

Timor-Leste

Since the outbreak of conflict in April 2006, Timor-Leste has experienced prolonged political volatility culminating in the recent presidential and parliamentary elections held in April/May and June 2007, respectively. Following a second-round run-off election, Jose Ramos Horta became the country's new President. While no single party gained enough seats to form a government on its own, the President invited a coalition, the Parliamentary Majority Alliance (AMP), headed by former President Xanana Gusmao to form the fourth constitutional government which took office on August 8, 2007. The appointment of the AMP government sparked violent protests in the east of the country by supporters of the former ruling party, Fretelin, which claimed a right to govern as the party with the largest number of votes polled, though lacking partners to form a majority coalition. The political unrest appears to have abated following the initial unrest, though the situation remains fragile.

There are still an estimated 30,000 people displaced in camps in Dili and it is estimated that the recent unrest has displaced a further 4,000 people since August. Stabilizing the security situation is thus an immediate priority for the new government, and the United Nations has been requested to continue its presence in the country, backed by foreign troops.

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 transport 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 the public investment program has been hampered by delays in 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 23 percent (in 2004), while unemployment amongst youth (15-29 year age group) is estimated at 40 percent. National youth unemployment is also high at about 25 percent, which is of particular concern as regards the potential for further unrest. The majority of the population depends on subsistence agriculture, and many face seasonal food shortages. According to a recent report by FAO/WFP, up to 220,000 Timorese will need food assistance during the lean months of October 2007 to March 2008.

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. Deposits accumulated in the Petroleum Fund had reached \$1.4 billion by June 30, 2007. The growth of petroleum revenue has meant that "sustainable" budget spending is presently estimated at over \$300 million per year. The new government has prepared a transitional budget for the remaining period of the current year, paving the way for a proposed change in the budget cycle to the calendar year starting January 2008. While this gives the government some room to formulate its spending priorities, the critical challenge will be to improve budget execution so that those spending priorities can be better realized.

The country thus faces the continuing challenge of rebuilding trust and addressing the security situation and the rule of law, while also addressing the basic humanitarian needs of the displaced population and the restoration of their normal lives. In parallel, there is a need to jump-

start the economy, the primary mechanism for which in the short term will have to be through increased government spending. The Government will thus need to substantially improve its ability to execute spending priorities as reflected in its annual budgets. There is also an urgent need to develop a social safety net to provide support to the poor and vulnerable segments of the population.