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Investment Advisory Services to the Government of East Timor

First Annual Report (July 5, 2003-June 30, 2004)

Prepared by

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Task Order 832 under Contract No. PCE-I-832-98-00016-00**

Investment Advisory Services to the Government of East Timor

First Annual Report

PART I

INTRODUCTION

This is the First Year Annual Report of the Investment Advisor Services provided to the Government of East Timor (GOET) by Nathan Associates under the USAID contract No. PCE-I-832-98-00016-00. The contract effective date is May 29, 2003 and the estimated completion date is May 31, 2005. The Resident Investment Advisor (RIA) arrived in East Timor on July 7, 2003 to begin the two-year assignment.

This report is not an obligation under the contract. Original reporting obligations under the contract were limited to monthly activities reporting. However, at the time of preparation of the First Annual Workplan, it was agreed with USAID CTO that quarterly reports should also be provided to include project fiscal and financial status to assist USAID/Dili with its reporting requirements. While this report is not a contractual obligation, because of the length of the two-year contract, it is deemed appropriate to present a mid-point stocktaking of progress made toward completion of project objectives and tasks. As monthly and quarterly reports submitted to USAID focused on project activities for the respective reporting periods, this Annual Report will measure project implementation progress against the milestones established in the First Annual Workplan. As such, this Annual Report highlights accomplishments and complements the monthly and quarterly activities reports submitted throughout the year.

Overall, it can be summarized that the project has been making steady progress toward meeting contractual goals and objectives. However, due to the incipient nature of private sector in East Timor and the embryonic development of its regulatory framework, much time was dedicated to collaborative work with other Ministries and departments during the past year in order to help set up and strengthen the overall private sector framework. Because an enabled private sector environment is a necessary condition for the development of the core private investment framework, the status of the existing private sector environment had a measurable impact on the rate and extent of implementation of project activities as established in the First Annual Workplan. Hence, as can be seen from the report on the implementation status of project milestones under the five main headings of project activities, progress toward achievement of planned activities fell under the following four categories: completed, ongoing or in progress, initiated and not started. The vast majority of milestones were either completed or in progress. On the other hand, some milestone activities were either initiated later than expected or not started as a result of prior steps or actions which either began late or are taking longer than originally anticipated. The latter two categories affected particularly milestones relating to investment promotion activities which depend on the passing of the investment legislation and regulation, and the establishment of the investment and export promotion agency.

This annual report presents the salient aspects of project progress and achievements during the first year of project implementation. The report is structured in five parts: Part I comprises this brief introduction, followed by a summary of project fiscal and financial status and ends with a highlight of project accomplishments. Part II briefly recapitulates project background, project goals and objectives, and reporting requirements. Part III focuses on actual implementation progress. It presents a brief introduction to each of the five milestone categories followed by a table with detailed status of each milestone established in the First Annual Workplan. Finally, Part IV covers Deemphasized Activities while Part V presents Other Activities, not originally contemplated in the Annual Workplan but which were carried out and complement or support overall Project goals and objectives.

FINANCIAL STATUS OF THE PROJECT

Fiscal data and financial status of the project as of June 30, 2004 are presented below:

| | | | |
|-------------------------|-------------------------|----------------------------------|-------------|
| Contractor | Nathan Associates, Inc. | Contract/Grant Amount | US\$982,966 |
| Type | Contract | Obligated | US\$982,966 |
| Contract No. | PCE-I-832-98-00016-00 | Unobligated Balance | US\$0 |
| Activity Title | Investment Advisor | Est. Accrued Expenditures | US\$422,193 |
| Activity Start | May 29, 2003 | Est. Unexpended Balance | US\$560,773 |
| Activity Finish | May 31, 2005 | Est. Budget Used | 43% |
| Percent Complete | 50% | | |

PROJECT ACCOMPLISHMENTS

Project accomplishments below are addressed in terms of major accomplishments and other accomplishments:

MAJOR ACCOMPLISHMENTS

For the first year of project implementation there were three major accomplishments, all of which fall under the general rubric of establishment of the regulatory environment. These were:

- Development of a Private Investment policy
- Development of the Investment Legislation
- Securing World Bank Funding to Support Investment Promotion Program

Development of a Private Investment Policy

Within 45 days of arrival of the RIA in East Timor a preliminary draft of a private investment policy was drafted and presented to the Prime Minister (through the Secretary of State for Tourism, Environment and Investment) for GOET review. A private investment policy was viewed as a necessary first step in the process of defining and developing the overall private investment strategy and regulatory framework, consisting of the policy, legislation and subsequent regulation. The draft policy document also including a projected “next steps”, which anticipated staging a Forum in late September 2003 to carry out public consultation on private investment with the various stakeholders. However, due to an overloaded agenda GOET “go ahead” was not given until mid-November 2003, thereby permitting the staging of the two-day Private Investment Stakeholders’ Forum on December 16-17, 2003.

The Forum was a major event, presided by the Prime Minister, with over 100 people from the private and public sectors in attendance. The participants took part in active discussions of broad-based issues ranging from the role of the state in private investment, the various types of private investor target groups, the needs of and servicing of private investors, and finally the role of domestic and foreign investors in East Timor. The Private Investment Stakeholders’ Forum was generally considered a success and a key point in the process of developing a private investment regulatory framework. The private sector was particularly sensed that their voices had been heard by decision makers early in the process of developing a private investment framework. Following the Stakeholders’ Forum, the draft policy document was revised and adopted by GOET as a precondition for developing the private investment legislation.

The Stakeholders’ Forum was thus a culminating event marking a key point in the consultative process of the private investment policy document. In addition to this broad public consultation, several smaller events such as seminars and workshops were held with the domestic business people, as well as, presentations to private investor delegations visiting East Timor from abroad. These smaller events were important and served to gather

views and opinions of the various types of investors regarding their concerns and preferences which should be taken into account in the development of a responsive private investment framework for the country.

