

TIMOR-LESTE

Investment Reform Map

Modernizing Timor-Leste's investment policy and promotion framework to attract investment in priority sectors, stimulate growth and support diversification of the economy

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ABBREVIATIONS AND ACRONYMS

ACIA	ASEAN Comprehensive Investment Agreement
ADB	Asian Development Bank
AFAS	ASEAN Framework Agreement on Trade in Services
ASEAN	Association of Southeast Asian Nations
BCA	Binding Constraints Analysis
BIT	Bilateral Investment Treaty
CoM	Council of Ministers
DVA	Domestic Value Addition
EAP	East Asia and Pacific
FCI	Finance, Competitiveness & Innovation
FDI	Foreign Direct Investment
FET	Fair and Equitable Treatment
GDP	Gross Domestic Product
GoTL	Government of Timor-Leste
GVC	Global Value Chain
I&C	Investment & Competition unit
IC	Investment Climate
ICB	Investment Competitiveness Benchmarking
ICSID	International Center for Settlement of Investment Disputes
ICT	Information and Communications Technology
IFC	International Finance Corporation
IIA	International Investment Agreement
ILO	International Labor Organization
IMF	International Monetary Fund
IPA	Investment Promotion Agency
IPP	Investment Policy & Promotion
IPS	Investment Policy Statement
IRA	Investment Reform Agenda
IRM	Investment Reform Map
ISDS	Investor-State Dispute Settlement
ISS	Investment Sector Scan
IT	Information Technology
JPDA	Joint Petroleum Development Area
KPI	Key Performance Indicator
LDC	Least Developed Country
M&A	Mergers & Acquisition
M&E	Monitoring & Evaluation
MCAE	Minister of State and Coordinator of Economic Affairs
MFN	Most Favored Nation
MNE	Multinational Enterprises
MTI	Macroeconomics Trade & Investment Global Practice
NEM	Non-equity mode of investment
NGO	Non-Government Organization
NT	National Treatment
O&G	Oil and Gas
ODA	Official Development Assistance

OECD	Organization for Economic Cooperation and Development
PIL	Private Investment Law
PPP	Public Private Partnership
RCA	Revealed Comparative Advantage
R&D	Research and Development
SDP	Strategic Development Plan
SERVE	Serviços de Registo e Verificação Empresarial
SEZ	Special Economic Zone
SIRM	Systemic Investor Response Mechanism
SME	Small and Medium Enterprise
TITL	TradeInvest Timor-Leste
TRIMS	Trade Related Investment Measures
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNESCAP	United Nations Economic and Social Commission for Asia and the Pacific
USD	United States Dollar
WBG	World Bank Group
WTO	World Trade Organization
ZEESM	Oecusse Special Zone for Social Market Economy

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However, this report was not completed during the referred period and was later revisited and reviewed during the VIII Government and subsequently completed during IX Government through MCAE and TradeInvest TL team due to its critical importance to analyze opportunities and barriers for investment, identifies priorities for reform, and proposes an agenda for concrete action to support Timor-Leste's investment vision and maximize its attractiveness for FDI as well as benefits to the local economy.

The reviewed Team from TradeInvest TL was composed of Mr. Arcanjo da Silva, Executive Director of TradeInvest TL, and his Directors, Mr. Decio Ribeiro Sarmiento, Mr. Ezaquiel Babo, and Mr. Roberto Lai. Meanwhile, the MCAE team was composed of Ms. Maria da Silva, Mr. Leonito de Jesus, Ms. Jorginha Martins and Mr. Apolinario Leite. The team would like to thank the inputs and constructive feedback of all the involved parties throughout the development of this document.

EXECUTIVE SUMMARY

- Stimulating private investment is a key objective for Timor-Leste. The long-term vision in the Strategic Development Plan 2011-2030 needs to be complemented by focused and concrete actions to attract, facilitate, retain, and expand new private investment.
- The small size of the domestic market of Timor-Leste combined with distance from major markets push up transport and production costs, limiting export industries to those that can secure premium prices in global markets. Foreign and domestic investment can be key in the development process and targeting the appropriate sectors is crucial. In an increasingly globalized world, there is no doubt that foreign investment has a significant role to play in propelling Timor-Leste's economy forward and connecting it with larger markets. The GoTL can use FDI strategically to bridge the gap in inequality and maximize FDI's transformational benefits for its people.
- Creating and opening markets in Timor-Leste therefore should entail a three-pronged strategy to generate growth and create 'stable' income earning and employment opportunities for a young and growing population: (i) increasing market supply, (ii) encourage local production, and (iii) targeting niche exports.
- Given the low levels of diversification and the long time required to change some constraints currently affecting the country (i.e., skills, infrastructure) it would be extremely difficult to make a radical shift towards significantly new economic activities. Therefore, initially focusing on attracting investment in relatively known and not very complex economic sectors (i.e. sustainable tourism, agro-industries, agricultural products, construction materials) may be the best option for Timor-Leste, in the short term, to progressively incorporate new technologies and know-how to further develop and upgrade these sectors, in the medium and long term. In parallel, domestic infrastructure needs to be developed as a supporting pillar of the economy.
- A strategy to open and create markets entails elimination of different types of discriminatory measures that protect domestic markets, as well as reduction in barriers that increase the cost of business transactions. De-risking investment in Timor-Leste involves removal or reduction in policy and regulatory risks at both the project and country-level. It entails creating and promoting reliable regulations and institutions, thereby shifting perceptions from the belief that the way to do business is through secretly negotiated deals that give the firm a privileged position, to a process that is rule-based, transparent and predictable.
- Therefore, aligning with the Government strategic vision and policies, the WBG proposes the following 17-point investment reform agenda to modernize Timor-Leste's investment policy and promotion framework to attract investment in priority sectors, stimulate growth, and support diversification of the economy including enhanced opportunities for women.

Investment Lifecycle	Proposed Solutions for Timor-Leste
Investment vision & strategy	Finalize a high-level committee “TradeInvest Timor-Leste Consultative Council” with the responsibility of moving reforms forward
	Develop an Investment Policy Statement at the national level
	Consolidate a more comprehensive investment promotion strategy to be in line with IRM
Investment attraction	Finalize & implement TradeInvest’s 5-year Strategic Plan (2022-2027) to be in line with IRM
	Identify relevant skill gaps within TradeInvest and design a capacity building plan to bridge such gaps
	Strengthen capacity within TradeInvest to update sector-based intelligence, ensuring access to up-to-date data & adapting assessments to Timor-Leste’s priorities
	Strengthen TradeInvest policy advocacy role through “TradeInvest Timor-Leste Consultative Council”
	Revise, if needed, an efficient & well-targeted incentives framework to support both FDI and NDI attraction in competitive sectors
Investment entry & establishment	Implement a risk-based approach to licensing process
	Advocate for more simplified process to obtain a visa and propose an action plan to streamline process

	through “TradeInvest Timor-Leste Consultative Council”
	Publish the updated negative list of investment sectors if changes occur
	Work in coordination with relevant government entity to ensure the new land law provides enough clarity to both foreign and national investors
Investment protection, retention & expansion	Develop & implement an investor grievance mechanism to address grievances at an early stage
	Develop a model BIT for Timor-Leste to negotiate more comprehensive IIAs with potential partners
Investment linkages	Conduct a feasibility study to identify & develop a linkage strategy between foreign investors and potential domestic firms
	Develop a comprehensive strategy to strengthen the linkage between investment and export diversification

I. CONTEXT

A. Introduction and Background

1. **Following the restoration of independence, Timor-Leste has created the preconditions for successful development.** It has credibly emerged from a crisis of internal violence and political instability in 2006/7. Since the crisis, Timor-Leste has become increasingly economically independent, with own-resources far surpassing Official Development Assistance (ODA).

2. **The Government of Timor-Leste (GoTL) is embarking on an ambitious economic development agenda with the objective of Timor-Leste becoming an upper middle-income country by 2030,** as set out in the Timor-Leste Strategic Development Plan 2011-2030 (SDP)¹. The SDP recognizes that diversification of the economy away from petroleum production and government spending is necessary to achieve strong economic growth over the medium and long term. The SDP's vision rests on private sector-led growth to create jobs and income, and tackle persistent poverty. The private sector has substantial growth potential, and is expected to drive growth in the priority sectors identified in the SDP, but faces significant constraints in the investment environment, and infrastructure bottlenecks.

3. **Timor-Leste is faced with many challenges - limited private investment, weak trade integration, high informality, low productivity, and a lack of structural transformation.** Despite these years of independence and relative political and economic stability, the major share of FDI attracted by Timor-Leste continues to be in the oil & gas (O&G) sector. While this is important investment for the economy, such FDI does not contribute sufficiently to job creation, and the GoTL has grown dependent on this sector, which finances 90 percent of public spending through the Petroleum Fund. With limited oil reserves, diversification of the economy is a key objective of the GoTL. In addition, the lack of integration of the O&G sector with the domestic economy has reduced its potential for creating jobs and increasing potential value added. With annual population growth of 1.8 percent according with Timor-Leste population and housing census 2022, and a population with 60 percent under the age of 25, Timor-Leste needs to attract other forms of investment beyond natural resources and find better ways to link its economy with regional trade and investment.

4. **Like the rest of oil-dependent economies in the world, Timor-Leste is experiencing a period of low growth and economic uncertainty.** Oil prices have recently increased due to global surge in oil supply annual revenues from oil and gas production shows steady decrease². While revenues from the Joint Petroleum Development Area (JPDA) in the Timor Sea constitute a substantial windfall, existing fields are steadily depleted with its near term of production,³ while the petroleum fund balance is expected to be declining. The government understands its economy remains highly dependent on petroleum revenues and is vulnerable to fluctuations in world oil prices. Moreover, most households in Timor-Leste are rural and agricultural, mostly family oriented production, where most of the labor force employed in the agriculture sector which is characterized by low level agricultural output, low productivity and operating at close to subsistence levels.

5. **Within this context, the GoTL has recognized that private investment is key to economic growth, and that it will benefit from being open to the regional and global economy.** It has prioritized

¹ The SDP is built on three pillars: (i) social capital, covering human development, gender, and social inclusion; (ii) infrastructure development; and (iii) economic development for a non-oil economy. A fourth cross-cutting pillar addresses institutions and macroeconomic foundations that underpin implementation. The document is currently under review during the VIII Constitutional Government, and is expected to be concluded within 2023.

² As per the World Bank's latest Timor-Leste Economic Report (December 2022)

³ Government estimates, National Authority for Petroleum and Mineral Resources.

membership in the Association of Southeast Asian Nations (ASEAN) and its ongoing membership to the World Trade Organization (WTO) as a key strategy to accelerate growth and economic diversification. In addition, GoTL identified some key sectors – agriculture, tourism, fisheries, manufacturing and industry and downstream petroleum sectors, as well as mining – to drive economic diversification, which has also been integrated through Timor-Leste’s effort towards its accession and integration to ASEAN and WTO.

6. **The Government of Timor-Leste approved its first Private Sector Policy and Strategy in 2022, which includes policy towards improving the participation of small and medium enterprises participation in the formal economy, as well as an annexed Guide for its Implementation.** As a living policy document for the government, titled “Timor-Leste is Open for Business”, the Policy highlighted imperative issues to be addressed as well as the strategy to generate confidence and mobilize private sector active participation, as partner in the development of Timor-Leste’s economy.

B. Timor-Leste’s Development Agenda

7. The Strategic Development Plan provides the vision for Timor-Leste to transition from a low income to upper middle-income country by 2030 and it provides a framework for identifying priorities, as well as guidance to implement strategic recommendations.

8. **Two key areas of the SDP are inevitably related to the investment: (i) infrastructure development and (ii) economic development.** On the first one, the country lacks the necessary infrastructure to develop a competitive private sector. A core strategic pillar is to develop and maintain the infrastructure (road networks, water supply, electricity, seaports, airports, telecommunications) needed to get to the markets. The development of Timor-Leste’s infrastructure is a vital step to be taken to develop a vibrant private sector and to be able to attract foreign direct investment (FDI) to foster economic diversification.

9. Under the economic development area of the SDP, the primary focus is *to build a modern, diversified economy based on the agriculture, tourism and petroleum industries, with a flourishing private sector and new opportunities for all our people.*⁴

To address domestic issues, the SDP envisages the development of a National Planning Framework to identify opportunities and encourage private sector investment in specific areas and sectors. The Plan recognizes the strategic and transformational role of investments (it does not differentiate much between foreign and domestic investment) and identifies specific areas for reform, where the Government has revised its Private Investment Law in 2017, and the Government has also passed its land and property law, where the Government is working on the regulations for land titles.

10. **The SDP specifically states the following regarding the attraction of investors to the country:** *To build our nation and provide jobs and income for our people, Timor-Leste needs to attract investors to our key industry sectors, partner with international firms in building our infrastructure and support local firms to start-up and grow.* It recognizes the importance of investors’ confidence, market openness and regulatory certainty to be able to foster investment (both domestic and foreign into Timor-Leste). Investment climate improvements are key to build up a mature, efficient and well-functioning private sector allowing the country to transition to a non-oil economy. Areas of weaknesses are stated in the document as well, including contract enforcement, property registration,

⁴ Timor-Leste Strategic Development Plan 2011-2030.

land tenure and dispute resolution, in addition to infrastructure related obstacles and access to finance. Government is working on implementation regulation for land tenure and arbitration law has been approved by the National Parliament

11. **The SDP spells out the key areas and instruments specifically related to investment to be used in implementing the strategy,** namely: (i) improvements to regulatory frameworks that affect investment climate and promote diversification-led growth; (ii) improvements to increase the capacity of the investment attraction body; (iii) provision of adequate energy supply, efficient logistics and enhanced connectivity; (iv) development of the nation's banking and finance industry; and (v) development of Special Economic Zones (SEZ) to attract FDI by providing investors specific incentives.

12. **However, the SDP depicted above does not delineate with adequate clarity and sectoral granularity the role that FDI is meant to play in Timor-Leste's development trajectory.** Moreover, the SDP was written in a different economic context, in which oil revenues were much higher than they currently are, and diversification needs were not that obvious. The SDP does not pay direct specific attention to the core elements of a targeted FDI attraction and retention strategy for the country, and it only touches superficially on several issues.

13. To address this gap, **the IX Constitutional Government is committed to prioritize the economic diversification and job creation through attracting more private sector investment as one of its economic priorities to meet the challenges of modernity and support a young and fast-growing population.** The Government will continue to improve its business enabling environment through three key areas: social capital, infrastructure development and economic development that is aligned with the 2030 Agenda for Sustainable Development of the United Nations and the National Strategic Development Plan. To achieve these priorities and to integrate into the region and facilitate global trade, the Government will improve business enabling environment to facilitate private sector to invest in potential sector such as hospitality, agribusiness, light transformative and mining and oil and gas.

14. **Timor-Leste positions itself with great competitiveness by making a difference, especially in the region.** The Government aims to capitalize on both land and maritime resources sustainably, adopting the Blue and Green Economy towards the country's future development. This includes implementing a strategy for the development of the Blue Economy for Sustainable Development and diversifying its agriculture and non-agriculture industries. The development Timor-Leste economy will be built around the growth of three critical industries: agriculture, tourism, petroleum and minerals that have significant advantages due to our natural resources, geographic location and economic profile.

15. **As a strategy to develop its green economy, the Government considers agriculture as the basis for the country's economic and social development.** The agriculture sector is estimated to be providing direct employment to about 70 percent of our employed population. Therefore, it is in Timor-Leste's vision that by increasing investment and improving the sector's market access value chain, the current subsistence farming practices will progress towards commercial, and more agriculture industry in the country.

16. **Another important cornerstone of Timor-Leste's future economic development is the petroleum and mineral resources sector.** The Tasi Mane project will boost economic growth, create jobs and generate direct and indirect economic benefits across the country. Timor-Leste continues to put its priority in this sector to increase its investment portfolio by enlarging the studies on the resources and reserve potential. Thus, investment in this project will have multiplier effects on the economy, stimulating other industrial sectors and benefiting local businesses.

17. **Regarding tourism, the Government aims to develop a national strategy to create synergies with other locations in the region in Asia and the Pacific.** Currently That is why the Government intends to develop an effective strategy for attracting tourists, where promotion and marketing will be fundamental to affirm this competitiveness.

18. **In the VIII Constitutional Government, MCAE recognizes that there are many political decisions already taken that impact upon development of the investment policy framework of Timor-Leste,** such as on the World Trade Organization (WTO) and ASEAN accession and on fiscal reform⁵. The GoTL has therefore requested the WBG to develop an IRM in attracting investment and setting an agenda for concrete actions that would unblock constraints to investment and support Timor-Leste's long-term investment vision.

19. During the VI Constitutional Government, a revised Private Investment Law (PIL) was promulgated, the highlights of which can be found in Annex 1⁶. Among other reforms, it purports to abolish the investment certificates, abolish ex-ante screening and provides for new mandate for TradeInvest to pro-actively market Timor-Leste to investors in selected priority sectors.

20. **To complement the IRM, MTCI has developed an industrial policy that would implement supply side measures⁷.** The aim is to use scarce resources to focus on value chains that can attract investment. In addition, to use these investments to add value to existing industries (e.g., agro-processing) by increasing use of technology, adopting new managerial techniques, etc. to increase productivity. Such Industrial Policy also aims to identify potential industries that can be leveraged under goods and services sectors.

C. Objective of the Report

17. **The Report aims to identify the key constraints and available opportunities for investment as an engine for growth and development in Timor-Leste.** The analytical framework used in this report analyzes barriers to and opportunities for investment, identifies priorities for reform, and proposes an agenda for concrete action to support Timor-Leste's investment vision and maximize its attractiveness for FDI as well as benefits to the local economy.

18. The main objective of the WBG project under which this Report is produced to assist the Government of Timor-Leste to **(a) improve the quality of its investment climate for both domestic and foreign investors, and (b) explore which sectors can potentially play a key role in attracting foreign and domestic investment into the country.** Therefore, the Report pursues three inter-related objectives:

- (i) To assist GoTL to identify what constraints are affecting the country's investment competitiveness;
- (ii) To assist GoTL to develop and implement an effective investment policy and promotion strategy to start an economic diversification process by generating increased levels of domestic and foreign investment in key strategic sectors; and,

⁵ There has been a wide-ranging fiscal policy and administration reform program including proposals for the introduction of a VAT system, removing incentives from the Private Investment Law and moving it to the General Tax Law, eliminating tax holidays and favoring tax deduction based on employment of Timorese citizens available to all businesses. Not all these proposals have progressed to implementation.

⁶ The WBG provided intensive advice on the PIL while the IRM was being drafted. The findings, principles and good practices mentioned in the IRM were communicated and transferred to the Timor-Leste team in parallel during the development of the law.

⁷ A draft report was submitted by UNDP.

- (iii) To assist GoTL to promote and generate investments in key sectors, away from oil and gas (O&G), to help in economic transformation and diversification.

19. **The report also reviews current institutional arrangements, operational strategy and capacity of the recently restructured Investment Promotion Agency –TradeInvest Timor-Leste (TITL)** - to provide effective services in support of GoTL's investment attraction objectives. The report can thus serve as an input in formulating structural and operational recommendations to improve the investment attraction capabilities of Timor-Leste in strategic economic activities.

II. ANALYTICAL FRAMEWORK

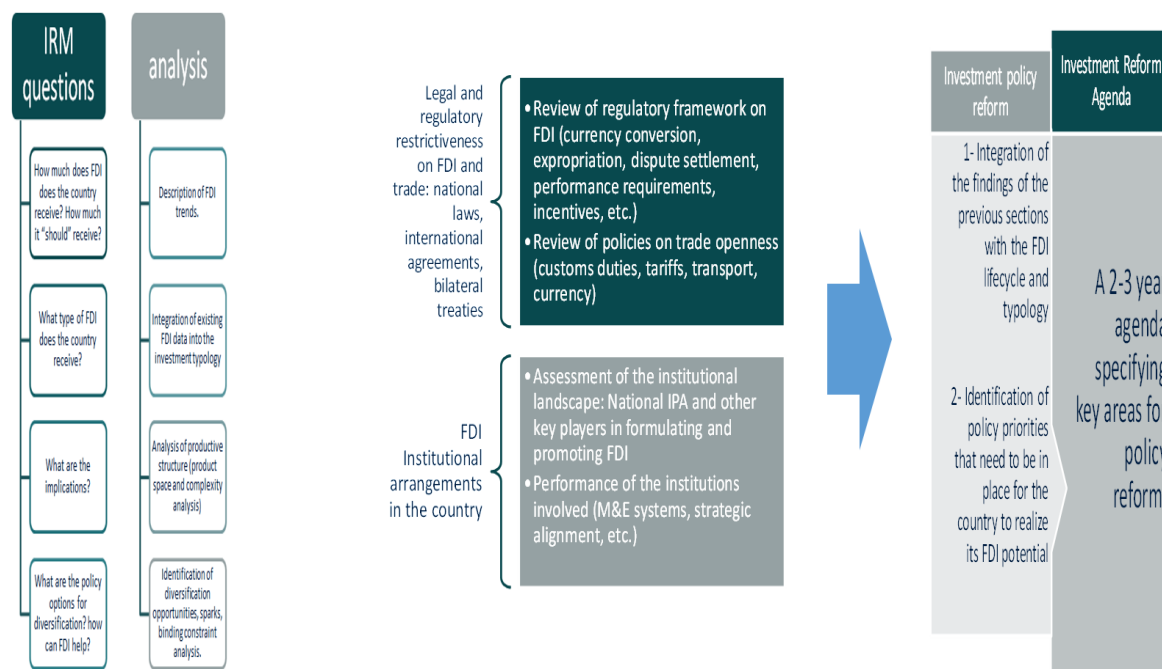
A. The IRM Approach

20. The IRM serves as a logical framework that would enable Timorese policy makers to “connect the dots” among the numerous variables at different levels affecting how Timor-Leste inserts itself into the international economy, and use investments to diversify exports, create more and better jobs and thus improve the standards of living of citizens. The IRM helps host economies to better capitalize on FDI opportunities and it does so based on a brief, tailored, diagnostic report rooted in a typology (see below) of the different kinds of investments the host economy should be targeting and their potential impact on the development process. The purpose of such a diagnosis is to enable a dialogue between host economy policymakers and other key stakeholders leading to an agreed plan of action.

21. The IRM provides policymakers with several key elements needed to frame policy reform options and priorities (see Figure 2). The IRM is a tool that guides governments through the process of:

- (i) Diagnosing investment promotion and policy barriers and opportunities;
- (ii) Developing an action plan for reforms to realize the potential impact of foreign direct investment in the local economy; and,
- (iii) Ensuring policy coherence through cooperation and coordination of investment-related policymaking institutions and their implementing agencies.

FIGURE 1 INVESTMENT REFORM MAP ANALYTICAL FRAMEWORK



Source: WBG IPP Team.

Why is an investment vision important?

22. While it is important for policymakers to understand the drivers of foreign firms' decisions to invest in their country, it is also essential for them to appreciate what aspects of their country's business environment motivate a firm's decision to locate its investment there.

23. **Motives for investment in a geographic location are known as host-country determinants and cover a set of economic, geographic, political, social, and policy factors.** The relative importance of each of these determinants and their successful combination will depend largely on the firm's own drivers and strategic motives, whether it is a new investment or a re-investment, whether it is made in the form of greenfield investment.

How can FDI help Timor-Leste develop?

24. **FDI can be instrumental in facilitating the objective of diversification into more sophisticated and knowledge-intensive activities.** Successful economic diversification depends on fostering a wider range of opportunities for private economic activity, and on the ability of local companies to integrate into global production value chains. To the extent that FDI is the element that anchors the development of many value chains, it becomes a key factor in fostering a more diversified local economy.

25. **The previous benefits are far from automatic.** The global economy has plenty of examples of countries that attract large quantities of FDI without being able to diversify or to move up the value chain. And other countries attract FDI without linkages to the private sector. In the absence of a strong policy framework, a key risk for Timor-Leste is that capital-intensive investments do not have backwards linkages. This will contribute to a domestic private sector mentality that FDI is 'displacing' domestic investment, not growing the pie. Accordingly, the record of the empirical literature is far from conclusive. Some econometric studies have found FDI to drive processes of diversification (Tadesse & Shukralla, 2013). Yet in many of these studies the magnitude of the effect varies significantly across host country characteristics (Iwamoto & Nabeshima, 2012). The same goes for the relationship between FDI and knowledge spillovers. In general, the literature has identified positive effects from FDI through vertical spillovers (Javorcik, 2004), while the evidence for horizontal spillovers is more mixed, or even negative (Aitken & Harrison, 1999). Similarly, approaches focusing on case studies show that FDI spillovers do not emerge automatically.

26. **The lack of generality on the positive effects from FDI is also symptomatic of the difficulties inherent to investment policy.** A sound policy framework for investment is essential to facilitate the rise of these more advanced benefits from FDI. Yet, designing and implementing the type of investment policy a country needs is a challenging task. To maximize the development impacts of FDI, an appropriate investment policy framework is needed. The difficulty starts when decision-makers try to identify what "investment policy" is, or should be. A broad range of stakeholders, issues, institutions, legal instruments, and administrative tools are captured in investment policy which may lead to confusion for policy makers. Even if policy makers can identify the end-objectives, it can be difficult to know where to start and which concrete actions to prioritize, to have the most impact. Investment policy is dynamic – there is no "one size fits all" solution, it must be re-evaluated as the economic, political and social circumstances of the country evolve. An approach that works in one country for one type of investment at one point in time will need to be continually revised, adapted and improved, to consider the changes in the domestic economy, the transformations occurring in different types of businesses and any changes in the country's general circumstances. One way to visualize is to follow a sequential approach, by which, in the case of FDI, the main objective of maximizing its potential benefits entail previous stages, covering the stage by which foreign investors

are attracted to invest into the host country, the stage when such investment is materialized and it is established, then the stage when the investment starts to be managed, operated and once retained hopefully begins to expand, leading to linkages and thereby “rooting” the FDI with the domestic economy.

27. **Therefore, the IRM is a tool to help the GoTL to capitalize on these FDI opportunities.** The technical sections following this introductory section provides a brief, tailored diagnostic with the objective to enable dialogue with the country’s policymakers and other relevant stakeholders that will lead to an agreed plan of action. The IRM provides policymakers the key analysis they need to consider their FDI policy reforms options and priorities.

B. Two Pillars of the IRM Analytical Framework: The Investment Lifecycle and the Investment Typology

30. **The IRM is a diagnostic and client engagement tool that provides a clear pathway for policy makers to clarify the current and potential positioning of their economy in an integrated international economy and align their investment policy reforms accordingly.** The IRM sets forth recommendations for concrete short- and medium-term action items that can both be implemented within national political calendars and can be evaluated against a set of performance indicators.

31. **The WBG has designed an investment policy framework with two analytical pillars to guide the effectiveness of policies related to investment.** The first pillar is the investment lifecycle, which sees FDI as a dynamic relationship with the host economy, and not merely as a one-time transaction. This view corresponds to an investment policy capable of addressing issues along various stages of the relationship between foreign investors and the host economy, including FDI attraction, entry and establishment, retention and expansion, and linkages. The second pillar, is the investment typology, which sees FDI as a heterogenous phenomenon, which can be broadly categorized along four types (natural resource-seeking, efficiency-seeking, domestic market-seeking and strategic asset-seeking). This typology enables to group investments across different location determinants, different development effects, and ultimately different types of policies.

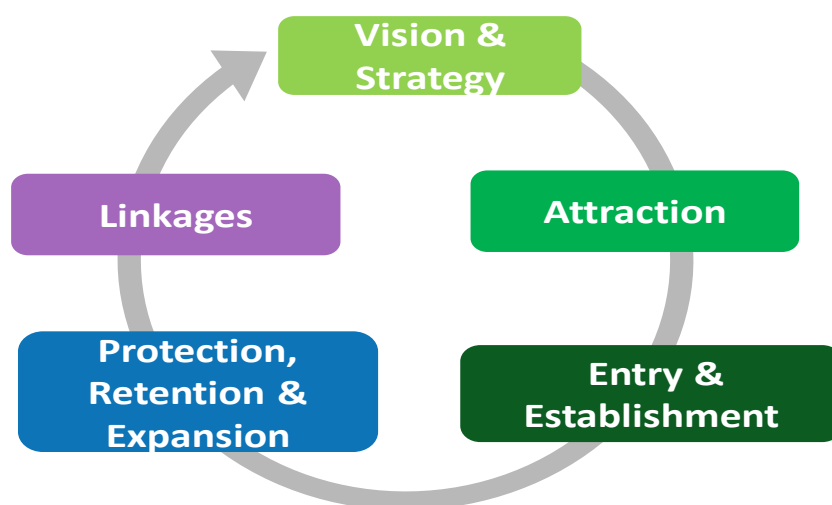
The Investment Lifecycle

32. **The Investment Lifecycle rests on the notion that investment is a relationship rather than a one-time transaction** (see Figure 3). Too often, states focus only on promotion and attracting new investors to their country. This is important, but it is only one small part of the story. The real benefits to the state come later in the relationship, as the foreign firm brings in capital, employs local staff, provides goods and services, generates exports, shares technology and know-how, sources from local suppliers, and helps to diversify and upgrade the economy. If a country wants to ensure that foreign investors come, stay, and contribute, what does it need to do at each stage of the relationship? How can a government build long-lasting ties with investors to improve the quality of the interaction between the foreign firm and the domestic economy? Crucially, how can the state make sure that more investments get to the final stage of the cycle – the point where they create the linkages and spillovers to move the country up the value chain?

