately detailed explanation.

The Law also places specific constraints on the types of financial instruments that the Fund may be invested in. Most notably, the Petroleum Fund Law of 2005 required that at least 90% of the Fund be invested in U.S. Treasuries or equivalent, although that requirement has since been amended. Responsibility for managing the Fund lies ultimately with the Government. Management decisions are made by the Ministry of Finance, with the cooperation of the Central Bank, the operational manager. An Investment Advisory Board provides investment advice and the Central Bank may contract with External Managers to manage portions of the Fund in accordance with guidelines that are provided to them. A Consultative Council serves as an advisory body to Parliament, when the legislature is considering appropriations from the Fund. The institutional structure contains several provisions designed to promote transparency, namely various reporting requirements and an independent, third-party External Auditor.

III. PETROLEUM FUND AMENDMENTS OF 2011

SECTION OBJECTIVES

- To understand the major changes made to the fund by the Petroleum Fund Amendments of 2011, and the consequences for how the Fund is managed.
- To consider the competing values of permanency and flexibility in the legislative process.

In 2010, a working group of the Ministry of Finance began preparing a draft of proposed amendments to the Petroleum Fund Law of 2005, with the goal of introducing more flexibility into the law and loosening the law's strict investment rules. The Ministry submitted its draft to the Council of Ministers, which, in June of that year, approved the proposed law and submitted it to Parliament. Parliament approved the law, and it was promulgated by the President and published on September 28, 2011 As the **First Amendment to Law No. 9/2005, the Petroleum Fund Law, Law No. 12/2011 (September 28) ("The Petroleum Fund Amendments of 2011")**. The 2011 Amendments do not replace the Petroleum Fund Law of 2005 wholesale. Instead, the legislation left the original law and the framework that it created largely intact, but made specific changes to several key provisions. The Primary goal of the Amendments is contained in the Preamble:

The Petroleum Fund Amendments of 2011

Preamble

. . .

This law is intended to change the rules and principles of investment, allowing greater flexibility in terms of diversifying the investment portfolio to increase future investment returns, within a clear definition of the limits on exposure to risk.

. . .

We will cover the most significant of these changes in this subchapter.

1. Permanence Versus Flexibility in Legislation

When the Petroleum Fund Law was initially passed in 2005, Fretlin held a majority of seats in Parliament and the Act enjoyed unanimous support. The Petroleum Fund Amendments of 2011 were passed by the Parliamentary Majority Alliance, which controlled Parliament at that time, and some members of Parliament opposed the Act. The Amendments were contentious, and interested parties weighted in on both sides of the debate, with some pushing for more

sweeping changes, and others urging lawmakers to retain the status quo. The debate raises important questions about the interplay of politics and good policy.

On the one hand, if legislation does not represent a binding commitment, and can be amended too easily and often, its purpose is defeated. Parties in control may see fit to revise the law frequently and make adjustments that further their own political goals and increase their own popularity—for example, by increasing expenditures to fund pet projects. Clearly, the management mandates of the Fund should not be overly subjected to the vagaries of election politics. On the other hand, economies do not grow in linear fashion; they are subject to cyclical patterns and unforeseen events. Placing permanent restrictions on the government's ability to spend Petroleum Fund dollars can be inefficient, because they do not allow the government to respond to new needs. How would you address this tension? Consider the following questions.

Question 1

Assume, for a moment, that it is ten years in the future. You work as an advisor to a politician who would like to ensure that there is a higher degree of permanence in the Petroleum Fund Act. What means would you suggest to her to accomplish this goal?

Answer

One means for ensuring a higher degree of permanence is codification of law in the Constitution, which may only be amended by a supermajority vote of the National Parliament. Your boss may propose a bill to amend the Constitution.

Question 2

Your boss thinks that this idea is worth consideration. But, she points out, the Constitution is a foundational document and probably not a suitable repository for detailed legislation like the Petroleum Fund Act. She asks if you have any other suggestions.