The outcome of this policy consultative process served to demonstrate that domestic investors generally looked favorably upon foreign direct investment (FDI) in the country. However, it was made clear from the outset that they wanted to be treated on equal footing to foreign investors, including having their own investment law, with the same rights and privileges as those to be accorded foreign investors.

Development of the Investment Legislation

As soon as the policy document was finalized, work began in the drafting of the investment legislation. The development of investment legislation was a key step in the creation of the legislative and regulatory framework to guide private sector investment in Timor Leste. Two Round Tables were held in late April and mid-May 2004 to debate and discuss the domestic and external investment draft laws, respectively. These two major events constituted high points in the investment legislation development process as they afforded an opportunity to put drafts laws out for public consultation with the various stakeholders. Smaller consultative sessions with Timorese domestic investors at workshops and other similar gatherings preceded the Round Tables with a view to gauge perceptions of domestic private sector groups.

Private sector feedback received at the consultative sessions was overwhelming positive. In particular, credit was given to the clarity and ease of understanding of the two draft investment laws, the investment guarantees and incentive package proposed, as well as, the consultative process that, for the first time, sought private sector input early on in the legislative development process. Some development partners, however, were less enthusiastic with the proposed draft laws and one, subsequently, presented extensive written comments criticizing, among other things, the placement of fiscal incentives in the draft laws, as well as, the investment approval mechanism that the GOET wishes to be a part of its investment processing regime. Following public consultation at the Round Tables and subsequent private reviews with specialized public sector departments and bodies, the two draft laws were revised in response to valid comments received and which do not run counter to GOET intentions. Finally, the revised draft laws and support documentation were submitted to the Council of Ministers in late June for review. Following expected Council of Ministers review of the two draft laws in early July, these will be submitted as formal Bills to Parliament for ultimate approval after end of parliamentary recess in mid-September.

The proposed two draft laws are virtually mirror image of each other in terms of investment guarantees, proposed incentives and post entry investor treatment. The few distinctions between the two are: (a) a higher minimum amount of investment threshold required of the external vs. the domestic investor (exact amounts yet to be determined in the regulation to the laws), (b) location of residency of the investor and the origin of invested capital, i.e. from abroad vs. from within the country, (c) right of external investors to repatriate profit and capital and (d) right of foreign investors to pursue conflict resolution abroad under ICSID¹ rules. Otherwise, the two draft laws treat all investors equally and do not discriminate between domestic and foreign investors. However, while some have rightly observed that one investment law would have sufficed instead of two, the ultimate decision to present two draft investment laws instead of only one has to do with domestic investor preference for its own law and government's decision to be responsive to private sector demand on this aspect. At the end of the day, the two proposed draft laws represent a win/win situation for the following reasons: (1) no discrimination in post entry treatment among investors, (2) demonstrated government goodwill to listen to its domestic investors, and (3) highly satisfied domestic investors who perceive that ownership was exercised in the development of the private investment regime in the country.

¹ ICSID - International Center for Settlement of Investment Disputes. As East Timor is a member of the World Bank it is automatically a party to the ICSID Convention.

Securing World Bank Funding to Support the Investment Promotion Program

Securing World Bank funding to support the investment promotion program was a major achievement for two basic reasons. First, upon arrival the RIA found an investment promotion concept that anticipated the creation of a “one stop shop” to assist foreign investors to be lodged within the Investment Division of the Ministry of Development and Environment (MDE). Judging from the limited human resources capacity within the civil service in general and the Investment Division in particular, the proposed “one stop shop” was quite likely to function as “one more stop shop” rather than a “one-stop-shop”. Hence, one of the first challenges faced early on was to communicate effectively to GOET decision makers that a successful investment promotion program for the country depended on the establishment of a strong and highly visible entity to lead this effort. Thus, a specific proposal was put forward to create an autonomous agency to support foreign direct investment (FDI) based on a best practice model as is the case in other countries/regions where FDI is promoted on a successful basis. This agency model was first proposed to GOET within 45 days of RIA arrival in East Timor as part of the initial draft of the private investment policy document. The agency model was soon agreed to by the GOET but there remained the question of the required funding to launch the agency and the investment promotion program, estimated at about \$500,000 per year for a small fully established agency.

Following intense dialog with key GOET Ministers and Secretaries of State as well as key World Bank personnel on the notion of the new FDI promotion concept and the required funding, the RIA generally received “a sympathetic ear”. Fortunately, as the Small Enterprise Project II, funded by an IDA grant from the World Bank was being restructured, funding became available by deemphasizing the credit component and supporting other components, among which the investment promotion program. Thus, \$800,000 was allocated under the SEP II Project to support the investment promotion agency and the proposed program. While clearly an insufficient amount to support the investment promotion agency and program for a 5-year cycle, the initial funding support is essential to launch the first two years of the agency operation and program until additional funding can be obtained.

OTHER ACCOMPLISHMENTS

In addition to the major accomplishments highlighted above, below are other accomplishments achieved during the first year of project implementation. These were:

- MoU between Investment Division, IPIM of Macau and other CPLP Countries.
- Investment Staff Capacity Building
- Private Sector Strategy Development under Sector Investment Program (SIP)

MoU between Investment Division, IPIM of Macau and other CPLP Countries.

The RIA accompanied a joint Government and private sector delegation to Macau in October 2003 to attend the Economic Forum between Portuguese-speaking countries and China. Among the fruitful business contacts between Timorese and Macanese investors, a multilateral Memorandum of Understanding (MoU) was signed between the Investment Division and the Macau Institute for Investment and Export Promotion (IPIM). The MoU was also extensive to seven other Investment Promotion Agencies (IPAs)/Chambers of Commerce from other Portuguese-speaking (CPLP) countries present at the Forum Conference. The RIA participated in reviewing the proposed draft text and accompanied the Investment Division Director to the signing ceremony. The MoU opens the door to a possible twinning relationship between the Macanese IPIM and the proposed IEPA (Investment and Export Promotion Agency) currently being set up in East Timor whereby it is expected that the former would assist the latter with institutional and human resources capacity building.