33. **The investment lifecycle is a framework that identifies the different stages of foreign investment along with the policy challenges that arise at each stage.** It helps to understand how different problems for foreign firms can arise at different stages of their engagement in the host country, with the different stakeholders that are involved in the process of foreign investment; and how investment policy reforms can help address those issues. The Investment Lifecycle begins with

the host country's investment vision and policy priorities for FDI, attraction, entry and establishment, retention and expansion, linkages and benefits for the national economy.

FIGURE 2 THE INVESTMENT LIFECYCLE



Source: WBG Investment Reform Map Toolkit 2015.

34. The investment lifecycle begins with the host government's **vision and strategy** for investment within the overall national development strategy – the policy decisions the government makes about how it will attract, regulate, and engage with foreign and domestic investors.

35. Next, **investment attraction** identifies how the country will market itself to potential investors, and share information about the potential benefits of investing locally. The current highly competitive environment for FDI requires both a favorable investment climate and investment promotion efforts. Investors look for political, social and economic stability, a welcoming legal/regulatory/operating environment and a helping hand to speed up their exploration of opportunities, establishment and operation. Governments worldwide are becoming increasingly aware of the role that effective Investment Promotion Institutions (IPIs), including those operating at the sub-national level, can play as implementers of investment policies and strategies to attract investors to their locations, particularly with respect to: (i) strengthening a location's image; (ii) servicing investors' information needs; (iii) targeting and generating investment; and (iv) advocating for policy reforms for a better business enabling environment.

36. **Investment entry and establishment**, the third stage in the lifecycle, marks when an investor has decided to establish an enterprise in the host economy. It considers all the "barriers to entry" that a foreign investor faces at the entry stage. Investment entry barriers can include both rule-based, legal barriers ("*de jure* barriers") and factual barriers that arise on the ground ("*de facto* barriers"). Investment establishment thus covers the practical and legal steps that an investor must take to set-up a business, including obtaining permissions or licenses, bringing in foreign personnel and capital, and gaining access to industrial land and other utilities.

37. In addressing the challenge of **investment protection, retention and expansion**, host governments must look closely at how they treat established investors, and how they anticipate, address and mitigate grievances or disputes. As reinvested earnings often constitute the most important source of foreign capital, ensuring clear communication and a functional relationship between businesses and government is essential. In failing to recognize foreign investment as a

relationship, host economies all too often undermine their ability to reap the benefits of subsequent expansion, technology transfer, job creation, and domestic competition.

38. Finally, the full benefits of investment are only achieved if a country can enhance the **linkages and spillovers** from foreign investment, including technology and skills transfer, and greater insertion of local suppliers in the operations of foreign established firms.

39. **FDI is a key component of financing for development.** According to the United Nations Conference on Trade and Development (UNCTAD), FDI remains the largest external source of finance for developing economies. FDI flows to developing economies remained stable at USD671 billion in 2017 with a total FDI stock in developing countries exceeding USD10.3 trillion. Governments are naturally concerned about attracting FDI and strengthening domestic value addition (DVA) to help spur economic diversification and growth, generate much needed employment and increase incomes. Research shows that FDI can trigger multiple direct and indirect benefits in a host country, most importantly the transfer of new technology, managerial capabilities and increased productivity. However, these benefits do not materialize automatically.

The Investment Typology

40. **The second concept that shapes investment policy relates to the heterogeneity in FDI.** Different types of investment have specific drivers and are characterized by distinct benefits, opportunities and challenges. Accordingly, different types of investment require different policies.

41. **The fourfold Investment Typology, pioneered by the British scholar John Dunning, can be usefully employed to help host economies appreciate how different types of investment can present challenges and opportunities, calling for differentiated policy approaches and promotion⁸.** The investment typology acknowledges that different types of investment are driven by varying investor motivations, exert differing impacts on the host economy, involve different trade profiles, and require more finely-tailored policy frameworks (see Figure 4). The four types of investment are:

“Natural resource-seeking investment”: a type of investment in where investors are interested in accessing and exploiting natural resources⁹. Currently in Timor-Leste, there are both state-owned enterprises as well as the private investments. Namely, the state-owned enterprises:

1. Timor Gap, EP
2. EDTL, EP
3. BTL, E.P.
4. Companhia Mineira de Timor, S.A

The private investments:

1. Timor Resources Pty Ltd
2. Santos, Ltd
3. Pelican Paradise Group Limited
4. TL Cement, Lda
5. Heineken Timor, S.A
6. GOTA Bebidas e Alimentos, Lda
7. Consorcio Austim Beverage, S.sA.
8. Leste Food and Beverage, S.A

⁸ John H. Dunning and Sarianna Lundan, *Multinational Enterprises and the Global Economy* (second edition), Edward Elgar, 2008.

⁹

Such investments occur when a foreign investor establishes an enterprise in the host country to access immobile natural resources, such as O&G, mining and minerals, or water and solar power. The firm may be seeking access to resources that it cannot obtain in its home country, or which are available at lower cost and better terms than in the home country. The key determinants of natural resource-seeking investment are the location of the resources, their quality and quantity available, and the conditions for gaining access to those resources (e.g., the fiscal regime, legislation, contracts or production sharing agreements). Investors are also influenced by the general investment climate of the host country, including its political, legal and economic stability, and access to export markets, both in terms of physical access through transport and infrastructure and market access through preferential trade agreements. All things considered, and although the investment climate may still be relevant to investment decisions, natural-resource seekers are generally more resilient to a poor business climate than other types of investors. This type of investment poses challenges for both regulation and benefit (i.e., extractive-rent) sharing purposes.

- **“Market-seeking investment”:** This type of investment is driven by the foreign investor’s intention to establish production facilities in the host economy to supply goods and services to the host country market, e.g., Burger King, Gloria Jeans. Thus, countries with big and growing domestic markets tend to attract significantly higher flows of this type of investment relative to smaller economies. Another key characteristic of this type of investment is that in addition to import-substitution of manufacturing, it tends to emerge in non-tradable sectors, particularly services. Many of these sectors require a physical presence in the country, particularly in areas like utilities, infrastructure and construction, certain business services (e.g., legal, accounting, etc.) and retail services.

This form of investment can bring a wide array of benefits to the economy. It can be an important source of jobs, and particularly of the higher-skilled, better-paid jobs associated with the services sector. Thus, it may represent a potentially more inclusive form of economic activity than poorly managed natural resource-seeking investment. It can also bring international business practices, standards, know-how and technology. And very importantly, it can help to create competition within the domestic economy – increasing productivity and lowering prices to consumers, which in turn can have a cumulative effect to improve the general business climate, render the country more competitive, and provide a platform for other kinds of investors to arrive to the host economy. Because of these pressures towards greater competition in domestic markets, this type of FDI is often resisted by incumbent providers of goods and services who are already located in the host economy. The capacity for attracting these investments, however, is not only conditioned by the size of the domestic market, but also by its rate of growth, as domestic market-seeking investment tends to be more sensitive to investment policy in the host country.

- **“Efficiency-seeking investment”:** This type of investments is generally export-oriented, and occurs where the investor seeks to increase cost efficiency of production by taking advantage of factors of production located in the host country whose utilization improves the international competitiveness of the enterprise. Efficiency-seeking FDI is not oriented to the domestic but rather to international markets. A typical example of efficiency-seeking FDI is Global Value Chains (GVC) where many firms integrate international production patterns to maximize efficiency gains. Thus, the key determinant for efficiency-seeking investment is not natural resource endowments, or the size or growth of the domestic market; but rather “competitiveness”, which can be defined as “the ability of companies, industries, regions, nations and supranational regions to generate, while being and remaining exposed to international competition, relatively high factor income and factor employment levels on a

sustainable basis” (OECD, 1994). Thus, efficiency-seeking FDI will flow into an economy, only to the extent that the host country can contribute to enable the firm to have a competitive edge in its target international markets. Efficiency-seeking investment has the most transformative potential of all types of foreign investment, not only through the transfer of technology and skills, but also through its contribution to economic diversification, particularly when these investments encompass non-traditional export sectors or the insertion into global value chains. The ability to attract efficiency seeking investment is fundamentally conditioned by two considerations. First, the high dependence on competitiveness issues implies the need for a comprehensive and sound pool of location determinants that not all countries possess. Second, the level of host country competition. In all, the range of structural and policy determinants, as well as the degree of host country competition make the attraction of efficiency-seeking investment a challenging endeavor for many countries.

- **“Strategic asset-seeking investment”**: This type of investment occurs when a multinational enterprise seeks to cement or improve its positioning in each market by acquiring “strategic” assets such as brands, human capital, know how, market share, etc. An example in Timor-Leste is Oi, which owns Timor Telecom. In most cases, this type of investment entails the acquisition of an existing enterprise, with mergers & acquisitions (M&A) as the typical mode of FDI entry in the host economy. We distinguish between two types of strategic asset-seeking investment. First, there is investment motivated by the need to acquire or control an asset of another firm. Second, there are also examples of investment where the firm is motivated by a strategic asset in the host country. This might be a key feature of the country (whether physical, cultural, or historical) that creates opportunities for tourism, or that is strategically important for an international economic activity. Annex 1 offers a synthetic depiction of key differences between the four types of FDI covered by Dunning’s investment typology.

FIGURE 3 DIFFERENT TYPES OF FDI GENERATE DIFFERENT TYPES OF TRADE PATTERN

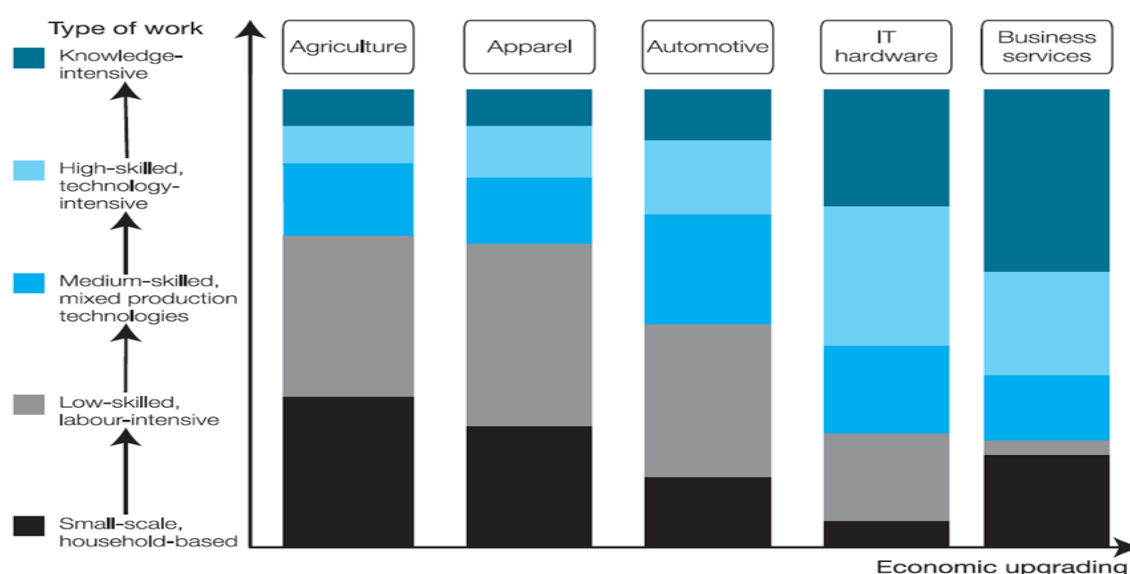


Source: WBG, 2018. Global Investment Competitiveness report 2017/2018: Foreign Investor Perspective and Policy Implications.

41. **The Investment Typology provides a sound guidance for investment policy design, as it sheds light on the different benefits that each type of FDI brings to the host economy.** For example, and as Figure 5 illustrates, different types of investments generate different types of jobs. Investments in sectors associated with natural resource-seeking investments, such as agriculture, generate mostly

small-scale household / informal or low-skilled jobs. Investment endeavors in sectors like Automotive or IT hardware will tend to generate higher-skilled, technology-intensive jobs. In this context, the contribution of each type of investment to the upgrading of the host economy may differ substantially. For instance, resource-seeking FDI, the type most associated with agricultural and extractive sectors, will generally show a limited ability to create knowledge-intensive jobs. Moreover, the capacity of an investment endeavor to generate employment will differ even *within* the same type of FDI. Specifically, efficiency-seeking FDI may take place in several of the sectors illustrated in Figure 5, i.e., Apparel, Automotive, IT hardware or Business Services; each of them prone to generate different types of jobs in terms of skills and technology embeddedness. The more a country moves towards efficiency-seeking and strategic asset-seeking investments the more knowledge-intensive and high-skilled jobs are created in the local economy.

FIGURE 4 TYPES OF JOBS CREATED BY SECTOR



Source: Barrientos, S., G. Gereffi, & A. Rossi (2011) 'Economic and Social Upgrading in Global Production Networks: A New Paradigm for a Changing World', *International Labor Review*, 150(3-4): 319–40.

42. **Given these conceptual foundations, the IRM analysis utilizes two diagnostic tools, which feeds into the identification of investment policy reforms and in turn informs the investment reform agenda** (see Figure 2). **The first, “Foreign Direct Investment Analysis”, aims to answer various questions related to the FDI that Timor-Leste receives.** It documents the levels and types of FDI received in the country, and the consequences that such pattern of FDI accruals has over the trade specialization of the country. In addition, it identifies a set of sectors that could be attractive for a diversification strategy in the country, as well as the business environment dimensions that stand in the way of leveraging FDI in those sectors. The Investment Sector Scan (ISS) is designed to help Timor-Leste identify new sectors with strong potential for investment generation and job creation. It starts with a basic analysis of Timor-Leste’s background and level of economic diversification to then make the most suitable selection from a menu of established analytical methodologies. The approach covers sector selection to enable short term investment promotion efforts as well as identify more comprehensive long-term reforms to enhance competitiveness for investment.

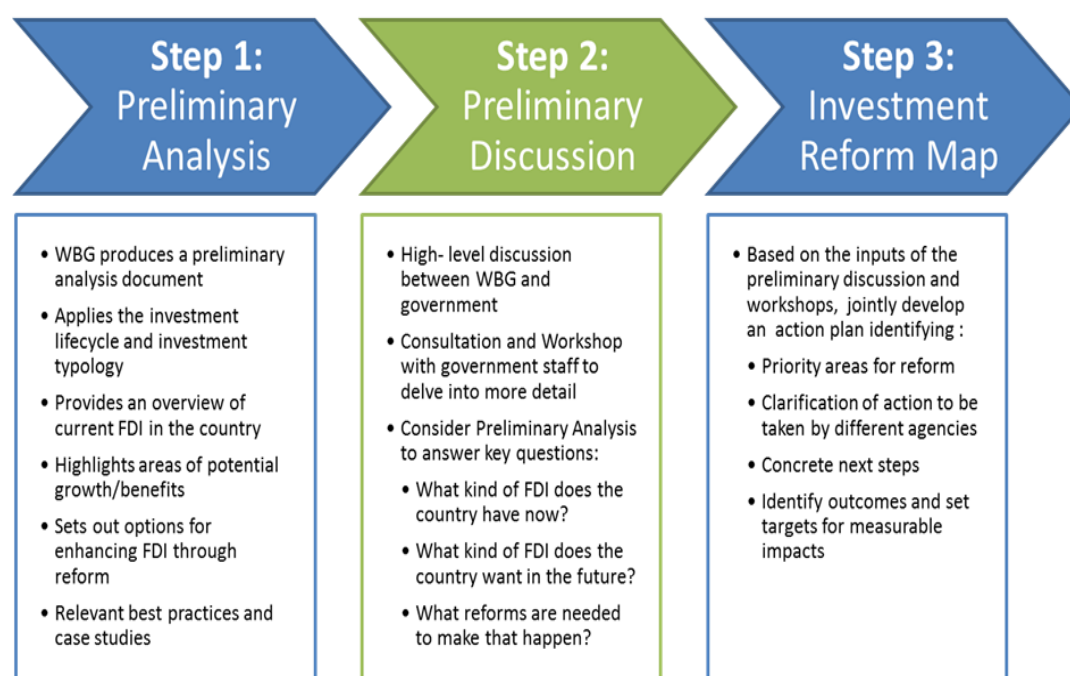
43. **The second, “Institutional, Legal, and Regulatory Assessment”, provides a detailed analysis of primary and secondary laws and regulations directly governing investment in Timor-Leste.** The legal assessment allows for the identification of measures that are key constraints to private

investment in Timor-Leste along the investment lifecycle covering the stages of: vision and strategy, entry and establishment, retention and expansion, and linkages and spillovers of the investment. The analysis not only looks at the text of legal instruments (*de jure*), but also the associated *de facto* practices (when information was available) to assess the level of implementation of the legal framework.

The IRM Process

44. **The IRM process typically follows a sequence of analysis, discussion, and planning** (see Figure 6). It is important to keep in mind that the IRM is not a single document or report, nor is it a static action plan. Instead, it is a process that allows a government to focus discussion, set priorities, and agree on defined activities. As Timor-Leste's Investment Vision and Strategy are refined over time, the IRM will also be adjusted to the changing circumstances.

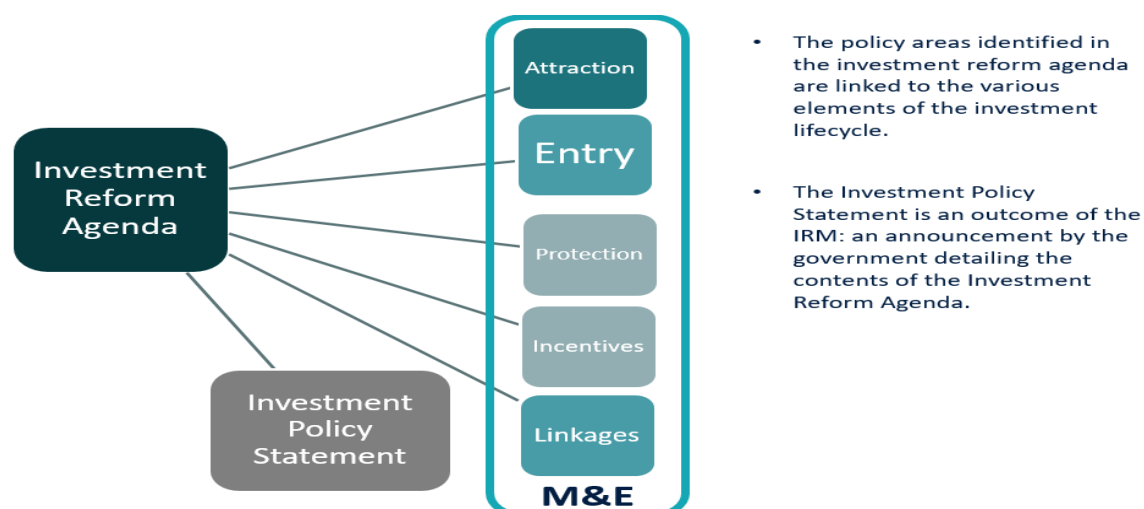
FIGURE 5 THE IRM PROCESS



Source: WBG IPP Team.

45. **The outcome of the IRM process would be a proposed agenda of concrete short-term reform activities aligned with Timor-Leste's long-term development vision** with the aim to bring about measurable impacts within approximately three years (see Figure 7).

FIGURE 6 THE INVESTMENT REFORM AGENDA



Source: WBG IPP Team.

III. INVESTMENT IN TIMOR-LESTE

A. FDI Economic Analysis

46. **This section presents some pertinent facts about Timor-Leste's current FDI picture** that inform the analysis presented later in this report, especially aggregate FDI flows, Timor-Leste's relative position vis-à-vis regional comparator countries, and indicators of the relative importance of FDI to the domestic economy. The section is designed to help the GoTL answer three pertinent questions regarding its FDI policy, namely¹⁰:

- What is the level and type of FDI that Timor-Leste receives?
- Given the current state of FDI in Timor-Leste. What are some potential opportunities for diversification?
- What are key competitiveness challenges that stand in the way of developing further these sectors via FDI?

(1) FDI trends – Does Timor-Leste have enough FDI?¹¹

47. **Total investment in the economy has risen since 2007 driven by a large fiscal stimulus, but private investment has not grown significantly and remains low** when compared with neighboring countries in Southeast Asia and the Pacific. Skills shortages and weaknesses in the business enabling environment continues to weaken Timor-Leste's attractiveness as an investment location.

48. **Timor-Leste needs new sources of productive FDI.** Timor-Leste has experienced a relatively long period of economic growth based on public expenditure and some private sector activity, driven by O&G revenues. Lower oil prices, weak integration with the region, and a contraction in hydrocarbon

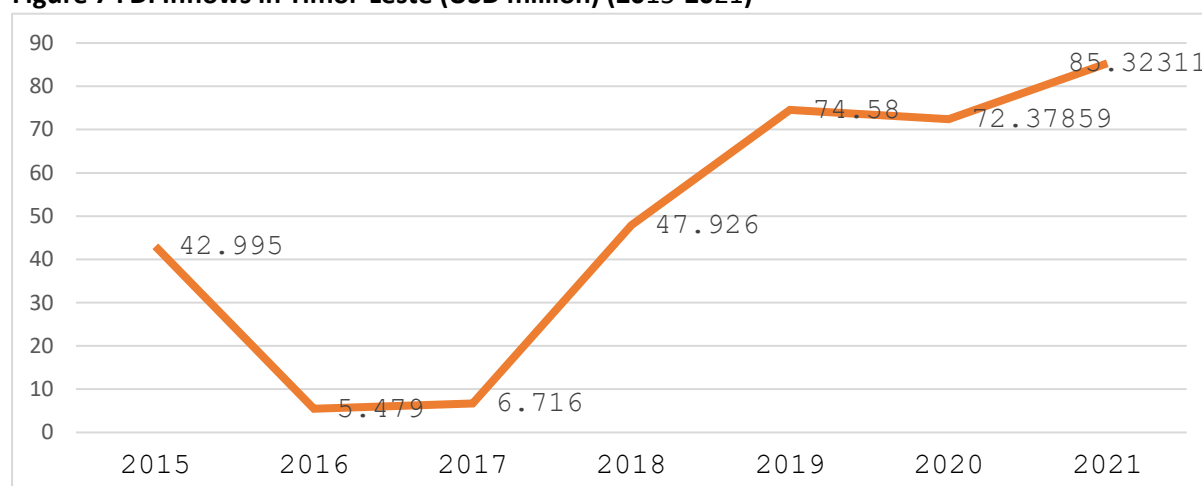
¹⁰ It should be noted that there are some methodological issues constraining an in-depth analysis of FDI in Timor-Leste, given that FDI information and data compiled at the sector level is scarce and the quality of the data compiled at the national level is limited. The WBG team has relied on a variety of sources (mainly previous WBG and other institutions' reports; Greenfield investment data from the fDi Markets database produced by the Financial Times) to gain an idea of the sectoral nature of FDI inflows into Timor-Leste in recent years.

¹¹ The team proposes to update the FDI data once government operations in Timor-Leste has normalized.

production are rapidly erasing the current account surplus the country enjoyed during the oil boom years.

49. **Data on FDI inflows to Timor-Leste is scarce and only available after 2002.** Analyzing the period comprised from 2015 to 2020 (see Figure 8), FDI net inflows into the country decreased sharply from USD 43 million in 2015 to USD 5.5 million in 2016. However, FDI net flows bounced back and sharply increased to over USD 74 million in 2019 and 2021. However, **these amounts are very small both in absolute value and in relation to the size of the domestic economy.** FDI flows in 2021 (latest year available for Timor-Leste in the UNCTAD FDI database) remain increased, an-all-time high, at USD 85 million, compare to the previous years.

Figure 7 FDI Inflows in Timor-Leste (USD million) (2015-2021)



Source: UNCTAD.

(2) How does this compare to other benchmark countries?

50. **In relation to other developing economies and regional peers, Timor-Leste does not fare well:** FDI flows averaged 3.0 percent of GDP during the period 2015-2021, compared with 3.6 percent for Asian developing economies (excluding China and least developed countries (LDCs)) and with ASEAN's average for the same period, 4.44 percent (see Table 1). Timor-Leste performs well as other regional comparator being only close to Myanmar (3.2 percent) for the period analyzed.

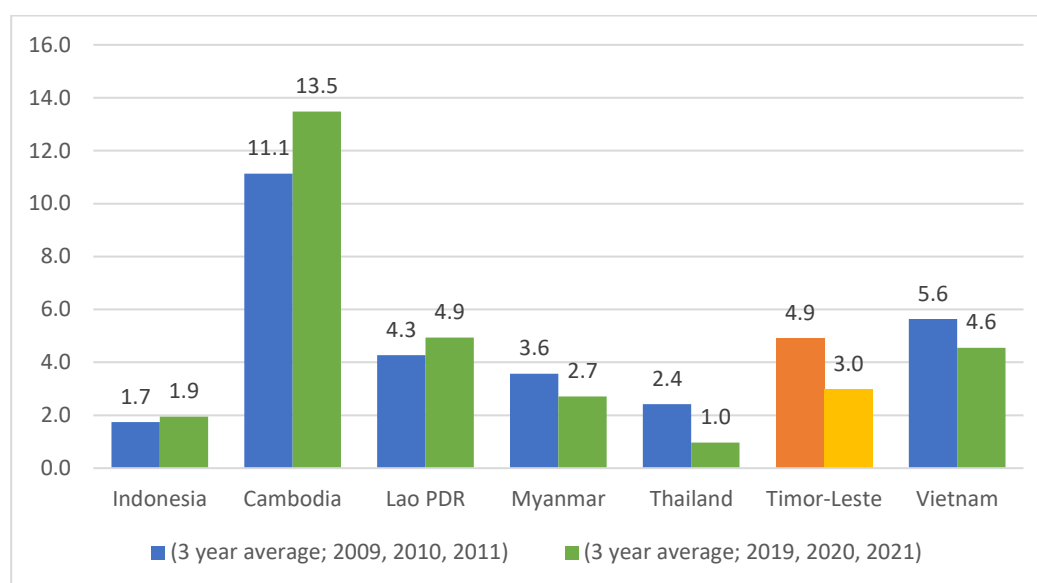
TABLE 1 FDI FLOWS AS A PERCENTAGE OF GROSS DOMESTIC PRODUCT: REGIONAL COMPARISON

YEAR	2015	2016	2017	2018	2019	2020	2021	AVERAGE
Brunei Darussalam	1.3	-1.3	3.8	3.8	2.8	4.8	1.0	2.9
Cambodia	10.1	12.4	12.6	13.1	13.5	14.3	13.0	12.7
Indonesia	1.9	0.4	2.0	2.0	2.1	1.8	1.7	1.9
Lao People's Dem. Rep.	7.5	5.9	9.9	7.5	4.0	5.1	5.6	6.1
Malaysia	3.3	3.8	2.9	2.1	2.1	0.9	3.1	2.9
Myanmar	4.9	4.4	6.5	3.9	3.4	2.7	4.2	3.2
Philippines	1.8	2.6	3.1	2.9	2.3	1.9	2.7	2.1
Singapore	19.4	21.2	24.0	19.7	28.4	22.2	25.7	21.5
Thailand	2.2	0.8	1.8	2.6	0.9	-1.0	2.3	1.7
Viet Nam	6.1	6.1	6.3	6.3	6.2	5.8	5.5	5.8
ASEAN Countries	5.9	5.6	7.3	6.4	6.6	5.9	6.5	6.1
Timor-Leste	2.7	0.3	0.4	3.0	3.6	3.8	4.2	3.0

Source: UNCTAD.

51. **Regardless of comparative country performances, Timor-Leste has seen improvements in its FDI net inflows over time compared to other regional comparators.** Looking at Figure 9, Timor-Leste's FDI net inflows decreased in the last ten years by average of 3 years amid the COVID-19 pandemic which also affected some of the region's average decline in FDI. Nevertheless, Timor-Leste's FDI net flows performed better than other countries in the Region, including Indonesia, Myanmar and Thailand.

FIGURE 8 FOREIGN DIRECT INVESTMENT, NET INFLOWS (% OF GDP), TIMOR-LESTE VS REGIONAL COMPARATORS



Source: World Development Indicators 2021, World Bank.

(3) Composition of FDI by sector and origin

52. Despite the lack of complete data on the sectoral distribution of FDI, existing reports, from several institutions, shed some light on this area. According to the information gathered from different reports^{12, 13}, **the O&G sector accounts for the clear majority of FDI received in Timor-Leste, which is unsurprising given the size of this component relative to the size of Timor-Leste's economy.** Large multinational corporations from developed economies (i.e., Australia, United States) operate in the extractive industries in Timor-Leste, mainly in the Timor Sea JPDA. Multinationals like ConocoPhillips, Shell or BHP Petroleum are or have recently been actively operating in the country.