Answer

You may suggest that your boss introduce a bill proposing a Constitutional amendment that would require all legislation amending the Petroleum Fund Act to be ratified by a supermajority in the National Parliament.

Question 3

Your boss is again pleased with your answer. However, she notes, a bill to amend the Constitution itself requires a supermajority to pass the National Parliament, in addition to promulgation by the President. She thinks that this type of legislation would command only a bare majority in the current National Parliament. What other options can you suggest?

Answer

This is a difficult question. You could propose that she introduce a bill that would simply amend the Petroleum Fund Law to require a supermajority for all future amendments. However, it is not clear that such a bill would itself be Constitutional. Can the National Parliament voluntarily constrain its future lawmaking authority through the laws it passes? Is this wise? There be could be unforeseen implications in the future.

Question 4

Your boss has settled on a strategy—she would like to introduce a bill that amends the **Rules of Procedure for the Legislature** such that future acts by the National Parliament to amend the Petroleum Fund Act require a supermajority vote. However, she remains concerned that the Government could nonetheless amend the Petroleum Fund Act independently, through a Decree Law. She would like you to research whether this is possible.

Answer

Article 96(1)(k) of the Constitution (see below) *allows* the National Parliament to authorize the Government to make laws on "General rules and regulations for requisition and expropriation for public purposes." It appears from this language that the National Parliament must first authorize the Government to act before the Government could amend the Petroleum Fund Act by Decree Law, or before it could pass other Decree Laws that affect the Petroleum Fund.

Constitution of Timor-Leste-Leste

Section 96: Legislative Authorization

(1) The National Parliament may authorize the Government to make laws on the following matters:

. . .

(k) General rules and regulations for requisition and expropriation for public purposes;
. . .

The above questions and answers are meant to illustrate the difficulties inherent in crafting laws that strike the appropriate balance between permanency and flexibility. Let's now examine the revisions that the Petroleum Fund Amendments of 2011 made to the existing law and how these changes will affect the Fund.

2. Changes to the Portfolio's Investment Rules

From 2005-2010, the Fund's strategy of investing 90% or more in U.S. Treasuries yielded a return of approximately 2% above inflation. As you will recall, the calculation of ESI is based on an assumption that the Fund will yield an annual return of 3%. Since the Fund's performance was not meeting this expectation, the drafters of the Amendments were faced with two choices. They could retain the conservative investment requirements contained in the 2005 Petroleum Fund Law and revise the 3% assumption downward. This would cause the size of the ESI to decrease considerably, and would require a commensurate decrease in government spending, if spending were to remain at ESI. Alternatively, they could loosen the rigid investment restrictions to allow a larger portion of the Fund to be invested in higher-yield instruments, in the hope of achieving the 3% annual return that the ESI assumed. The drafters took the latter approach.

Article 15 was amended to require only a minimum of 50% of the Fund to be invested in low-risk instruments:

The Petroleum Fund Amendments of 2011

Article 15

. . .

(2) No less than 50% of the Petroleum Fund should be invested in eligible investments in bank deposits or debt instruments that are interest bearing, namely, bonds and other fixed and variable rate debt instruments, or other fixed income assets of equivalent interest and provided that:

(a) It is determined that the debt instruments have at least an investment grade rating, or

(b) The deposits are held in financial institutions with credit ratings that correspond to at least investment grade.

. . .

The provision both reduces the proportion of the Fund that must be invested conservatively, and expands the types of instruments that satisfy the requirement. Whereas previously the Law required the Fund to invest in debt instruments issued by sovereign states, such as U.S. Treasuries or equivalent, it now requires only that the instruments be interest-bearing and have an investment grade rating (which indicates a low risk of default). The other 50% of the Fund may now be invested in stocks. The amended Article 15 also allows for up to 5% of the Fund to be invested "other eligible investments" which could include real estate, derivatives, or other non-stock instruments, and which may carry more risk than stocks. The condition that all investment instruments must be issued abroad has remained in place.

