State-led prosperity or 'runaway state-building'? Timor-Leste's new development strategy

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Introduction

Prime Minister Xanana Gusmão has adopted a bold and ambitious strategy to transform Timor-Leste in twenty years from the poorest state in Southeast Asia into a prosperous upper middle income country. In April 2010 he launched the Strategic Development Plan 2011-2030 (SDP or PEDN) which, after some further revisions, was finally presented to the National Parliament in July 2011. Initially entitled 'On [the] Road to Peace and Prosperity' and 'From Conflict to prosperity', the plan addresses three key areas: social capital, infrastructure development and economic development (RDTL 2011, 10). Its goal is that by 2030 Timor-Leste will have eradicated extreme poverty and established a sustainable and diversified non-oil economy (RDTL 2011, 194). It sets out to establish the conditions for a sustainable and vibrant economy that will grow beyond dependency on the petroleum sector, transform subsistence agriculture so that agriculture becomes a leading driver of private sector jobs, and establish a modern education and health system that will create a new workforce able to master new technologies and 'respond to new opportunities with dynamism, creativity and enthusiasm' (RDTL 2011, 9).

The strategy pursues a model of state-led development underwritten by large withdrawals from the Petroleum Fund. The engine of continued double-digit growth will be fuelled by the Fund. The Fund, created by Law No.9/2005, reached US$6.9 billion by the end of 2010 and was approaching US$8 billion by mid-2011, notwithstanding the largest single quarterly withdrawal from the Fund of US$436 million in the last quarter of the year (La'o Hamutuk 2011b). Other than petroleum revenues, the Timor-Leste economy continues largely as one of subsistence agriculture. Timor-Leste is 'the most petroleum-dependent country in the world', with 95 per cent of state revenues coming from its maritime gas and oil reserves (La'o Hamutuk 2010a).

Whether it succeeds or fails, state-led development on the scale of the SDP will remake the nature of the state in Timor-Leste. This paper considers the possible political outcomes of the SDP in terms of an antithesis to the thesis proposed by the SDP. The thesis is that the development strategy, which is urgently needed to address poverty and overcome dependency upon petroleum income, will achieve its developmental and inclusive social goals. The antithesis is that the strategy will move Timor-Leste into the dangerous territory of what O'Dwyer (2006) calls the spiral of 'runaway state-building', the profligate deployment of state funds to pursue political objectives. In poor states that have a mono-economy dependent upon a single major source of state revenue the risk of runaway state-building is compounded by the threat of the 'Resource Curse' where governments of energy-rich but poor states create an enclave economy of big spending surrounded by continuing mass poverty (Auty, 1993).

Runaway State-Building

State-led development funded by petroleum revenues if mismanaged and driven by political interests will present Timor-Leste with major challenges if the experience of other resource-rich, poor states is considered. The experience of some African states, including Nigeria and the Democratic Republic of the Congo (Brown and Kaiser 2007) and of a number of the reinvented post-communist states in Eastern Europe confirms that illiberal democracy and corruption are real dangers when state resources are distributed for political advantage.

Illiberal democratic regimes are characterised by weak party systems manipulated by self-serving political élites. Political parties in illiberal democracies do not represent the public interest (Hague and Harrop 2010). 'Runaway state-building', the extraction of state resources to fund patronage politics, became a characteristic of party politics in the new, post-communist states of Eastern Europe (O'Dwyer 2006). Patronage expands the population of clients of state largesse within and outside the bureaucracy. A similar pattern developed in Latin America (Geddes 1994). Competition between rival élite political actors, of course, does not equate to democratic politics. State capacity is undermined by poor and corrupt governance.

By and large, Timor-Leste has so far escaped the threat of retreating into an 'illiberal' (merely procedural) democracy. It experienced major crises in 2006 and again in 2007 but its competitive multiparty political system has survived and the 2012 parliamentary election, like that in 2007, will probably be fair and free. It will be argued here, however, that as the SPD involves continuing large withdrawals and higher risk investments for the Petroleum Fund, a trend towards runaway state-building, already evident, will accelerate with the associated risk of entrenching an illiberal democratic system characterised by clientalism and patronage.

The first indicator that runaway state-building is a potential threat in Timor-Leste is a succession of very rapidly growing annual budgets. The proposed 2012 budget of US$1.763 billion represents a 35% increase in government spending over 2011, and more than five times the 2008 budget. La'o Hamutuk in its analysis of the 2012 budget notes that 'according to the IMF World Economic Outlook, Zimbabwe is the only country in the world whose state budget grew faster during the last four years (La'o Hamutuk 2011a). In its submission to Committee C of the National Parliament in October 2011, La'o Hamutuk repeated its warning that "the resource curse is already here, manifesting itself in a range of symptoms including inflation ('Dutch disease'), extreme import dependency, neglect of non-oil sectors and revenue sources, ineffective public expenditures, credible rumours of corruption and failure to plan for the long term". Prime Minister Gusmão has taken direct control over a growing share of state budget funds. Large projects such as the National Development Agency and the Human Resources Directorate are located now in the Office of the Prime Minister (Bano, 2011). His intention is to make things happen, to personally push an accelerated development strategy rather than work through the admittedly underperforming ministries.