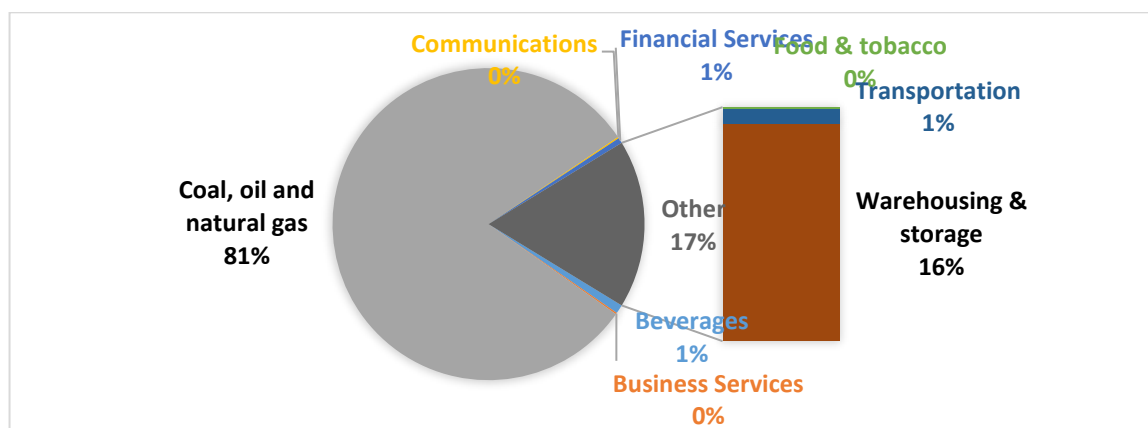
53. **Other large multinational players operating in Timor-Leste can be found in the telecommunications sector**, in which a Portuguese multinational company, TPT, S.A, also operating in Brazil, owns around 54.01 percent of Timor Telecom, the Government of Timor-Leste owns around 30 percent, 17.86 percent owned by Macau multilateral company, while other small shares are owned by a national company and other Portuguese company. Also in the telecom sector, licenses were issued for companies from Vietnam and Indonesia.

¹² Investment Climate Statement. US State Department 2015.

¹³ Growing the Non-Oil Economy. A Private Sector Assessment for Timor-Leste. ADB 2015.

54. Other Portuguese companies with important historic commercial relations in the country operate in economic areas such as construction or retail, and many small private sector players invest in the country (at different levels of formality) in sectors such as logistics, trade, tourism and consumer goods.

55. **From 2003-2015, 81 percent of Greenfield investments were in the coal, oil and natural gas sector, making it the sector with the highest FDI received, with a total value of 5 billion USD (see Figure 10).** Figure 9 Timor-Leste: Sum of Capital Investment by Sector (2003-2015)



Source: fDi Intelligence, fDi Markets from Financial Times Ltd.

56. **There had been several “mega-deal” Greenfield investment projects (>1 billion USD) in Timor-Leste:** in 2003 and 2010 investments in oil and natural gas (Australian investment of USD 4 billion and Italian investment of USD 1 billion)-. Moreover, manufacturing (i.e., beverage, food processing, O&G-related), as well as sales, marketing and support, appear to have been the most dominant business activities receiving FDI since 2003 according to Financial Times FDI Markets data. In 2016, French Bollore engaged in a public-private partnership (PPP) with the GoTL, agreeing to invest USD 490 million in the construction of a major port in Tibar, near Dili. Subsequently, the Port has been completed and now operating at its full potential.

58. According to TradeInvest Timor-Leste (TITL)’s data - issued FDI certificates and signed SIA during the period between 2016-2022 with a total value of USD 845,2 million, indicates that a **concentration of intended investment in sectors such as tourism, processing industry of beverages, banking services, poultry, dockyard development, agriculture, health care, agriculture** and others (FDI licenses for the oil sector were not issued by the agency so the sector is not included). According to the monitoring report of TITL, it reveals that FDI for non-oil & gas sector remained increasing. See Table 2 with information on the companies licensed by sector below:

Table 2 Foreign Investment Licenses Issued by TITL (2016-2022)

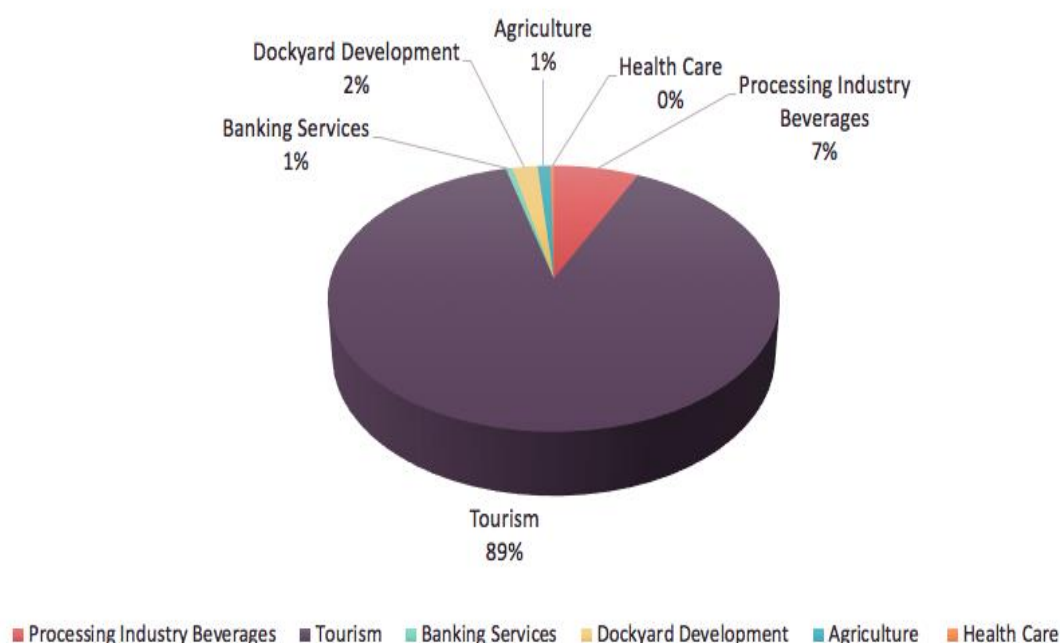
No.	Sector	2016	2017	2018	2019	2020	2021	2022
Sector/Activities		Planned/Intended (in U\$ million)						
1	Tourism	0.0	0.0	0.0	0.0	2	50	700
2	Processing Industry of Beverages	45	3,03	0.0	6, 3	5	0.0	0.0
3	Banking services	0.0	4,7	0.0	0.0	0.0	0.0	0.0
4	Poultry	0.0	2	0.0	0.0	0.0	0.0	0.0
5	Dockyard Development	0.0	17,5	0.0	0.0	0.0	0.0	0.0

6	Agriculture	0.0	0.0	0.0	0.0	1,7	0.0	0.0
7	Health Care	2,3	0.0	0.0	0.0	0.0	0.0	0.0
8	Agriculture (Vanilla)	0.0	0.0	0.0	0.0	0.0	294 ^{thou} sand	0.0
9	Agriculture, Aquaculture no Livestock	0.0	0.0	0.0	0.0	0.0	2	0.0
10	Hatchery	0.0	0.0	0.0	0.0	0.0	0.0	3
Total		47,3	27,2	0.0	6,6	8,7	52,3	703

Source: Produced data by TradeInvest-TL.

59. Data provided by TradeInvest Timor-Leste between 2016 and 2022 on the 15 certificates issued and signed Special Investment Agreement (SIA) indicated a total amount of intended investment (in non-oil related activities) for this period amounted USD 845.2 million. As it can be seen in Figure 11, 89 percent of the FDI went to the tourism sector¹⁴, followed by the Processing Industry of Beverages (7 percent), the Dockyard Development (2 percent), and others with 1 percent or less.

FIGURE 10 INTENDED INVESTMENT ACCORDING TO CERTIFICATES ISSUED AND SIGNED SPECIAL INVESTMENT AGREEMENT (SIA) (PERCENTAGE OF THE TOTAL AMOUNT PER SECTOR) (2016- 2022)

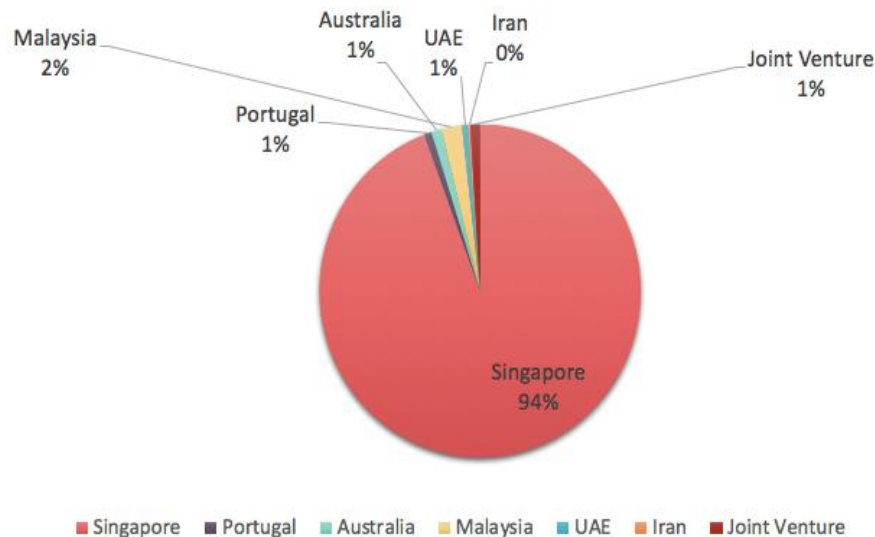


Source: Produced data by TradeInvest-TL.

60. In regards to the sources of the foreign investment inflows to Timor-Leste, the data provided by TradeInvest on certificates and intended investments (see Figure 12) shows that Singapore is the most important investor in the country non-oil industry with 94 percent of the total intended investment for the period 2016 - 2022. This is followed by Malaysia with 2 percent but Portugal, Australia, UAE and Joint Ventures (Timorese, Australian, Malaysian, Chinese and Iranian) each with 1 percent or less.

¹⁴ It is important to note that many of the investments in this sector are aimed at UN/expat housing. These investments capture rents from distorted land values. In some cases, these investments also service actual tourists, however in most cases they do not (e.g., long term expat housing, available only monthly).

FIGURE 11 SOURCES OF INTENDED INVESTMENT ACCORDING TO CERTIFICATES ISSUED AND SIGNED SPECIAL INVESTMENT AGREEMENT (SIA): 2016 - 2022 (PERCENTAGE OF THE TOTAL AMOUNT PER COUNTRY)

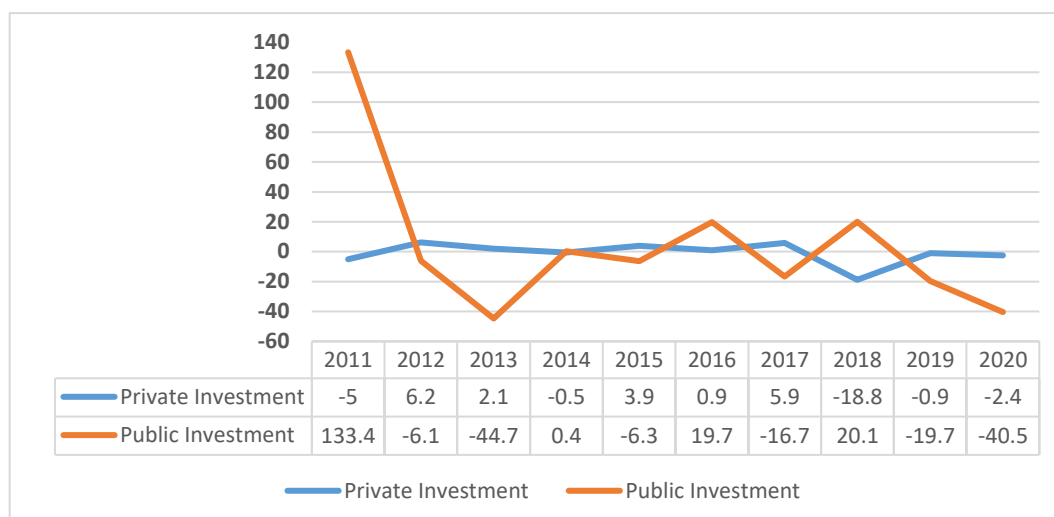


Source: Produced data by TradeInvest-TL.

61. According to the evidence, and despite the lack of good official data by sector, much of the FDI inflow to Timor-Leste appears to be resource-seeking in nature, drawn by the country's natural resources endowments. Evidently, Timor-Leste's market seems to attract market-seeking investments. More shares of FDI attracted to Timor-Leste's productive sector such as mining, tourism, processing industry, agriculture and fishery sector would appear suggestive of a generally strong to attract FDIs and an equally strong leveraging of regional and global value chains and preferential access to international markets, particularly in South East Asia, since the country will be part of ASEAN soon as well as become a WTO member.

62. In any case, as Figure 13 shows, **total private investment (both domestic and foreign) is low in Timor-Leste**. Moreover, total private investment activity in the non-oil sector has been focused on servicing, directly or indirectly, the demand created by government spending.

FIGURE 12 PUBLIC VS PRIVATE INVESTMENT LEVELS IN TIMOR-LESTE (PERCENT OF NON-OIL GDP) (2011-2020)

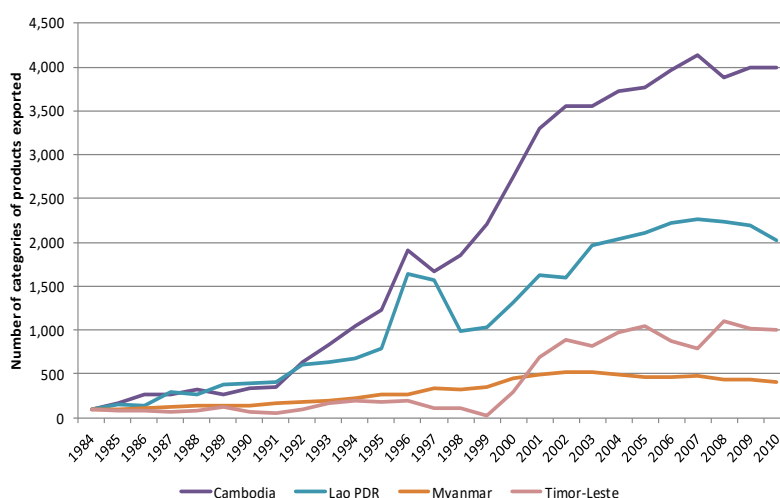


Source: Timor-Leste National Accounts 2000-2020. Ministry of Finance.

(4) Export trends and performance

63. Regarding export diversification level, Timor-Leste has historically remained low, relative to select regional comparators, but has steadily improved over time (see Figure 14).

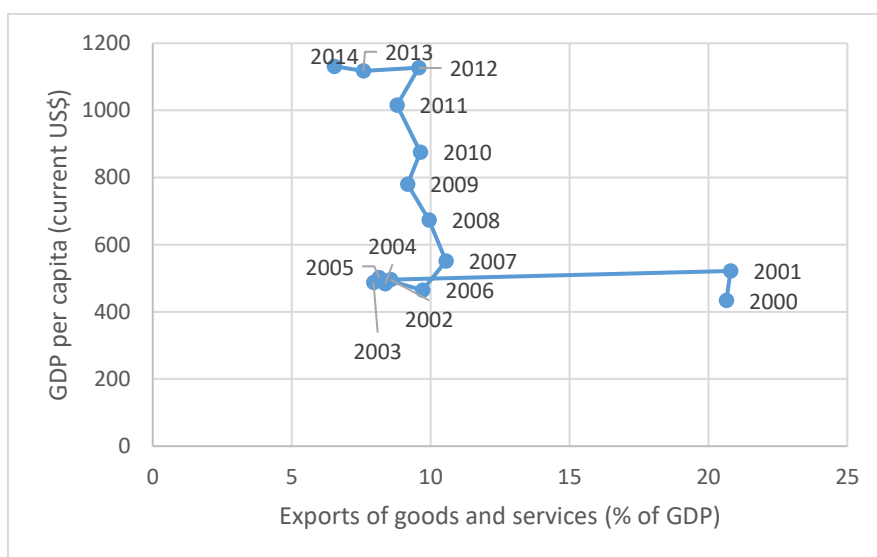
FIGURE 13 EXPORT DIVERSIFICATION: TIMOR-LESTE VS REGIONAL COMPARATORS (1984-2010)



Source: ESCAP, based on trade data from the United Nations Commodity Trade Statistics Database (COMTRADE).

64. Moreover, Timor-Leste's growth has historically been predominantly more inward-oriented than export driven (see Figure 15). This inward orientation is also seen in more recent years, as marked by the inward shift from 2012 to 2014.

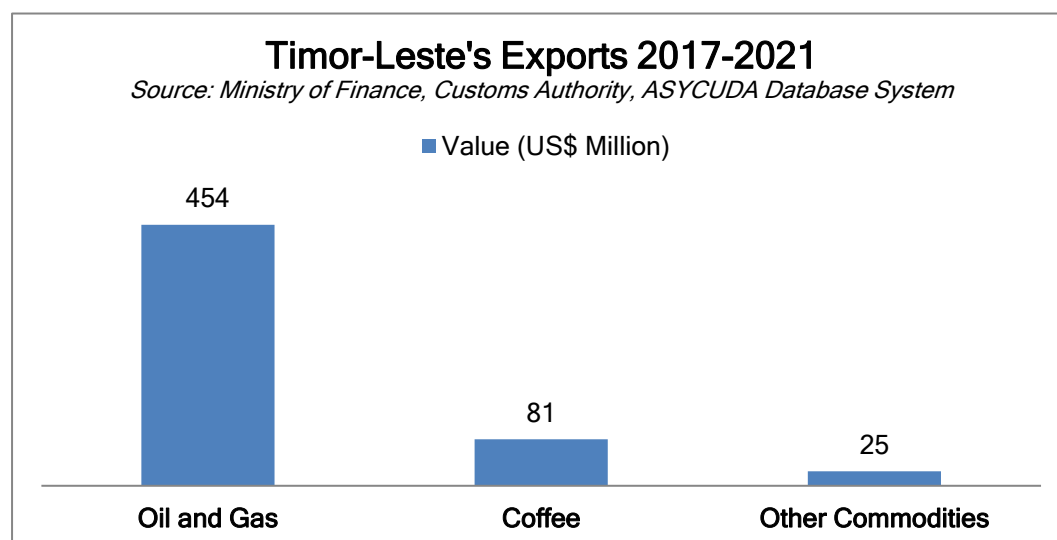
FIGURE 14 HAS TIMOR-LESTE'S GDP GROWTH BEEN MAINLY DOMESTIC OR EXPORT DRIVEN?



Source: World Development Indicators 2016.

65. **Timor-Leste's dependence on petroleum is evident in its export portfolio** (see Figure 16). From 2017 to 2021, Timor-Leste exports in the form of raw materials of oil and gas products in the large volume followed by coffee and other commodities (konjac, candlenut, copra, used clothing, wood, aluminium cans, scrap metal and pipe and frozen fish).

FIGURE 15 TIMOR-LESTE'S EXPORTS 2017-2021.

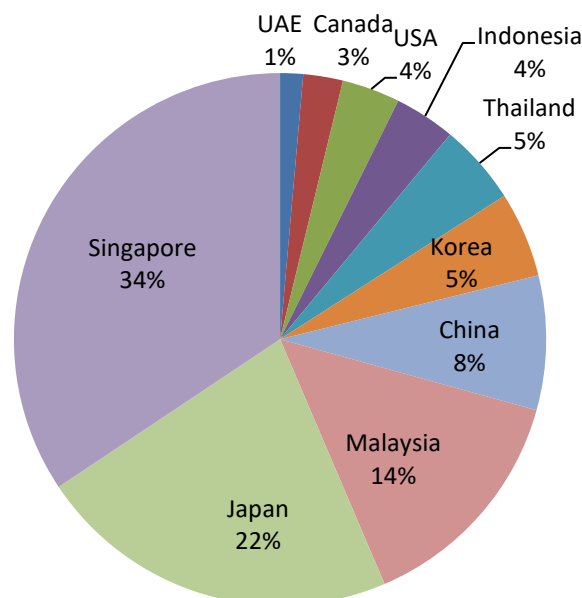


66. **Geographically, most of Timor-Leste's export destinations have been in Asia**, as dominated by exports to Singapore, Japan, Malaysia and China in the last 2017-2021 (see Figure 17).

FIGURE 16 TIMOR-LESTE'S TOP 10 EXPORT DESTINATIONS (AS % OF TOTAL EXPORT DESTINATIONS) 2017-2021.

Timor-Leste's Top 10 Export Destination 2017-2021

Source: Ministry of Finance, Customs Authority, ASYCUDA Database System

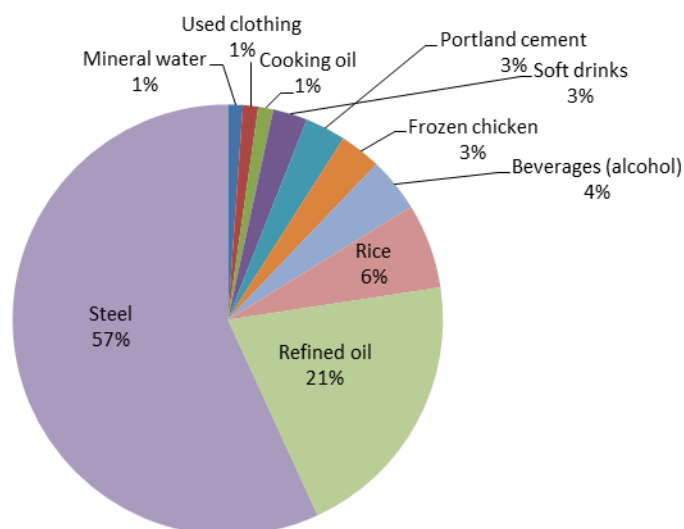


67. Regarding Timor-Leste's imports, majority of its imports from 2017-2021 have been steel, followed by refined oil (57% and 21% respectively, see Figure 18). Historically, rice has remained a top good in Timor-Leste's import basket.

FIGURE 17 TIMOR-LESTE'S TOP IMPORTS (AS % OF TOTAL IMPORTS) 2017-2021.

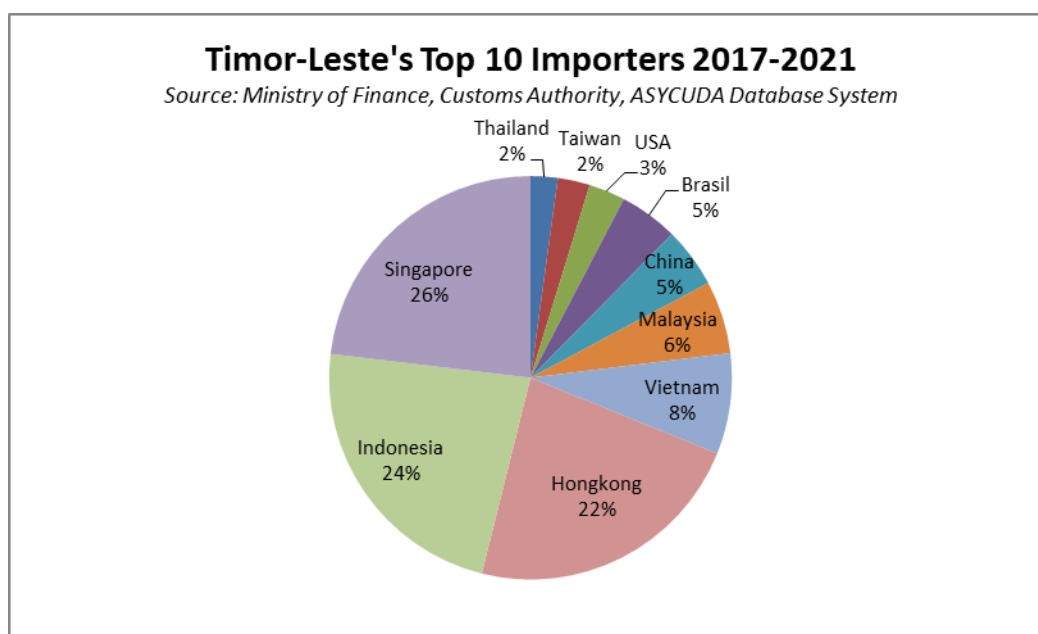
Timor-Leste's Imports 2017-2021

Source: Ministry of Finance, Customs Authority, ASYCUDA Database System



68. **Geographically, Timor-Leste's imports are predominantly from within the Asian region, with Singapore (26%) as Timor-Leste's top importer from 2017-2021. Timor-Leste's other regional import destinations include Indonesia, Hongkong, Vietnam, Malaysia and China (see Figure 19).**

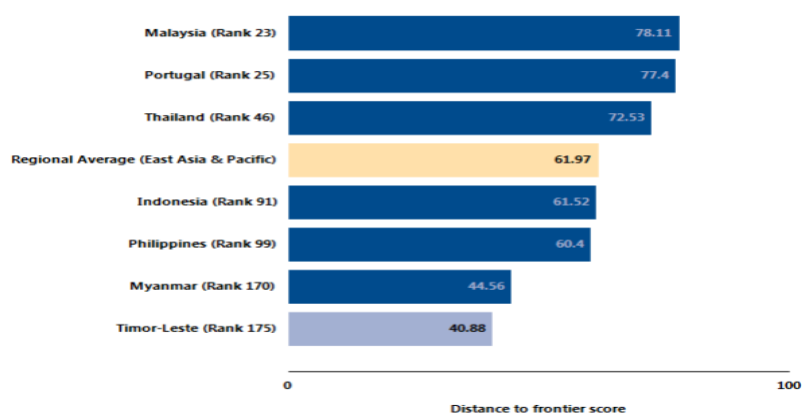
FIGURE 18 TIMOR-LESTE'S TOP 10 IMPORTERS (AS % OF TOTAL IMPORTERS) 2017-2021.



(5) Investment climate overall performance: key indicators

69. The following figures (see Figures 20-23) show how Timor-Leste performs in some of the most influential international rankings on investment and business climate issues. **Timor-Leste's position in the Doing Business ranked from the 181th position out of 190 economies in 2020.** Timor-Leste performs far from its East Asian & Pacific (EAP) regional peers in 2016, with a regional averaged rank of 94.

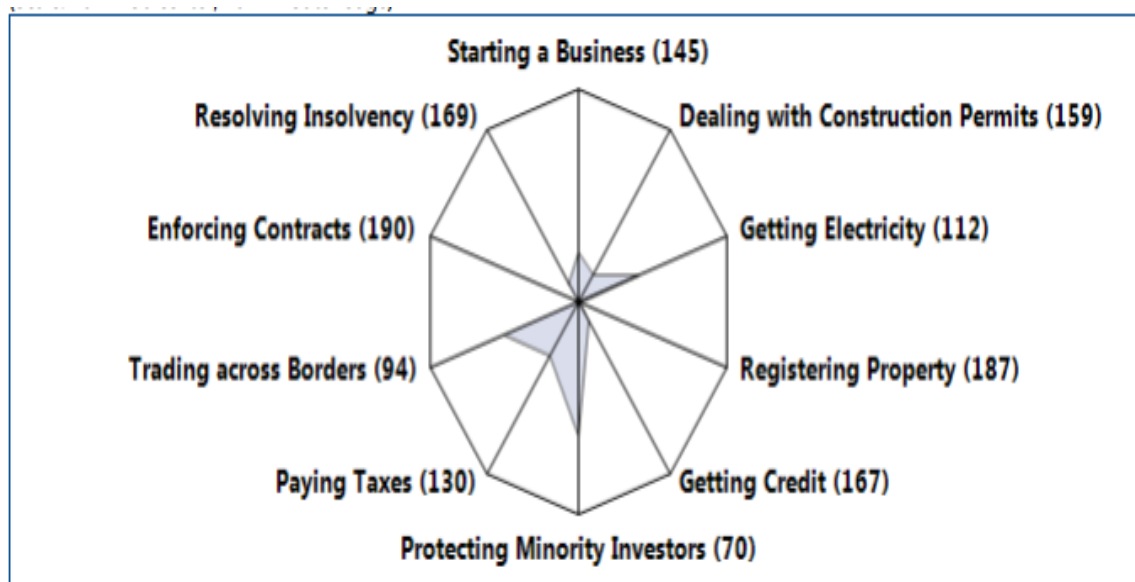
FIGURE 19 DOING BUSINESS RANKS: TIMOR-LESTE VS EAP AND SELECTED ECONOMIES (2016-2017)



Source: Doing Business 2017. World Bank.

70. In terms of specific indicators analyzed in the 2017 Doing Business report, **Timor-Leste's performance is observed to be lower than the EAP average across most of the indicators.** Timor-Leste's performance is especially poor in the indicators of Enforcing Contracts (190 out of 190), Registering Property (187), Resolving Insolvency (169) and Getting Credit (167 out of 190). Timor-Leste's performance has dropped in Paying Taxes (from 126 to 130), and it is better than some regional peers around Protecting Minority Investors (70) and Trading across Borders (94) (see Figure 21).