The Government acted quickly to take advantage of the law's new investment rules. In July of 2012, the Central Bank and the Minister authorized State Street Global Advisors to become the Fund's third External Investment Manager, with a mandate to invest an additional 15% of the Fund in equities, bringing the Fund's current investment portfolio to approximately 80% Treasuries and 20% equities. It is still much too early to determine whether the new investment approach has paid off. Shifting to more volatile investments can make short-term forecasting more difficult; only time will tell if Timor-Leste's new strategy will pay off in the medium- and long-term.

Another significant change in the Law involves using the wealth of the fund as collateral for borrowing money. The Petroleum Fund Law of 2005, Article 20, expressly forbade any portion of the Fund to be encumbered and stipulated that any agreements encumbering the Fund would be null and void. The Petroleum Fund Amendments of 2011 eased this requirement, by allowing for up to 10% of the total value of the Fund to be encumbered as collateral against state borrowing:

Petroleum Fund Amendments of 2011

Article 20: Encumbrance on the assets of the Petroleum Fund

(1) Any amount that is invested in accordance with Articles 14 and 15 is, independently of the form which it is invested, the property of the State of Timor-Leste.

(2) By contract or agreement it is possible to encumber the assets of the Petroleum Fund, up to 10% of the total value of the Petroleum Fund as of the date of the creation of the

encumbrance or charge, provided that the principles in the general system of creation, issuance, and management of public debt are respected.

There are benefits to allowing for encumbrance: access to international loans and the possibility of lower interest rates. In 2011, Parliament passed the **Public Debt Regime Law No. 13/2011 (28 Sep. 2011)**, allowing for state financing through public debt. The Government of Timor-Leste created public debt obligations for the first time in its history in 2012, taking out loans for a total of $33.1 million dollars. The Government's primary purpose for borrowing in 2012, as indicated in its annual budget report, was to finance infrastructure projects where the cost of borrowing is lower than the economic returns of the project in the medium term.

3. Changes to the Institutional Structure

The 2011 amendments contain a small but potentially significant change in Article 17, providing the requirements for the composition of the Investment Advisory Board. The amended Article reads:

Petroleum Fund Amendments of 2011

Article 17: Structure of the Investment Advisory Board

(1) The Investment Advisory Board consists of five or more members appointed by the Prime Minister, on the advice of the Minister, and at least three must have considerable experience in investment management.

(2) The director of the Treasury and a representative of the Operational Manager are entitled to participate without vote, in meetings of the Investment Advisory Board.

. . .

(5) Before taking office, members of the Investment Advisory Board shall submit a written declaration that the appointment has no conflict with other personal or family interests.

Notice that the Director of the Treasury and the Head of the Central Bank are no longer awarded voting seats on the Investment Advisory Board. Additionally, the Prime Minister now appoints the members, on the advice of the Minister of Finance, and there is no limit to the number he may appoint. In June of 2012, Prime Minister Xanana Gusmão exercised this new power and expanded the Petroleum Fund's Investment Advisory Board by appointing two new

members. The Investment Advisory Board plays a very important role in influencing investment decisions by the Minister and the Central Bank. The new structure of the board shifts the power to control appointments and to determine the Investment Advisory Board's composition firmly into the hands of the Prime Minister and the Minister. Although the effect is indirect, it surely gives the two officials more investment decision-making power than previously, while reducing the control of the Central Bank.

The Article, as revised, considerably loosens the disclosure requirements for members of the Investment Advisory Board. Compare text of section (5), above, with the text it replaced:

Petroleum Fund Law of 2005

Article 17: Structure of the Investment Advisory Board

. . .

(5) The members of the Investment Advisory Board shall, on occasion of taking and vacating office, submit a declaration concerning their assets and income from property and capital, including information relating to their bank accounts.