Investment Staff Capacity Building

Notwithstanding institutional and Investment Division staff limitations mentioned below, considerable organization and planning capacity building occurred among Division staff members. Much of this experience was gained in three key events: the Private Investment Stakeholders' Forum and the two Round Tables on draft investment laws. These major events gave staff the opportunity to actively engage in every aspect of the organization and implementation of these public events as this was the first time Division staff participated in organizing events of this size and importance. As a result of these experiences, improvement in organizational capacity was markedly noticeable from one event to the next. By the time of the last Round Table in mid-May, the Interim Director was able to adequately supervise his staff at various levels of details, thereby requiring only key and minimal involvement on the part of the RIA.

Additionally, the RIA guided staff in the gathering and reporting on National Development Plan (NDP) semester indicators and reports. By June 2004 many of the planning and reporting documentation required from the Division against NDP documents were being completed by Division staff under the supervision of the Interim Director with limited RIA input. In sum, the RIA observed that supervisory and coordination skills of the Interim Director has show marked improvement and staff performance is also appreciably higher than that seen about one year ago. These improvements are attributed to day-by-day learning on-the-job, whereby first the task is explained and demonstrated, followed by coaching and ultimately encouragement of "solo flight" by the learner with only back up support, on as needed basis.

Private Sector Strategy and Program Development under Sector Investment Program (SIP)

The incipient nature of the private sector legislative and regulatory framework in East Timor constitutes a major hindrance to the development of the private investment framework. There is much still to be done in terms of legislation and regulation to adequately support the development of the private sector in the country. The RIA worked closely with the chief planning advisor (Russell Cheetham) other advisors and Ministry staff in the initial drafting and revision of private sector section of the SIP document. To foster greater interagency coordination, staff from various Ministries and Secretariats of State met on numerous occasions to discuss cross-cutting issues that affect private sector development. This collaborative work and intense participation of GOET operation staff raised awareness of the importance of teamwork and contributed significantly to staff capacity building as indicated above. Finally, the RIA prepared PowerPoint presentations on private sector development and assisted the Vice-Minister of MDE to make presentations to development partners based in East Timor.

PART II

PROJECT GOALS AND OBJECTIVES

The goal of the Investment Advisory Project is to help the East Timor Government generate and retain foreign and domestic investment that will support economic growth and poverty reduction. While the principal focus of the activity is on inward investment and related export promotion (due to the limited skills, financial resources and market available domestically), the project recognizes the intimate relationship between foreign and domestic investment and as a result dedicated considerable amount of time during the past year to create the policy and regulatory environment that support both groups of potential and actual investors. To be sure, foreign investment is expected to play a key role in the development of a vibrant economy in East Timor. This is evident already in the gas and oil sector where major offshore investment² has begun to occur and more is expected both offshore and on land. However, only by building capacity and competitiveness of the private

² One investment alone in the Timor Sea gas field of Bayu-Undan led by Conoco-Philips is projected at USD 1.62bn on the East Timor side. Total project investment, including the pipeline to Darwin, Australia, is calculated at USD 3.2bn. The project is expected to begin operation in 2004/2005.

sector as a whole can income and job creation be achieved on the scale necessary to sustain broad-based growth and development in East Timor.

The Investment Advisor and Support Activities project is expected to help strengthen East Timor's business policy framework, including specific laws and regulations relating to foreign and domestic investment, as well as contribute to the strengthening of the business environment for the whole private sector. It will also focus on creating and reinforcing the institutions and mechanisms necessary to support private sector development (PSD). The ultimate goal is to help build the capacity of the private sector to create sustainable jobs over the near, medium and long term through the promotion of domestic and foreign investment, generate government revenues and alleviate poverty.

ACTIVITY BACKGROUND

The GOET fully recognizes the importance of investment to the country's future and therefore accords it a high priority in the national development agenda. With USAID financial support, the RIA began working within the Investment Division of the MDE in early July 2003 to assist in the development of a favorable private investment framework across all sectors of the economy. The RIA enjoys a good working relationship with GOET leadership and staff and has therefore worked productively with both the leaders and the line staff of various Ministries, Secretariats of State and key public bodies in the implementation of the First Annual Workplan. While the Annual Workplan made a best effort to anticipate specific activities during this first year of project implementation, many other priorities, usually of an *ad hoc* or emergency nature, particularly those associated with the implementation of the National Development Plan and the Transition Support Program³, which emerged along the way and took considerable time and effort. Hence, in addition to the five activities group areas set out in the Annual Workplan, a sixth, comprising unanticipated activities, will also be addressed in this report.

Three Areas of Investment Related Activity

As indicated in the First Annual Workplan, the contribution of the RIA should be understood in the overall context of three types of business activity/investment important to East Timor.

- Encouragement of small-scale domestic business activity and investment;
- Promotion of overseas investment in non-gas and oil, and mineral resources sectors, as well as upstream investment supporting petroleum and mineral exploration and extraction investment, as well as downstream business activities that result for the petroleum and mining products; and
- Promotion and professional management of investment in the extraction of natural gas and oil both from offshore and onshore reserves.

RIA advisory activities to date have focused primarily on the first two categories. While close relationship is maintained with the petroleum management authority (Timor Sea Designated Authority) and with the team of advisors and Ministry staff in this area, this relationship has been ostensibly of an information sharing nature. The RIA did however participate in meetings where the proposed petroleum laws were being discussed to ensure complementarity with the general investment legislation. Further, close consultation has been maintained with the staff of the Timor Sea Office under the Prime Minister to ensure effective coordination and dovetailing of the overall investment legislation with that proposed for the petroleum sector.

