

# The policy challenges and limited options for the new Government – guteriano

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## **The policy challenges and limited options for the new Government**

Timor's new government is operating in a challenging environment. It is expected to reverse the trend with the available policy options are limited. This adds to the fact that it is operating in a highly uncertain political environment.

During the last ten years, Timor's economic growth has been driven by the domestic consumption and public investment. The domestic consumption is subsidized by the petroleum through public spending. Investment in productive sectors and social services is low in terms of the percentage. The result is that despite economic growth, it does not have much impacts on the domestic productivity and job creation. At the same time, the gap between urban sector – primarily Dili – and the rural is growing and obvious.

The new government is expected to reverse this trend. It is expected that meeting current basic needs of the people while laying down the foundation for long-term will become the main policy priority for the new government. It needs to address various forms of poverty and deprivation through tackling poverty, providing employment, and social services for the needed one, and improving basic infrastructure.

The policy implication is that fostering economic growth is not sufficient enough to address these challenges. One needs to look deeper at the type of economic growth. The growth should come from the sectors where most people live in. In the context of Timor, investment in Agriculture is the most strategic investment at least for the next ten years. This is so because the majority of Timorese are still living in agriculture, and rural poverty is higher than the national average. Thus investment in agriculture can address some issues like rural employment, rural poverty, preventing migration to the urban area, and malnutrition.

Investment on social services like education, health, water, and sanitation are critical at this point, because of its long-term effect, and also important to get public support at this point in time. These are the sectors that affect people directly on the daily basis. Thus this is the long-term investment and politically strategic.

The Prime Minister, in some occasions that lead to the formation of new government, already makes some important point about how to reverse the trend. This includes the investments in the sectors that are matters for the people and preventing immigration to urban, and investment in the social sectors. Fretilin itself is characterized as the left-wing party. Thus, the expectation is that social spending and agriculture will be more prioritized by the new government.

The temptation, however, will come from the political-economic aspect of it. With highly political uncertainty, and without the majority in the Parliament, the government will have to compromise. Some of the compromises at the elite's level can be against what people at the bottom really need. Some signs of it are already observed in the current government structure, which is still relatively big given the small size of the population.

The biggest temptation is the policy of "buying growth". With sixteen billion dollars sitting in the Petroleum Fund Account, combining with high expectation, and political uncertainty, the government can be tempted to satisfy everyone through "buying growth" policy. It also can be tempted to satisfy the demand from the interests' groups through various forms of subsidies. The implication is that the government will continue to embark on large spending, subsidizing urban consumption, and continue to spend on big projects that do not have clear investment return. If that is the case, then Timor might have a new government with the old policy.

The problem is that the government does not have many available options when it comes to policy instruments. Unlike the governments everywhere, Timor-Leste does not have monetary policy to intervene the economy. This means that fiscal policy is the only options available to the government. Even with the fiscal policy, the options for revenues are limited. With the 41 percent are still live below the national poverty line, low-income group, and small private sector, the tax base is very small. Even the government can manage to increase the tax-to-GDP ratio, it will only small impacts. If it decides to increase the tax rate, it can reduce the purchasing power of the people. Henceforth, from revenues side, the government will still depend on the Petroleum Fund Account to finance its spending.

Foreign Aid is still another important source of investment in the economy, but it has been in declining trend. With the fact that the major donor countries like Japan, the United States, and the Eurozone are facing economic hardship, combining with the other problems around the world that need more attention, foreign aid will continue to decline obviously. The Australia is still the biggest donor; but it is also in declining

trend.

Attracting private investment either domestic investment or foreign investment has been one of the policy goals that Timor's intend to achieve. One measure that the previous government has been doing is through the economic policy. It is obvious from the official statements that one of the policy goals of the government is to attract private investment to create employment for the high proportion of youth.

However, like many oil-dependent countries, the private sector activities are highly centralized in the capital and tend to depend on the government's projects. It is also important to bear in mind that not all the private investments are good. One cannot view the private investment as the panacea. One needs to look at the type of private investment are necessary for the country, given its current development stage. At the same time, the government also needs to overcome some of the administrative hurdle and other structural issues that constrain the private investment.

At the end, given the current development stage, public spending will still be the main driver for the economy in Timor. The issue, however, is what kind of investment that it will prioritize. Therefore, it has to navigate through a challenging environment where the public demand for the public services is high, at the same time it has to make a compromise to get the political support among political elites. This takes place in a context where the available policy options are limited to the government.

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