There are fears the ministries and their departments lack the capacity to execute the budget. President Ramos-Horta attacked the government's decision to so steeply increase state expenditure in an election year, warning that the government was incapable of managing and expending such large sums in the name of its national development strategy (Ramos-Horta 2011a; Ramos-Horta 2011b). Mismanaged state funds increase the opportunities for corruption, a problem that Prime Minister Gusmão has acknowledged exists in the ministries (Gusmão 2011a). His government has taken action to address this problem. The Anti-Corruption Commission (CAC) is finalising its strategic plan and has initiated prosecutions. Timor-Leste has adopted EITI (Extractive Industries Transparency Initiative) to improve governance of its petroleum resources. The government is establishing of a Superior Audit Agency and an eProcurement Portal that will allow access to the government tender process, promoting greater transparency (Gusmao 2011b). The problem however, as President Ramos-Horta has warned, is lack of administrative capacity to control its own procurement processes (Ramos-Horta 2011a).

The second indicator of runaway state-building is the concentration of budget control, and with this the temptation for political patronage (as distinct from corruption) in the political executive, specifically the Prime Minister himself. As budget responsibility increasingly transfers to the political executive, the authority of the National Parliament correspondingly weakens. This was evident when the 2011 Budget was presented by the Government to the parliament in November 2010. Initially, the 2012 Budget was US$985 million, of which US$734 million was drawn from the Petroleum Fund, within the 3 per cent Estimated Sustainable Income (ESI) limit of annual withdrawals mandated by the Petroleum Fund Law. On 28 January, however, Parliament approved a state budget presented to it of US$1,306 million, including US$1,055 million from the Petroleum Fund, exceeding the ESI.

The 2011 budget now included US$599 million allocated to two, new Special Funds (the Infrastructure Fund and the Human Capital Development Fund). These funds would not be part of the Consolidated Fund, but administered by the National Development Agency (ADN) under the Ministry of Finance with the power to shift expenditures from one area of allocation to another. When the 2011 budget was referred by parliament to President Ramos-Horta for promulgation he referred it in turn to the Court of

Appeals to ask for a preventative appraisal of its constitutionality. His concerns were that detailed expenditures of the Special Funds were not specified and the US$321 million now proposed above the 3 per cent ESI from the Petroleum Fund had not been justified as required by the Petroleum Fund Law (Dias 2011). The Court advised that the budget law was constitutional.

The consequences of these developments in 2010 were that the political executive, in effect, the Prime Minister, exercised wide-ranging discretion in the allocation of state funds. Arsénio Bano, the Vice-President of FRETILIN (the opposition party) accused the Prime Minister of taking into his own hands control of over 57% of the National Budget through the Prime Minister's Office and the Office of the Presidency of the Council of Ministers which the Prime Minister also controlled, and in his role as Minister of Defence and Security (Bano 2011).

The claim is an exaggeration but the Prime Minister has increasingly involved himself in the distribution of state funds. During his tour of the sub-districts in 2010, Gusmão personally authorised the allocation of 'development capital' grants for local infrastructure projects. The grants are coordinated by the Prime Minister's department and administered by the Ministry of State Administration and Territorial Management (MSATM). Hundreds of new local companies proliferated, scrambling for government tenders.

The distribution of special funds to local contractors for local constructions started with the Referendum Package (*Pakote Referendum*, PR) in 2009. In 2010, the Decentralisation Development Package (*Pakote Dezenvolvimentu Desentralizadu*, PDD), provided US$31 million for local tenders that were expected to produce immediate benefits at the sub-district and *suco* levels. The allocation for PDD-II in 2011 was US$28,811,000 (Bano 2011).

Questions were raised about the capacity of these new local contractors to complete their projects and allegations were made of favoured treatment for politicians' family members in the award of tenders (Borges 2010). The senior official in MSATM responsible for overseeing PDD acknowledged that there were problems with contractors and with installing a responsible procurement system (MSATM 2010). PDD funding was not included in the state budget or subject to parliamentary scrutiny and was distributed outside the usual budgetary and fiscal procedures. La'o Hamutuk, warned the Government that it must learn from the 'weaknesses of Pakote Referendum … which resulted in corruption, poor planning, and intermittent implementation'. Timor-Leste was moving closer towards the 'Resource Curse' (La'o Hamutuk 2010c).