Given the incipient nature of the domestic business sector, the RIA advised regularly on needs and strategies to support domestic business sector as it seeks to benefit from supply chain linkages with foreign business activity, and achieve growth in employment, exports and incomes.

³ The Transition Support Program is a donor support initiative that provides budget support to the GOET based on measurable progress made toward the achievement of established goals and objectives.

The challenges facing East Timor in stimulating private investment and creating economic growth cannot be underestimated. A dynamic and phased approach must be adopted to sequence activities in order to progressively advance from one phase to the next. To be sure, the agenda to develop the broader private sector regulatory framework has only just begun with the recent passing of the Commercial Companies Law which creates the basis for establishing various types of company models. Many other laws and regulations are still needed to frame the surrounding business environment, at the core of which sits the investment legislative framework. Thus, during its first year, the project focused primarily on improving the policy and regulation environment for domestic and foreign investment promotion. Once the investment laws are passed by Parliament, efforts will be channeled toward the strengthening of the investment promotion capacity at the institutional and human levels.

Organizational and Human Limitations, and Capacity Building

The project began against a background of extremely limited institutional and human resource capacity within the Ministry of Development and Environment and its Investment Division. Theoretically, the RIA was expected to work as advisor to the Director of the Investment Division. However, because the actual Director is currently a member of Government, the position is temporarily filled by a lower ranking manager who is the Acting Director. The institutional vacuum created by the absence of the Director, combined with the limited capacity of the other Division staff pose serious constraints to effective capacity building. Further, a change in programmatic responsibility, shifting investment promotion from the Division to the soon to be created Investment and Export Promotion Agency, thereby limiting the Division's role to policy and regulation also introduced changes which the staff has not yet fully understood. Notwithstanding these limitations, considerable organization and planning capacity building occurred among Division staff members as they were actively engaged in the organization and implementation of the policy Stakeholders' Forum and the two Round Tables, as well as, participation in data gathering and reporting on National Development Plan (NDP) indicators, as indicated earlier.

PART III

PROJECT ACTIVITIES AND MILESTONES REPORTING

As indicated above, the focus of the Project is directed at five main areas of investment advisory activities, as well as, a sixth area which may be appropriately referred to as other project-related activities.

Monthly and quarterly reports were submitted to USAID regularly during the year reporting on how time was spent and tasks accomplished. Monthly and quarterly reporting format were agreed with USAID CTO and were submitted electronically (per CTO preference) with copies to Nathan home office Investment Specialist. Beginning with the November report (to be submitted by mid-December, CTO requested that Quarterly reports be submitted in lieu thereof with more level of detail, including up to date project fiscal and cumulative financial data.

Many of the project's activities were dependent upon action being taken by various other government departments. This meant that some project milestones were subject to slippage through no fault of the project itself but rather to the delay in government actions on specific items. The Stakeholders' Forum, for example, was initially proposed in late August with the intent that the Forum would take place by mid to end of September instead of the actual date of mid-December 2003 – almost three months later than originally projected! However, this delay should not be equated to a lack of political will on the part of decision makers, but rather to an overloaded agenda in terms of competing demands and priorities. Fortunately, this the most significant delay registered in terms of key project outputs and the RIA is pleased to acknowledge that investment promotion agenda has been placed near the top of priorities by the Executive Branch of GOET.

Whereas monthly and quarterly reports focused on project activities for the respective reporting periods, this Annual Report will measure project implementation progress against the milestones set out in the First Annual Workplan. Although major milestones such as the development of the private investment policy and the investment legislation were presented in quarterly segments in the Annual Workplan, where possible this report will address the totality of the milestone rather than its quarterly targets. Hence, milestones reported in this Annual Report are fewer than the numbers of quarterly target milestones contained in the First Annual Workplan. In addition to reporting on milestone implementation progress this Annual Report also serves a solid base upon which to launch the Second Annual Workplan.

Improving the Policy Environment for Private Sector Investment

The four main activities under this milestone heading as set out in the First Annual Workplan are:

- Formulation of a Private Investment Policy (PIP) for East Timor
- Preparation and approval of the Foreign Investment Law (FIL)
- Providing inputs into complementary business/investment-related legislation
- Helping improve the business environment

The table below indicates succinctly specific implementation progress made toward meeting milestones objectives under this activity heading:

| Activity Area | Milestones | Status |
|--|--|--|
| Improving the Policy Environment for Private Sector Investment | <ul style="list-style-type: none"> • Draft, discuss and revise private investment policy document for GOET approval and adoption • Draft, discuss, revise and submit foreign investment law (FIL) for CoM approval • Provide written input to sectoral laws relevant to investment • Draft guidelines on Administrative Aspects of Investment Division/IPA staff/Project Assistant under RIA guidance • Compilation of draft administrative guide to Investment in East Timor | <ul style="list-style-type: none"> • Completed. • Completed. <i>The draft Domestic Investment Law was an additional output not anticipated in the Annual Workplan</i> • Ongoing. Comments were prepared for the Companies Law, the Fisheries Decree-Law and Draft Bankruptcy Law • Initiated. Preliminary drafts of investment processing flowchart to be used by the IPA were prepared to and roles of ID/IPA also defined • Initiated. Preliminary background data and information gathered to develop the investment guide for East Timor once the IPA is operational. |

As can be seen from the table above, two milestones were completed, one is ongoing and two others were initiated and are yet to be completed. Of those completed, the private investment policy and investment legislation are key outputs which marked the watershed of major accomplishments for the year. Further, it is worthy to note that while the Annual Workplan anticipated the drafting of only one foreign investment law (FIL), the outcome of policy dialog and domestic investor consultation resulted in two draft investment laws being prepared. Thus, an extra output was produced beyond those initially set in the Workplan.

Although inputs were made into three key pieces of legislation, this is an ongoing milestone as the policy document identifies a list of almost two dozen key pieces of legislation still to be developed or revised in order to create an adequately regulated private sector framework.