Members of the Investment Advisory board are no longer required to submit a declaration concerning their assets and income from property and capital. Instead, the declaration now need only indicate that the "appointment has no conflict of interest." The statute does not define elsewhere exactly what a conflict of interest is for purposes of this provision, or how potential conflicts should be evaluated. In the absence of a declaration containing independently verifiable data (like bank account information), those seeking to determine whether an appointee has a conflict or not must accept the judgment of the appointee.

Conflicts: A Closer Look

Conflicts of interest in the investment environment can be difficult to detect and prevent. The 2011 amendments retained the "offshore investment" requirement discussed in Section II, Subsection 6, above, prohibiting the Fund to be invested in domestic debt instruments. This can help reduce, but does not by any means preclude, conflicts of interest on the part of Investment Advisory Board members. Do you think that Article 17's new disclosure requirements are adequate? Can you think of a benefit of loosening the disclosure requirements? One answer might be that doing so potentially allows the Prime Minster to draw from a larger pool of talent because some persons who might have declined an appointment (due to an unwillingness to divulge their private financial information) may now be willing to become a member. Can you think of any others?

The rules concerning the selection of External Investment Managers have also been changed:

Petroleum Fund Amendments of 2011

Article 12: External Investment Managers

. . .

(2) The Operational Manager may select and contract with one or more external investment managers under the preceding paragraph and pursuant to the following paragraph as soon as the Minister confirms that the following requirements have been met:

(a) That the External Investment Manager is a legal person with share capital, guarantees and insurance adequate to the operational risks involved;

(b) That the External Investment Manager has demonstrated an optimum record of operational and financial performance, and

(c) That the commercial references and international reputation for the External Investment Manager, in the management of financial funds, are of the highest standard.

(3) In cases where the External Investment Manager is a national Timor-Leste legal entity, the requirements referred to in (b) and (c) above may be waived if the Manager satisfies, and the Minister confirms, that the risk of not meeting the criteria outlines above is safeguarded, and the Minister Submits the confirmation of the External Investment Manager for approval by the Council of Ministers.

Section (3) of Article 12 was added by the 2011 amendments. The change was evidently made to promote employment and employment opportunities among Timorese financial professionals.Co nsider the costs and the benefits of such a provision. How many jobs as External Investment Managers are likely to be available to Timorese as a result? Will the hiring of Timorese asset managers spur the development of a domestic financial sector? By contrast what are the costs? Perhaps sub-optimal management of a portion of the Fund's investments?

The Petroleum Fund Amendments of 2011 revised Article 9 as well:

Petroleum Fund Amendments of 2011

Article 9: Transfers in excess of the Estimated Sustainable Income

No transfers from the Petroleum Fund in excess of the Estimates Sustainable Income can be made in any fiscal year unless the Government presents in advance to the National Parliament:

(a) The reports referred to in paragraphs (a) and (b) of the preceding Article;

(b) A report estimating the amount the Estimated Sustainable Income for fiscal years thereafter will be reduced, by virtue of a transfer from the Petroleum Fund which exceeds the Estimated Sustainable Income;

(c) An auditor's report which certifies the estimates of reduction in the Estimated Sustainable Income referred to in paragraph (b) of this Article.

(d) Justification of the reasons that it is considered in the long-term interest of Timor-Leste to transfer an amount greater than the Estimated Sustainable Income.

As you can see, the Law retains the general prohibition on withdrawals from the Fund in excess of ESI.

Question

Has the standard for making withdrawals from the Fund in excess of ESI changed? Is it now a weaker or a stronger standard?

Answer

Look carefully at the text of the amended Article 9. Notice that, whereas the former text of Article 9(b) compelled the Government to provide Parliament with "a detailed explanation of why it is in the long-term interests of Timor-Leste" to make such a transfer. The new Article 9(b) compels the Government to present to Parliament "justification of the reasons that it is considered in the long-term interests of Timor-Leste" to make the transfer. This is a very subtle difference; however a *detailed explanation of why it is* in the interests of Timorese may be a slightly more stringent standard than a *justification of why it is considered* in those interests. Think back to our discussion in the previous Section about how open to interpretation this standard seemed under the old Law—the new language might introduce even more room for interpretation.