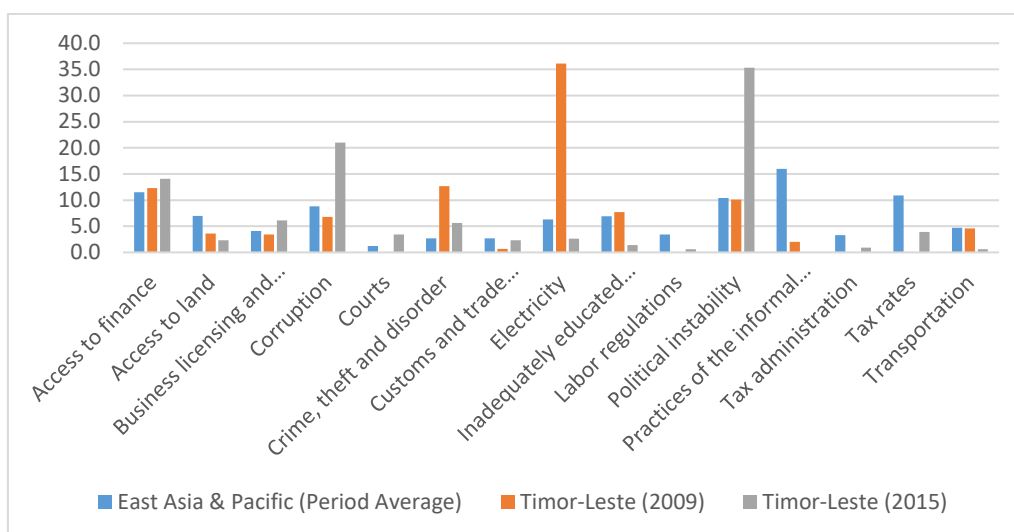
FIGURE 20 DOING BUSINESS INDICATORS: TIMOR-LESTE (2017)



Source: Doing Business 2017. World Bank.

71. As the World Bank's Enterprise Survey data for 2009 and 2015 noted (see Figure 22), **the single most important constraint for Timor-Leste has changed over time from electricity (2009) to political instability (2015).** Moreover, these two constraints were more highly reported in Timor-Leste relative to the EAP average.

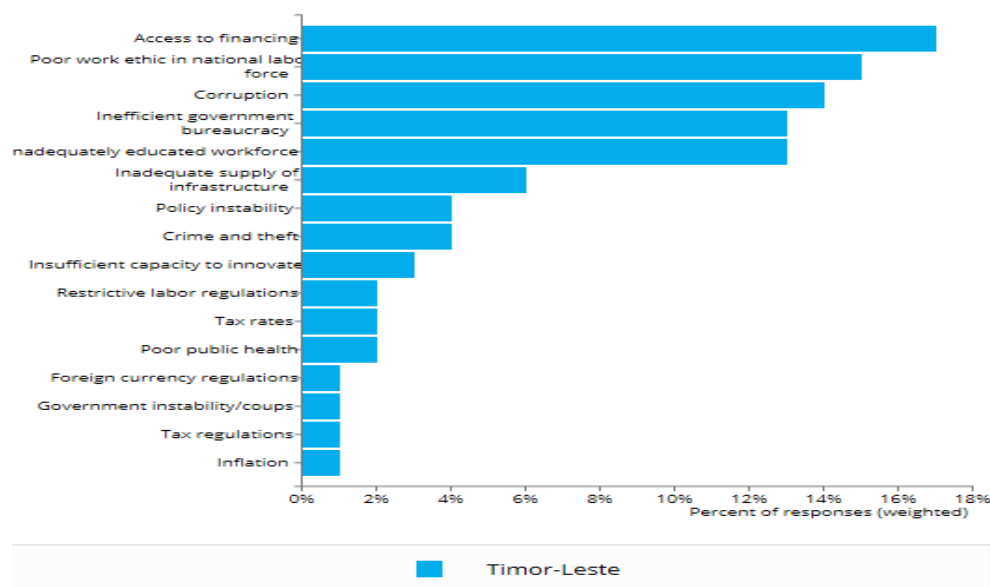
FIGURE 21 ENTERPRISE SURVEYS: TIMOR-LESTE VS EAP, BIGGEST OBSTACLES (2009; 2015)



Source: Enterprise Survey (2009; 2015). World Bank Group.

72. Data from the World Economic Forum's *2013 Global Competitiveness Report* on executives' opinions shed light on the most problematic factors faced by firms in Timor-Leste (see Figure 23). **Access to financing is the number one problematic factor according to executives, followed by issues related to poor work ethic in the national labor force, followed by corruption, and inefficient government bureaucracy.**

FIGURE 22 EXECUTIVES OPINION SURVEY: MOST PROBLEMATIC FACTORS

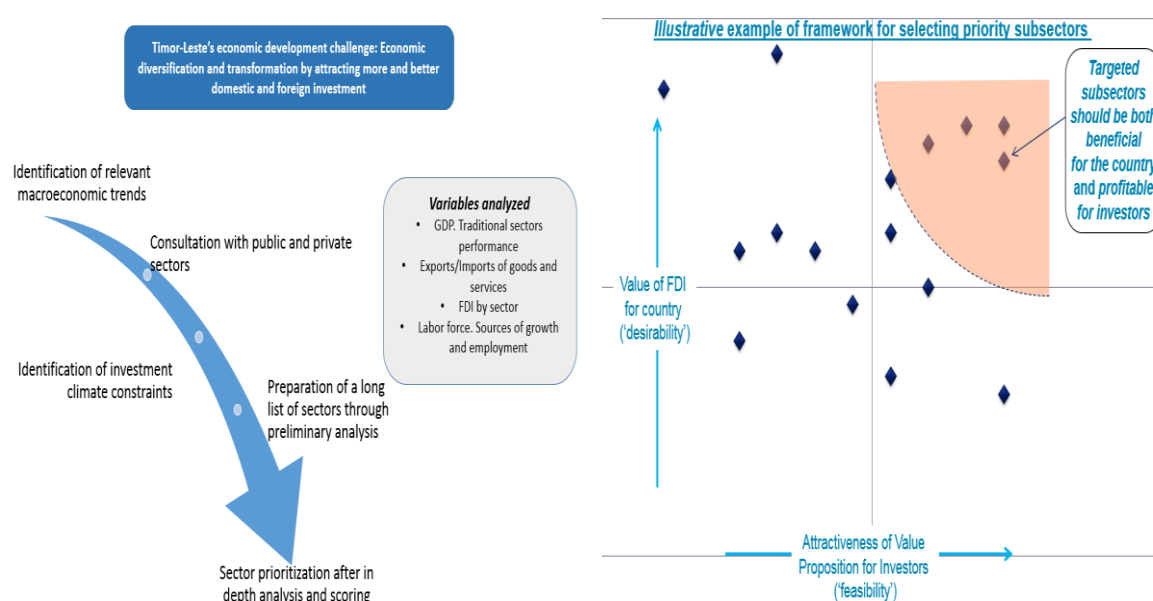


Source: Global Competitiveness Report 2013. World Economic Forum.

B. Sector FDI Potential Analysis

73. This section of the report focuses on opportunities for FDI diversification by identifying sectors and priority reforms that maximize returns considering Timor-Leste's development objectives. The WBG utilized its Investment Sector Scan tool (see Figure 24), which maps out sectors by both their potential for investment in the country and their ability to contribute to development goals, and facilitates a structured conversation with stakeholders to identify constraints currently holding them back. The tool is flexible enough to support quick interventions targeting sectors that are already 'ready to go', or to work towards identifying high potential 'aspirational' sectors and laying out a reform agenda to turn them into a reality. The reforms resulting from such efforts may well be horizontal in nature (e.g., improvements in logistics, infrastructure, and public institutions), but correspond to the needs of such priority sectors.

FIGURE 23 POTENTIAL SECTORS IDENTIFICATION PROCESS IN ALIGNMENT WITH NATIONAL PRIORITIES



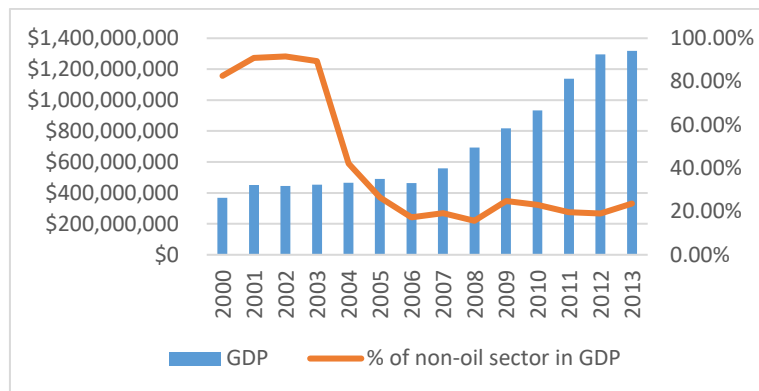
Source: WBG IPP Team.

74. The discovery of oil changed the structure of Timor-Leste's economy that had traditionally been focused on agriculture, a sector besides public administration that still drives the economy outside of O&G. **A development model based on public expenditure and financed by petroleum resources is unsustainable and the Government needs to reverse this public-financed economic model to one where the private sector is the driver of the economy.**

75. **Although the country has recently seen an episode of growth fluctuation, Timor-Leste has yet to see the desired positive spillover effects on the national economy.** Moreover, the current oil price crisis requires the GoTL to act to enhance the competitiveness of alternative sectors, diversifying economic activity away from a reliance on O&G.

76. **Figure 25 represents well the radical change in Timor-Leste's economic structure over time,** showing both a significant growth of GDP over the last decade (from USD 463 million in 2006 to more than USD 1.3 billion in 2013) and an extreme shift in terms of the participation of non-oil economic activities that represented 91.6 percent of GDP in 2001 and accounted for just 23.6 percent of GDP in 2013.

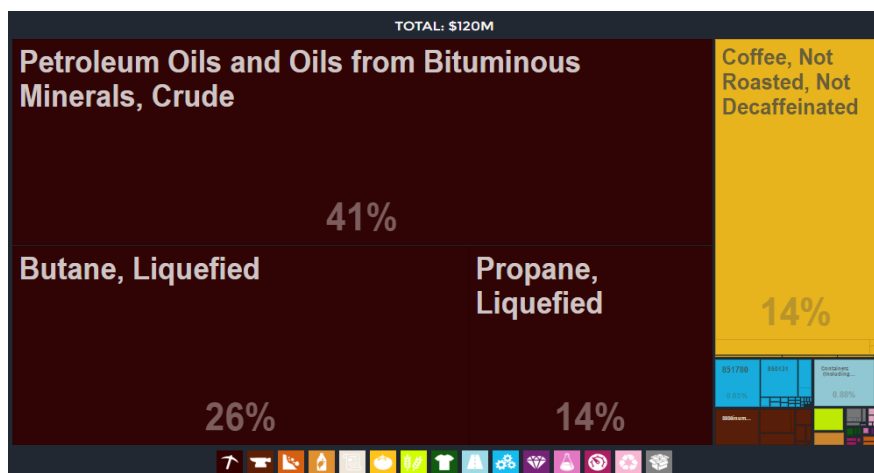
FIGURE 24 REAL GDP IN USD AND NON-OIL, % OF TOTAL GDP



Source: World Bank Staff elaboration based on World Bank Economic indicators and Timor-Leste's National Accounts.

77. A consequence of the duality between oil and non-oil sectors and the high levels of concentration of economic activity in a dominating O&G sector (see Figure 26) (that represents more than 75 percent of the GDP) has been lower levels of development and competitiveness in other economic sectors. Similarly, Timor-Leste's exports are highly concentrated in O&G, sectors that are not providing the Timorese population with sufficient employment opportunities.

FIGURE 25 TIMOR-LESTE'S TOP EXPORTS (HS96), 2014



Source: MIT. "The Observatory of Economic Complexity: Timor-Leste."

78. Several key points emerge from the foregoing economic analysis that need to be considered and clearly supports the urgent need for diversification:

- Economic growth has been driven by primary sectors growth (almost entirely oil & gas).
- This growth has been inward-driven.
- Little role for exports, which are poorly diversified. The export basket is less diversified now than ten years ago.
- Economic competitiveness and capacity outside of oil & gas and basic agriculture is extremely limited.
- Employment is concentrated in the agriculture sector.

(1) Investment sector scan - methodology

79. **The ISS evaluates sectors based on two dimensions: their attractiveness to investors (or ‘feasibility’ dimension), and the expected benefit of increased investment to the country (‘desirability’ dimension).** Sectors with a high score on both dimensions are considered ‘ready to go’, while those with a high ‘desirability’ and low ‘feasibility’ score can be considered ‘aspirational’. The challenge then is to identify a reform agenda that could increase their ‘feasibility’ score sufficiently to bring them into the ‘ready to go’ zone.

80. **A common operational example for using the sector scan approach is proactive investment promotion, which involves the direct targeting of individual investors in selected sectors.** It is an expensive activity for governments to engage in and takes significant time and effort. Therefore, most countries concentrate such proactive promotional efforts on a relatively small number of priority sectors, whilst still maintaining a capacity to respond to any good investment opportunities that may present themselves from other sectors. The sector scan can support the selection of such priority sectors, while at the same time identifying reform priorities for sectors that were identified as ‘aspirational’.

81. The assessment for Timor-Leste covered several sub-dimensions of both ‘desirability’ (e.g., a sector’s contribution to jobs, exports, economic upgrading) and ‘feasibility’ (e.g., availability of required skills, market potential, institutional and regulatory capacity). **The assessment is based on the following sources of information:**

- Stakeholder interviews with investors, business associations, government counterparts, donors, and embassies from key investor countries;
- Review of existing literature, including sector studies and information produced by the WBG, other donors active in Timor-Leste, consulting firms, research institutes, sector associations, etc.;
- Data driven approaches, including: Enterprise Survey, Input-Output, Trade / Market access, and Labor Force Survey data to assess various dimensions of the ‘desirability’ dimension such as innovation, linkages with domestic firms, job creation.

(2) Evaluation and prioritization of sectors

82. **This section analyzes different economic sectors in Timor-Leste to help identify potential areas for development in which investment can play a role.** Following the ISS framework, the WBG team identified a long list of sectors with potential to attract domestic and foreign investment into Timor-Leste, drawing also on stakeholders’ consultation and the investors’ survey conducted in December 2016.

83. **A strictly quantitative method to prepare a long list of sectors would not provide much needed details to be able to assess the overall economic picture regarding sector attractiveness and investment feasibility.** In addition, data is scarce in Timor-Leste. Therefore, the consultations with relevant public and private sector stakeholders and Timor-Leste’s economic priorities were key in developing this long-list (see Figure 27).

FIGURE 26 LONG-LIST OF POTENTIAL SECTORS¹⁵



Source: MCAE & Authors.

(3) Investment climate constraints affecting the sectors

84. **It can be said that Timor-Leste's investment potential is constrained by internal supply side factors more than by external barriers.** Supply side and structural constraints include issues around factor inputs like land access, skills, and infrastructure as well as the business and investment environment. Based on the team's research, the following factors appear to be acting as constraints to investment attraction and affecting Timor-Leste's economy across all sectors, hampering their competitiveness:

- Inefficient business environment: Red tape, e.g., investment projects licensing processes take too long in some cases.
- Unpredictability in the FDI environment: e.g., unclear laws, policies and regulations, e.g., instability of the tax exemptions regime for importers.
- Land access and ownership related issues: Land in Timor-Leste is scarce and governed by a disconnected institutional structure and complex legal environment.
- Inefficient Incentives framework: In many sectors, there may be no need for special government incentives or support; investors just need to be made aware of the opportunities and potential non-commercial risk mitigation instruments.
- Domestic and foreign investment related institutional capacity, especially investment promotion capacity.
 - Lack of a clear investment vision and strategy is hampering the efforts of TradeInvest to target new investment.
 - Failure to make investors aware of opportunities:
 - There are areas where increased local production requires relatively limited investment or simple technology, in some cases within the capacity of local

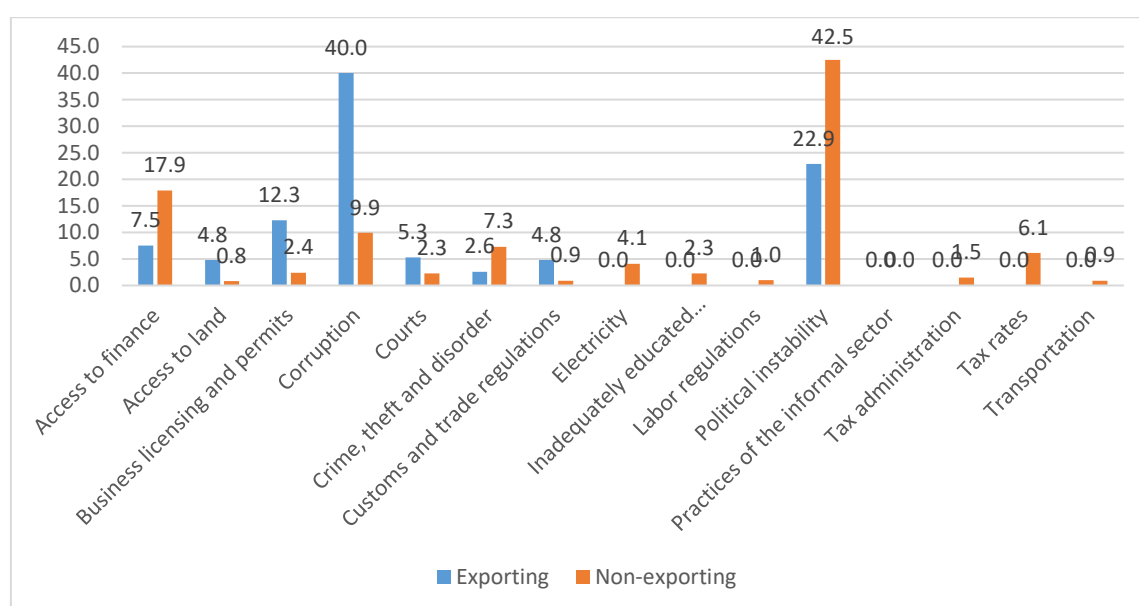
¹⁵ Note: Both agro-industries and agricultural products sectors include several subsectors / products that have been considered to elaborate this analysis.

investors but local entrepreneurs are unaware of the opportunities or of the technologies and techniques required.

- In other sectors, potential international investors are unaware of Timor-Leste's competitive endowment factors (e.g. in tourism, or in food processing for Malaysian or Indonesian investors).
- Education and skills: lack of sustainable supply of skills in many sectors.
- Lack of Infrastructure.

85. As Figure 22 shows electricity (2009) and political instability (2015) were more highly reported in Timor-Leste relative to the average reporting of EAP countries. **When observing differences between exporting and non-exporting firms, it can be observed that 40 percent of exporting firms reported corruption as the biggest obstacle, while roughly 40 percent of non-exporting firms report political instability as the biggest obstacle.** In fact, as Figure 28 shows, there are noticeably large differences between exporting and non-exporting firms across the perceptions. On the one hand, access to finance was a reported obstacle for about 18 percent of non-exporting firms, while only an obstacle for 7.5 percent of exporting firms. On the other hand, exporting firms reported access to land, businesses licensing and permits, courts, and customs and trade regulations as obstacles, relative to much smaller portions of non-exporting firms.

FIGURE 27 TIMOR-LESTE'S BIGGEST OBSTACLES (EXPORTING VS NON-EXPORTING FIRMS) (2015)

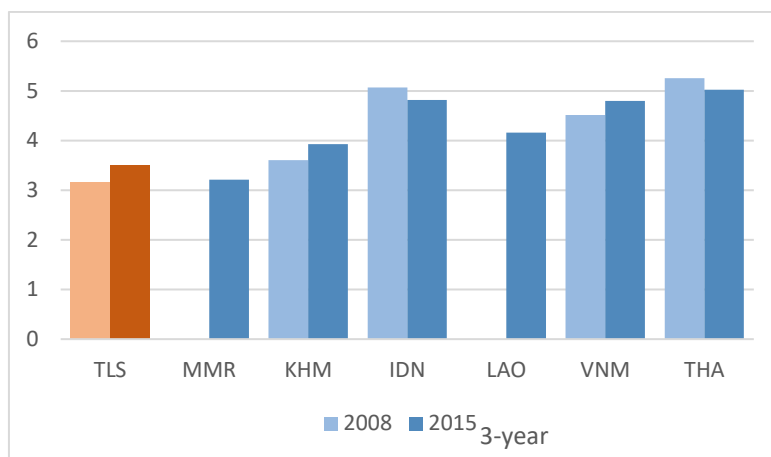


Source: World Bank Enterprise Surveys, 2009 and 2015.

86. **Doing Business and World Economic Forum data indicate that infrastructure is a key issue area for Timor-Leste.** In addition, the 2015 Enterprise Survey found several differences between exporting and non-exporting firms' reported infrastructure challenges.

87. **The quality of local suppliers is key in determining a location's potential to attract certain kinds of FDI that need specific inputs to produce goods or to deliver services.** Over time, according to Figure 29, the quality of local suppliers appears to have improved slightly in Timor-Leste, though it still falls below the median of its regional comparators.

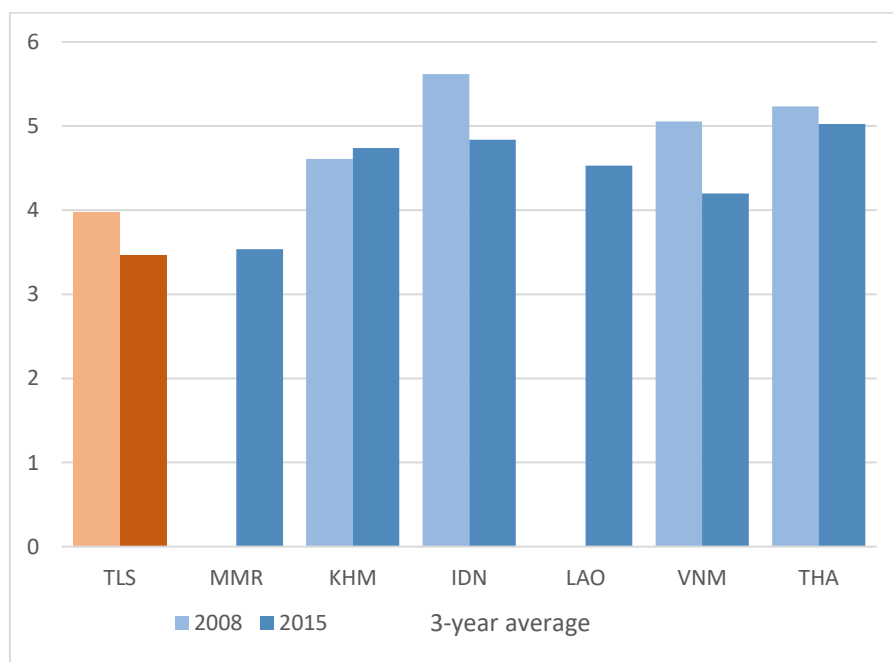
FIGURE 28 LOCAL SUPPLIER QUALITY, 1-7 (BEST)



Source: World Bank Enterprise surveys, 2009 and 2015.

88. **One of the issues of attracting resource-seeking investment is that it does not facilitate skills and technology transfer in the same way export-oriented FDI does.** According to Figure 30, Timor-Leste appears to be benefitting the least relative to its regional comparators on technology transfer from FDI. This finding is in line with the low scores for technological readiness observed in the World Economic Forum data, as well as the infrastructure challenges observed in the Enterprise Survey findings.

FIGURE 29 FDI AND TECHNOLOGY TRANSFER, 1-7 (BEST)



Source: World Bank Enterprise surveys, 2009 and 2015.

(4) WBG investors survey findings

89. **The WBG team undertook a survey in the last quarter of 2016 to get up-to-date information directly from investors (both domestic and foreign) operating in Timor-Leste.** A total of 22 investors

expressed their views on investment issues and potential in Timor-Leste. The survey provided additional details on specific issues. Key findings from this exercise are summarized below:

- Access to the domestic market was the reason for establishing operations for most respondents (60 percent).
- In terms of main policy and regulatory barriers for investment among the top responses were issues related to land/land acquisition, access to finance and dispute settlement.
- On specific constraints affecting the sector in which the investors operate lack of skilled labor, poor regulatory environment, poor infrastructure and financial restrictions appeared to be the most relevant areas. 64 percent of respondents said that these and other constraints are hampering the expansion of their operations.
- Visa restrictions were also a problem according to surveyed investors. Lack of visas for workers was mentioned as a common sector specific constraint for investors and visa facilitation to foreign workers was the top action that investors would suggest the government to take.
- Inefficient institutional settings to provide support for investments is considered a constraint across sectors. In fact, more than half of surveyed investors responded that they never received information about investment opportunities from any official agency. Specifically, lack of assistance from the tourism ministry was explicitly mentioned in the survey.
- Regarding future potential for investment attraction in Timor-Leste, Services with a 53 percent (mostly tourism and hospitality), manufacturing with a 40 percent (mainly construction related) and agriculture with a 7 percent were mentioned as potentially interesting areas for international and domestic investors.

90. These findings reinforce findings from previously conducted international reports, as well as, WBG analytical assessments.

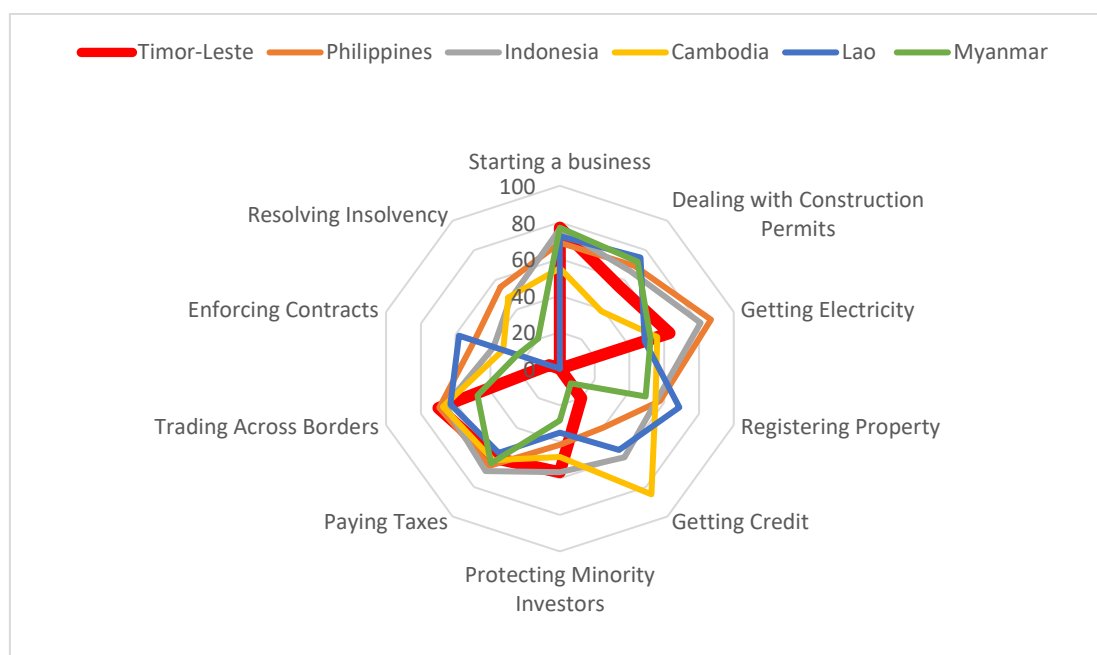
(5) Binding constraints analysis

91. **The objective of the analysis is to identify ‘binding constraints’ in terms of Timor-Leste’s sector competitiveness.** Countries need to be competitive in various aspects of the investment climate to successfully export a given product and/or attract foreign investment to a given sector.

92. **In the binding constraint analysis (BCA), the relative importance of a strong investment climate for a given sector is assessed in comparison to the performance of other countries in the world in two areas: (i) Export potential, and (ii) FDI attraction.** The comparator countries selected are either successful exporting countries or FDI attractors and tend to have strong investment climate characteristics. If Timor-Leste is found to perform significantly below these successful countries, this would indicate a likely binding constraint. For the measure of investment climate (IC), the team used data from the 2017 Doing Business Report and the 2014 World Economic Forum’s Global Competitiveness Report. The indicator descriptions of both sources are detailed in Annex 2.

93. **As Figure 31 shows, Timor-Leste performs comparably or better than its regional comparators in the Doing Business areas of Starting a Business, Protecting Minority Investors, and Trading across Borders.** Conversely, we observe that Timor-Leste performs relatively worse than its regional comparators in the Doing Business areas of Getting Credit and Getting Electricity.

FIGURE 30 TIMOR-LESTE DOING BUSINESS PERFORMANCE VS REGIONAL COMPARATORS (2017) *

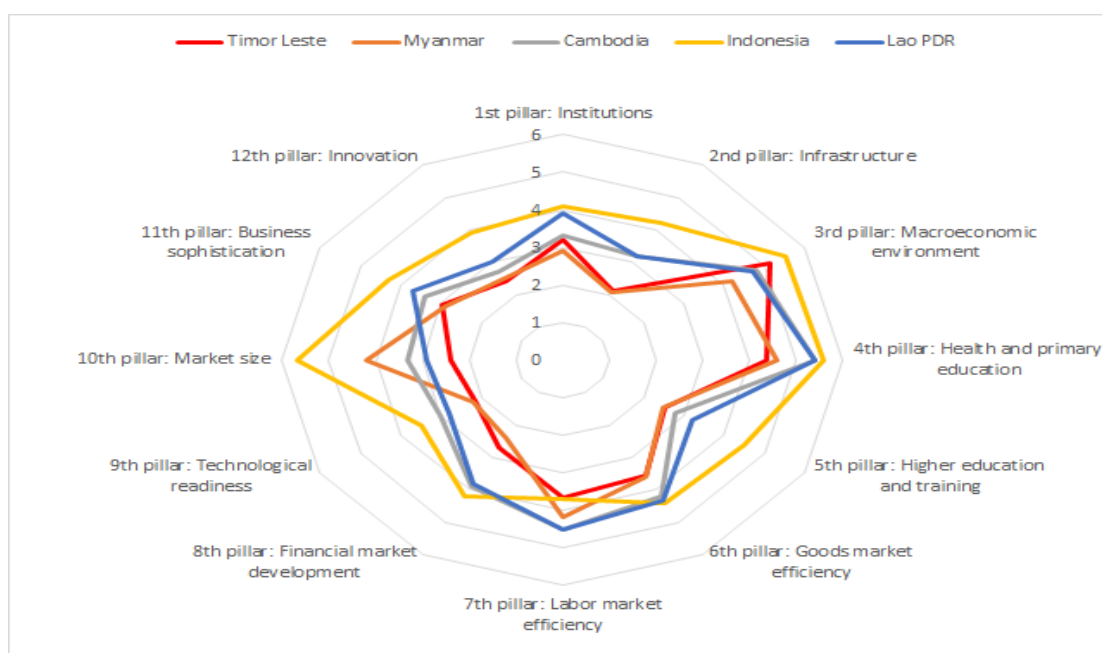


*Note that data was unavailable for “Registering Property” and “Resolving Insolvency”.