The two last milestones above were initiated but their completion is pending the establishment of the investment and export promotion agency. It is anticipated that the agency will be legally created the last quarter of the current calendar year and staffed during the first quarter of 2005.

Improving Investment Promotion through Institutional Strengthening and Promotional Activities

The major goal of this activity area is the transition from the Investment Division of the MDE to the establishment of an Investment and Export Promotion Agency (IEPA). The IEPA will initially undertake the promotion of both inward investment and exports of goods and services produced by Timorese companies. At some time in the future when the volume of exports increases to justify the creation of a separate agency, this component of the IEPA will be spun off, thus effectively separating investment from export promotion. Until then both activities will be handled by the IEPA, albeit with principal emphasis on inward investment promotion. As indicated above, \$800,000 has been secured under the World Bank-funded SEP II to support the IEPA during its first two years of operation.

Additional milestones focused on planning, creation of institutional and human capacity, network development and promotion of investment opportunity to various visiting delegations from the region.

The table below provides details implementation progress on milestones under this activities grouping:

| Activity Area | Milestones | Status |
|---|---|--|
| Improving Investment Promotion through Institutional Strengthening and Promotional Activities | <ul style="list-style-type: none"> • First Investment Promotion Tour conducted (Macau) • WB (SEP II) discussed and formally proposed • IPA set-up plan prepared including design, structure and reporting lines • Prepare draft plan for introducing East Timor promotional tours/road shows • Sign MoU of cooperating with one overseas IPA • SEP II allocation for IPA approved • Draft technical/legal documentation for IPA submitted to PM/CoM • Proposed government contribution to IPA activities announced • East Timor Investment Promotion folder compiled and printed • Draft Five-Year Strategic Program for Investment Division/IPA submitted • Conduct second ET promotional Tour (Australia?) • Identify and appoint public/private IPA Board • Key staff for IPA recruited • Finalization of premises for IPA • East Timor Investment Promotion website launched/updated. • IPA open for business | <ul style="list-style-type: none"> • Completed. Accompanied members of Government and 25 private sector investors. • Completed. Participated in the restructuring of SEP II project and helped to secure funds to support investment promotion. • Ongoing. Drafts presented to GOET and World Bank as part of SEP II project component; to be finalized with IEPA staff. • Initiated. Research done and key presentations prepared. To be completed with IEPA staff. • Completed. Joint MoU signed with IPIM of Macao and various other CPLP⁴ countries agencies. • Completed. \$800,000 allocated to support IEPA. • Initiated. Information gathered and model identified; drafting to be done as part of external investment law regulation. • Ongoing. Prepared initial budget for inclusion in the 2004/2005 budget. • Initiated. Preliminary data and information gathered. Production of folder and brochure awaiting IEPA set up. • Initiated. Preliminary concept and budget forecast done as part of IEPA design. Actual drafting to be done with IEPA staff. • Not done. The promotional tour was postponed pending passing of investment legislation and set up of IEPA. • Initiated. Potential public and private sector Advisory Board members identified. Pending establishment of IEPA. • Ongoing. Prepared TORs for expatriate CEO and national counterpart. Participating in the recruitment process of CEO. • Ongoing. Several sites identified but yet to be finalized. • Not started. Pending establishment of IEPA. • Not started. Pending IEPA setup. |

Of the 16 milestones under this grouping of activities, the vast majority was either completed or in progress, including those already initiated. Of the three not started yet, all were related to the establishment of the IEPA, which is expected to be legally created by the end of the current year.

⁴ CPLP is Portuguese acronym for Portuguese-speaking countries.

Capacity Building and Skills Transfer Activities

Investment-related capacity building of GOET institutions and the individuals that work within them is a key objective of this project. The main counterpart institutions are the Investment Division of the MDE, and, in the future, the proposed Investment Promotion Agency.

Capacity building of relevant staff took place on two levels. The RIA provided best-practice advice to senior government officials on investment related issues on an ongoing basis. The RIA advised on Investment Division staff training in various investment-related skills as well as language skills to line staff of the Division. Additionally, efforts are ongoing to identify further external resources as appropriate to support training in investment promotion areas. Two key Investment Division staff participated in investment promotion training abroad, one in Japan for 45 days and another in China for one month.

With the recent recruitment of a multilingual Project Assistant it is anticipated that more hands-on training in business data processing and computer skills will now be delivered. In addition to supporting the RIA, the Project Assistant is expected to coordinate and deliver basic training activities (e.g. workshop organization, computer/presentation investment-related language skills, etc.) for Investment Division and IEPA staff under RIA guidance.

Much of the project's capacity building and skills transfer took place in the form of learning by doing. For example, this includes the compilation of data and information pertaining to various economic and business areas, including economic and business statistics, land, immigration, labor, taxes and other areas. The compilation of an inventory of businesses, including domestic and foreign investment, SMEs and microentrepreneurs in collaboration with the Business Registration Unit provided awareness of the interrelated intricacies of private investment in the country by providing both snap shots and time series of the evolution of the business environment.