On a related note, compare section (c) with its counterpart from the 2005 Law. Notice any difference? Whereas previously the Government was required to submit a report from the Independent Auditor certifying the estimates of reduction in ESI, now the Government need only present the same report from "an auditor." The distinction might be unimportant. Then again, strictly read, it does relieve the Government of its obligation to use the Independent Auditor, who must meet certain qualifications under Article 34. The Law does not elsewhere define "an auditor," allowing for the possibility that the Government could, if it chose, "shop around" for an audit report that suits it—defeating the purpose of an audit entirely.

4. Summary

The 2011 amendments are characterized by two overarching themes. First, by changing the portfolio investment requirements, the new Law allows for a much larger portion of the Fund to be invested in higher-yield, higher-risk instruments and for a small percentage of the Fund to be used as collateral for government borrowing. The previous requirement that 90% of the Fund remain in U.S. Treasuries has been relaxed—now 50% of the Fund must be invested relatively low-risk in interest-bearing instruments, and up to 50% may be invested in stocks. Second, the new Law modifies the institutional structure of governing the management of the Fund in a way that appears to shift managerial control away from the Central Bank and to the Minister of Finance.

IV. REVIEW

Timor-Leste possesses sizeable petroleum deposits that have generated billions of dollars of wealth for the country. The existence of petroleum wealth holds great promise for the country's future development and for the benefit of future generations of Timorese. The history of developing nations with similar non-renewable resource wealth has been mixed, however. The unique nature of petroleum resources, namely their size, scale, price-instability, and potential for secrecy, has led some scholars to the conclusion that countries with petroleum reserves are especially prone to the effects of the "resource curse." This term is used to describe a phenomenon observed among developing states in which states with considerable non-renewable natural resource reserves can surprisingly fare more poorly development metrics than similar countries that do not possess similar reserves. Consideration of the resource curse and its affect on development have informed the regime that Timor-Leste has created to govern the acquisition and use of petroleum revenues by the State.

The **Constitution of Timor-Leste** declares that all subsoil resources, including petroleum, belong to the State. The government implemented this mandate by creating a sovereign wealth fund, called the Petroleum Fund, into which all profits, taxes, fees, and other petroleum revenues belonging to the State are deposited. The Fund and the rules governing the Fund were established in the Petroleum Fund Law of 2005, which was later amended. A very high percentage of Timor-Leste's government expenditures derive from the Fund. The Government annually submits to Parliament a budget proposal that details how much it wishes to

withdraw from the Fund for that year. Interest from the Fund's investments yields an annual Estimated Sustainable Income, or ESI, which, in theory, is the maximum amount that the Government may withdraw without decreasing the overall value of the Fund.

Expenditures in excess of ESI are discouraged, but not prohibited, by Article 9 of the Law, which requires that the Government demonstrate that expenditures must be in the interest of the Timorese people. The Court of Appeal has found at least one such expenditure to be illegal where the Government did not provide adequately detailed explanation. The Law places specific constraints on the types of financial instruments that the Fund may be invested in. Most notably, the Petroleum Fund Law of 2005 required that at least 90% of the Fund be invested in U.S. Treasuries or equivalent. This was amended in 2011 to require only that 50% of the value of the Fund must be invested in interest-bearing instruments—a full 50% may be invested in equities instead.

Responsibility for managing the Fund lies with the Government. Management decisions are made by the Ministry of Finance, with the cooperation of the Central Bank, the operational manager. The Investment Advisory Board provides investment advice and the Central Bank may contract with External Managers to manage portions of the Fund in accordance with guidelines that are provided to them. A Consultative Council advises Parliament regarding appropriations from the Fund. The institutional structure contains several provisions designed to promote transparency including an External Auditory and the requirement that the Minister of Finance publish an annual report containing various information about the Fund and its performance.

