

## ***Timor Leste***

Timor-Leste slid into crisis in April 2006, after over 40 percent of the army went on strike to protest alleged discrimination, after which they were dismissed by the Government. The ensuing violence was centered in Dili and left about 160,000 internally displaced, 35 dead and over 2,000 houses burnt. The violence exposed tensions within the military, between military and police, and between eastern and western parts of the country, and the country was forced to call upon international forces to restore order. While the conflict subsided after the arrival of foreign troops, security conditions remain fragile and incidents of violence, often gang related, have continued.

The security crisis led to a political crisis, forcing the resignation of former Prime Minister Alkatiri in mid-2006, his replacement in July by former foreign minister Ramos-Horta, and the house-arrest of the former interior minister on charges of distributing arms. UN supervised Presidential elections are scheduled for April 9, 2007, with parliamentary elections to follow in June-July 2007. Amidst a fragile political environment, concerns of possible violence during or after the elections however remain.

There are still an estimated 30,000 people displaced in camps in Dili. Government and international agencies are continuing to provide humanitarian assistance, but many of the displaced are fearful of going back to their homes amidst concerns of insecurity.

The economy in 2006 was set back by the unrest with the closure of some government departments and disruption in private sector activity. Coffee production, the main non-oil export commodity, fell by about 20 percent, although the offshore oil and gas sector was undisturbed. Real non-oil GDP is estimated to have declined by nearly 2 percent in 2006, notwithstanding a year-end boost from higher public spending and international aid. CPI inflation spiked to nearly 7 percent by end-2006, reflecting supply disruptions and higher transportation costs. With the buildup of the new UN mission and higher government spending, non-oil GDP growth is expected to increase in 2007.

The implementation of Government's investment program has been hampered by delays in capital budget execution due to weak capacity. Private investment and job creation have also been weak. Unemployment in Dili, where about a quarter of the formal labor force resides, was estimated at 27 percent, and with 53 percent of the population under age 17, urban youth unemployment of 40 percent (aged 15-24) is a particular problem that appears to have exacerbated the intensity of the recent conflict. A critical challenge therefore is to improve budget execution so that spending priorities can be better realized.

The fiscal and current account balances in 2006 each recorded surpluses of over 100 percent of non-oil GDP, and are projected to increase during 2007/08 reflecting large and growing revenue and royalties from offshore oil and gas fields. The FY2006/07 Budget provides for higher government spending, particularly for emergency assistance, wage bonuses for civil servants, and an increased subsidy to the state-owned electricity company (offsetting a reduction in electricity prices). Capital spending, particularly for infrastructure projects, is budgeted to more than triple, but actual spending is again expected to be well below budget reflecting the aforementioned constraints. Deposits accumulated in the Petroleum Fund had reached \$1 billion by February 2007.

The country faces the challenge of rebuilding trust and addressing the security situation and the rule of law. Adequate response to basic humanitarian needs and development requirements is also vital. In parallel, there is a need to jump-start the economy and respond to basic humanitarian needs and development requirements. Strong governance over the rapidly accumulating Petroleum Fund will need to be maintained, as will reforms to spur non-oil private sector activity.