A detailed review of project financial pipeline has been conducted and a proposal has been developed for USAID approval to reallocate funds from lesser used activities into activities such as study tours and investment promotion abroad where the RIA is expected to accompany key public/private delegation to relevant investment locations to learn investment best practices such as in Cape Verde, Fiji and Mauritius. Investment promotion trips are anticipated for Australia, Portugal, Malaysia and Singapore during the coming year. The RIA is expected to support and accompany select delegations on these trips by providing logistical support with the assistance of the Project Assistant and preparing and delivering specific investment promotion presentations.

| Activity Area | Milestones | Status |
|--|--|--|
| Capacity Building and Skills Transfer Activities | <ul style="list-style-type: none"> • Capacity building and skills transfer activities for Investment Division of MDE through on-the-job training on daily investment issues and during site visits, promotional tours, etc. • Prepare Draft MoU for Investment Project and submit to USAID/MDE • Investment policy/program guidance provided to Sec State for Investment and MDE Vice-Minister through PIP process and draft document preparation • Appointment of Project Assistant with key Capacity Building/Basic Training Job Description • Deputy Interim Investment Director and other Investment Division staff to collect and prepare summaries of procedures and other information on two or more administrative procedures relating to investment under RIA guidance (for eventual inclusion in investment guide). • Training needs assessment for IPA staff/ID prepared • Inventory of existing major investors prepared • Training of new IPA staff using administrative guide to investment in ET. | <ul style="list-style-type: none"> • Ongoing. Considerable progress made in building staff capacity in organizational, supervisory and administrative areas; due to low staff skills, capacity building in technical areas is limited. • Not started. However participated in preliminary discussions with USAID/MDE/WB. • Completed. Worked closely with MDE and Trade and Industry leadership in development of PIP. • Ongoing. Recruitment process finalized and offer made to top candidate. • Ongoing. Coached Investment Division leadership and staff in data and information collection and presentation preparation to group of potential investors. • Not started. Awaiting IEPA setup. • Ongoing. Preliminary data collected. • Not started. Awaiting IEPA setup. |

| | | |
|--|--|---|
| | <ul style="list-style-type: none"> Two basic training courses for IPA/ID staff delivered (computer/investment promotion skills) by RIA, JIA, HQ Investment Specialist, others | <ul style="list-style-type: none"> Initiated. Assisted in sending two ID staff for training in Japan and China. IEPA training not started; pending IEPA setup. |
|--|--|---|

Collaboration with Donors and other USAID Projects

One of the important objectives of the project is collaboration with donors and other USAID-funded projects.

Collaboration was particularly close and fruitful with several donors. In particular, effective working relationships were established with the World Bank and Ireland Development Cooperation, both of which made funds available to support investment-related activities and private sector development, as indicated above. Additionally, regular contacts were maintained with the IMF and ADB offices in Dili. Regular contacts were also maintained with AusAID Representative and key projects in Fisheries and Agriculture, financed by AusAID.

World Bank collaboration, for example, yielded an \$800,000 support from the SEP II project to help in the establishment and first two years operation of the proposed IPA. Regular contact was also maintained with a private sector enabling project under the SEP II project, implemented by Bannock Consulting. Additionally, close collaboration was commonplace with World Bank advisors in the drafting and revision of the private sector component of the SIP.

Contact with Ireland Development Cooperation was also quite productive. Key meetings with two assessment teams, one on investment climate assessment mission early in the year and the other on private sector assessment provided important insights on shared experiences from Ireland’s successful investment promotion strategy. Of particular importance to the year’s investment development agenda, funds were obtained from Ireland Development Cooperation to support two key initiatives: policy Stakeholders’ Forum and the two Draft Investment Laws Round Tables.

Collaboration with other USAID-funded projects, especially the ARD-coordinated Land Law Project (LLP) proved particularly helpful in presenting a concerted strategy to GOET on land access and real estate property rights, both issues of major concerns to private investors, especially foreign investors. Additionally, regular contacts were maintained with the Economic Growth Small Grants Program to identify funding opportunities of key investment-related activities. A TOR was presented to support the feasibility study of a Business Park in Dili. The table below provides details of progress made towards achievement of milestones under this activities grouping:

| Activity Area | Milestones | Status |
|--|---|--|
| Collaboration with other donors/USAID programs | <ul style="list-style-type: none"> RIA participates in WB SEP II restructuring discussions Prepare written critique of business environment program being implemented by Bannock Consulting WB (SEP II) support for IPA discussed and formally proposed Provide input to WB Sectoral Investment Program (SIP) process Provide input to WB SEP II mission and response to Aide Memoire SEP II allocation for IPA approved RIA/Investment Division participation in land reform agenda USAID/AusAID Capacity building through joint case study of Bali tourism cluster. Implementation of Investor Roadmap | <ul style="list-style-type: none"> Completed. Resulted in a restructured project with \$800,000 component to launch and support investment promotion. Complete. Critique provided to SETAI and Vice-Minister MDE on Bannock deliverables, including reports and draft bankruptcy law. Completed. As part of project restructuring exercise. Completed. Played key role in drafting private sector section of SIP in collaboration with WB experts. Completed. Provided written comments on draft SEP II Aide Memories. Completed. \$800,000 allocated to help launching of IEPA. Ongoing. Works closely with COP in various issues, including land access and property rights. Initiated. Preliminary research done. Activity to be completed at end of R&R per agreement with CTO. Initiated. Worked with WTO experts in outlining |

| | | |
|--|--|---|
| | <p>approach to one key sector in collaboration with WB SEP II agenda</p> <ul style="list-style-type: none"> • Prepare Memorandum of possible complementary resources for investment-related capacity building | <p>development of Tourism Master Plan for East Timor.</p> <ul style="list-style-type: none"> • Ongoing. MOU signed with IPIM Macao and discussions are ongoing to establish “twinning” arrangement between IPIM and the future IEPA in East Timor. |
|--|--|---|

Of the 10 milestones under this grouping of activities, six were completed, two are ongoing and two initiated. It is anticipated that both the initiated milestones will be complete before the end of the current year.

Support Investment-related Activities on Regions, Zones and Sectors

Investment policy, legislation and implementation coordination take place primarily at the national level. Very little investment decision making at this stage takes place at the regional level. The central government has been conducting so called “open government” sessions at regional levels to inform the population about policy and actions in general as well as measures to promote investment and private sector development at the regional and local levels. While these events are primarily political in nature, there are plans to have advisors participate more actively in the future. The RIA expects that when the investment laws and regulations have been passed then it would be opportune to discuss investment opportunities at the regional and local level. To date, the RIA’s role in this area has been essentially that of preparing information for presentation by GOET leaders at these events.