Source: Doing Business 2017.

94. When comparing Timor-Leste’s global competitiveness performance (using the World Economic Forum’s 12 pillars of global competitiveness) against its regional competitors (who are part of the ASEAN Free Trade Area) the findings confirm that Timor-Leste’s comparative strength lies in macroeconomic environment performance, while infrastructure, health and primary education, higher education and training, labor market efficiency, market size, and business sophistication are areas where Timor-Leste score comparatively worse (see Figure 32).

FIGURE 31 WEF GLOBAL COMPETITIVENESS REPORT 2014 SCORES: TIMOR-LESTE VS NEIGHBORING COUNTRIES



Source: World Economic Forum. Global Competitiveness Report 2014.

(6) Analysis of Timor-Leste's current export portfolio

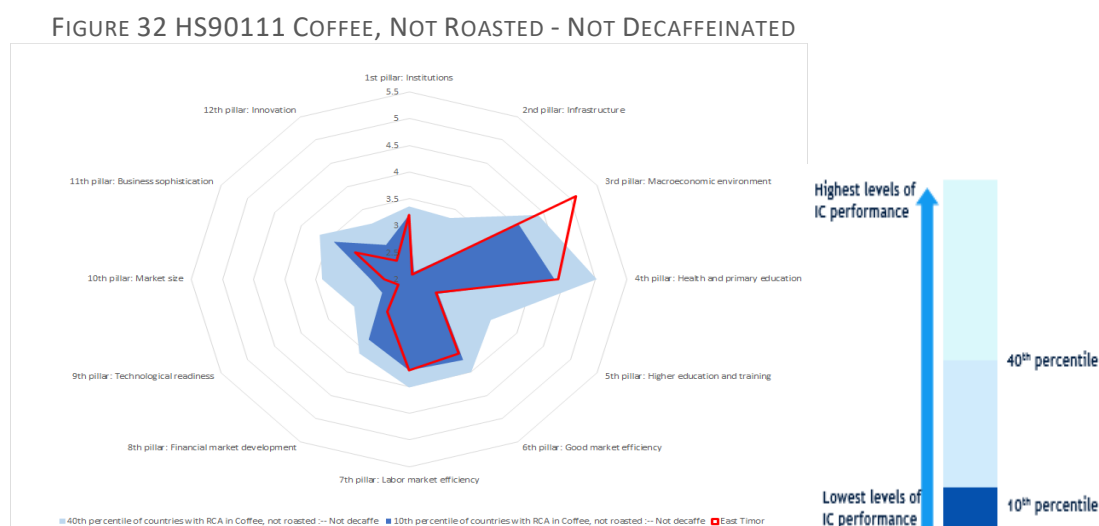
95. To uncover the binding constraints for a given sector or product, the team identified clustering of IC variables by looking at the bottom 10th and 40th percentile for a given IC variable of all countries with revealed comparative advantage for a given product.

96. The next several graphs show the performance of other countries with revealed comparative advantage¹⁶ (RCA) in Timor-Leste's largest export categories (per Figure 26): mineral products (81 percent of exports in 2014) and coffee products (14 percent of exports in 2014). Specifically, 41 percent of exports were petroleum oils, oils from bituminous minerals, crude oil, and another 40 percent were petroleum gases and other gaseous hydrocarbons. Another 15 percent of exports were coffee, coffee husks and skins, and coffee substitutes.

97. The following products were chosen for analysis, as they appear to be sizable sub-categories of key industries, based on the Massachusetts Institute of Technology (MIT) export diagram (see Figure 26):

- Coffee roasted (not decaffeinated) (see Figure 33); and,
- Petroleum oils and oils obtained from crude oil (see Figure 34).

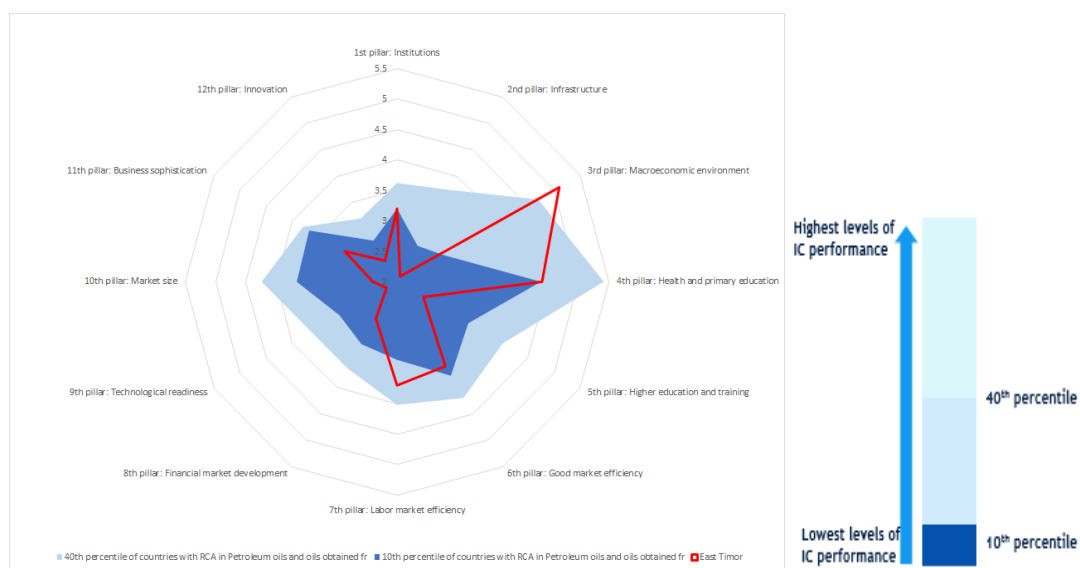
98. The results show that across each of these products, Timor-Leste consistently scores better than the 40th percentile in macroeconomic environment. However, even for these traditional exports, Timor-Leste fares worse than the 10th percentile of successful exporters across nearly all indicators. Timor-Leste scores particularly low relative to 10th percentile successful exporters in areas of infrastructure, higher education and training, technological readiness, and innovation. These results are in line with the patterns observed between Timor-Leste and its neighboring countries (see Figure 32).



Source: World Bank Staff elaboration based on data from COMTRADE and World Economic Forum Global Competitiveness Report.

¹⁶ A country is considered to have revealed comparative advantage in each product if the share of this product in the country's export basket exceeds the same product's share in global exports. To diminish the effect of re-exports and other potential outliers, we construct the RCA variable separately for the years 2011-14, and only count a country having RCA in each product for the purposes of this analysis if there is RCA in at least three out of these four years.

FIGURE 33 HS270900 PETROLEUM OILS AND OILS OBTAINED FROM CRUDE OIL



Source: World Bank Staff elaboration based on data from COMTRADE and World Economic Forum Global Competitiveness Report.

(7) Analysis of Timor-Leste's potential export diversification (based on selected priority products)

99. **The next portion of the BCA focused on several potential products for future development.** Based on research compiled by UNESCAP¹⁷, UNDP¹⁸, and information provided by key stakeholders on possible economic diversification opportunities for Timor-Leste, the following priority product areas have been selected for analysis:

- Agricultural products, including rice, coconut oil, fish and livestock, and maize;
- Textiles, textile articles and articles of apparel.

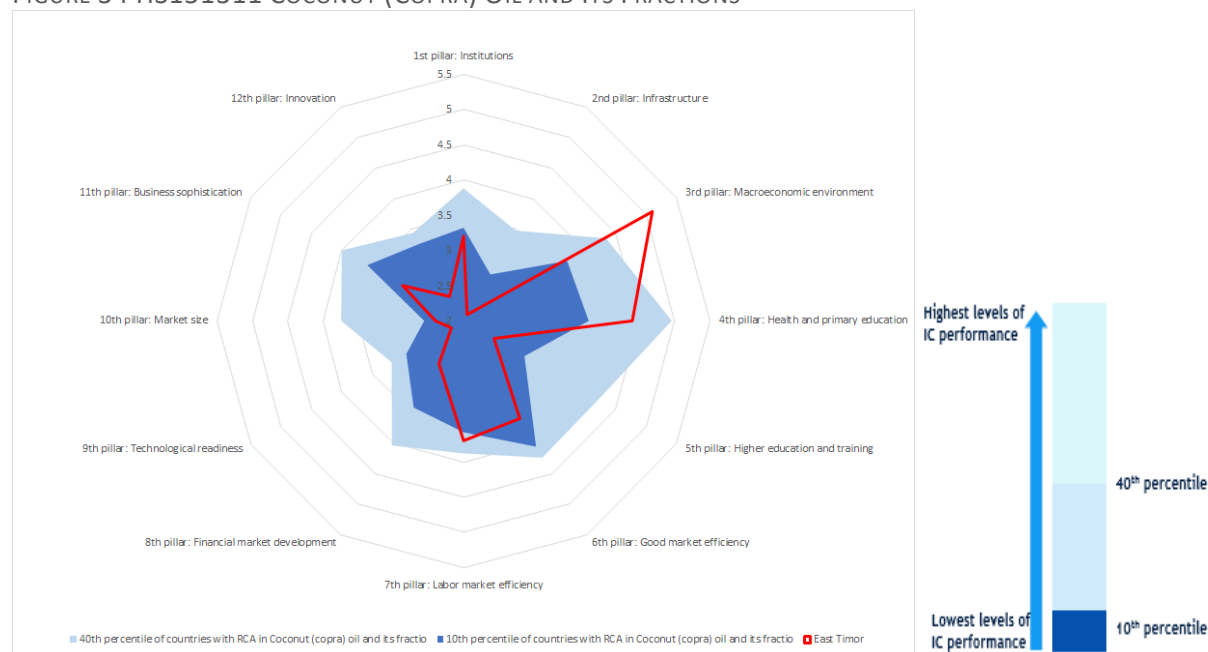
100. **Moving into these more sophisticated, new priority exports, it is observed that the same indicators that posed as binding constraints for traditional exports persist,** specifically infrastructure, higher education and training, technological readiness, and innovation, and Timor-Leste scores even worse than 10th percentile exporters across several of the other IC pillars. Moreover, Timor-Leste's comparatively high score in macroeconomic environment appears to shrink (marked by the shorter distance between Timor-Leste's score and the score of 40th percentile exporters) in several of these more sophisticated products. These results indicate that weaknesses under many of the IC pillars are likely to present binding constraints for Timor-Leste to develop these new, higher value-added exports. Specifically, Timor-Leste frequently scores worse than 10th percentile exporters in areas of good market efficiency and health and primary education.

101. In terms of agricultural goods, select products, such as soya beans, rice in the husk, and coconut oil (see Figure 35) appear to score slightly better across a few IC pillars, such as good market efficiency (rice in the husk and soya beans) and health and primary education (coconut oil). For textile and apparel products (see Figure 36), Timor-Leste tends to score equal or worse than 10th percentile exporters across all IC areas, except macroeconomic environment and labor market efficiency.

¹⁷ Opportunities for economic diversification in Timor-Leste. UNESCAP 2015.

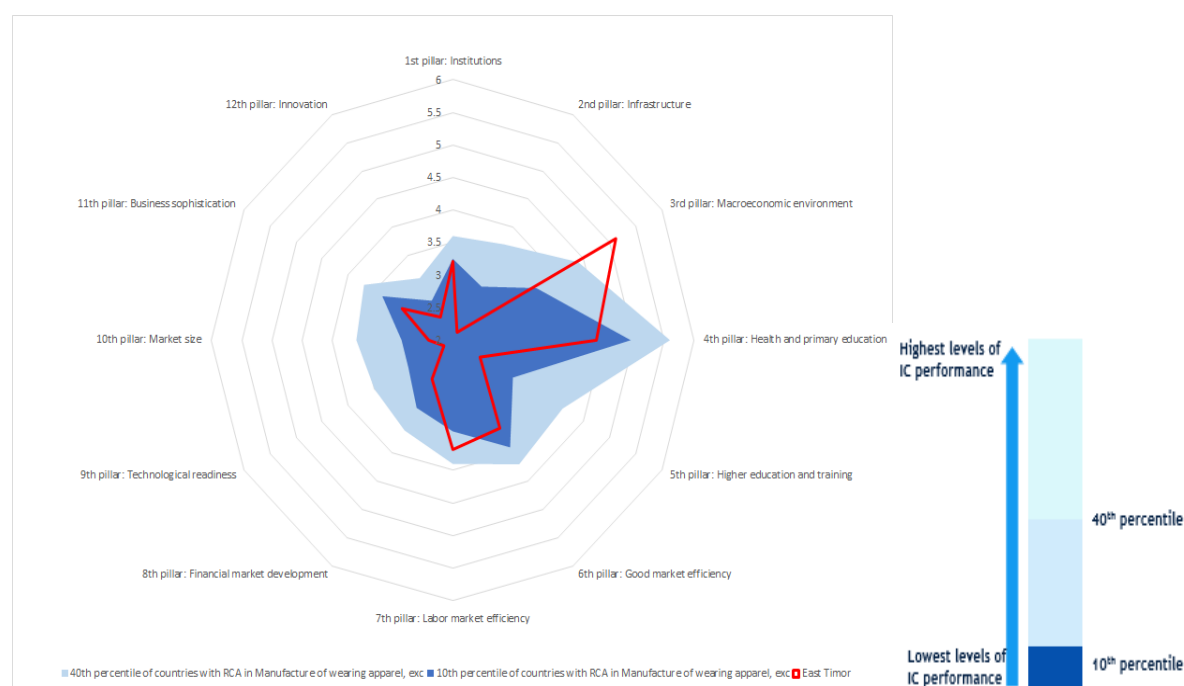
¹⁸ Draft Industrial Policy of Timor-Leste. UNDP.

FIGURE 34 HS151311 COCONUT (COPRA) OIL AND ITS FRACTIONS



Source: World Bank Staff elaboration based on data from COMTRADE and World Economic Forum Global Competitiveness Report.

FIGURE 35 ISIC1810 MANUFACTURE OF WEARING APPAREL



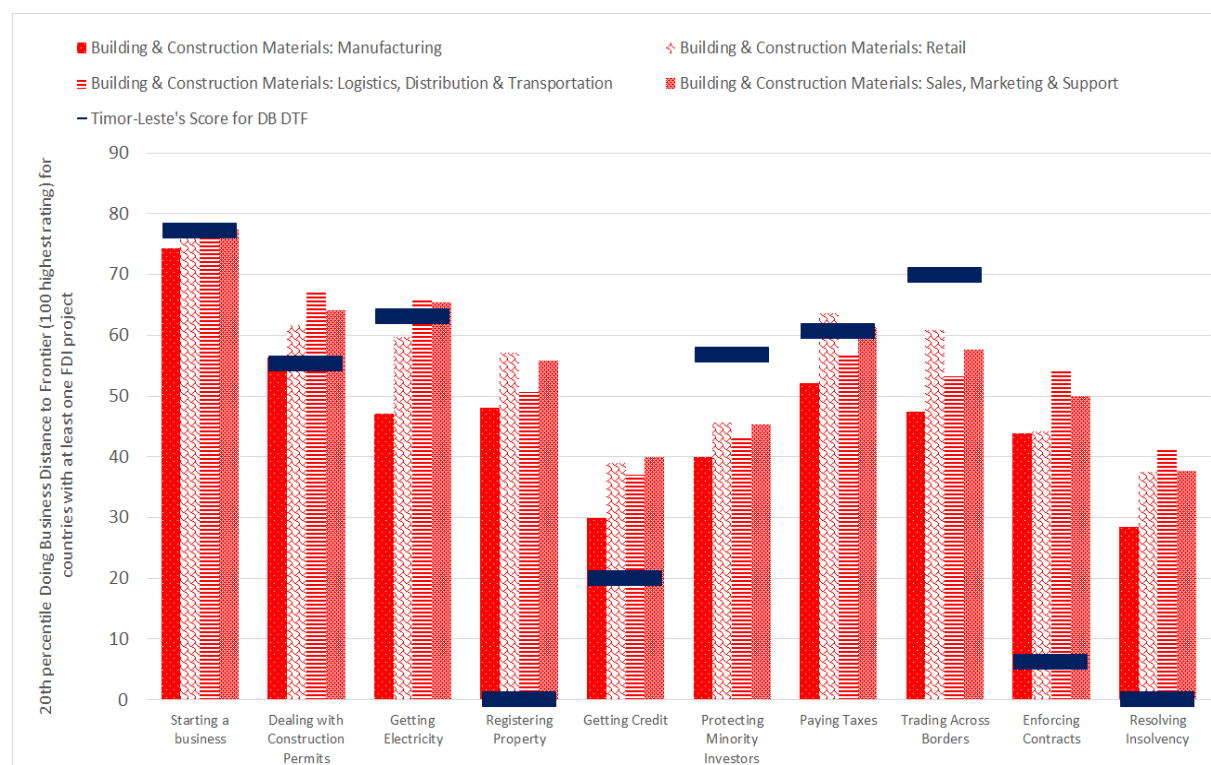
Source: World Bank Staff elaboration based on data from COMTRADE and World Economic Forum Global Competitiveness Report.

(8) Analysis of FDI attraction for upgrading within priority sectors

102. The team used ‘IC Mountain’¹⁹ graphs to assess Timor-Leste’s potential for value chain upgrading within sectors; specifically, Timor-Leste’s potential to attract FDI for various business activities within priority sectors (or proxies) with available data (namely building and construction, coal, O&G, food and tobacco, hotels / tourism and textiles). The team evaluated Timor-Leste’s performance along the Doing Business indicators relative to 20th percentile countries that have attracted FDI in each sector.

103. In the case of Building & Construction (see Figure 37), the team observed that Timor-Leste performs well in attracting FDI to all activities along the value chain, considering its performance in the Doing Business areas of Starting a Business, Trading across Borders, and Protecting Minority Investors. However, the team also observed that Timor-Leste faces across the board ‘binding constraints’ in the areas of Getting Credit and Enforcing Contracts. In terms of attracting FDI towards higher value-added activities, such as logistics, sales, and retail, Timor-Leste appears to face ‘binding constraints’ in several additional Doing Business areas: Dealing with Construction Permits, Getting Electricity, and Paying Taxes.

FIGURE 36 BUILDING & CONSTRUCTION: TIMOR-LESTE VS 29TH PERCENTILE COUNTRIES WHO HAVE RECEIVED FDI SINCE 2011



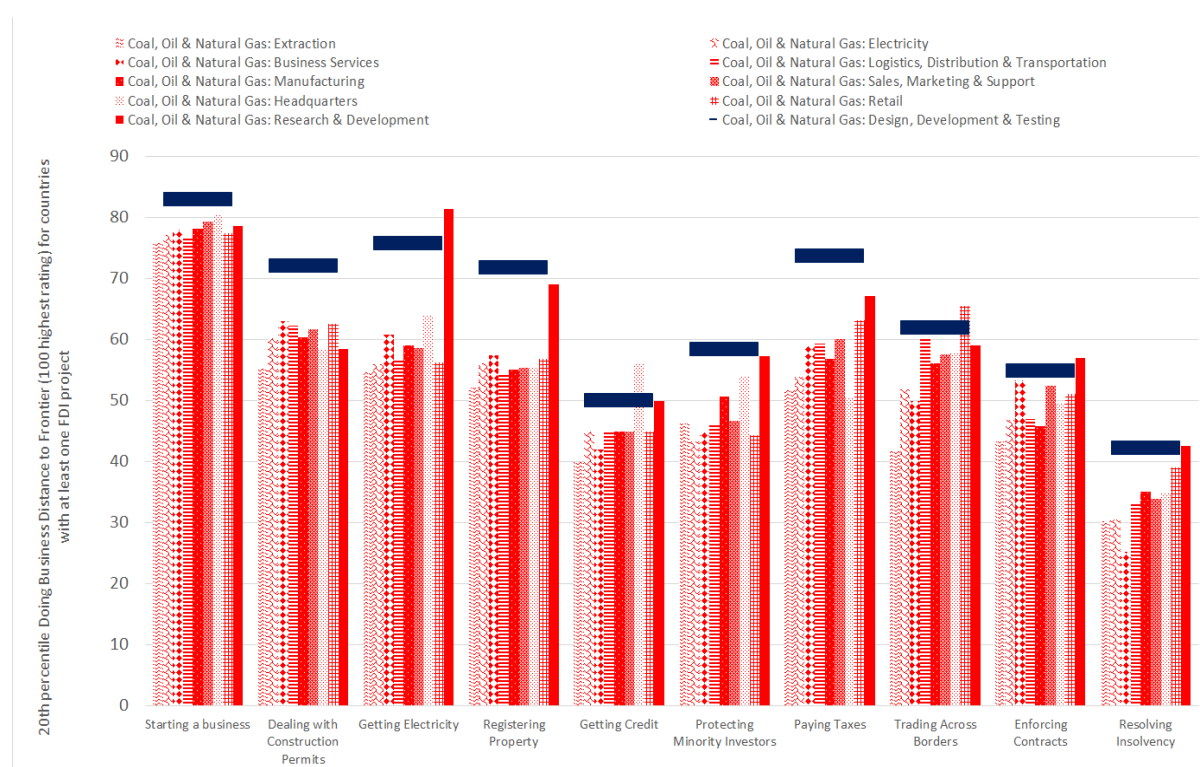
Note: Timor-Leste has not received FDI for any of these activities since 2011. Scores of zero for Timor-Leste in the areas of “Registering Property” and “Resolving Insolvency” reflect unavailable data, not a poor performance.

Source: World Bank Staff estimates based on data from Financial Times fDi Markets database and Doing Business 2017.

¹⁹ ‘IC Mountain’ graphs assess Timor-Leste’s potential to move into higher value-added business activities within a given priority sector, given its competitiveness in each area.

104. In evaluating Timor-Leste's FDI attraction in Coal, Oil and Natural Gas (see Figure 38), the team observed that Timor-Leste performs well in attracting FDI towards most of activities along the value chain, considering its general Doing Business performance. Timor-Leste does not face any across the board 'binding constraints' in this sector. The team observed that for FDI attraction towards select higher value-added activities, Timor-Leste does appear to face select 'binding constraints', as observed in the Doing Business areas of Getting Credit (headquarters) and Trading Across Borders (retail). Moreover, the team also observed that in terms of its performance in the Doing Business areas of Getting Electricity and Enforcing Contracts, Timor-Leste faces 'binding constraints' in attracting FDI specifically towards R&D activities in this sector.

FIGURE 37 COAL, OIL & NATURAL GAS: TIMOR-LESTE VS 20TH PERCENTILE COUNTRIES WHO HAVE RECEIVED FDI SINCE 2011

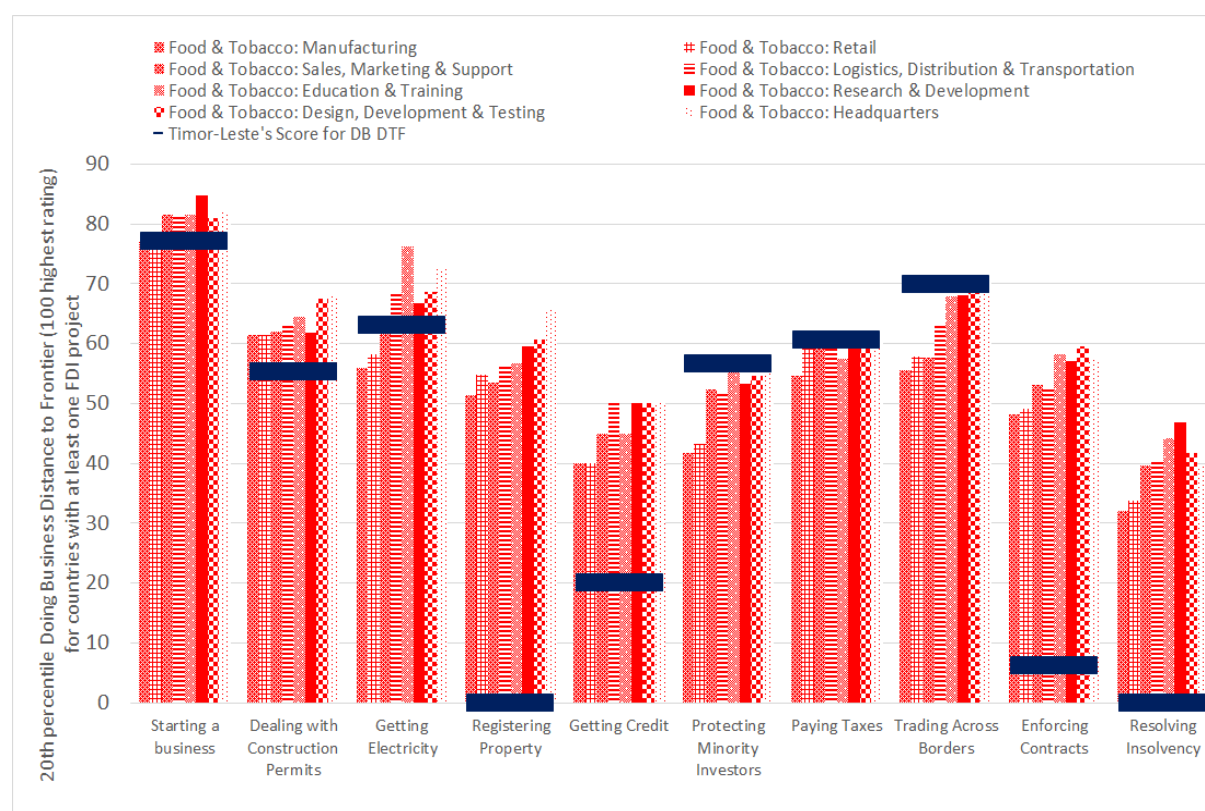


Note: Timor-Leste has not received FDI for any of these activities since 2011. Scores of zero for Timor-Leste in the areas of "Registering Property" and "Resolving Insolvency" reflect unavailable data, not a poor performance.

Source: World Bank Staff estimates based on data from Financial Times fDi Markets database and Doing Business 2017.

105. In terms of the Food & Tobacco sector (proxy for agro-industries) (see Figure 39), the team again observed that Timor-Leste performs well in the Doing Business areas of Protecting Minority Investors, Trading across Borders, as well as Paying Taxes. The team again noted that Timor-Leste appears to face across the board 'binding constraints' in the areas of Dealing with Construction Permits, Getting Credit, and Enforcing Contracts. Furthermore, the team observed that in attracting FDI towards higher value-added activities, including design, development & testing, R&D, and others, Timor-Leste begins to face additional 'binding constraints', notably in the Doing Business areas of Starting a Business and Getting Electricity.

FIGURE 38 FOOD & TOBACCO: TIMOR-LESTE VS 20TH PERCENTILE COUNTRIES WHO HAVE RECEIVED FDI SINCE 2011



Note: Timor-Leste has not received FDI for any of these activities since 2011. Scores of zero for Timor-Leste in the areas of “Registering Property” and “Resolving Insolvency” reflect unavailable data, not a poor performance.

Source: World Bank Staff estimates based on data from Financial Times fDi Markets database and Doing Business 2017.

106. For the Hotels & Tourism sector (see Figure 40), the team noted that Timor-Leste performs well in the areas of Protecting Minority Investors and Trading across Borders. Again, the team observed that Timor-Leste faces across the board ‘binding constraints’ in the areas of Dealing with Construction Permits, Getting Credit, and Enforcing Contracts. Furthermore, the team observed that for attracting FDI towards higher value-added activities, such as customer contact centers, sales, and headquarters, Timor-Leste faces additional ‘binding constraints’, in the Doing Business areas of Starting a Business, Getting Electricity and Paying Taxes. Finally, the team noted that construction activities appears to be the activity within this sector that Timor-Leste appears most competitive for attracting FDI.