In 2011 Parliament passed legislation amending the Petroleum Fund Law. As indicated, the revised Law allows for a much larger portion of the Fund to be invested in higher-yield, higher-risk instruments and for a small percentage of the Fund to be used as collateral for government borrowing. The 2011 amendments also altered the institutional structure governing the management of the Fund in a way that appears to shift managerial control away from the Central Bank and to the Minister of Finance. Some of these changes include increasing the Minister and Prime Minister's appointment power over the Investment Advisory Board, and possibly loosening the standard that must be met in order for the Government to make withdrawals in excess of ESI.

THE PETROLEUM FUND LAW

FIGURE 1: COMPARISON CHART OF 2005 AND 2011 LAWS

PETROLEUM FUND LAW OF 2005	CHANGES MADE BY 2011 AMENDMENTS
Investment Advisory Board consists of Head of Central Bank, Director of Treasury and three members appointed by the Minister	**Internal Advisory Board** consists of five or more members appointed by Prime Minister, on the advice of Minister; Head of Central Bank and Director of Treasury have no vote
External Investment Managers are appointed by the Central Bank; Minister confirms that they meet minimum professional standards.	Minister may waive the professional standards requirement for **External Investment Managers** who are Timorese legal entities.
Investment of the Fund is restricted to 90% U.S. Treasury bonds, or equivalent.	**Investment of the Fund** is restricted to 50% interest-bearing debt interests; up to 50% may be invested in equities, of which 5% may be instruments other than stocks.
Estimated Sustainable Income (ESI) is set at 3% of the value of the Fund.	No change.
Spending Beyond ESI requires the Government to submit reports and "detailed explanation" to Parliament. **Independent Auditor** must certify the estimates of reduction of the Fund.	**Spending Beyond ESI** requires Government to provide reports and "justification" to Parliament. "An auditor" must certify estimates of reduction of the Fund.
Transfers from the Fund must be authorized in the budget approved by Parliament.	No change.
Encumbrance of the Fund is prohibited.	Up to 10% of the total value of the Fund's assets may be encumbered.

This table has been adapted from a chart developed by Lao Hamutuk, available online at: http://www.laohamutuk.org/Oil/PetFund/revision/10PFRevision.htm.

THE PETROLEUM FUND LAW

GLOSSARY

Auditor: A firm that examines the financial records of the Fund to make sure all money is accounted for and invested properly.

Conflict of Interest: When a Fund manager, auditor, or overseer has a financial or personal connection to a potential Fund investment. For example, when a member of the Investment Advisory Board owns a significant part of a company the Fund may invest in.

Constitutional Review: When a court (or other body) decides whether a law or rule complies with the Constitution.

Diversification: Investing Fund money in a wide range of equities and fixed-income investments, which can lower the risk of Fund losses.

Encumbrance: Using Fund assets as collateral for a loan (giving a right for the loan grantor to seize the Fund money if the loan is not repaid).

Estimated Sustainable Income (ESI): The maximum amount that can be withdrawn from the Petroleum Fund in any given year without diminishing the value of the fund in the future.

Equities: Stocks or other capital investments that give 'ownership' in a company or asset. These investments are generally riskier than bonds or "fixed-income investments" but also generally yield higher income.

Fixed-Income Investments: Such as bonds, these investments promise a regular, fixed payment with less risk than stocks but no opportunity for greater returns than the fixed payment.

Interest/Yield: Money earned by investing Fund money in bonds, stocks, or other investments.

Offshore Investment: Investments made outside of Timor-Leste, such as on foreign stock-exchanges or in foreign bonds.

Portfolio: The range of investments, such as stocks and bonds, made using money in the Fund.

Resource Curse: The phenomenon that developing countries with non-renewable natural resource abundance tend to experience slower rates of economic growth than countries without natural resource abundance.

U.S. Treasuries: Bonds issued by the U.S. Government, promising a fixed-rate of income. Considered to have essentially no risk of loss.