Much of the project's engagement with the subnational level takes place through various zone-related and sectoral activities. The RIA has to date provided advice on the need to think the country in terms of zones and natural endowments thereby assessing more realistically the opportunities, difficulties and challenges to promote investment in the country as a whole as well as from region to region. The aim of this approach is to assess critically the capacity and challenges in moving people and goods throughout the country as well as inbound and outbound in the context of investment and business promotion.

Currently, specialized zones, industrial and business parks are being considered for development as a means to create the necessary infrastructure to launch investment initiatives. These include the development of an Industrial Zone near Baucau for which a feasibility study has already been conducted, of the Business Park in Dili where TOR have been developed by RIA to conduct a feasibility study with possible USAID Small Grants Program support. Additionally, an initial draft TOR has been developed by the RIA to identify upstream/downstream gas industry-related investment opportunities. The possibilities of onshore gas-related investments are currently being discussed between GoET and Conoco-Phillips, the consortium leader of a major Timor Sea gas field.

In terms of economic sector collaboration, the RIA has also provided advice to various Ministries and Secretariats of State. In the tourism area, for example, collaboration in developing sustainable commercial tourism strategies has been initiated by working closely with the Tourism Division and advisors, including a team from the World Tourism Organization which came to strategize for the development of the tourism master plan. Towards the preparation of this strategy the RIA began the process to undertake a rapid case study of the Bali tourism cluster and highlight key lessons for East Timor, both positive and negative. Close working collaboration also took place with the Secretariat of State for Trade and Industry (SSTI) both on SME development and foreign and business registration issues. Two new advisors recently arrived at SSTI and already close working relationship has been established to move forward the agenda on industry and trade promotion. Additionally, close working collaboration has also taken place with the Ministry of Agriculture, Fisheries and Forestry. This fruitful collaboration occurred both at the legislative level where the RIA make key inputs in the development of the fisheries and quarantine legislation as well as review and advice on major agribusiness and fisheries projects currently under consideration, including technical revision of specific project agreements proposed by foreign investors and assistance in drafting of MoUs in pre-investment stage. More recently, collaboration was initiated with the Immigration Department, and Labor and Solidarity to address issues related to foreign investor and worker visas and permits. Moreover, close collaboration has been

established with advisors at the Ministry of Justice to develop legislation and regulation which affect business organizations and registration.

Finally, initial contacts were established with relevant business associations and promotional organizations overseas with a view to build linkages and partnering agreements. This agenda is already in progress as a result of the Portuguese-speaking country economic summit in Macau. Other possible partnerships include Australian, Portuguese and Singaporean organizations (e.g. Singapore Manufacturers Association, Australian Chamber of Commerce and Portuguese/Timor Chamber of Commerce).

| Activity Area | Milestones | Status |
|---|---|---|
| Support for investment-related activities focused on particular sub-national regions, zones and sectors | <ul style="list-style-type: none"> • Carry out investment orientation tour to Baucau, Vemasse, Maubisse • Conduct site visit to, and provide comment on, feasibility of planned industrial zone in Vemasse • Prepare TOR for gas/oil upstream advisory activity for Sec State Investment • Prepare TOR for industrial park task force • Deliver one or more investment promotion presentations to visiting overseas delegations • Sign partnership MOU with overseas business association/IPA • Prepare memorandum with investment-related recommendations for Industrial and Business Park • Prepare one sectoral investment profile/guide • Conduct rapid case study of Bali tourism cluster • Prepare MoU with second overseas business association • Prepare second sectoral investment profile/guide • Prepare draft commercial tourism strategy | <ul style="list-style-type: none"> • Ongoing. Visited Baucau, Vemasse and Com to survey condition of and potential for infrastructure development. • Completed. Provided comments to Secretaries of State for Investment, and Trade and Industry on the industrial zone. Revised project agreement with first investor in the zone.⁵ • Initiated. Initial draft under preparation. • Completed TOR for Dili Business Park for USAID Small Grants Program funding. • Ongoing. Made four investment presentations to groups of potential investors from Macao, Singapore, Malaysia and Korea. • Completed. MOU signed with Macao IPIM. • Completed. Memo to PM with TOR to create Task Force for Dili Business Park. • Initiated. Worked with WTO on preparation strategy to develop the Tourism Master Plan • Initiated. Preliminary research done. Activity to be completed at end of R&R per agreement with CTO. • Initiated. Preliminary discussions with CPLP Business Association. • Initiated. The Bali tourism cluster rapid assessment which is has been initiated. • Initiated. Worked with WTO in preparation of strategy to develop the Tourism Master Plan. |

Of the 12 milestones under this grouping of activities, four have been completed, two are ongoing and the remainder has all been initiated. It is anticipated that initiated milestones will be complete before the end of the current year.

PART IV

DEEMPHASIZED ACTIVITIES IN WORKPLAN

Based on discussions with the USAID CTO and project counterparts, it was mutually agreed that the following activities would be deemphasized from the Scope of Work and hence the Annual Work Plan as these activities are judged to be premature at the current stage of East Timor development. Hence, the following two tasks of the original SOW were deemphasized with others to be replaced in the Second Annual Workplan.

⁵ Revised draft agreement between GOET and Timor Cement which is the first plant at the Vemasse Industrial Zone.

National Stock Market Development. Activity deemphasized ostensibly due to the incipient nature of private sector development in the country which, for a lack of activity in this sector, renders this activity premature at this time.

Support for local governments in the formulation of investment-related legislation, policies, procedures and programs. As explained above, investment-related legislation, policy and program activities are concentrated ostensibly at the national level. Sectoral and zone-related support will naturally include local government stakeholders in the development of policy and program.

