

TIMOR-LESTE

Timor-Leste has experienced prolonged political volatility since the outbreak of conflict in April 2006. The presidential and parliamentary elections were held in April/May and June 2007, respectively. Following a second-round election, Jose Ramos Horta became the new President. With no single party gaining enough seats to form a government, the President invited a coalition, the Parliamentary Majority Alliance (AMP), headed by former President Xanana Gusmao to form the government, which took office in August 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 most votes polled, though lacking partners to form a majority coalition. Although the political unrest subsequently abated, President Ramos Horta was wounded in an assassination attempt in February 2008, in a plot that also involved an unsuccessful attack on the Prime Minister.

There are still about 30,000 displaced people living in camps in the capital, Dili, and another 70,000 in the districts in a total of 58 camps. Stabilizing the security situation thus remains of high priority for the new government. The United Nations has been requested to continue its presence in the country, backed by foreign troops.

The crisis compounded weak economic performance over the previous five years. Implementation of the Government's investment program remains constrained by delays in capital budget execution due to weak capacity. Private investment and job creation have also been weak, and inflation, which had increased to nearly 7 percent in 2006 in part reflecting supply disruptions, remained above 7 percent through much of 2007. In 2007, non-oil GDP is estimated to have expanded sharply, aided by higher government spending and the demand generated by buildup of the new UN mission. But this followed a contracting non-oil economy in 2006, when private activity was disrupted by the unrest, and some government departments were also temporarily closed.

The lack of productive jobs is a critical problem, which has exacerbated recent tensions. Only about 400 formal jobs per year were created in recent years versus over 15,000 annual entrants to the labor market, and youth unemployment in Dili is estimated to have risen to 40 percent following the crisis. The majority of the population depends on subsistence agriculture, and large segments face seasonal food shortages. According to a recent report by FAO/WFP, up to 220,000 Timorese were projected to be in need of food assistance during the lean months of October 2007 to March 2008.

Rapidly growing petroleum revenue, reflecting global price trends and increased production, has contributed to large budget and current account surpluses, of over 300 and 200 percent of non-oil GDP, respectively. These surpluses are projected to increase in the medium term as revenue and royalties from offshore oil and gas fields continue to grow. Deposits accumulated in the Petroleum Fund reached nearly \$2 billion by end-2007. The rising petroleum revenue has meant that "sustainable" budget spending is presently estimated at over \$300 million per year.

A critical challenge for the new government is to improve budget execution so that legitimate spending priorities, as reflected in annual budgets, can be better realized. In the short term, increased government spending will be the primary mechanism to revive the domestic economy on a sustained basis. There is also an urgent need to develop a social safety net to provide support to the poor and vulnerable segments of the population. Success in these efforts would help the challenges of rebuilding trust and addressing the security situation and the rule of law, while addressing the basic humanitarian needs of the displaced population.