FIGURE 39 HOTELS & TOURISM: TIMOR-LESTE VS 20TH PERCENTILE COUNTRIES WHO HAVE RECEIVED FDI SINCE 2011

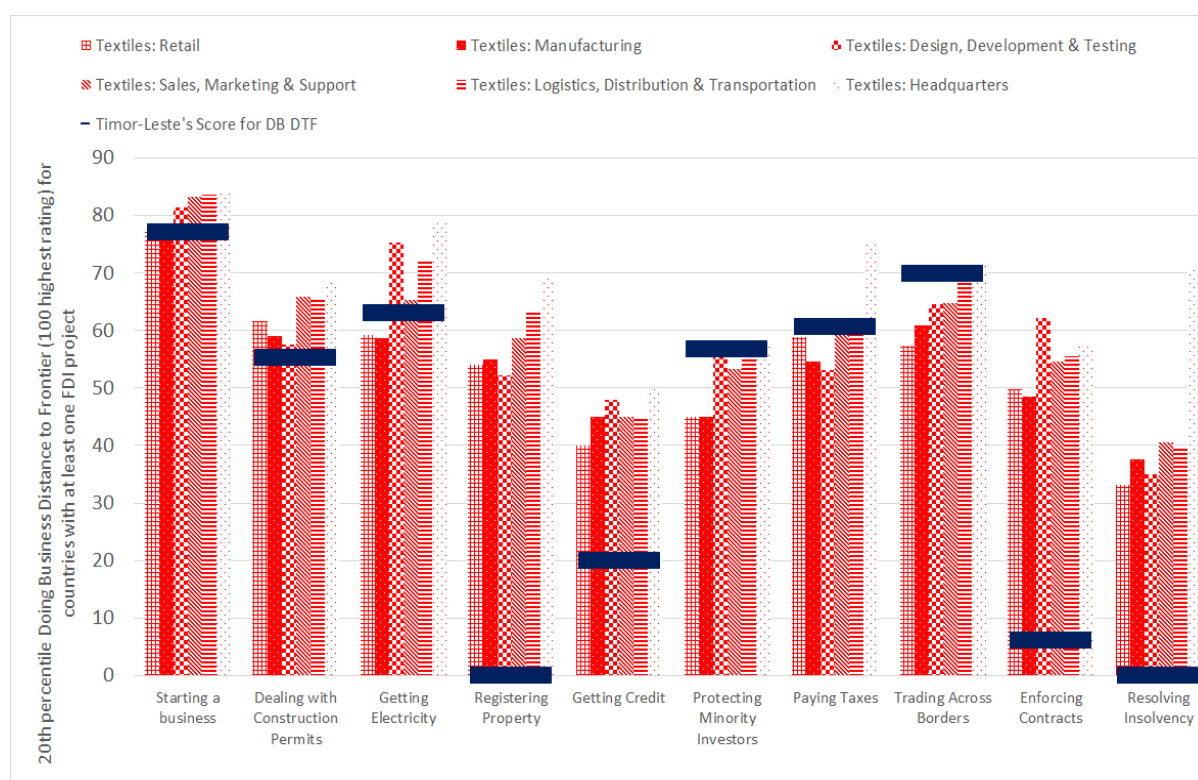


Note: Timor-Leste has not received FDI for any of these activities since 2011. Scores of zero for Timor-Leste in the areas of “Registering Property” and “Resolving Insolvency” reflect unavailable data, not a poor performance.

Source: World Bank Staff estimates based on data from Financial Times fDi Markets database and Doing Business 2017.

107. **In the Textiles sector (see Figure 41), the team noted that Timor-Leste performs well in the areas of Protecting Minority Investors and Trading across Borders.** The team observed that Timor-Leste faces across the board ‘binding constraints’ in the areas of Dealing with Construction Permits, Getting Credit, and Enforcing Contracts. Furthermore, the team observed that for attracting FDI towards higher value-added activities, Timor-Leste faces additional ‘binding constraints’, in the Doing Business areas of Starting a Business, Getting Electricity and Paying Taxes.

FIGURE 40 TEXTILES: TIMOR-LESTE VS 20TH PERCENTILE COUNTRIES WHO HAVE RECEIVED FDI SINCE 2011



Note: Timor-Leste has not received FDI for any of these activities since 2011. Scores of zero for Timor-Leste in the areas of “Registering Property” and “Resolving Insolvency” reflect unavailable data, not a poor performance.

Source: World Bank Staff estimates based on data from Financial Times fDi Markets database and Doing Business 2017.

(9) Analysis of Timor-Leste’s skills and infrastructure constraints

108. As both the Enterprise Surveys and the BCA revealed, Timor-Leste appears to suffer from particularly poor performance in the investment climate areas of skilled labor force and infrastructure. To best assess Timor-Leste’s FDI attraction potential (considering these constraints), the team benchmarked Timor-Leste along various dimensions related to infrastructure (see Figure 42) and skills (see Figure 43) against all other countries in the world that have managed to attract FDI in each subsector, between 2010 and 2015. Admittedly, the FDI data at the subsector level for Timor-Leste is sparse; however, given our list of priority sectors, and the high availability of global skills and infrastructure data, the team figured this analysis would be worthwhile to include.

FIGURE 41 INFRASTRUCTURE: BENCHMARKING OF TIMOR-LESTE VS GLOBAL COMPETITORS FOR FDI TOWARDS SELECT SUBSECTORS (2010-2015)

	Infrastru cture (WEF)	Internet user (per 100 people) (WDI)	Access to electricity (% of population) (WDI)	Fixed broadband subscription s (per 100 people) (WDI)	Fixed telephone subscription s (per 100 people) (WDI)	Mobile cellular subscripti ons (per 100 people) (WDI)	Getting Electricity DTF (DB)
Agriculture	Yellow	Red	Yellow	Red	Red	Green	Green
Coffee & Tea	Red	Red	Red	Red	Red	Green	Yellow
Construction	Yellow	Yellow	Yellow	Red	Red	Green	Green
Hotels	Red	Red	Red	Red	Red	Green	Green
Livestock	Yellow	Red	Yellow	Red	Red	Green	Green
Oil & Gas	Yellow	Yellow	Yellow	Red	Red	Green	Green
Textiles & Garments	Red	Red	Yellow	Red	Red	Green	Green

*Legend: Red (severe underperformance); Yellow (moderate underperformance); Green (competitive performance)

Source: WEF, WDI, Doing Business, FDImarkets data on FDI project aggregated by country-subsector.

109. When benchmarking Timor-Leste along various dimensions related to infrastructure (see Figure 42), as measured by various global indicators, against all other countries in the world that have managed to attract FDI in each subsector from 2010-2015, the team noted that Timor-Leste performs well in the areas of Mobile Cellular Subscriptions and Getting Electricity. Moreover, the heat map shows that though Timor-Leste may score poorly around Getting Electricity relative to some of its high-performing regional comparators (see Figure 31), this area of infrastructure is likely not a specific constraint for attracting FDI towards its priority subsectors.

110. In addition, the team noted that Timor-Leste has only moderate underperformance in the areas of Access to Electricity, Internet User (per 100 people), and general Infrastructure, for several its priority subsectors. Across subsectors, Timor-Leste appears to suffer from severe underperformance²⁰ in the areas of broadband and fixed telephone subscription; in other words, Timor-Leste falls below the minimum scores of countries that could attract FDI in this sector.

111. Timor-Leste's comparable performance along several infrastructure dimensions reveal that Timor-Leste would be most competitive in attracting FDI in the following subsectors: Agriculture, Construction, Livestock, O&G, and Textiles & Garments.

112. When benchmarking Timor-Leste along various dimensions related to skills and labor force (see Figure 43), as measured by multiple global indicators, against all other countries in the world that have managed to attract FDI in each subsector from 2010-2015, the team noted that Timor-Leste does not score among top performers along any indicator. This observation further

²⁰ 'Severe underperformance' means that Timor-Leste falls below the minimum score of countries that could attract FDI in this subsector. In other words, no country in the world with a score in this indicator ranking as poor as Timor-Leste has been able to attract investment in this subsector. 'Moderate underperformance' means that Timor-Leste preforms between the minimum and 20th percentile of successful FDI attracting countries.

underscores that poor skills performance is a serious constraint for Timor-Leste's competitiveness in attracting FDI to its priority sectors.

FIGURE 42 LABOR FORCE & SKILLS: BENCHMARKING OF TIMOR-LESTE VS GLOBAL COMPETITORS FOR FDI TOWARDS SELECT SUBSECTORS (2010-2015)

	Labor force, total (WDI)	Female labor force participation rate (ILO)	Health & Primary Education (WEF)	Higher Education & Training (WEF)	Labor Market Efficiency (WEF)	Expenditure on education as % of total government expenditure (%) (WDI)
Agriculture						
Coffee & Tea						
Construction						
Hotels						
Livestock						
Oil & Gas						
Seafood						
Spices						
Textiles&Garments						

*Legend: Red (severe underperformance); Yellow (moderate underperformance); Green (competitive performance)

Source: WEF, ILO, WDI, Doing Business, FDI markets data on FDI project by country-subsector.

113. Moreover, the team observed that Timor-Leste has only moderate underperformance in the areas of Labor Market Efficiency and, for select subsectors, Health and Primary Education. **Across sectors, Timor-Leste appears to suffer from severe underperformance in the areas of Size of Labor Force, Female Participation in the Labor Force, Higher Education and Training, and Public Expenditure on Education.** In other words, Timor-Leste falls below the minimum scores of countries that could attract FDI across sectors, indicating that a lack of labor availability and skills are notable constraints for Timor-Leste's FDI competitiveness within these subsectors.

114. From the heat map (see Figure 43) the following priority subsectors see relatively fewer skills constraints: Agriculture, Construction, Livestock, and Oil & Gas.

(10) Final selection of sectors

115. **Timor-Leste (as many other developing countries) is trapped in the export of unsophisticated products, specifically O&G commodities, making the process of structural transformation difficult.** Progressively diversifying and upgrading Timor-Leste's productive structure is Timor-Leste's key challenge. Shifting economic activity away from O&G towards other sectors, by attracting investment and bringing new technologies and skills can help Timor-Leste foster and sustain inclusive growth.

116. Considering the analysis undertaken, the information gathered through investors' survey, stakeholders' consultations and available market information on each of the long-listed sectors, the relative competitive potential for each of the sector has been assessed in detail (find matrixes for sectors in the next pages).

117. In general, most of the preliminary selected sectors offer some value for Timor-Leste, some of them offer potentially good business propositions for investors and others do not seem to offer a good business case neither for Timor-Leste's value in terms of positive economic impact nor for potential investors in terms of attractiveness.

118. **A key objective of this prioritization exercise for proactive investment promotion and policy reform action is to triangulate available data and information to be able to give different scores** (scores are not exact but illustrate the order of magnitude of the results) to different sectors / subsectors. The analysis tries to consider the present context and future potential in the short to medium term.

119. **Five areas have been finally chosen for the GoTL to undertake further analysis, develop targeted strategies and plans to attract potential investors and proceed to implement the necessary reforms:**

- Sustainable Tourism;
- Agro-industries (subsectors with the highest potential include: virgin coconut oil and processed coffee);
- Agricultural products (subsectors with the highest potential include: spices, peanuts, coconut and coffee);
- Construction materials;
- Strategic Infrastructure.

120. Specific details underpinning the selection of these subsectors / sectors are provided in the next pages of the report. **A shared characteristic between the five of them is that they can potentially offer an attractive / feasible business case for investors and Timor-Leste as a country can benefit from investment in these economic areas (they are desirable for the country).** Two of the subsectors in the list of selected sectors (**Agro-industries and Agricultural products**) were identified in the analysis (based on stakeholders' consultations and limited data) as areas with medium to long-term potential for export diversification and the capabilities needed to produce these goods do not appear to be very different from the existing capabilities available in Timor-Leste now.

121. Private sector consultation and in-depth interviews also provided valuable insights to be able to prioritize other sectors preliminarily selected for the long list. There was a consensus regarding the potential for investment in **Tourism, Construction materials and Strategic Infrastructure sectors**. Three economic activities that are strongly interrelated and can create positive synergies to facilitate Timor-Leste's domestic market development and economic upgrading in the long term.

122. **The five sectors ruled out in this exercise are Fisheries, Livestock, Garments, Downstream petrochemicals, and Oil & Gas.** The fact that these sectors have not been prioritized for short term specific policy action does not mean that they do not present future potential to create positive impact and desired inclusive economic growth in Timor-Leste. **It is important to understand that no country can be competitive in every sector.**

123. In the case of **garments, fisheries and livestock**, all of them offer potential for diversification, but Timor-Leste would need to implement some medium-term reforms to make the country attractive for investors. Although desirable, realistically it would be very difficult to attract investment into these sectors in the short term and Timor-Leste's policy action efforts should be currently focused in more feasible options aligned with existing capabilities and national economic priorities.

124. **The current gap regarding existing capabilities (technical expertise, infrastructure, services, regulations, etc.) would make it difficult for Timor-Leste to target attracting investment in fisheries,**

livestock and garments in the short term. These sectors may have the necessary potential to add value to the domestic economy in the medium-long term and **the WBG team highly encourages the GoTL to further investigate how to improve the attractiveness of these sectors and how to remove existing constraints.** These sectors would comprise a set of aspirational areas for future development and the government should design long term plans to become competitive in these areas in the long term.

125. In the case of **Downstream Petrochemicals**, the technical skills gap is even larger and the long-term viability of the industry is directly linked to the availability of the raw material.

126. For the **O&G** industry, attracting more investment could be relatively easy for Timor-Leste but **this type of investment would not contribute towards Timor-Leste's economic diversification.**

127. The following table (see Table 3) includes scores for the different areas assessed and the aggregated results for the sectors. For this scoring, an Excel model has been developed to allow project profiles to be “scored” against the available metrics. The overall score for a sector profile is based on the scores under impact, opportunities, endowments and barriers (between 1 (very negative) and 5 (very positive)) and all the areas are equally important. Each score is based on a combination of the information gathered from private and public-sector stakeholders’ interviews, investors’ survey, studies²¹ and quantitative data analysis undertaken. **Although these scores are not meant to be exact measures, they do help in the prioritization of sectors / activities for investment promotion and policy action in an informed manner.** Without a way to measure it would be difficult to get a good overall picture of the current scenario regarding investment opportunities for Timor-Leste in the short term.

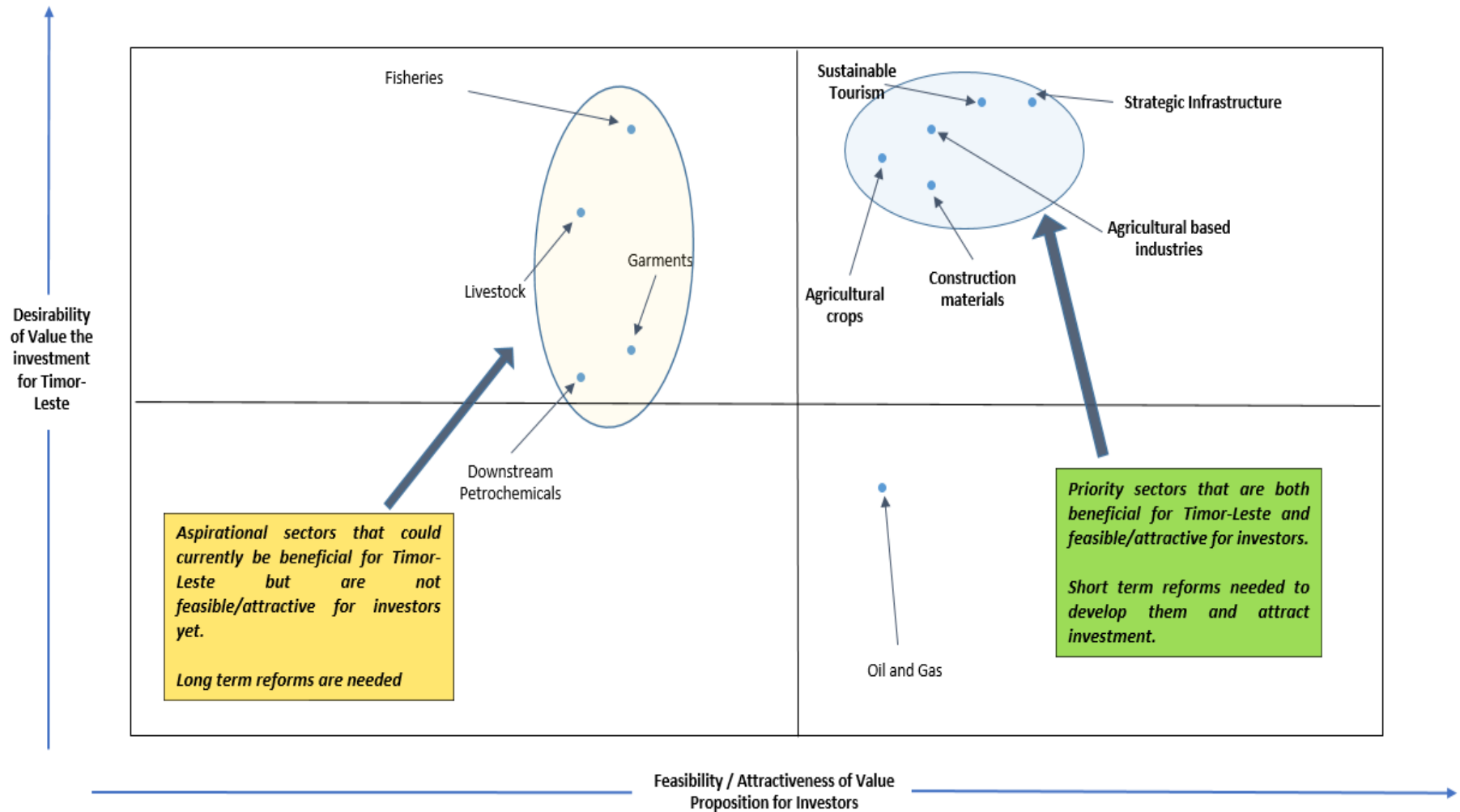
²¹ It should be noted that data used in this report, particularly on supply side factors is limited in places. Additional work to refine findings would therefore benefit from additional data research. As a next step, a focus group discussion is likewise recommended to further fine-tune the scoring.

TABLE 3 SECTORS AND SCORES IN ALL AREAS ASSESSED: MAIN RESULTS

Combining the scores for each segment yields the following conclusions											
	Desirability or Value for Timor-Leste					Feasibility or Attractiveness for investors					
	Impact on:					Opportunities	Endowments			Barriers	Total
Sector	Value addition	Jobs	Performance & linkages	Impact on Trade	Alignment with national objectives	Domestic and global market	Natural endowment	Infrastructure & cost	Skills & services		
Sustainable Tourism	4	5	5	5	4	4	5	2	3	3	40
	23					17					
Garments	4	3	3	2	2	2	2	2	2	2	24
	14					10					
Fisheries	5	4	4	4	5	2	4	1	2	1	32
	22					10					
Strategic Infrastructure	5	4	5	4	5	5	3	3	3	4	41
	23					18					
Construction materials	4	4	3	4	5	4	4	3	2	3	36
	20					16					
Downstream petrochemicals	4	2	2	3	2	2	2	2	1	2	22
	13					9					
Agricultural crops	4	4	4	4	5	4	4	2	3	2	36
	21					15					
Livestock	4	4	4	3	4	2	2	1	2	2	28
	19					9					
Agricultural based industries	4	5	5	3	5	4	5	2	3	2	38
	22					16					
Oil and Gas	2	1	2	2	2	3	3	4	2	3	24
	9					15					
Evaluation key:	Very Positive (5)		Positive (4)		Neutral (3)		Negative (2)		Very negative (1)		
											Selected
											Not selected

Source: Authors. Elaboration based on existing data and interviews with investors.

FIGURE 43 PRIORITIZATION OF SECTORS FOR PROACTIVE PROMOTION



Source: Authors.

128. According to the results derived from the in-depth assessment of the long-listed sectors the following areas have the potential to attract investment and therefore should be included in Timor-Leste's investment policy and promotion plans (see Table 4 and Figure 46). More detailed information on each sector is provided below.

TABLE 4 REASONS FOR FINAL SECTOR SELECTION

SECTOR	KEY REASONS FOR SELECTION
Sustainable Tourism (overall score: 40)	• Key sector with major potential for economic development, employment generation especially for women, and linkages and supply chain effects, e.g. in agriculture, coffee plantation visits could be organized as an attraction for tourists. • GoTL has recently approved the National Tourism Policy, and is currently working on a strategic and action plans. • Positive impact in balance of payments. • Regional and global tourism demand is growing. • Wide range of options for tourism development provided by diversity of natural endowments, including Atauro Island. Opportunities are not only available in hotels but in tourism specific activities and supporting services or management contracts (non-equity modes of investment).
Strategic Infrastructure (overall score: 38)	• Strategic sector that can have a positive impact in all other industries (Enabler sector). • Increasing the efficiency of communications and cargo transportation will facilitate the development of markets by connecting different producers with buyers and bringing business opportunities for the provision of related services. • Plans to further develop existing infrastructure are in place. Opportunities for investors can be brought to the market to raise awareness.
Agro-Industries (overall score: 38)	• Production basics and underlying know-how can be developed. • Regional and global markets are attractive. • Employment opportunities especially for women. • Tourism growth will increase demand in years to come. • Although costs are not more competitive than in some regional competitors, Timor-Leste's area of competition should be quality, not volume or price (developing the Made in Timor-Leste brand in the long term).
Agricultural Products (overall score: 36)	• Good quality of some products with certain degree of recognition in external markets. • Capable labor force available to a certain extent; employment opportunities especially for women. • Good potential to develop export markets in the medium-long term for several products. • The GOTL is actively supporting and promoting this sector: forestry development plan and coffee sector development plan.
Construction Materials (overall score: 36)	• As a young nation rebuilding from the conflict years, Timor-Leste must reconstruct a large portion of the country. • This sector has the potential to upgrade to more value-added segments in the future (architecture, design, engineering planning, etc.). • Domestic market will grow driven by public investment. • Available low skill-base, albeit limited.

Source: Authors.

IV. ASSESSMENT OF THE INSTITUTIONAL, LEGAL, AND REGULATORY FRAMEWORK FOR INVESTMENT

129. This section provides an overview of Timor-Leste's current policy, legal and regulatory framework for FDI at the national and international levels and the institutional set-up of government agencies dealing with investments.

A. The Legal and Regulatory Framework for Investment²²

130. **According to different reports and studies²³, *de jure*, there are not many restrictions on FDI in Timor-Leste and it is welcomed in most of the sectors.** Some exceptions reserved for the state include postal services, weapons production and distribution and public communications.

131. Timor-Leste's investment legal framework comprises the Constitution of the Democratic Republic of Timor-Leste, the 2017 Private Investment Law, which replaces the 2011 Private Investment Law²⁴, the 2017 Commercial Companies Law, the Commercial Registration Code and the 2008 Taxation and Duties Act.

132. The above mentioned **Private Investment Law 2017(PIL 2017) is the main legal instrument dealing with private investment in Timor-Leste**, which main aim is to attract private investments into the country. The PIL 2017 regulates investment and re-investments made in Timor-Leste by both, domestic and foreign investors. The PIL is applicable to direct investments only.

133. **Several issues regarding the implementation of the investment related laws and regulations appear to affect Timor-Leste's investment environment.**

(1) Admission screening

134. **TradeInvest is given the task under the PIL 2017** to ensure that all investments in Timor-Leste comply with the general principles of the PIL. In a step to simplify the investment entry and admission into Timor-Leste, the PIL 2017 eliminates investment screening and the requirement for Investor Certificate and minimum capital requirement apart from those seeking Special Benefits.

135. **The PIL 2017 provides that investors are free to invest in Timor-Leste and there is no prior authorization required.** Hence, the Law does not provide for an admission procedure as it adopts an automatic admission, which does not require screening apart from those provided in sectoral laws. Based on discussions with Serviços de Registo e Verificação Empresarial (SERVE), the company registry, what an investor needs to do is to register a company at SERVE, followed by obtaining the necessary sectoral

²² This section has been amended to reflect changes to the PIL, using the PIL 2017 as the new baseline.

²³ Growing the non-oil economy. A Private Sector Assessment for Timor-Leste. ADB 2015.

Investment Climate Statement. US State Department 2015.

²⁴ Foreign investment in the oil and gas, and mining sectors fall outside of the scope of the Private Investment Law 2011. Under the new PIL 2017, investments in the oil and gas sector and mining are governed by Petroleum Activities Law 13/2005 and the Mining Code 2016 respectively. In addition, the PIL 2011 did not apply to retail and distributive trade such as sale of goods and equipment and consumer products; and property development. This is no longer the case under the new PIL 2017.

license. This means most investors and investments will only need to register an enterprise and to deal with sectoral license or permits as and when necessary.

136. Investors seeking Special Investment Agreement, however, are required to comply with the procedures in the Government Decree No. 2/2018.

(2) Sector restrictions

137. **The PIL 2017 provides for the creation of the prohibited and restricted sectors for investments (generally known as the Negative List). TradeInvest, with the support of the WBG has approved on a Negative List, which has been published in June 2021, with its second revision made in August 2022. The GoTL has prepared a national negative list which outline the areas of the economy that are closed to foreign investors, the areas where joint-ventures are encouraged, and the areas where foreign investors may hold 100% ownership.** It is international good practice to use short negative lists to protect certain activities and open all other activities to foreign investors.

138. **Most of the main investment and services sectors are unregulated in Timor-Leste, since the country does not have any specific regulations over sectors that are normally regulated in other countries.** For instance, Timor-Leste does not have any regulations relating to professional services like engineering, architecture and accountancy that are normally regulated, not only to deal with professional conduct of the members of the profession but also to protect members of the public over health and safety issues and financial integrity. Other services sectors including tourism, retail and distributive services are also not properly regulated.

139. **Whilst there are existing lack of regulations and under-regulations in certain main and services sectors, the Government is now prioritizing to develop the services sectors through its accession process to the WTO.** The accession process to the WTO means Timor-Leste will have to list out services sectors, which are open to foreign investors to set-up operations in the country in the means of market access and national treatment, in what is called the Schedules of Services Commitment using the positive list format. Timor-Leste's accession to ASEAN also requires Timor-Leste to work on a negative list of investment sectors under the ASEAN Comprehensive Investment Agreement (ACIA). Thus, any effort to prepare a national negative list under the PIL should consider of the country's accession to the WTO and ASEAN.

(3) Special investment agreements

140. **The option of a special investment agreement is available for investments of a value to the national development strategy;** such an agreement must be authorized by the Council of Ministers and provides the possibility of tax reductions or exemptions, customs incentives, leases of state property, and up to a 100 percent cost sharing in the training of employees²⁵. The State may, exceptionally, conclude an investment agreement with an investor by defining special conditions for investment projects which, by their size or nature or their economic, social, environmental or technological impact, according to the Strategic Development Plan justifies the adoption of special and other specific non-fiscal benefits to be negotiated with the investor. The special investment agreement will have to be authorized by Government Resolution, with an explicit indication of the reasons justifying the agreement and the special regime.

²⁵ Heineken, Pelican Paradise and TLC received special investment agreements.

(4) Use of discretion

141. **Apart from the issuance of Declaration of Benefits and Special Investment Agreement, the PIL 2017 has reduced the use of discretion.** The Government Decree No. 2/2018 provides for more structured criteria and decision-making process for the issuance of Declaration of Benefits and Special Investment Agreement, which makes it more transparent and predictable to investors.

(5) Minimum capital

142. Under the PIL 2017, foreign investors are no longer required to invest a minimum required capital of USD 1.5 million.

(6) National treatment and Most favored nation treatment

143. **The PIL 2017 follows international best practices by providing for an equal treatment for all investors.** The PIL adopts the concept of National Treatment (NT) and Most Favored Nation Treatment (MFN). In this situation, foreign investors are treated in the same way as domestic investors. At the same time Timor-Leste undertakes to provide same treatment to all investors regardless of their nationalities. At the same time Timor-Leste reserves the rights to provide certain exceptions, which is consistent with treaty practice.

(7) Senior management and board membership

144. **Foreign executives may be part of the board of a Timorese company but at least one of the directors must live in Timor-Leste.** Foreign workers can be hired under the PIL 2017 following immigration regulations in place. However, applications for visas can take significant time and effort.

(8) Transfers of funds

145. **There are no official currency controls in place in Timor-Leste, although the Central Bank of Timor-Leste imposes reporting requirements for the importation of cash into Timor-Leste and the exportation of cash out of Timor Leste in an amount exceeding US\$ 20,000, or its equivalent in foreign currency, required the CBTL's prior authorization.** If the relevant amount of cash being imported and/or exported exceeded US\$ 5,000, or its equivalent in other currency, but did not exceed US\$ 20,000, or its equivalent in other currency, it had to be declared before the customs officer at the port of arrival and/or departure. Further, no cash importation or exportation in excess of US\$ 150,000, or its equivalent in other currency, was permitted except: (i) when carried out by a bank or financial institution duly licensed to operate in Timor-Leste; and (ii) in exceptional situations, where the restriction on the import or export of cash in excess of US\$ 150,000 was likely to cause serious injury, e.g. in situations of medical emergency, subject to authorization by the CBTL. In addition to the Central Bank's requirements, banks may also impose reporting requirements for transactions above a certain amount to comply with home-country anti-money laundering regulations.

146. **The PIL 2017 adopts the transfer of funds provision that meets international best practices.** It is a major change from the the transfer of fund provisions in PIL 2011 that did not clearly allow transfer of capital apart from capital resulting from the sale, liquidation etc., and capital resulting from reduction of share capital. The PIL 2017 widened the scope of coverage of the transfer of funds. Importantly the new provision covers the ability to transfer both the capital and profits arising from the investments. The

provision could be further improved by including the right to transfer in freely usable currency and without delay. Under the PIL 2017, an investor may transfer funds in a freely usable currency subject to meeting certain Central Bank regulations.

(9) Expropriation

147. **Under the PIL 2011, and Article 54 of the Constitution, expropriation or requisition of private property may be made in the public interest and if just compensation is paid to the investor.** The PIL 2017 improves these provisions by addressing indirect expropriation and conditions when an expropriation may take place. The PIL 2017 adopts the four elements of best practice, where expropriation is only possible: with public purpose; without discrimination; with due process; and against payment of *prompt, adequate and effective* compensation.