PART V

GUIDANCE AND INPUTS ON INVESTMENT-RELATED ISSUES AND PROJECTS

As indicated above, the RIA worked closely with various GOET entities, Ministries and Secretariats of State on issues which were either inherently of an investment nature, enabling or potentially a hindrance to investment promotion. Although much of this important collaborative work was not initially contemplated in the Annual Workplan it is expected that this type of fruitful collaboration will continue as many of these entities actively seek RIA guidance and advice on private sector development and investment-related matters. Below is a brief presentation of the principal activities undertaken outside of the Year One Workplan. These are:

Parliament

The RIA was requested to work with the Parliament Special Committee on Economy and Finance in the discussion and debate of the Commercial Companies Law (CCL). Given its technical nature, the CCL proved a difficult Bill for the Committee and needed continuous clarifications before Parliamentarians could effectively discuss and vote on this fundamental business legislation. For the coming year, the RIA will again work closely with this Special Committee on at least the two proposed investment legislation and possibly on land rights and land access legislation, among others.

MAFF

As indicated earlier, the RIA collaborated with the Ministry of Agriculture, Fisheries and Forestry on policy and legislation development, project negotiation with the World Bank and inward investment initiatives. Key investment initiatives reviewed and provided advice on follow:

- **Cassava Starch Project** – The RIA reviewed a proposal made by a major German firm to set up a cassava starch agribusiness operation in the southern part of the country that would employ over 500 people in the rural area on a regular basis plus seasonal workers. Cassava starch has many food and industrial applications. Output will be ostensibly for the export market. The US \$10 Million dollar project is sound and the firm is currently seeking concession financing from the German government as well as an operating partner.
- **Palm Oil Project** – The RIA reviewed and commented on a proposed draft Project Agreement presented by a Malaysian group with experience in palm oil production to set up a major operation in the southern part of East Timor. The estimated investment in this agribusiness operation is over USD 20 Million in an area covering some 30,000 hectares. The project anticipates employing over 6000 people on a regular basis in addition to a large number of seasonal workers. Considering that the potential investor is seeking broad fiscal and other investment incentives and the fact that the investment laws have not yet passed, the RIA recommended and drafted a Letter of Intent that set out the intentions of both parties and permits the potential investor to raise the necessary funds to implement the project. Both parties were satisfied with this outcome as the RIA advised that sufficient conditions did not exist as yet to permit entering into a binding Project Agreement. In any event, the RIA also revised the initial

draft Project Agreement to reflect the GOET position and the document is almost ready for signing once the investment legislation is passed.

- **Fisheries Joint Venture** – The RIA reviewed and commented on a proposed draft Joint Venture Agreement presented by a major Korean-Japanese investor to set up a comprehensive fisheries operation in East Timor with GOET participation. The project envisages up to 50 20-ton fishing vessels based in East Timor and the set up of canning and other fisheries-related businesses. Initial advices in the structuring of the business partnership were provided to GOET by the RIA and both parties are assessing options before undertaking final structuring of the business.

MPF

The RIA collaborated with many departments of the Ministry of Plan and Finance. As indicated earlier, there was close collaboration with advisors in the drafting and revision of the Private Sector Development chapter of the SIP. This close collaboration is expected to continue for the coming year as well.

Additionally, a close working relationship was also established with Customs, which is an entity under the MPF. The intent is to integrate Customs as a permanent member of the proposed Investment Commission with a view to facilitate foreign investment approval and customs clearance of exempted goods under the proposed investment legislation.

Finally, important dialog was initiated with the Treasury and the Revenues Offices to debate the fiscal revenue impact of the proposed investment legislation. As can be expected, the position of these two departments is, in principal, against any type of fiscal incentives as inducements to attract investment and promote exports. On the other hand, the investment promotion position has argued cogently in favor of incentives in the proposed investment legislation, showing that it will have negligible net impact on actual reduction of fiscal revenues, when viewed from a cost/benefit perspective. It is argued that the proposed investment legislation is ostensibly “revenue neutral”, that is to say, without customs and fiscal incentives the overwhelming number of new investments beyond the normal growth of the economy would not have occurred. Therefore, in a scenario of little to no new investment generation due to lack of incentives, there would be no loss of fiscal revenues that will not occur beyond the marginal growth of the economy, which is estimated to be no more than 2% growth within the next 2-3 years. Hence, the notion of “revenue neutrality” impact of the proposed investment laws. While no consensus has yet emerged from the two positions, both sides are engaged in fruitful dialog and it is anticipated that quantifiable impacts, based on an agreed upon set of assumptions will lead to less polarized positions to enable the GOET to make a decision on the nature and extent of incentives to be provided in the proposed investment laws.

SSTI

As indicated earlier, the RIA collaborated closely with the Secretariat of State for Trade and Industry (SSTI) on matters of policy, initiatives and business registration procedures. In the context of restructuring the SEP II project, The RIA participated in the revision of the concept and TOR for the economic zone opportunity study to be implemented by the SSTI. Likewise, the RIA worked closely with the business registration unit under the SSTI to identify problems and recommend streamlining of procedures under the new Commercial Companies Law. This latter task was also done jointly in collaboration with the Ministry of Justice, the GOET entity ultimately responsible for all matters of registration, including business registration. The RIA will be drafting a proposal for submission to GOET to operationalize and streamline business registration in conformity with the requirements of the new Commercial Companies Law.

Additionally, discussions were also initiated on the issue of foreign trade and export promotion. The latter is a key component of the Investment and Export Promotion Agency mentioned earlier to support both inward investors, as well as potential Timorese exporters seeking markets abroad. While the proposed investment legislation contemplates incentives for exports, policy and legislation are still needed to regulate exports of goods and services from East Timor. This task is to be carried out during the next annual work plan in close

collaboration with the Customs Department, the “gate keeper” that controls the flow of goods into and out of the country.

Timor Cement – The RIA finalized revision of a draft project agreement between the GOET and a Singapore investor group to set up a cement bagging plant in the Vemasse Industrial Zone. The operation is up and running and is the first major industrial investment to start since East Timor reclaimed its Independence on May 20th, 2002.