Deploying the Petroleum Fund

The SDP is clearly a political as well as a development strategy intended to position the CNRT to win the 2012 elections in its own right and deliver the Prime Minister undivided control of his government. The expectation is that generous deployment of state resources to the electorate will win the CNRT majority support in the parliament and obviate the need to negotiate a coalition majority. The development capital funds, the large National Budget increase for 2012 in an election year, and the relaxation of the formerly tight controls over the Petroleum Fund are all justified in terms of the SDP but they have obvious political advantages for the Prime Minister and his party as the parliamentary elections approach.

The Prime Minister provided a justification for the radical remaking of the deployment of petroleum revenues in a speech delivered in May, 2010 (Gusmão, 2010). Previously, he said, government had adopted a 'prudent and simple investment strategy' imposing strict legislative conditions limiting risk; now was the time to move on from this 'limited' and 'conservative' strategy and to maximise and diversify petroleum savings. The time for prudence had passed:

> If the needs of the country require fast and sustainable growth, we have to invest in basic infrastructure, and for this to be possible, we need to unblock the mistaken policy of savings in order to invest those revenues in the best way.

The Petroleum Fund Law (2005) established a funding regime where withdrawals from the Petroleum Fund required approval by the National Parliament and advice from the Petroleum Fund Consultative Council

(Drysdale 2007, 78). No transfer could be made from the Petroleum Fund in a Fiscal Year in excess of the Estimated Sustained Income for the Fiscal Year (set at 3% of annual petroleum income) without a detailed justification to the parliament and a commitment to restore the withdrawal above the ESI in following Fiscal Years (RDTL 2005). Petroleum revenues were invested in United States Federal Treasury Bonds, the Petroleum Fund Law allowing only 10% of the Fund to be invested less conservatively (Drysdale 2007, 78).

In 2010-2011, the Government reviewed the Fund's investment strategy and introduced amendments to the Petroleum Fund Law that expanded the limits on annual withdrawals from the Fund from 3% to 5%. Some withdrawals from the Fund could now be made without parliamentary authorisation (La'o Hamutuk 2010c). The decision was made to increase the limit from 10% to 50% of Petroleum Fund investment in the international share market, a move that was opposed by the Consultative Council for Petroleum Fund (CCPF 2011) and was made at a time of serious instability in global share markets . A former Australian adviser to the CCPF, Dr Tim Anderson, warned that 'substantial changes proposed for East Timor's Petroleum Fund law will expose the nation's finances to high risk and open the door to corruption' (Anderson 2011, IRIN, 2011). The National Parliament approved the proposal for greater flexibility in investments from the Petroleum Fund in August 2011 ('East Timor Parliament' 2011).

In the past, deployment of petroleum revenues has not improved the situation for the mass of Timor-Leste's citizens. Poverty actually increased in Timor-Leste between 2001 and 2007 (World Bank 2008). About half the population continue to live below the poverty line: while they have until now received little of the benefits of an annual real growth rate per GDP of between 19 and 7 percent over the past three years, they do suffer the effects of inflation, which has risen to around 13% (La'o Hamutuk 2011). In 2010 food prices increased 10 percent and continue to rise (Index Mundi 2010).

Conclusion

In a country with a population half of whom are identified as below the poverty line, the need for development that reaches the poor is urgent and obvious. In 2010-2011, the government of Timor-Leste decided to draw heavily on its one important source of income, the Petroleum Fund, to kick start an ambitious strategy of state-led development that is intended to transform Timor-Leste into a prosperous and peaceful upper middle income country. The concern, held not only by the FRETILIN opposition, is that this raises the risk of political manipulation of the Petroleum Fund, of mismanagement and of corruption.

The possibility has been raised in this discussion that the imprudent deployment of savings in the Petroleum Fund risks Timor-Leste experiencing the phenomenon of 'runaway state-building' similar to that experienced in the new post-communist states of eastern Europe, and that Timor-Leste could experience negative consequences of the distorted political economy known as the 'Resource Curse'.

There is the associated danger that a system of misuse of state resources for political patronage could become entrenched. The potential for 'money politics' to subvert the political system is real. Poor management of the ambitious, petroleum-funded development strategy and its appropriation for political advantage may well be only a worst case scenario in Timor-Leste where elections are competitive and fair, where governments can be voted out of office, and where the Constitution is generally respected. State-led development in a poor, resource rich country can succeed as the achievements of Botswana's first president, Seretse Khama, demonstrated (Brown and Kaiser 2007). Botswana, however, is the exception. Valuable natural resources, badly managed, can corrupt and ruin a state as Nigeria and the Democratic Republic of the Congo demonstrate. If their experience is a guide, the antithesis to state-led development, runaway state-building, is at least a potential risk for Timor-Leste.

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