(10) Performance requirements

148. **Timor-Leste does not impose performance requirements²⁶**, such as local partnering, domestic marketing obligations, and domestic sourcing of inputs or technology transfer. However, the government announced in the SDP 2011-2030 and in its five-year program approved in September 2012, that it would develop a National Labor Content policy that would require both domestic and foreign investors to devote a minimum percentage of the value of "major projects" to either the employment or training of Timorese citizens. As a result, some parts of the PIL 2017 can be classified as performance requirement, which may go against the ACIA (Art. 7) and the WTO Trade Related Investment Measures (TRIMS). These include Article 23 (2) (c) (employment and training requirement) and Article 23 (2) (f) on the information on transfer of capital. As Timor-Leste is not yet a member of ASEAN and WTO, the country may continue with the existing measures. However, Timor-Leste may have to revisit these obligations later.

(11) Incentives

149. **The Government of Timor-Leste offers various investment incentives, the PIL 2017 further elaborated in the Government Decree No. 2/2018.** They include tax holidays, sales tax and custom duty exemptions²⁷:

- Under the PIL 2017 and Decree No. 2/2018, a minimum investment value applies to those seeking the special benefits and not to those seeking to invest in Timor Leste. In addition, the Declaration of Benefits, which was a kind of investment approval under the current law, is only linked to the rights to incentives under the new Law.
- Among the benefits granted to holders of Declaration of Benefits include:
 - A guaranteed minimum of five work visas for workers or collaborators qualified for supervisory, directing or technical functions as appropriate to the investment project. The Investor may request additional visas as and when required.
 - Leasing of State Property, of a maximum period of fifty years, renewable for periods of twenty-five years up to a total of 100 years.
- The PIL 2017 also creates Development Areas, with special benefits to Zone A: urban area of the municipality of Díli, corresponding to the administrative posts of Cristo-Rei, Dom Aleixo,

²⁶ Performance requirements can be imposed in the oil and gas sector.

²⁷ Democratic Republic of Timor-Leste Parliamentary Law 14/2011 which is later replaced by the Private Investment Law No. 15/2017.

Na'i-Feto and Vera Cruz; Zone B: areas corresponding to those located outside the boundaries of the urban area of the municipality of Dili; and Zone C: peripheral zones, corresponding to the geographical area of Oe-Cusse Ambeno and Ataúro, in accordance to the law.

- Investors who present projects of investment in the areas of economic activity listed in the Annex of the PIL 2017 (Agriculture, Animal Breeding, Hunting, Forestry, Fisheries and Aquaculture; Processing Industries; Accommodations; Tour Operator activities) may request a declaration of benefits that recognizes the tax and customs benefits.
- The tax benefits granted under the PIL 2017 include:
 - Article 29 provides:
 - an income tax exemption to the value of 100 percent for the period stated in Article 31;
 - up to 100 percent of all expenses incurred with the construction and repair of road access infrastructures not associated with the exercise of taxable business activities that benefit workers and populations in the corresponding areas shall be considered as costs, for determining the tax base;
 - exempt from sales tax to the value of 100 percent in relation to all capital goods and equipment used in the construction or management of the investment or re-investment project, for the period stated in Article 31;
 - exempt from service tax to the value of 100 percent in relation to developments geared towards the provision of specific services, as set out in the General Tax Law, for the period set forth in Article 31; and,
 - exempt from customs import duty to the value of 100 percent in relation to all capital goods and equipment used in the construction or management of the investment or re-investment project for the period stated in Article 31.
 - Article 31 provides for the period of incentives:
 - five years in the case of an investment or reinvestment to be carried out wholly or partly in Zone A;
 - eight years in the case of an investment or reinvestment to be carried out wholly or partly in Zone B; and,
 - ten years, in case of an investment or reinvestment to be carried out totally or partially in Zone C.

150. The PIL 2017 law provides a more transparent mode of implementing the special benefits, which are no longer automatic. The Government Decree No. 2/2018 provides procedures for granting special benefits to investors in Chapter III. Under Article 8.1, an investor must submit the request for grant of declaration of benefits, in written form, to the Executive Director of TITL in person or through a legal representative. In addition, the PIL 2017 allows an investor to challenge through judicial review of any refusal to issue a Declaration of Benefits.

151. **Timor-Leste, however, requires further support on implementing the Special Benefits such as publication of standard operating procedures and the capacity building of its staff.** At the same time, there is a need to have inter-departmental linkages to improve the delivery and implementation of special benefits to the investors.

(12) Land rights

152. **Section 54 of Timor-Leste's Constitution grants the right of land ownership exclusively to Timorese nationals, either individuals or corporate entities; however, foreigners may conclude long-**

term leases (up to 50-years). There is a law governing land ownership, however investors who wish to lease property must often sort through competing claims from the Portuguese colonial administration, the Indonesian occupation era, and the post-independence period. Serviced, accessible land for commercial use is limited. Under the PIL 2017, Article 14, the GoTL guarantees the right to private ownership and use of land for development of investment or reinvestment projects, subject to the limits provided under the Constitution and land legislation.

(13) Dispute settlement

153. Timor-Leste has established courts of first instance and a court of appeal. Civil disputes are generally handled through the domestic court system, which is short-staffed and ill-equipped to handle the current demand.

154. Timor-Leste does not have any arbitration law. Timor-Leste is party to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID Convention). It is not party to the New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards. Timor-Leste's Court of Appeals must recognize a foreign judgment or arbitral award for it to be enforced in the country.

155. Under the PIL 2017, investors are required to find an amicable solution to any disputes with the State. If such disputes cannot be resolved within 60 days, such disputes may be referred to the competent judicial entities, in accordance with the legislation in force or through arbitration including to ICSID.

(14) Intellectual property rights

156. In addition to the above, it is noted that Timor-Leste does not have any laws to protect intellectual property and intellectual property rights in the country. Although Section 60 of Timor-Leste's Constitution provides for the protection of literary, scientific, and artistic work, legislators have yet to codify or systematize domestic protection of intellectual property rights. Despite the absence of legislation regulating protection and registration of IP rights in Timor-Leste, several statutes adopted by Timor-Leste addressed IP-related matters, as described in this section. Thus, the Constitution provided that the State should guarantee and protect the creation, production and commercialization of literary, scientific and artistic work, including the legal protection of copyrights. Section 60 of the Constitution (Intellectual Property) constitutes the legislator's obligation to produce specific legal instruments to protect these rights. Holders of intellectual properties especially trademarks normally advertise their claims to certain marks in the local media to claim priority over the marks, but this would not in any way provide a clear protection. The PIL 2017 addresses this concern by providing the recognition of protection of industrial secrets, copyrights, industrial property rights, distinctive trademark signs, or any other intellectual property rights. However, this is a weak provision and it does not replace the need for a proper intellectual property rights law to be in place.

157. Timor-Leste had acceded to the World Intellectual Property Organization (WIPO) on 12 September 2017, following the deposit with the Director General of WIPO, at Geneva, of the Instrument of Accession to the Convention Establishing the World Intellectual Property Organization (WIPO), signed at Stockholm on 14 July 1967, and amended on 28 September 1979. Resolution of the National Parliament of Timor-Leste No. 16/2017 of 25 July 2017 ratified the Convention. The accession to the WIPO had opened avenues of institutional collaboration and partnership that would help Timor-Leste achieve compliance with the substantive obligations of the WIPO Convention and the international treaties and

conventions on Intellectual Property, such as the Paris Convention for the Protection of Industrial Property (Paris Convention) and the Berne Convention for the Protection of Literary and Artistic Works (Berne Convention). The Government of Timor-Leste and WIPO had signed a Memorandum of Understanding (MOU) in November 2021, aware of the importance of having a well-functioning and balanced IP regime in order to promote innovation and creativity, which are the main drivers of economic development of knowledge-based economies. The MOU allowed the Government of Timor-Leste to have access to specialized technical assistance in order to appropriately integrate IP related issues into the national development framework and cater for the interface of broad national IP policies and strategies with relevant national policy issues. The MoU ensured that WIPO's assistance would target the necessary legislation and policy reforms to comply with the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement), aiming to: (i) develop a National IP Strategy/Policy and its Action Plan; (ii) integrate IPR-related agreements into the national policy and regulatory framework; and, (iii) set up a National IP Office and capacity building. To achieve these objectives, the Government of Timor-Leste committed to using the existing methodology and tools of the WIPO, while still recognizing the specific national circumstances and requirements.

158. In 2022, the Government of Timor-Leste, assisted by USAID and WIPO, is finalising the development the Industrial Property Code which would include provisions on trademarks, patents, utility models, industrial designs, geographical indications and trade secrets. This draft Code together with the draft Copyright Law and the draft Decree-Law on the Establishment of the IP Office are expected to be promulgated in 2022, while Provisions on treatment of plant varieties were yet to be developed separately.

(15) Labor rights

159. On labor rights, **the 2012 Labor Law put in place regulations for labor conditions, including a 44-hour work week, standard benefits such as leave and premium pay for overtime, and minimum standards of worker health and safety.** In June 2012, the government set the minimum wage for full-time employment at USD 115 per month. Enforcement of labor laws is uneven, but increasing. A Social Security Law came into force in 2017, and a draft occupational health and safety law is being considered by the GoTL. The GoTL has acceded to many of the major international labor and human rights conventions including: International Labor Organization (ILO) Convention No. 29 on Forced Labor; ILO Convention No. 87 on Freedom of Association and Protection of the Right to Organize; ILO Convention No. 98 on the Right to Organize and Collective Bargaining; ILO Convention No. 182 on the Worst Forms of Child Labor; the International Covenant on Civil and Political Rights; the International Covenant on Economic, Social, and Cultural Rights; and the International Convention on the Protection of All Migrant Workers and Members of Their Families.

(16) Special zones

160. **There are no foreign trade or free trade zones in Timor-Leste.** The GoTL is planning to pilot a free trade zone in the exclave district of Oecusse. However, laws defining and regulating the establishment of the project, known as the Special Zone for Social Market Economy (ZEESM), have yet to be approved by Parliament. The PIL 2017 provides that Special Economic Zones and Special Industrial Zones may be created as areas geographically defined for the implementation and operation of specific economic activities according to their nature.

161. **The WBG has assisted the GoTL in assessing the viability of establishing an industrial park or estate**, the Tibar Bay Industrial Park, to attract more diversified and job creating investment. This development would be associated with the new port that is being developed under a PPP arrangement. While this is a positive development, if the improvements are not made in the regulatory environment to give investors greater confidence, the project will face challenges attracting and retaining investors.

(17) International investment agreements (IIAs)

162. **Timor-Leste signed a bilateral investment treaty (BIT) with Germany in 2005, but it has not entered into force.** Timor-Leste and Portugal have signed an Agreement on Mutual Protection and Promotion of Investment.

163. **Timor-Leste is not a member of WTO** thus it does not yet have any obligations under the WTO's Trade Related Investment Measures provisions. Having said that, upon acceding to the WTO, in future, should such measures be introduced, they would be in compliance with the WTO Agreement on Trade-Related Investment Measures (the TRIMs Agreement), as the Government was willing to fully comply with WTO rules.

B. Institutional Framework for Investment

164. **Responsibility for the development of investment related policies, administration and the improvement of business climate rests on multiple agencies:** Office of the Prime Minister, Office of the Coordinating Minister for Economic Affairs, Ministry of Tourism and Environment, Ministry of Commerce and Industry, and Secretary State of Land and Property, SERVE, and TradeInvest Timor-Leste.. They are responsible (in coordination with other relevant Ministries) for the design, execution and evaluation of different policies (always defined and adopted by the Council of Ministers) for the implementation of key areas of the *National Strategic Plan* that are related to both domestic and foreign investment.

165. **In 2005, the GoTL established an investment promotion agency, TradeInvest Timor-Leste to promote FDI and exports**, under Decree 7/2005 (dated July 27, 2005)²⁸. Article 3 of the decree stated that the duty of TITL is *to promote, coordinate, facilitate, register, and follow-up on foreign investment and exports, as well as centralize the necessary administrative procedures for authorizing and registering foreign investments within the framework of laws, incentives and benefits provided in the Foreign Investment Law*. Article 4 also guaranteed funds for TITL from the government's regular budget with a view to sustaining TITL's operations. TITL was supposed to operate as 'one-stop-shop' to foster FDI.

166. The GoTL created the Secretaria de Estado de Apoio e Promocao do Sector Privado (State Secretariat for the Support and Promotion of the Private Sector, or SEAPRI) as well, responsible for creating an attractive investment climate.

167. **TradeInvest was established** with its goal to facilitate and support potential investors to locate in Timor-Leste and assist foreign companies in identifying projects and business opportunities that are emerging in Timor-Leste. The PIL 2017 and the Government Decree No. 2/2018 recognize TradeInvest as

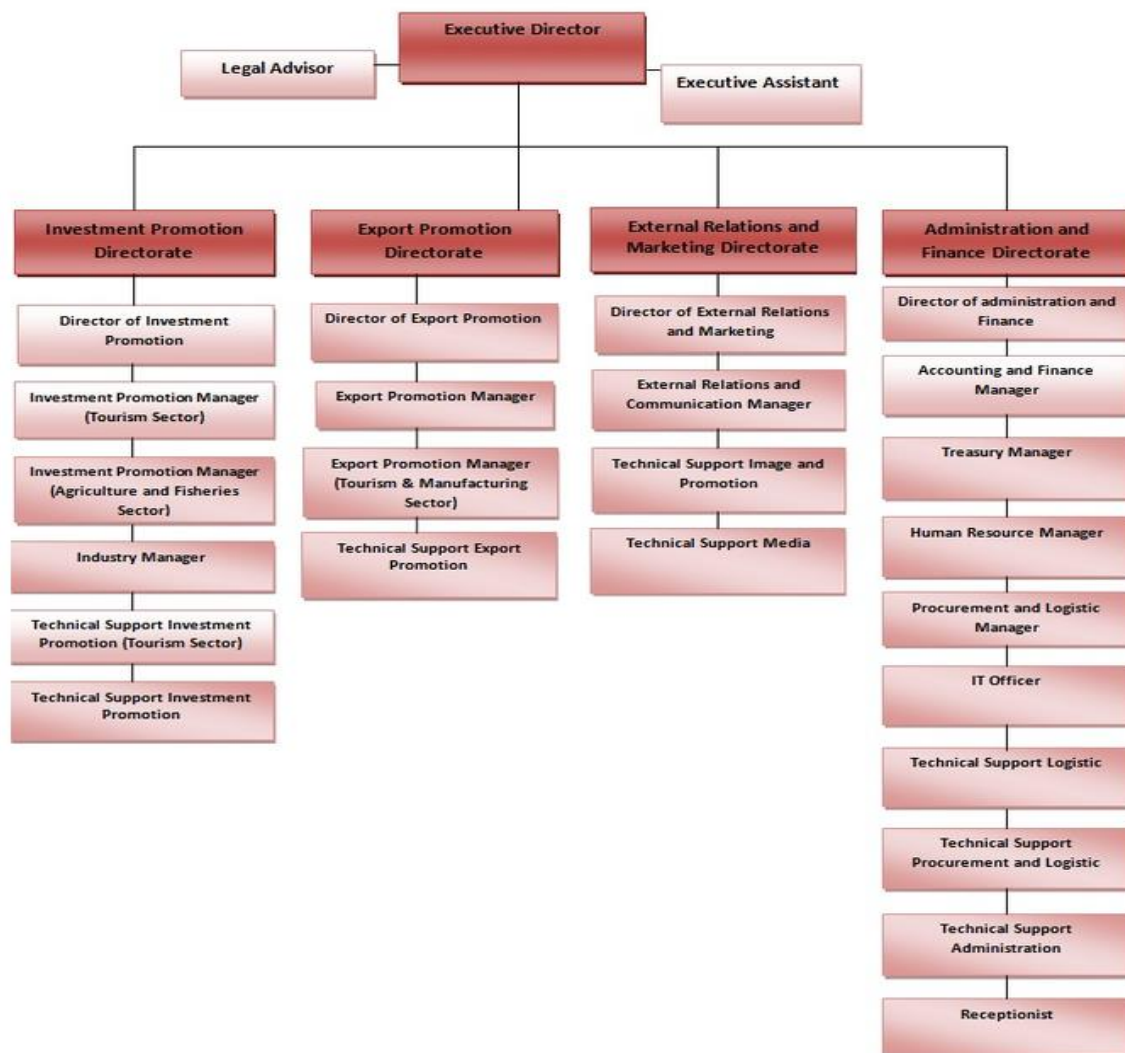
²⁸ Timor-Leste Expanding Near-Term Agricultural Exports. World Bank 2011.

the body in charge of promoting, facilitating and monitoring of private investment and exports and for issuing the declaration of benefits and negotiation of the special investment agreements.

168. TradeInvest is an entity with 28 staff working in four different functions under one director for each department (see Figure 45):

- Investment promotion
- Export promotion
- External relations and marketing
- Administration and finance

FIGURE 44 TRADEINVEST ORGANIZATIONAL STRUCTURE



Source: TradeInvest.

169. **The number of staff working on investment promotion is limited.** Four sector managers work on each of the sectors in which the department is organized. They must undertake many different functions, some of them not related with the traditional investment promotion activities.

170. **For the moment the agency is a reactive body that waits for investors to come and it does not take a proactive targeted approach towards investment promotion.** The lack of a clear strategy is one of the reasons. According to WBG team discussions with TradeInvest officers, the agency does not have a board of directors and the advisory board in place is not operational yet.

171. **The new institution is very young and will need time to develop certain capabilities.** There are several issues that are hampering TradeInvest's investment promotion capabilities and Timor-Leste's institutional framework for investment promotion. Some of them are:

- TradeInvest is currently focusing on a wide range of topics: from investment promotion, to incentives or administrative, screening / licensing and procedural issues. Currently, there is not a very clear separation of functions between export promotion, investment promotion and the rest of the licensing functions.
- Lack of a clear FDI attraction strategy in alignment with key national economic objectives. There is not a strategy that clearly states specific plans for TradeInvest to implement, targeting specific sectors and setting goals against which the performance of the agency can be measured (Key Performance Indicators (KPI)).
- TradeInvest is not clearly articulating Timor-Leste's value proposition as an investment destination, neither specific strong value propositions for each of the promising sectors and specific opportunities that can support economic diversification.
- TradeInvest is not efficiently coordinated with other agencies and institutions playing a role in the investment landscape.
- The operational capacity can improve. Staff numbers are low and are not trained yet to develop their functions (facilitation, outreach, image building, aftercare or policy advocacy).
- Lack of information and access to external databases limiting TradeInvest's ability to perform targeted lead generation and outreach.

C. Investment Policy and Promotion Reforms

172. **As a post-conflict state, Timor-Leste is naturally preoccupied with institutional development and building government personnel capacity.** This report aims to assist Timor-Leste to build the foundations for a non-oil economy that can eradicate poverty, create jobs, and improve livelihoods. It focuses support to private investment and creating a favorable business and investment climate. Furthermore, it takes the view that FDI firms have key advantages at overcoming market deficiencies and increasing productivity thereby helping GoTL create and open markets that would help transform and diversify the economy.

(1) Vision and strategy

173. **The government of Timor-Leste through TradeInvest Timor-Leste has developed a strategic plan for its five-year vision** that reflect aspirations of the country to create a prosperous Timor-Leste with a strong and a vibrant private sector led economic growth. The plan was prepared to inspire change, to support collective actions on private sector and export industry development, and to plan for the better future.

The strategies and actions set out in this strategic plan aim to **transition Timor-Leste from the slow growth of private investment and export to a prosperous nation enabled by private investment and export**. Private investment and export will grow in an entire ecosystem that is aligned with the objectives of the country's Strategic Development Plan (SDP) and the Sustainable Development Goals (SDGs). Our role is to ensure easy and efficient "one stop shop" services of promotion, facilitation, monitoring, and advocacy to investors and exporters.

174. **The findings of this report could inform a broad dialogue within the government regarding the nature and type of FDI to be attracted and the strategy to pursue to achieve Timor-Leste's development goals.** This includes identification of segments and locations, within the priority sectors identified, with the highest potential to attract investment, the incentives to be offered, the key target metrics to measure progress against objectives, how each institution with an investment promotion role can contribute to the overall effort, etc.

175. **A national Investment Policy and FDI Strategy should be developed for Timor-Leste.** Once this is drafted it could be discussed and debated along with the WBG findings with relevant Government institutions to help to raise awareness of the challenges in attracting FDI in sectors away from O&G and ensure that all participants understand what their respective roles could be in the future.

176. **Addressing poverty and increasing prosperity in Timor-Leste requires that income-earning opportunities are created and nurtured, especially in the districts.** This entails creating and opening markets, and ensuring access to markets by Timorese producers and businesses. Moreover, stimulating the growth of the sectors identified in the scan places demands on the state to solve economic coordination problems that appear beyond current capabilities.

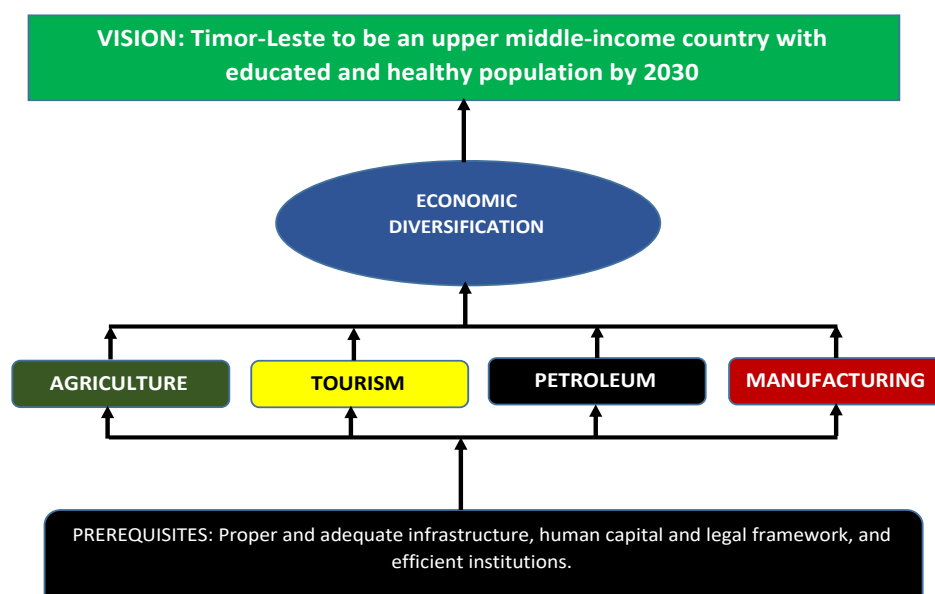
177. **The small size of the domestic market of Timor-Leste combined with distance from major markets push up transport and production costs, limiting export industries to those that can secure premium prices in global markets.** Low-volume production tends to keep the manufacturing sector relatively undeveloped and uncompetitive in a global context and makes it difficult for Timorese firms to join global value chains. In addition, large distance to markets mean that while Timor-Leste may be able to compete in standardized, lower-value tasks, it will have difficulty upgrading into tasks that require globally leading knowledge, coordination and knowledge exchange. Thus, the trade gap is huge with investment flowing into infrastructure and market-oriented activities and little into production and export-oriented economic activities. More export-oriented FDI in prioritized sectors will help to diversify the economy and to narrow the trade gap. Creating and opening markets in Timor-Leste therefore should entail a three-pronged strategy to generate growth and create 'stable' income earning and employment opportunities for a young and growing population ("youth bulge"):

- a. Increasing market supply - scope to diversify the economy through activities aimed at the domestic market (growth of existing activities). While domestically-owned enterprises may play the dominant role in catering to the local economy, market-seeking foreign investment may also be important players.
- b. Encouraging import substitution - emergence of new activities. Market-seeking foreign investors will be important players.
- c. Targeting niche exports - a small island economy such as Timor-Leste's need exports, including trade in services, to prosper. Market-seeking and efficiency-seeking foreign investors will be important players.

178. **Given above, it seems useful to prioritize sectors where specific reforms can have a relatively direct impact on FDI while being politically feasible.** It requires “quick wins” to send positive signals of private sector growth from the outset. Finding the right balance between regulatory reforms and “doing deals” is key as well as developing an appropriate strategy for a mix of quick-wins and longer-term programs. Therefore, in addressing the constraints identified in the previous sections and in supporting the creation and opening of markets, the WBG proposes the following agenda to foster dialogue and reform-oriented action across the different stages of the investment cycle.

179. **Foreign and domestic investment can be key in the development process and targeting the appropriate sectors is crucial** (see Figure 46). In an increasingly globalized world, there is no doubt that foreign investment has a significant role to play in propelling Timor-Leste’s economy moving forward and connecting it with larger markets. The GoTL can use FDI strategically to bridge the gap in inequality and maximize FDI’s transformational benefits for its people.

FIGURE 45 TIMOR-LESTE'S ECONOMIC DIVERSIFICATION FRAMEWORK



Source: Government of Timor-Leste, 2011.

180. Given the low levels of diversification and the long time required to change some constraints currently affecting the country (i.e., skills, infrastructure) it would be extremely difficult to make a radical shift towards significantly new economic activities. Therefore, **initially focusing on attracting investment in relatively known and not very complex economic sectors might be the best option for Timor-Leste, in the short term**, to progressively incorporate new technologies and know-how to further develop and upgrade these sectors, in the medium and long term. **In parallel, domestic infrastructure needs to be developed as a supporting pillar of the economy.** Annex 3 include further details on the in-depth evaluation of all the long-listed sectors.

181. **There is a need for a strong and high-level mechanism to ensure effective coordination and collaboration among investment-related agencies.** The implementation of the reforms should be supported by a dedicated institutional mechanism to manage the process of reform and strategy implementation and oversee all stakeholders' contributions. This mechanism should be able to regularly update and monitor progress on the reform implementation, publish reform progress and investment results under each reform area, identify corrective measures as needed while continuously ensuring strategic alignment of reforms with Timor-Leste's economic development vision and objectives. An appropriate agency should be appointed to fulfill the role of secretariat, ensuring its efficient and effective operation. The monitoring and evaluation (M&E) framework that represents an integral part of the proposed reform action plan can form the basis for program management and overview.

182. **Applying a gender lens when developing an investment strategy matters, since enhanced female participation in the formal labor market tends to be associated with improved economic and**

social outcomes²⁹. FDI can be positive in creating significant job opportunities for women. However, enhanced FDI tends to affect men and women differently: significant job opportunities tend to be available for women in labor-intensive, export-oriented industries (i.e. tourism, textiles, call centers), but as industries upgrade, women can lose jobs to men and they are pushed down the production chain into subcontracted work³⁰. It is suggested the GoTL anticipate these issues when developing the FDI strategy and sector promotion.

(2) Attraction

183. Successful investment promotion requires an effective IPA able to effectively communicate with investors and meet the desired standards. It has collaboration with key partners by establishing systems and collaboration protocols and building skills to improve their investment promotion performance. An action plan to enhance the institutional strength of TradeInvest and reinforce Timor-Leste's investment attraction capacity is needed (see Box 1). A strategic realignment and institutional organization restructuring will not only strengthen TradeInvest's position, but will also leverage its investment attraction effectiveness in collaboration with stakeholders and other governmental bodies. Investors currently underserved will be benefited by a better performing TradeInvest.

BOX 1 KEY PRIORITIES FOR TRADEINVEST TL

In the short term TradeInvest needs:

- A corporate strategy with clear strategic directions in alignment with national development priorities.
- A well-articulated sectoral approach in cooperation with key Ministries to guide operations.
- Discuss the adoption of the five identified sectors as priorities for GoTL-led proactive investment promotion and further research and segment the identified sectors and select the specific competitive opportunities in more detail (e.g., to identify specific subsectors and markets within each sector to isolate the best opportunities for investors).
- A focused mandate on investment policy and promotion or a clearer separation between different functions and sufficient budget and resources for proper functioning.
- M&E mechanisms and key performance indicators (KPIs) to justify the need for resources.

A detailed evaluation of the current institutional structure and the effectiveness of TradeInvest and other government agencies that engage with investors is needed. This exercise will:

- Highlight areas for enhanced synergy, overlaps and conflicts in institutional remits and activities.
- Provide useful insights to enhance institutional performance and information to design targeted Capacity Building programs for staff of TradeInvest and other relevant agencies and institutions.

In summary, the assessment and the other actions will help Timor-Leste to set-up a credible and workable IPA that could assist in attracting the target sectors identified.

Source: Authors.

184. A modern IPA's key role is a service provider within the national FDI strategy and institutional landscape. A 4x4 matrix of investor services to get investors from concept to project success and

²⁹ Simavi, Sevi, et.al. Gender Dimensions of Investment Climate Reform: A Guide for Policy Makers and Practitioners, 2010. World Bank.

³⁰ Ibid.

development impact (see Figure 47) is suggested to underpin the organizational modernization of TradeInvest.

- **Marketing services:** IPA improves its marketing and outreach capabilities, e.g., IPA adopts a promotion/marketing/investor outreach strategy and implements at least one investor outreach program with a sector/market focus, be it at attraction, or at retention/expansion or at linkages/spillover stages of the investment lifecycle;
- **Information Services:** IPA launches or re-launches an improved information service provision, e.g., through a new or upgraded investment promotion website designed per best practices or a new or upgraded investor inquiry handling system with defined standards of response, and an associated investor information library/system, and research support introduced, be it at attraction, or at entry, or at retention/expansion or at linkages/spillover stages of the investment lifecycle;
- **Assistance Services:** IPA implements an assistance strategy to provide enhanced services for investors during attraction (often called investor facilitation or site/location selection services), or investment entry (often related to a virtual One Stop Shop) and establishment (often called Aftercare), or at retention/expansion (also Aftercare), or at linkages/spillover (often called Aftercare too, or Linkages) stages of the investment lifecycle;
- **Advocacy Services:** IPA implements an advocacy strategy designed to identify and advocate for investment climate reforms, and submits first reform proposal. This could also be at attraction, or at entry/establishment, or at retention/expansion or at linkages/spillover stages of the investment lifecycle.

FIGURE 46 INVESTOR SERVICES

	ATTRACTION	ENTRY & ESTABLISHMENT	RETENTION & EXPANSION	LINKAGES & SPILLOVERS
Category 1 Marketing services	✓		✓	✓
Category 2 Information services	✓	✓	✓	✓
Category 3 Assistance services	✓	✓	✓	✓
Category 4 Advocacy services	✓	✓	✓	✓

Source: WBG IPP Team.

185. **A well targeted sector approach and outreach is critical to increase investment leads and achieve higher conversion rate of announcements to actual projects.** To do this the following characteristics need to be put in place:

- Priority target sectors established;
- Specific potential investors within priority sector/s identified;
- Tailored value propositions and marketing materials for target sector developed;
- Outreach activity implemented; and,
- Post-outreach follow-up started.

186. This report’s identification of the five priority sectors need to be disseminated and shared to stimulate dialogue on Timor-Leste’s investment attraction potential. As noted in the report, the conditions for production in Timor-Leste in the selected sectors are good but in some cases investors are simply unaware of the opportunities. There is also a widespread perception among interviewed investors that the government has never targeted efficiently (or just simply never targeted) the promotion of specific sectors.

187. Adopting a ‘Team Timor-Leste’ approach to ensure a holistic and integrated approach to the market is critical for effective investment facilitation. Key suggestions for GoTL include:

- Undertake consultations with the private sector: in many areas, private investors have already identified the opportunities, targets and barriers to be removed.
- Emphasize collaboration from the start: convene sector working groups, bringing together private players, relevant public institutions and others, to develop coordinated strategies to promote the selected sectors (Team Timor-Leste approach).
- Bring all different players to the discussion: many non-government organizations (NGOs) and development agencies are working in the field trying to develop markets to foster growth. In many cases what is required is coordination and information sharing between private sector, GoTL, development partners and NGOs to take advantage of pre-existing work and align priorities.
- Be realistic about the capabilities gap within government systems in implementing the full suite of reforms that will be necessary for growth.
- Undertake “female-friendly” investment promotion. Branding Timor-Leste as a “female-friendly” investment destination including marketing corporate social responsibility initiatives such as fair treatment for female employees can enhance Timor-Leste’s reputation and position itself for ethical investment.

188. In the context of incentives for investment attraction, a potential area of immediate action is in redesigning the incentives offered and in reducing the discretion of their granting process. Increased awareness and transparency would help “level the playing field” for investors. Timor-Leste needs to think about developing new behavioral investment incentives, especially in key strategic sectors to diversify its economy, with a view of assessing their effectiveness in achieving the desired policy objectives. This exercise would entail a cost-benefit analysis of incentives. A framework for designing an effective incentives regime is suggested below (see Box 2).

TradeInvest should participate in consultation with relevant stakeholders in the design of an efficient and well targeted incentives framework to support investment attraction in potentially competitive sectors.

- Currently, Timor-Leste's incentives regime is poorly-targeted and expensive (offering broad, blanket incentives to almost every sector, some of which may not need the incentives), and marked by frequent changes. As the Government is revising this issue, it should focus on developing an incentives regime governed by the principles of predictability, transparency, targeting and cost-efficiency.
- However, incentives may or may not be needed as part of a package to attract FDI from the priority sectors identified. Further work will be needed to determine the role and type, if any, of incentives that may be needed. Additional rigorous analysis needs to be completed to understand whether and how incentives may or may not influence investor behavior by looking at global evidence, and country-specific firm level data on returns on investment and cost-benefits. Key steps to be taken to design an efficient incentives framework:



- Global experience suggests that investment incentives are more effective for low margin export oriented manufacturing and services enterprises, but less so for firms that serve mainly the domestic market (market-seeking) or explore natural resources.
- Any incentives targeting key sectors need to be designed to generate investment impacts (both quantitative and qualitative) greater than the fiscal costs of the incentives.

Source: Authors.

(3) Entry and establishment

189. An investment law, with WBG assistance, was promulgated in 2017 that provides a better investment entry process and some additional protections for investors. Much depends on the effectiveness with which the new law is implemented, and supporting reforms to improve the investment climate.

190. The removal of *de facto* and *de jure* barriers in the establishment of investments, including the further streamlining of requirements and processes needs urgent attention:

- Key to streamline the licensing process and remove screening of investments. TradeInvest's One Stop Shop lacks the full authority to grant approvals in a timely fashion, or issue approvals directly, which does not serve the purpose of its establishment.
- Timor-Leste needs to facilitate visas for foreign investors with fewer requirements.
- Timor-Leste needs to facilitate access to land for foreign investors.
- Work towards the accession to The Hague Apostille Convention to allow for the mutual recognition of documents and the setting of e-apostille to allow for the faster recognition of documents. This will assist in the quicker processing of applications for business-related documents, work visa and other paperwork associated with foreign investors.

(4) Protection, retention and expansion

191. The improvements introduced in the PIL 2017 on a range of investor protections and guarantees is a welcome development, such as equal treatment of investors, fair and equitable treatment, protection against expropriation including indirect expropriation and transfer of funds and the provision of dispute settlement mechanism. However, neither the PIL nor any other legal instrument provides for an effective mechanism to ensure expansion of investment on the ground. It is typically easier to achieve development benefits through investors that have already established a presence in the country (i.e., existing investors). Encouraging investment expansion by ensuring a long and deep engagement of investors in Timor-Leste is as critical as attracting new investment. Evidence shows that over time, satisfied investors tend to diversify their operations in host countries, evolving from lower value-added towards higher value-added activities.

192. Countries' ability to retain investment is impacted by perceptions of political risk. Investment decisions are influenced not just by the costs of regulatory compliance, but also by the risks – actual or perceived – generated in the investment climate, affecting the risk-return calculations and drive up the hurdle rate of returns for investors. This action can be deliberate – such as adverse regulatory changes that deprive investors of their ability of appropriate returns of their investments – or systemic – such as uncertainty and unpredictability caused by arcane bureaucratic processes or non-transparent non-inclusive rule making. Without risk mitigation, many investments that are commercially profitable and economically attractive do not materialize³¹. In this context, there is a clear link between investor protection and investment retention and expansion. Without protection for investors, retention and expansion becomes virtually impossible – only very few investors with very specific objectives and plans will bear the risks associated with malfunctioning political, regulatory and legislative systems.

193. The GoTL should explore the possibility of establishing such a systemic investor response mechanism (SIRM) allowing for the coordination of relevant agencies in ensuring expansion of investments and dealing with investors' grievances. The SIRM should be an early warning and tracking mechanism to identify and resolve complaints and issues that arise from government conduct, ultimately preventing legal disputes and facilitating harmonious relations between investors and States, thereby reducing regulatory risk and enhancing predictability. It should respond to investor grievances in a timely and suitable manner and in accordance with Timor-Leste's laws, regulations and IIAs.

³¹ WBG research shows that around 25% of all investment established in developing countries and economies in transition either stops expanding or totally withdraws from host countries due to political risks arising from conduct of public agencies, in particular subnational ones or sector-specific regulatory authorities. These risks stem from four main categories of government conduct: (i) arbitrary or adverse regulatory changes, (ii) breach of contract, (iii) expropriations, and (iv) problems related to transfers and currency convertibility.

194. **The operation of the SIRM includes:** (i) identification of specific patterns and origins of government conduct generating grievances and augmenting perceptions of political risks; (ii) measurement of affected investments as “evidence” to advocate for timely changes; and (iii) strengthening capacity in the “offending” institutions to minimize the recurrence of these events. A SIRM is designed based on a country’s specific political economy realities and its legal and institutional framework. The capacity of the government and resources available also determine the design of SIRM for the country in question. In some countries, a centralized SIRM may be set up, while in others a sub-national approach is more fitting. In countries where most of grievances arise in a specific sector, a sectoral SIRM may be appropriate.

195. **Having high level political support is essential for a SIRM to be effective.** Political risk and investor protection related grievances often involve multiple levels of government and can relate to controversial government conduct. The thrust for political decision making to solve investor grievances is peer pressure from other government agencies and not one “lead” agency. This is also important to secure high-level support to help ensure that the consensual solution to the grievance agreed by representatives of governments and investors is not ignored or disrespected by one of the many other agencies.

196. in terms of IIAs, there is only one in force (with Portugal). This means that only investors from Portugal are covered by a solid range of investor protection guarantees. The GoTL should pursue IIAs with as many relevant partners as possible, since IIAs provide investor protection guarantees that are not reflected in the PIL.

197. **Timor-Leste should double its efforts to become part of ASEAN** and to be able to carry out the obligations of membership in the short-medium term. Timor-Leste continues to be outside of the regional grouping four years after the country applied to join. Being part of ASEAN would provide the advantage of a new network of preferential trade and investment agreements.

(5) FDI linkages

198. The creation of backward and forward linkages between FDI and local firms is an important mechanism for spreading new technology, know-how and improved standards among local firms while contributing to longer-term economic development. **A combination of deliberate effort, targeted policies and hands-on support is required to facilitate FDI linkages.** Understanding the specific contexts and transmission channels through which such benefits work is an essential precondition for effective policy-design so that FDI linkages work for development. The linkages potential varies dependent on the investment motivation (e.g., efficiency vs. market seeking investments) and multinational enterprises (MNE) sourcing strategies, the type of value chain (e.g., supplier tiers, tradables vs. consumables), as well as the capacity of local suppliers (e.g., technology intensity, absorptive capacity). To achieve economic and job growth, it is crucial that DVA is increased on a competitive basis, i.e., not by increasing import barriers or local content requirements, but by enabling local firms to upgrade and compete.

199. As the results from the World Bank Enterprise Surveys show, the quality of the suppliers in Timor-Leste is lower than the regional average. **Undertaking steps towards the identification of potential suppliers and connecting them with potential investors looking for specific inputs needs to be a priority area of work to attract FDI into Timor-Leste.** This could include, among others, producing a database of potential suppliers for investors in the priority sectors identified in the scan (see Table 4) and cooperating

with training institutions to develop specific programs to raise the skills of local suppliers (see Figure 43 for a benchmarking of Timor-Leste's labor force and skills constraints in selected subsectors).

200. Measures to promote skills upgrading, local sourcing and other benefits from FDI include:

- a. Promoting skills improvement, for example in foreign languages. This is particularly important for efficiency-seeking investors since they target foreign markets for their exports.
- b. Designing and implementing targeted hands-on supplier development programs around priority FDI sectors identified in this report to promote supplier linkages.
- c. Establishing a high-quality supplier database that is up-to-date and publicly accessible. Such a database is a basic but important tool for matchmaking services and reducing the search and find costs typically associated with local sourcing.
- d. Designing and introducing smart behavioral incentives around FDI priority sectors that will encourage local firms to invest in upgrading, management and skills training, standards compliance and certification or that encourage foreign investors to source from or train local companies.
- e. Promoting market entry and investment by internationally competitive suppliers of goods and services, including non-equity modes of market entry, by removing existing legal or administrative barriers and providing targeted investment promotion.

201. Other horizontal policies that would help provide the best possible environment for diversification include: Enhancing the quality of physical (connectivity) infrastructure and logistics performance to reduce trade costs; pro-competitive reforms in key service (input) industries, such as telecommunications, transportation and financial services; boosting productivity, including through technological upgrading and the development of human capital through targeted training programmes; and providing better access to finance through financial deepening and financial sector reforms.

D. M&E Framework

202. The GoTL need to implement a rigorous M&E framework to be able to measure and demonstrate the impact reached through the implementation of the reforms. To achieve the goals, there is a logical sequence of government actions that need to be undertaken for outcomes and targets to be met. To operationalize the logical framework, the GoTL need to establish a set of KPIs for its actions, outcomes and impacts to monitor and evaluate progress of reforms. Specific actions include:

- a. Design an M&E methodology for investment;
- b. Allocate roles and responsibilities for carrying out the methodology;
- c. Develop the specific indicators and data collection mechanism;
- d. Develop a feedback loop into investment policy; and,
- e. Implement a program to build the capacity for M&E.

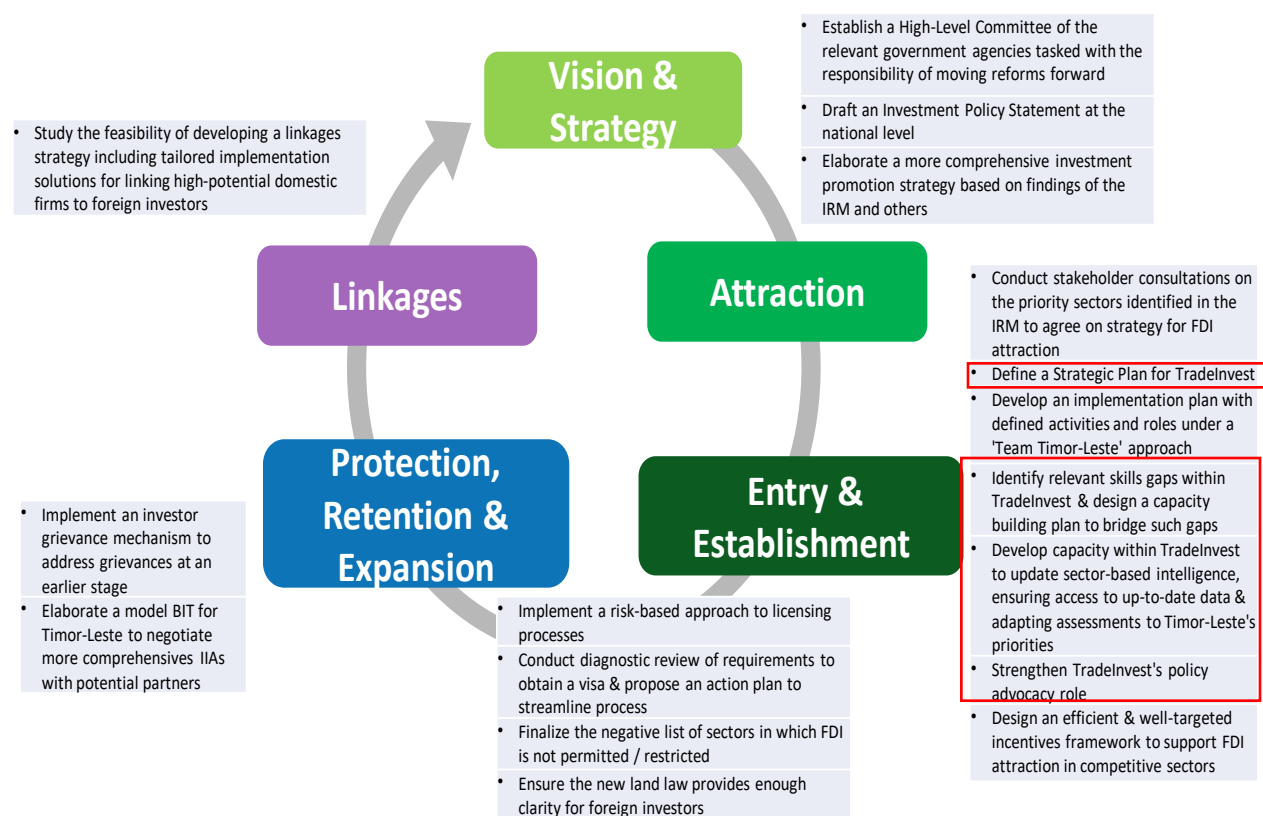
V. RECOMMENDATIONS: THE INVESTMENT REFORM AGENDA FOR TIMOR-LESTE

203. According to the findings of the IRM, Timor-Leste clearly needs to improve its Investment Climate in most of its areas. Timor-Leste's investment performance is weak and the country needs a short-medium term strategy to be able to improve the current situation and attract investment in strategic sectors.

204. For Timor-Leste to achieve the level of economic development, diversification, employment and technology transfer required to show impact in terms of its policy objectives, efforts to position itself to attract and retain private domestic and foreign investment in strategic sectors need to be significantly augmented. Attracting foreign investment today requires a well-designed and sophisticated approach. International competition is fierce and potential investors need to be convinced of the competitiveness of sectors. Timor-Leste needs to be able to answer the question as to why any investor should come to Timor-Leste rather than other locations.

205. The proposed Investment Reform Agenda (IRA) addresses the “how” question along the five stages of the investment lifecycle (see Figure 48 and Table 5).

FIGURE 47 CONNECTING THE DOTS IN INVESTMENT POLICY AND PROMOTION REFORMS



Source: Authors.

Proposed Reform Action Plan

206. **The following table defines the 17 reform priorities and sets forth recommendations into more specific action items.** The reform action plan is organized based on the constraints to investment identified in the report and according to suggested policy reforms discussed in the previous section. The proposed actions are categorized along the investment lifecycle with short-term recommendations and medium to long-term recommendations for each area. Importantly, the 17 proposed actions have been reviewed and agreed to by MCAE and TradeInvest officials, ensuring ownership of the reform priorities.

TABLE 5 INVESTMENT REFORM AGENDA: ACTION PLAN

Cross-cutting issues:

- Budget: who can finance the action plan – government, development partners, etc.
- Integrating the actions into government budget planning particularly for the 2019 budget cycle.
- Timing of the actions: Strategic planning is the priority – the results of the strategic planning inform TITL's budget, structure, PIL regulations and revision of TITL Decree Law.

Investment lifecycle stage	No.	Reform Actions	Office of the Vice Prime Minister & MCAE TradeInvest	Implementing Mechanism	Comments	MCAE/TITL Comments
All	1	Establish investment Consultative Council at TITL	MCAE TradeInvest	Dispatch from supervisor (MCAE)	The High-Level Committee from key relevant institutions should meet twice a months depending on the investments case.	- This Committee will be formed soon Composition (Ministerial level, ED, GD, and ND level?)
I		Short-term Recommendations				

Investment lifecycle stage	No.	Reform Actions	Office of the Vice Prime Minister & MCAE TradeInvest	Implementing Mechanism	Comments	MCAE/TITL Comments
I		Medium and Long-term Recommendations				
II		Short-term Recommendations				
Attraction	4	Continue to debate the sector scan findings in this report with key public and private stakeholders with the objective of reaching a high degree of consensus on the top sectors with the highest potential to attract FDI.	Office of the Prime Minister	Working Groups	This step is necessary to reach consensus and design a coherent national approach towards investment attraction.	First consultation with private sector completed on 4/6/17. High consensus from private sector in the first consultation. Plan to conduct another consultation after the election.
	5					
	6	Develop an implementation plan for 2023-2027 with defined activities and roles to be played by public and private stakeholders in building a 'Team Timor-Leste' integrated approach.	TradeInvest	Implementation Plan	This will institute a system to more regularly consult with the private sector. In many areas, private investors or other public-sector stakeholders have already identified the opportunities and the barriers to be removed.	TradeInvest can align with existing private sector engagement program. Also need to integrate the implementation plan with the annual action planning process for the budget.

Investment lifecycle stage	No.	Reform Actions	Office of the Vice Prime Minister & MCAE TradeInvest	Implementing Mechanism	Comments	MCAE/TITL Comments
	7	Identify relevant skills gaps within TradeInvest and design a capacity building plan to bridge such gaps.	TradeInvest	Training Needs Assessment	To increase agency's effectiveness.	TITL has HR in-house that can work with existing capacity building training programs (Indonesia, Australia, as well as ASEAN region). Need to first assess what tasks do we want TradeInvest staff to do in the future. Once we know what tasks we want staff to do then we can work out what skills gaps we are. Completing a training needs assessment is very important. Once the assessment is completed then we can approach donors, embassies, etc. for support. This Needs Assessment can only be completed <i>after</i> the strategic planning.
II		Medium and Long-term Recommendations				
Attraction	8	Develop capacity within TradeInvest to update sector-based intelligence on a reasonably regular basis, ensuring access to up-to-date data or reports and adapting the assessment to	TradeInvest	Capacity Building Program	New opportunities for increasing exports and employment may appear due to changing cost factors, evolving demand, emergence of new markets, etc.	Need to establish a research / development department into the long-term. In the short-term, TradeInvest to: gather data, collect existing reports, establish a 'baseline' of information.

Investment lifecycle stage	No.	Reform Actions	Office of the Vice Prime Minister & MCAE TradeInvest	Implementing Mechanism	Comments	MCAE/TITL Comments
		Timor-Leste's changing priorities.				There was pushback from PM last year about developing research function in TITL. We need to demonstrate first that we are using existing reports and research first before implementing a new program.
	9	Strengthen TradeInvest's role to advocate for the improvement of the investment climate and the business environment.	MCAE	Revisions to TITL Decree Law Capacity building within TITL	To give TITL the <u>legal mandate</u> and <u>skills/training/tools</u> to be able to perform this role effectively. Critical is for TITL's role to be accepted by other agencies.	Need to think about how to proactively engage with other Ministries. This issue needs to be included in the revised TradeInvest Decree Law. If TITL does not have the legal mandate to do this work then it will not be able to perform its role effectively.
	10					
III		Short-term Recommendations				
Entry and Establishment	11	Implement a risk-based approach to licensing processes.	MCAE and relevant ministries	Licensing Decree Law (licensing)	A risk-based approach can allow the government to identify high-risk projects and prioritize. Risks could be categorized in accordance with highly sensitive sectors or industries, or more generally in accordance with health and safety, environment and public security risks.	This action need to be integrated with the recommendations from the IFC licensing project and the new licensing Decree Law. This is a longer term, more substantial issue.

Investment lifecycle stage	No.	Reform Actions	Office of the Vice Prime Minister & MCAE TradeInvest	Implementing Mechanism	Comments	MCAE/TITL Comments
	12	Conduct a thorough diagnostic review of the requirements to obtain a business visa and propose an action plan to streamline procedures.	MCAE, TITL with relevant ministries	Ministerial Decision	The success of the investment process requires measures to facilitate the entry of investors and skilled workers into Timor-Leste.	A new Immigration Law has been sent to Parliament. The first step needs to be to analyze the new law to see if improvements have been made. The diagnostic review needs to consider the new Immigration Law. The wording of this action may change after in-depth consultations with relevant Ministries (MNEC, SEPFOPE, etc.).
	13					
	14	Ensure the new land law provides enough clarity for foreign investors.	MCAE and Ministry of Justice	Regulations to the Land Law	Land is a key issue for investors in many of the sectors identified in this IRM.	Land Law is approved already by Parliament and promulgated by the President of the Republic. Need advice from legal team on the new land laws. Also need to establish a relationship with the relevant people in Sec of State for Land and Property.
IV		Short-term Recommendations				

Investment lifecycle stage	No.	Reform Actions	Office of the Vice Prime Minister & MCAE TradeInvest	Implementing Mechanism	Comments	MCAE/TITL Comments
IV		Medium and Long-term Recommendations				
Protection, Retention and Expansion	16	Elaborate a model BIT for Timor-Leste to be able to negotiate more comprehensive IIAs with potential trade and investment partners.	Office of MCAE and Ministry of foreign affairs	Model BIT	Unlike many countries in the region, Timor-Leste has only concluded one IIA. IIAs have positive effects on the investment climate in the signatory countries.	Examine the Kuwait exercise.
V		Short-term Recommendations				
FDI Linkages	17	Study the feasibility of developing a linkages strategy including tailored implementation solutions for linking high-potential domestic firms to foreign investors.	Office of MCAE and Ministry of Tourism and Environment	Report	The first step is to elaborate a review concentrating on identifying Timor-Leste's (i) policy environment and priorities, (ii) institutional setup, (iii) tools and support programs used to favor linkages, and (iv) partners and relevant work already underway. After a scoping mission, prepare a more comprehensive demand-supply gap analysis to determine the scope and scale for increasing linkages between FDIs and domestic firms. This will provide a good understanding on the gap between demand for inputs and	Agree this is important.

Investment lifecycle stage	No.	Reform Actions	Office of the Vice Prime Minister & MCAE TradeInvest	Implementing Mechanism	Comments	MCAE/TITL Comments
					local supplier availability / ability to meet this demand.	

Annex 1: The Investment Typology

Type of FDI	Natural Resource-seeking	Market-seeking	Efficiency-seeking	Strategic Asset-Seeking
Fundamental Determinants	Location of natural resources	- Market dimensions and income per capita - Market growth - Consumers' specific preferences - Kind of goods and services to be provided	- International production patterns - Level of systemic competitiveness of the host country vis-à-vis other potential host countries - Secure (or preferential) access to key export markets (see link with trade)	Firms sophisticated enough to move into the international market
Key Features/Process	- Frequent point of departure for any investment policy program in Developing Countries (DCs) - Traditional vehicle for integration into the world economy - Tends to be North-South, although increasing South-South - Export efforts start in this sector (and policies tend to mirror this trend) - As exports increase FDI tends to increase (also efficiency-seeking FDI in related sectors)	- Tends to occur through M&As - Traditionally it has been North-North, and then North-South, over the last two decades it is becoming South-South and South-North - Vehicle for internationalization of SMEs in DCs - Services FDI tends to concentrate in this type (although increasing in efficiency-seeking through outsourcing) - Regional integration helps to promote this kind of FDI in smaller DC's (to enlarge markets both for extra-regional and regional businesses). - See, however, Customs Union (CU) vs. Free Trade Area (FTA) debate	- Export oriented - Potentially, net generator of foreign exchange - Generator of jobs - Significant potential gains in terms of expansion and diversification of export supply of host economy and transfer of technology - Can also lead to non-equity forms of FDI	- Generation of Champion Companies in DCs. In many DCs, these champions are public investors (SOEs and SWEs) - Benefits for home countries depend on investing firms' ability to transforming and upgrading core competences and reverse-transferring intangible strategic assets Unique, intangible, and organizationally embedded assets: - Advanced technology - Brand assets - Managerial know-how
Political Economy/Challenges	- Distribution of rents. Fair distribution of gains derived from exploitation of resources - Sovereignty over natural resources - Dutch disease	Real or perceived effects over: - Domestic production (crowding-out argument) - Reaction of domestic suppliers - Competition policy	- Systemic competitiveness is difficult to achieve - Competition among countries (incentives?) - Importance of signals (vulnerability of smaller countries)	- Rising economic protectionism - More common South-North FDI - Reaction against SOEs and SWFs (Public investors)

	• Rent-seeking political structures • Strong pressures for corruption • Labor rights and other social conditions of workforce (i.e. health) • Environmental matters	• National security	• Increasing controversy in home countries	• Issue of liberalizing the financial account to allow for outward FDI in capital-constraint countries
Historical Perspective	• Oldest type of FDI • Rooted in colonialism • Origin of North-South divide • Currently growing because increased demand for raw materials and food supply	• Some initial flows in developing countries in the XIX century • Originally tended to focus among countries of the North • Changes with Import-Substitution Industrialization (ISI) policies • Currently growing and become another way to service a market (given the rise in trade in services, and the rise of BRICs) • Increasing emphasis on pre-establishment issues	• Resulting of GATT's impact on liberalization of trade in manufactures • Currently in vogue through international value chains	• Traditionally limited to North-North FDI, in the last 20 years has started to become increasingly common in developing countries • Acceleration of outward FDI from developing countries in recent years attests to compressing or leapfrogging the investment-development path
Relationship with Trade	• Original vehicle for generation of trade • Generates international division of labor leading to the original North-South divide (that is currently changing)	• Protectionist policies (infant industry argument and currently protectionist stances in some BRICs) • Original perception that FDI substitutes trade (tariff jumping) • Currently close links with international patterns of production generated by international competition • More market-seeking FDI leads to more trade not only of goods but also in services	• Makes trade to grow exponentially • Fosters intra-firm trade	• Trade is not the key driver or outcome, but outward FDI may be the next step in the internationalization process for exporting firms • Can help firms overcome competitive disadvantages and encourage trade in the long term
Implications for policy making/How to integrate host country in value chain	• FDI may not necessarily translate in benefits to local economy • Most difficult FDI to manage to minimize drawbacks and maximize potential benefits (Norway vs. Nigeria) • Constant demand of governments to increase value added of exports	• Often strong resistance from local interest groups must be overcome • Typical vehicle for SMEs from DCs to jump into international markets • Liberalization becomes the core topic around which the policy discussions tends to gravitate	• Given clarity of benefits, this is the kind of FDI that is more in demand • Systemic competitiveness becomes the core topic around which the policy discussions tend to gravitate • FTAs become critical	• This type of investment begs the question of the need for outward Investment Policy • Home country measures to encourage outward FDI – fiscal and financial, loans, political risk insurance • Support services for outward FDI

	• Need to increase beneficial spillovers and linkages and use these sectors to develop others through linkages (Australia, Canada) • Export promotion diversification (niches) both in goods and in services.	• Competition issues become critical.	• Logistics for integration with the international economy become key	• Institutional framework for outward FDI
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